

**REPORT ON BANKING  
SUPERVISION IN SPAIN**

**2015**

**BANCO DE ESPAÑA**  
Eurosystem









# REPORT ON BANKING SUPERVISION IN SPAIN 2015

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## ABBREVIATIONS

ASBA	Association of Supervisors of Banks of the Americas
ATM	Automated Teller Machine
BCBS	Basel Committee on Banking Supervision
BE	Banco de España
BRRD	Bank Recovery and Resolution Directive
CCR	Central Credit Register of the Banco de España
CET1	Common Equity Tier-1
CGP	Code of Good Practices
CI	Credit Institution
CNMV	National Securities Market Commission
CRD IV	Capital Requirements Directive IV
CRR	Capital Requirements Regulation
DGF	Deposit Guarantee Fund
DGS	Directorate General Banking Supervision
DTA	Deferred tax assets
EBA	European Banking Authority
ECB	European Central Bank
EHA	Ministry of Economic Affairs and Finance
ESRB	European Systemic Risk Board
EU	European Union
FROB	Fund for the Orderly Restructuring of the Banking Sector
FSB	Financial Stability Board
GDP	Gross domestic product
GL	Guideline
G-SII	Global Systemically Important Institution
ICAAP	Internal Capital Adequacy Assessment Process
ICO	Official Credit Institute
IFRSs	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IMF	International Monetary Fund
JST	Joint Supervisory Team
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LSI	Less significant institution
MCCD	Market Conduct and Claims Department
MPE	Multiple point of Entry
MREL	Minimum requirement eligible liabilities
NCA	National competent authority
NSFR	Net Stable Funding Ratio
OND	Options and National Discretions
O-SII	Other systemically important institution
PML&TF	Prevention of money laundering and terrorist financing
RD	Royal Decree
RDL	Royal Decree-Law
RWA	Risk-weighted assets
Sareb	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (asset management company for assets arising from bank restructuring)
SEP	Supervisory Examination Program
SEPBLAC	Commission for the Prevention of Money Laundering and Monetary Offences
SI	Significant institution
SPE	Single Point of Entry
SRB	Single Resolution Board
SREP	Supervisory Review and Examination Process

SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TLAC	Total Loss Absorbing Capacity

\* \* \*

€m	Millions of euro
€bn	Billions of euro
P	Placed after a date [Jan (P)], indicates that all the related figures are provisional. Placed after a figure, indicates that this and only this figure is provisional
bp	Basis points
pp	Percentage points
...	Not available
—	Nil, non-existence of the event considered or insignificance of changes when expressed as rates of growth



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## GOVERNOR'S INTRODUCTORY LETTER



Banking supervision in 2015 was marked by the embedding of the activities of the Single Supervisory Mechanism (SSM), the first pillar of European Banking Union and the new framework within which the tasks relating to supervising European credit institutions are undertaken.

Following its first full year of activity, we can affirm that the SSM has overcome the difficult challenges of establishing a common supervisory system in the participating countries and making its management system operational, led by the European Central Bank (ECB) in collaboration with the supervisory authorities of each country.

Under this new framework, the Banco de España is participating most actively in the supervision of significant Spanish institutions and directly leads the supervision of Spanish less significant institutions. Furthermore, through the SSM's Supervisory Board, the Banco de España is involved in the supervisory decisions regarding significant institutions in the other participating countries.

The good results obtained in this first full year of activity should not, however, deflect us from further efforts to foster banking supervision arrangements that are efficient, consistent and guided by best practices. We must therefore consider the benefits of moving ahead with standardising the role of the supervisor in reviewing the quality of institutions' financial information. In particular, this concerns the focus and depth of on-site inspections of credit risk and the supervisory actions resulting from these reviews.

Another significant challenge for the SSM is to continue making progress in integrating its component parts, harnessing synergies and encouraging contributions by all members, regardless of the authority to which they may belong.

Finally, looking back at supervisory activity in 2015, I would highlight the first use of the macroprudential toolkit provided for under the solvency regulations and the European regulations on the recovery and resolution of credit institutions. The latter have led to new tasks being conferred upon the Banco de España in its capacity as supervisor.

In conclusion, while the assessment of supervisory activity in 2015 has been a positive one, the Banco de España will continue to promote the efforts required to overcome the remaining challenges, with the aim of achieving more efficient and effective supervision.



## DEPUTY GOVERNOR'S INTRODUCTORY LETTER



2015 was the first full financial year in which the Banco de España conducted its supervisory activities within the framework of the SSM. Since 4 November 2014, when the SSM officially commenced operations, the ECB has taken on prudential banking supervision tasks for the entire Monetary Union, with the participation and support of the national authorities, which contribute their supervisory expertise and knowledge of the national banking systems.

The SSM, forged out of the serious financial crisis that began in 2008, was created with the aims of improving the quality and uniformity of supervision of credit institutions, fostering the integration of markets and breaking the negative feedback loop between the banking sector and sovereign debt. It is thus designed as a preventative tool and constitutes the first pillar of the Banking Union being built in Europe to safeguard financial stability and minimise the costs of banking crises.

The SSM's first year of operations centred on the "comprehensive assessment" of all the significant banking groups in the euro area countries, which was carried out in 2014. This assessment, which included an asset quality review and a stress testing exercise, enabled the information on and diagnosis of the actual situation of European banks to be improved. As a result, in addition to increasing transparency and investor confidence, corrective measures were adopted which helped bolster the solvency of the banks analysed.

However, the SSM's first year of operations was not without its challenges. The first of these was making progress in establishing a truly common operational framework for the different "supervisory cultures" that coexist in the participating countries. To this end, the Banco de España contributed its supervisory knowledge and expertise, participating in the development of operating procedures and methodologies that can be found in the Supervisory Manual, a living document that requires regular updating to incorporate the lessons learned from accumulated experience. Applying the methodologies described in the Manual in a consistent manner is crucial to completing the convergence towards supervisory best practices.

Along the same lines, and in order to contribute to achieving a common operational framework, throughout 2015 the Banco de España collaborated closely on the comprehensive review of national discretions, as established by the European solvency regulations and exercised by national supervisors, in certain areas such as the phase-in period for progressive adoption of the new standards and the granting of exemptions to compliance with certain prudential requirements. These discretions have been applied differently by each of the national supervisors and have thus given rise to different treatment depending on the country of origin. This situation complicates supervisory action and prevents uniform treatment of credit institutions across Europe. The result of this review process conducted within the SSM framework was an agreement that allows a common approach to be adopted in implementing options and national discretions, reducing their flexibility. The agreement reached to harmonise the application of solvency regulations can be considered to be extremely positive, even though certain divergences in supervisory practices still remain within the SSM, as I will explain at the end of this introduction.

Another of the fundamental challenges that the SSM faced during its first year of activities was achieving a governance structure that is operative despite its extreme complexity. This complexity derives, firstly, from the need to keep the ECB's monetary policy functions separate from its prudential supervision functions and, secondly, from the need to ensure appropriate interaction between the national supervisory authorities and the ECB such that the former play an important role in decision-making within the SSM, under the leadership of the ECB. Indeed, in 2015 the SSM's governance structure proved itself capable of achieving all these objectives, enabling the correct functioning of the mechanism and allowing the Banco de España and the other euro area national supervisors to actively participate.

In this regard, the SSM's first year of operations put to the test not only its own management bodies but also the internal bodies of the ECB and the national supervisors. At the Banco de España, in 2014 the departments of the Directorate General Banking Supervision were reorganised, and a structure mirroring that of the ECB was adopted to facilitate the relationship between the two institutions. Furthermore, a unit specialised in coordinating the Banco de España's participation in the SSM's decision-making bodies was created. 2015 demonstrated how this new structure has aided interaction with the ECB in supervisory tasks.

The year also witnessed the full development of the activities of the joint supervisory teams, which comprise staff from the ECB and the national authorities and are responsible for the day-to-day supervision of the significant institutions. These teams are coordinated by an ECB staff member with the support of a sub-coordinator from each national authority concerned, who helps to organise the work and manage the local teams. This is a new model that responds to the need to combine centralised management with the greater proximity to the local financial system provided by national supervisors. It is important to note that the Banco de España provides around 70% of the staff of the joint supervisory teams for the Spanish significant institutions.

Along with the joint supervisory teams, the SSM has a series of horizontal groups that undertake specialised tasks affecting the supervision of all institutions. In order to develop these horizontal functions, several expert working groups have been set up, in which the Banco de España is actively participating.

There are two more fields in which the Banco de España contributes. First, an extremely high percentage of the staff who carry out the on-site inspections of significant institutions in Spain are from the Banco de España. These staff are usually tasked with leading these inspections. Second, the Banco de España continues to be responsible for direct supervision of the less significant institutions.

In short, following the SSM's commencement of operations, the supervisory activity of the Banco de España is just as demanding and resource intensive now as it was in the past. Furthermore, we have had to address the challenge posed by these efforts to adapt to and participate in the implementation of this new mechanism against a backdrop of a significant loss of human resources to the ECB. So far, almost 100 staff from the Banco de España have joined the new SSM structure (around 80 of them from the Directorate General Banking Supervision), including a Director General and three Deputy Directors General, meaning the loss of approximately a quarter of the supervisory staff.



Moreover, it must be noted that the launch of the SSM has not affected the supervision of other financial institutions different from credit institutions. Thus, the Banco de España fully maintains its supervisory powers, within the scope set by Spanish law, in relation to specialised lending institutions, mutual guarantee companies, reguarantee companies, appraisal companies, payment institutions, electronic money institutions, currency-exchange bureaux, banking foundations and Sareb.

The Banco de España also retains responsibility for supervising the market conduct of all the institutions under its control, including credit institutions, as this has not been transferred to the SSM. In this area, the Banco de España attaches the utmost importance to bank transparency, customer protection and the proper functioning of customer service and conflict resolution mechanisms, in line with the widespread heightened awareness internationally of the importance of ensuring the proper conduct of financial agents. 2015 was the first full financial year in which this supervisory work was undertaken by the Market Conduct and Claims Department, hierarchically and functionally independent from the Directorate General Banking Supervision. In 2015, as well as designing its own procedures, the supervision of conduct was essentially focused on reviewing the marketing and settlement of mortgage loans and carrying out checks on the implementation of the urgent measures for protecting mortgage debtors who have no resources, on the use of floor clauses and on the response strategies of institutions to complaints from customers related to these clauses.

It is worth highlighting certain new regulations that were introduced in 2015 regarding tools for supervising credit institutions, such as those related to monitoring liquidity risk and to macroprudential supervision.

In October 2015 the formal requirement for a short-term liquidity coverage ratio entered into force, which lays down quantitative requirements concerning the liquid assets institutions must hold to cover net cash outflows under stressed conditions for a period of 30 days. This was the first step in standardising the requirements for mitigating liquidity risk, and the process will be completed in the coming years with the obligation to comply with a net stable funding ratio.

Another new development in European solvency regulations concerns the macroprudential toolkit. Most notable here is the introduction of capital buffers for systemically important institutions and a counter-cyclical capital buffer applicable to credit exposures in Spain. In 2015 the Banco de España for the first time worked on determining the levels at which these buffers should be set. At the end of 2015 the levels necessary for the 2016 financial year were announced.

2015 was also the year in which the Single Resolution Mechanism (SRM), the second main pillar of the European Banking Union, entered into force. The SRM, fully operational from 1 January 2016, aims to provide a way to manage non-viable entities, minimising the need to inject public funds, protecting depositors and ensuring the continuity of the critical functions of the institutions concerned.

In Spain the Banco de España has preemptive resolution powers, while executive resolution functions are entrusted to the Fund for the Orderly Restructuring of the Banking Sector (FROB). This allocation of functions, although different from that generally adopted in Europe, enables the experience acquired by the FROB in recent years to be harnessed

and, at the same time, permits closer coordination with the activities of the prudential supervisor.

The Banco de España's responsibilities as the preemptive resolution authority are exercised separately from the supervision of institutions, in the interest of the necessary independence required of these activities under European law. The tasks assigned within the framework of the SRM include most notably the following: i) designing institutions' resolution plans and ii) setting the minimum requirement for own funds and eligible liabilities (MREL) for each institution, with a view to guaranteeing that they have sufficient instruments available to absorb losses and recapitalise themselves.

The tasks conferred on the Banco de España as supervisor under the recovery and resolution regulations include most notably: i) reviewing recovery plans prepared by institutions; ii) adopting early intervention measures supplementary to traditional supervisory measures to intervene in institutions that have started to weaken but are still viable; and iii) ascertaining the non-viability of an institution as a prior step to its possible resolution or liquidation.

Finally, let me touch on four of the main challenges that the Banco de España faces in performing its supervisory tasks within the SSM framework in the next few years.

The first challenge is the need to continue monitoring how credit institutions adjust their business model in order to maintain appropriate profitability levels at a time when interest rates are still at an all-time low and economic activity has not reached the momentum necessary. This adjustment process should lead to the generation of recurring income in a sustainable manner, respecting each institution's appetite for risk and avoiding excessive risk-taking in the pursuit of yield.

The second one is the frequency and impact of changes made to the regulatory framework of credit institutions in recent years, which involve a significant effort both for institutions themselves and for supervisors. Broadly, institutions must comply with new liquidity and leverage ratios, with greater capital requirements and with new resolution demands that will foreseeably give rise to changes in their balance sheet structure. The need to strengthen own funds and liabilities eligible for absorbing losses may give rise to intense competition in raising funds on the capital markets. Supervisors should enforce this new regulatory framework in a consistent manner and check that in practice its implementation contributes to strengthening the soundness of institutions and financial stability. For this purpose, a period of certain regulatory stability would be advisable, during which the possible changes were directed mainly at simplifying the regulatory regime and helping to implement it uniformly.

A third challenge is strengthening bank customer confidence in credit institutions, following the evident reputational damage caused by recent cases of failure to observe, or improper application of, rules of conduct, particularly those on the marketing of financial products. The Banco de España promotes the implementation of international best practices in this area.

Fourth and last is the need to advance in the harmonisation of supervisory practices within the SSM. Despite the efforts made during 2015, it is still necessary to continue fostering the application of the highest quality standards to supervisory activities, avoiding convergence towards less stringent supervisory standards. In this connection, there are

two main fields in which it is necessary to move towards greater convergence: the review of internal capital models and the review of financial reporting.

The supervisory review of internal capital models should converge towards best practices for the purpose of increasing their credibility, ensuring consistency in the calculation of capital ratios and applying the same supervisory standards across all credit institutions. Precisely to commence this task, the SSM has designed a plan that will make it possible to carry out more in-depth analyses of internal capital models in the coming years.

The review of financial statements is a basic task that supervisors have to carry out to make their own diagnosis of the financial position and solvency of institutions, regardless of whether or not they have powers relating to accounting regulations. Convergence towards rigorous financial statement review by supervisors in credit risk inspections, through the review of credit risk files for loans granted, is essential for appropriately reflecting asset quality in the accounts and ensuring the reliability of capital ratios, the raw material of which is accounting information. In this respect, the lessons on provisioning policies and identification of best international practices learned during the asset quality review prior to the launch of the SSM, where this approach of reviewing risk files for specific transactions was already used, are relevant starting points to define common methodologies.

In conclusion, in 2015 the Banco de España contributed strongly to the major advances made in erecting European supervision within the SSM framework. These advances have revealed significant challenges that we must tackle promptly in coming years to further pursue a consistent and thorough supervision that complies with the ultimate objective of strengthening the European banking system's financial stability.



## 1 ORGANISATION OF BANKING SUPERVISION IN SPAIN



## 1 ORGANISATION OF BANKING SUPERVISION IN SPAIN

### 1.1 Supervisory functions of the Banco de España

#### 1.1.1 AS PART OF THE SINGLE SUPERVISORY MECHANISM

On 4 November 2014 the Banco de España joined the SSM, which exercises the prudential supervision of the more than 4,500 credit institutions of the 19 countries in the euro area. In order to exercise its functions, the new European supervisor has organised itself as an integrated system, made up of the ECB and the National Competent Authorities (NCAs), including the Banco de España. The NCAs contribute substantially to the functioning of the SSM, since they provide resources, supervisory experience and their superior knowledge of the domestic banking systems and institutions.

Membership of the SSM involves the Banco de España's participation in the decision-making relating to all the credit institutions of the euro area, channelled via its representation on the SSM Supervisory Board and the ECB Governing Council. In its first full year, the Supervisory Board adopted (or proposed for final approval by the Governing Council) more than 1,500 supervisory decisions. The bulk of those decisions were adopted through written procedures, which supplement physical meetings, enabling recurring or previously addressed matters to be expedited. With regard to Spanish institutions, a total of 351 supervisory decisions and actions were recorded, which either addressed the Spanish institutions specifically (188 decisions), or were more general in nature or dealt with matters of organisation and policies also affecting them (the remaining 163 decisions).

In the framework of the SSM a distinction should be drawn between two types of institution, based on criteria of size, economic significance and cross-border activity: "significant" institutions and "less significant" institutions. The ECB is responsible for the direct supervision of significant institutions, while the NCAs are responsible for the direct supervision of less significant institutions. However, even in cases where they are not directly responsible, both the ECB and the NCAs participate in the supervision of all institutions.

Thus, although the ECB is responsible for the direct prudential supervision of significant Spanish credit institutions, the Banco de España contributes notably to both the ongoing monitoring tasks and the on-site inspections of those institutions.

Ongoing monitoring is performed through the Joint Supervisory Teams (JSTs). The JSTs are made up of staff from the ECB and the Banco de España, and they are headed by an ECB coordinator assisted by a sub-coordinator from the Banco de España. In the case of groups of Spanish institutions with a presence in other SSM countries, and Spanish subsidiaries of groups of institutions of other SSM countries, the JSTs also have staff from other NCAs and a sub-coordinator from each of those countries.

The Banco de España participates in the JSTs of the 14 groups of Spanish credit institutions classified as significant according to the SSM criteria and in the JSTs of 22 significant foreign banking groups established in Spain (8 via subsidiaries and 14 via branches). At 2015 year-end, the Banco de España contributed 155 bank examiners and junior analysts to the JSTs of the Spanish banks, representing around 70% of the total staff assigned to those JSTs.

Also, the Banco de España plays a key role in the on-site inspections of Spanish significant institutions, and it contributed 95% of the staff assigned to the inspections performed in 2015. Those inspections were headed mainly by Banco de España staff.

STAFF FROM BANCO DE ESPAÑA AND THE ECB CARRYING OUT SUPERVISORY TASKS IN RESPECT OF SPANISH SIGNIFICANT INSTITUTIONS

CHART 1.1

1 ONGOING MONITORING

2 ON-SITE INSPECTIONS



SOURCE: Banco de España.

As regards the supervision of less significant institutions, the Banco de España is responsible for their direct supervision and the ECB maintains indirect supervisory powers.

Also, the Banco de España cooperates with the ECB in dealing with the so-called “common procedures” relating to both significant and less significant institutions. Those procedures are the authorisation of credit institutions, authorisation of qualifying holdings and withdrawal of licences. The Banco de España performs the first analysis of the procedures considered and prepares a draft decision. Subsequently, on the basis of that draft decision and other actions it deems relevant, the ECB adopts the final decision.

Furthermore, the Banco de España participates in various working groups and numerous expert networks, most of which are coordinated by the ECB, for the discussion and proposal of supervisory policy and technical criteria. In 2015 the Banco de España participated actively in 55 of the no fewer than 80 horizontal groups organised within the SSM sphere.

At 2015 year-end, the SSM supervisory framework covered 129 groups of significant institutions within the scope of the SSM, which comprise a total of 1,117 individual institutions, including holding companies. In addition, at the individual level there are a further 3,466 institutions classified as less significant. Of the 129 largest banking groups, 14 are headed by a Spanish institution<sup>1</sup> (15 in 2014, before Catalunya Banc was merged into BBVA). Those 14 Spanish groups are made up of 79 individual institutions of euro area countries, 57 of which are Spanish, and they represent 15% of the total assets of the 129 significant institutions of the SSM, behind only Germany and France. Additionally, there are a further 8 significant foreign groups in which Spanish subsidiaries hold ownership interests. The institutions supervised directly by the ECB account for around 96% of the Spanish banking system’s assets.

The Spanish credit institutions also comprise 73 less significant groups, including branches supervised directly by the Banco de España in the framework of the SSM. Table 1.1 shows the distribution of the Spanish credit institutions into those three groups.

<sup>1</sup> Santander, BBVA, La Caixa, Bankia, Sabadell, Popular, Unicaja, Bankinter, Kutxabank, Ibercaja, Abanca, Liberbank, BMN and Banco de Crédito Social Cooperativo.



Figures at December 2014 and 2015	2014		2015	
	Groups	Assets (%)	Groups	Assets (%)
Groups of significant Spanish institutions	15	94.9	14	95.6
Foreign groups of significant institutions in which Spanish sub-groups participate	8	0.6	8	0.6
Groups of less significant Spanish institutions (a)	75	4.5	73	3.8
<b>TOTAL</b>	<b>98</b>		<b>95</b>	

SOURCES: ECB and Banco de España.

a Including 11 branches in 2015 and 12 in 2014 of non-euro area EU banking groups, not supervised by the SSM. The number of groups of less significant institutions without including branches amounts to 62 in 2015 and 63 in 2014. It includes groups and individual institutions that are not part of groups.

1.1.2 OTHER SUPERVISORY TASKS OF THE BANCO DE ESPAÑA NOT TRANSFERRED TO THE SSM

In addition to the above-mentioned supervisory tasks in the framework of the SSM, the Banco de España performs the following supervisory functions:

- 1 The supervision of credit institutions in areas not attributed to the ECB, in cooperation —where appropriate— with other national authorities, such as: the oversight of institutions' conduct in matters relating to information transparency and customer protection in the marketing of products and provision of services common to banks; the prevention of money laundering<sup>2</sup>, in cooperation with the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC); or the control of activities relating to the financial markets, in cooperation with the National Securities Market Commission (CNMV).
- 2 The imposition of certain penalties.
- 3 The activation of the macroprudential procedures provided for in the Fourth European Capital Requirements Directive.
- 4 The supervision, within the scope established in Spanish legislation, of institutions other than credit institutions that provide services or perform activities related to the financial sector, such as: specialised lending institutions, mutual guarantee companies, reguarantee companies, appraisal companies, payment institutions, electronic money institutions, currency-exchange bureaux, banking foundations and Sareb.
- 5 The supervision of branches of third-country credit institutions.

Schema 1.1 summarises the Banco de España's various supervisory functions.

<sup>2</sup> In Spain, the authority responsible for the supervision and inspection of compliance with prevention of money laundering obligations and for the adoption of the necessary measures in the event of non-compliance is the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC). The Banco de España cooperates in the actions relating to that matter, in accordance with the cooperation arrangement established in Law 10/2010 of 28 April 2010 and in the agreement signed with SEPBLAC in 2013.

FUNCTIONS WITHIN THE SSM CONTEXT	
<b>Relating to Spanish significant institutions</b> Participation in ongoing monitoring Participation in on-site inspections	<b>On Spanish less significant institutions</b> Direct supervision of less significant institutions
Common procedures: participation in authorisations, qualified holdings and licence withdrawals procedures	
<b>General functions (Spanish institutions and also from other SSM countries)</b> Participation in supervisory decision-making process (on the Supervisory Board) Participation in horizontal tasks (through expert networks and specialised working groups)	
FUNCTIONS OUTSIDE THE SSM CONTEXT	
<b>Non-transferred areas relating to the supervision of credit institutions</b> Supervision of procedures to prevent money laundering, in collaboration with the SEPBLAC Supervision of market conduct, transparency and customer protection Supervision of activities relating to the securities markets, in cooperation with the CNMV Activation of macroprudential procedures, in cooperation with the ECB	
<b>Supervision of other financial institutions</b> Specialised lending institutions, mutual guarantee companies, reguarantee companies, appraisal companies, payment institutions, electronic money institutions, currency-exchange bureaux, banking foundations, SAREB and branches from third countries	

SOURCE: Banco de España.

## 1.2 Organisation of banking supervision in the Banco de España

The entry into force of the SSM brought about a very significant change in the European supervisory model. It is a more complex model that brings together different supervisory cultures and encompasses a high number of institutions. In view of this new scenario, the Banco de España has adapted its organisational structure in order to participate in this new mechanism in the most efficient manner.

Set out below is a description of the distribution of functions relating to supervision among the Banco de España's different directorates general and departments, the main organisational changes made in 2015 and the changes in the Banco de España's human resources.

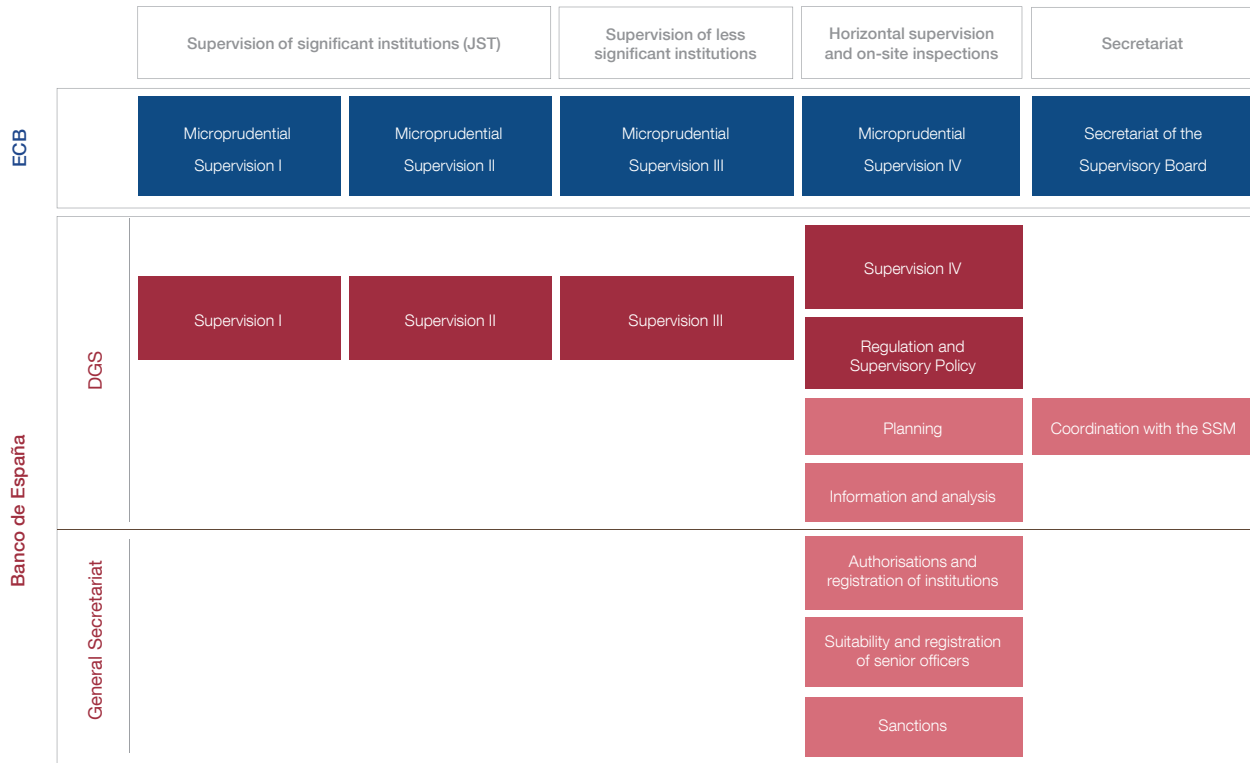
### 1.2.1 DISTRIBUTION OF FUNCTIONS RELATING TO SUPERVISION

Within the Banco de España, the Directorate General Banking Supervision (DGS) is responsible for the microprudential supervision of the credit institutions and other institutions over which it has supervisory powers, in coordination with other directorates general and departments with related functions. In 2014 various organisational changes were made in the DGS to create a "mirror" structure of the ECB structure, with a view to smoothing interaction with each of its four directorates general<sup>3</sup>. Schema 1.2 shows the organisational structure of the Banco de España in relation to that of the ECB.

Within the DGS there are four operating departments and other services and departments with horizontal functions:

- *Supervision Departments I and II*: responsible for the ongoing or day-to-day supervision of SSM significant institutions with Spanish parents through the JSTs.

<sup>3</sup> It should be noted that the horizontal tasks that the ECB has assigned to the Directorate General Microprudential Supervision IV are distributed among various administrative units in the Banco de España.



SOURCE: Banco de España.

- *Supervision Department III*: responsible for the ongoing supervision and on-site inspections of the SSM less significant Spanish institutions and significant Spanish institutions belonging to groups with non-Spanish parents, and the supervision of other financial institutions or institutions with functions related to the financial sector.
- *Supervision Department IV*: carries out specialised or horizontal tasks that affect all institutions under the direct supervision of both the ECB and the Banco de España, such as, for example, actions in the areas of technological innovation, regulatory compliance and custody services. Also, it performs on-site inspections of significant institutions and reviews of the internal capital models of Spanish institutions.
- *Regulation and Supervisory Policy Department*: includes functions relating to: i) the technical secretariat, which contributes to the definition of supervisory and regulatory policies; ii) banking regulation, e.g. the implementation and interpretation of banking accounting legislation and prudential legislation; and iii) coordination of the Banco de España’s participation in the European Banking Authority (EBA) and cooperation with Spanish and international bodies and fora on matters relating to its scope of action.
- *SSM Coordination Service*: created in March 2014, it supports the representative of the Banco de España in participating in the SSM Supervisory

Board for supervisory decision-making. Similarly, it is responsible for the internal organisation, distribution and monitoring of the information received in the SSM sphere at this level.

- *Supervisory Planning Service*: performs horizontal functions relating to: i) the preparation and monitoring of the supervision framework and annual plan; ii) supervisory methodology and Pillar 2; iii) the quality control of supervisory actions; and iv) the hiring and training of DGS employees.
- *Information and Analysis Group*: focuses on the computer processing of the financial information received from institutions with a view to facilitating their analysis by the monitoring and on-site inspection teams. Also, it carries out specific analyses of the developments in the Spanish financial system and its main risks.

Within the General Secretariat, the following divisions and departments exercise functions relating to supervision:

- *Suitability Assessment and Individuals Register Division*: responsible for assessing the compliance with the suitability requirements of board members, managing directors and similar officers of the institutions under direct supervision of the Banco de España or the ECB (in the case of the latter, the work is performed in cooperation with the ECB, which is responsible for approving or rejecting these procedures). Also, it is responsible for maintaining the Senior Officer Register, in which the aforementioned persons are registered.
- *Authorisations and Institutions Register Division*: participates in the granting and withdrawal of the authorisation of institutions subject to the direct supervision of the Banco de España or the ECB. Also, it is responsible for maintaining the Institutions Register.
- *Division for Sanctioning Proceedings and Collaboration with Jurisdictional Bodies*: responsible for instructing disciplinary proceedings corresponding to the Banco de España.
- *Market Conduct and Claims Department*: it has supervisory powers over the issue of banking transparency and the protection of institutions' customers.

Also, there are other areas within the Banco de España which participate in supervisory tasks. In particular, the Directorate General Financial Stability and Resolution has functions relating to supervisory activity through the following departments:

- *Financial Stability Department*: analyses the financial system from a macroprudential point of view.
- *Financial Reporting and CCR Department*: defines, receives, validates and acts as custodian of the information submitted periodically to the Banco de España by the institutions subject to supervision by it or by the ECB.

In 2015 there were major changes in the organisation of the supervisory activity in the Banco de España, the most significant of which are discussed below:

- 1 *Creation of the Regulation and Supervisory Policy Department.* The functions relating to the implementation and interpretation of banking accounting legislation and prudential legislation and the coordination of the Banco de España's participation in the EBA have been assigned to the DGS. Until April 2015 these functions corresponded to the former Directorate General Regulation and Financial Stability. This new department groups together the aforementioned functions plus the tasks relating to the provision of support to the Supervision departments and the DGS in matters of regulation and supervisory policy.
- 2 *Split in the Surveillance and Inspection of Institutions' Conduct Unit.* The Surveillance and Inspection Unit (of the Market Conduct and Claims Department) was divided into the Inspection Unit, on the one hand, and the Surveillance Unit, on the other hand, and they have worked in tandem since June 2015. Also, their resources have increased, since one of the lessons learned from the recent banking crisis is the need to dedicate more resources to supervising transparency in the marketing of complex financial products.
- 3 *Split in the Institutions and Individuals Register Division into the Authorisations and Registration Division and the Suitability Assessment and Individuals Register Division,* both within the Deputy General Secretariat, with an increase in resources and the incorporation of the Authorisations Unit, which previously formed part of the Directorate General Regulation and Financial Stability. All of the foregoing has strengthened those functions, reinforcing synergies and bringing them into line with the SSM framework.

The implementation of the SSM has affected the DGS staff significantly. Around 80 persons who belonged to the DGS have joined the ECB within the SSM structure. This poses a major challenge in terms of human resources, especially in view of the necessary adaptation to new common procedures and methodologies, the need to work in English and the significant regulatory changes in the banking sector in recent years.

Against this backdrop, the DGS has followed a two-pronged strategy. On the one hand, with a view to maintaining the high professional profile of its staff, numerous training actions have been carried out, adapted to the new supervisory situation, at both the Spanish and international level. Thus, the Banco de España offers the DGS staff an extensive annual internal training programme, with the objective of disseminating and refreshing the technical knowledge essential for performing supervisory work. Also, in cooperation with various international supervisory bodies (ECB, Basel Committee, EBA, etc.), the Banco de España also offers its examiners various courses and workshops abroad, with the aim of completing and reinforcing their training as much as possible. Lastly, considerable training actions have been performed to maintain and, where necessary, improve the DGS staff's command of English, which is essential in the new European supervisory framework.

Moreover, in recent years the number of positions advertised each year to join the team of inspectors of credit institutions has risen rapidly. In the coming years the current number

Number

	Directorate General Banking Supervision (a) (b)	Directorate General Financial Stability and Resolution	Market Conduct and Claims Department (c)	Deputy General Secretariat
Directors and other managers	48	27	9	5
Bank examiners/Inspection auditors	217	4	4	
Senior analysts/lawyers/experts	26	42	23	10
IT auditors	43	0	2	
Junior analysts	103	59	35	14
Administrative staff	52	16	12	11
<b>TOTAL</b>	<b>489</b>	<b>148</b>	<b>85</b>	<b>40</b>

SOURCE: Banco de España.

- a** The staff of the Directorate General Banking Supervision have the following functions:
- 155 persons have functions relating to the ongoing supervision of significant institutions conducted through joint supervisory teams set up by the SSM.
  - 27 persons have functions relating to the ongoing supervision of less significant institutions supervised directly by the Banco de España and indirectly by the ECB.
  - 22 persons have functions relating to institutions whose supervision has not been taken on by the ECB.
  - 102 persons have functions relating to the performance of on-site inspections or the review of models.
  - 109 persons have cross-departmental functions.
  - 74 persons have other functions.
- b** In April 2015, Executive Commission of Banco de España approved a reorganisation in Directorate General Supervision, creating Department of Regulation and Supervisory Policy and increasing the staff by 38 people.
- c** Of the total staff in the Market Conduct and Claims Department, 27 employees (Director and 26 assigned to Conduct Oversight Division) have direct functions relating to supervision.

of positions –around 25 per year– is expected to be maintained, as compared to the 12-15 positions advertised in the past.

It should be noted that, although the number of positions has increased, the selection process is still as demanding, so that the hiring of highly qualified persons is ensured. The selection process has two stages: i) a selection stage, in which the candidates have to show their knowledge of accounting, the financial system, financial mathematics, statistics and commercial law, as well as their command of the English language; and ii) a training-selection phase, with a duration of approximately 10 months, conducted by teaching staff of renowned academic institutions, practitioners from the financial sector and Banco de España professionals. Approximately 25% of the course is delivered in English and it covers a wide variety of subjects, including accounting, financial markets and risks, financial supervision, commercial and banking legislation, financial and economic analysis and quantitative methods.

It is estimated that in approximately four or five years the DGS's permanent staff numbers will once again be at full capacity. In the last two years around 100 persons have joined the DGS on temporary contracts.

## 2 MICROPRUDENTIAL SUPERVISION





## 2 MICROPRUDENTIAL SUPERVISION

### 2.1 Supervisory priorities and strategies

The year 2015 was the first in which the supervisory priorities were established jointly under the SSM framework, through its decision-making bodies, in which the Banco de España participated actively. The main areas requiring special attention by the supervisor in 2015 and those on which the work in 2016 will focus are discussed below and summarised in Schema 2.1. Also set out below is one of the main strategic challenges that the Banco de España considers needs to be addressed promptly: the convergence towards best practices in the review of financial information of credit institutions and in the review of the quality of the loan portfolio.

#### 2.1.1 SUPERVISORY PRIORITIES IN 2015

- 1 *Business model sustainability*: banks' profitability has been adversely affected in recent years due to the narrow interest margins resulting from the low interest rates environment and weak economic growth, and to high loan impairment losses. The sustainability of institutions' business models was therefore under the supervisory spotlight in 2015, with a dual purpose: i) to avoid excessive assumption of risk in order to offset the negative impact of low profitability on the quality of the loan portfolio; and ii) to avoid cost cuts centred on control functions, with the resulting impact on operational risk.
- 2 *Credit portfolio quality*: the supervisory work in 2015 in this area was centred on monitoring the correct presentation in the institutions' financial statements, or in their Pillar 2 requirements, of the outcome of the 2014 comprehensive assessment exercise. Also, in 2015 there were further reviews of non-performing loan levels, the coverage of operations and the overall volume of forborne exposures.

The main scope of around 60% of the 32 on-site inspections carried out in 2015, including significant and less significant Spanish credit institutions, was to review credit risk.

In this regard, the Banco de España is participating in the thematic review<sup>1</sup> of leveraged financing at the SSM level. The objective has been to achieve a greater understanding of this activity, in which credit institutions engage, and to identify best practices. It also participates in a working group that analyses best practices in the management and recognition of impaired risks in order to establish a coherent cross-country approach.

- 3 *Corporate governance*: in 2015 a thematic review was performed on the governance structure and risk appetite framework of the main significant institutions. The objective was to assess the Board's involvement in decision-making, the extent of its knowledge of risk exposure and the correct implementation of the risk appetite framework.
- 4 *Capital adequacy*: in 2015 institutions' capital planning was analysed for compliance with the new regulatory requirements.

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<sup>1</sup> A thematic review focuses on one particular matter and is conducted in the same way for all the significant credit institutions in the SSM sphere.



SOURCE: Banco de España.

The ECB and the Banco de España issued recommendations on the dividends distribution policies of the significant and less significant institutions respectively, urging them to maintain conservative distribution standards: institutions must follow a linear path, over four years, to cover the amount required to reach their fully loaded<sup>2</sup> ratio at 31 December 2014.

Lastly, it should be noted that in 2015 changes were introduced into Spanish fiscal legislation that have removed all doubt as to the compatibility of Spanish

<sup>2</sup> Fully loaded: compliance with the capital requirements upon completion of the transitional adjustment periods provided for in the new solvency regulations.

regulations on deferred tax assets on banks' balance sheets, that do not reduce own funds, with European competition law.

- 5 *Regulatory harmonisation*: in 2015 there was a review of the national options and discretions permitted by European solvency regulations, with a view to harmonising the treatment of the institutions supervised by the SSM and to make progress towards convergence in supervisory practices. That analysis, in which the Banco de España participated actively, resulted in a common approach for the application of most national discretions.
- 6 *So-called "technology risk and cybersecurity"*: the Banco de España participated in the thematic review of cyber risk, carried out in 2015 in the SSM framework, and in the horizontal group on this matter. The aim was to assess institutions' cyber risk profile in order to establish an on-site inspection plan for this matter. The ECB is also creating a database with records of incidents relating to cyber-criminal activities.
- 7 *Conduct and legal risks*: malpractice does not only lead to the loss of confidence of banking customers, but also directly impacts institutions' income statements; accordingly, malpractice surveillance was a supervisory priority for the Banco de España in 2015.

#### 2.1.2 SUPERVISORY PRIORITIES IN 2016

In 2016 further work will be carried out on the supervisory priorities identified the previous year. Additional work will most notably include:

- 1 *Adaptation to new regulatory developments*: in 2016 institutions will have to make a considerable effort to adapt to the new regulatory requirements, which impose new liquidity and leverage ratios, higher capital requirements and, in particular, the requirements of the resolution regulations. All of the foregoing is likely to bring about changes in the structure of banks' balance sheets and strong competition in the capital markets due to the need to reinforce own funds and liabilities with loss absorbing capacity, which will be subject to special supervisory monitoring.
- 2 *Business model sustainability*: as a result of the economic environment, marked by the still-incipient economic recovery, low interest rates and the high volume of unproductive assets, the sustainability of institutions' business models continues to demand attention. In 2016, a thematic review is planned on the business models of SSM significant institutions. That review will be centred on the identification of possible problems, such as the easing of lending standards or the excessive increase in the risk assumed in the search for profitability.
- 3 *Credit quality*: particular attention will continue to be paid to credit quality. Also, special monitoring will continue of certain banks' exposures to vulnerable emerging economies.

The Banco de España will participate in a thematic review within the SSM on the preparatory work by significant institutions for the application of the new IFRS 9, once it has been adopted and enters into force, foreseeably in 2018. This new accounting standard involves replacing the incurred loss model with

the expected loss model in loan loss provision calculations. This standard improves the measurement and coverage of lending risk, but at the same time the subjectivity and complexity of the calculation of provisions increases, thereby jeopardising cross-bank consistency and comparability. Therefore, the supervisory review of institutions' adaptation to this new standard is a priority issue for the coming years.

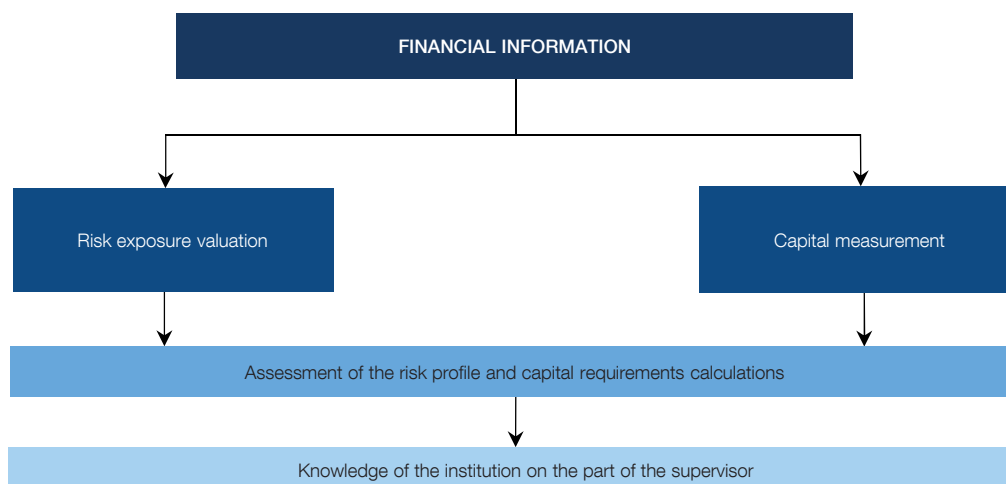
- 4 *Review of internal models:* 2016 will see the beginning of an in-depth review of the internal capital models in force within the SSM. Various tasks carried out by the EBA since 2013, as part of its review on the consistency of risk-weighted assets, have revealed a high variability in calculations, due not to the institutions' different risk profiles but mainly to the characteristics of the internal models. Therefore, the review scheduled for the coming years is intended to contribute to achieving consistency in the calculation of solvency ratios among the various institutions.
- 5 *Quality of information:* the Banco de España will participate in the thematic review of compliance with the Basel Principles for the effective aggregation of risk data and reports within the SSM. The quality of management information is essential to ensure correct decision-making by institutions' governing bodies. To this end, a modern technological infrastructure is fundamental.
- 6 *Monitoring of financing and liquidity risk:* particular attention will be paid to the impact of the new regulatory requirements in respect of institutions' liquidity risk on both their financing costs and their balance sheet structure, and to liquidity risk management and the internal liquidity adequacy assessment process (ILAAP).
- 7 *Performance of a stress test:* in 2016 the Spanish significant institutions will participate in a stress test, following the EBA methodology. As was the case in 2014, analyses will be performed on the impact of two macroeconomic scenarios – baseline and adverse – on institutions' solvency and results. A new feature in 2016 is the inclusion of conduct and exchange rate risk.

### 2.1.3 REVIEW OF FINANCIAL REPORTING BY THE SUPERVISOR

In recent years major efforts have been made to create a common regulatory framework for credit institutions and, in short, to converge towards best supervisory practices, both within the EU and globally. The new capital definition of the Basel Committee of Banking Supervision (BCBS), the approval in the EU of Regulation 575/2013 and the EBA guidelines on best supervisory practices in various areas have, inter alia, contributed to that progress.

Also, areas have been identified where homogenisation efforts must be stepped up. One field where further progress should be made is the convergence towards best supervisory practices in respect of financial analysis.

The main focus of supervision is the assessment of each institution's risk profile and the appropriate level of capital for that profile. Accounting information is the raw material used to assess the risks and the resources available to address them: its reliability determines how robust and comparable solvency ratios are. Consequently, the supervisor has a legitimate interest in the quality of that information and, therefore, its supervisory tasks should include checks on financial statements and the accounting criteria of relevant items, along with the review of risk files of specific operations granted by the credit institution.



SOURCE: Banco de España.

In accordance with strict banking supervision practices and international supervisory standards, the review of banks' financial statements by external auditors is an input in the supervisory process but it does not replace supervisory validation. The latter pursues broader objectives, safeguarding the institution's long-term solvency. The particular complexity and subjectivity inherent in the preparation and review of banking financial information reinforce the need for further supervisory review in addition to that of the auditor. Also, the supervisory review of financial information provides knowledge of the institution that is valuable in terms of assessing risk profile and capital adequacy.

At the international level, different supervisory practices are observed in the review of that information and in the actions arising from it. If that situation continues, it is necessary to prevent the risk of a de facto convergence towards the least rigorous supervisory practices to the detriment of the quality of supervisory work. Accordingly, it is important to build a strong culture of supervisory review of financial information on an international scale, based on best practices, which permits the correct diagnosis of institutions' positions by their supervisors and favours the adoption of measures geared to reinforcing their correct reflection in bank balance sheets.

## 2.2 Supervision of credit institutions

Table 2.1 shows the number of credit institutions operating in Spain at 31 December 2015 and that feature in the Banco de España register, and Table 2.2 contains details of the changes in the last year.

Spanish credit institutions are subject to ongoing supervision, previously conducted exclusively by the Banco de España and currently within the framework of the SSM, based on a prospective risk approach that is intensive in terms of supervisory activities and resources and intrusive in scope. That supervision combines supervisory ongoing monitoring activities with the performance of specific on-site inspections. The purpose of ongoing monitoring is to analyse the risk profile and financial position of each supervised institution, while the on-site inspections are reviews of specific previously identified areas.

The objectives of this model are the constant updating of the institution's risk profile, the early detection of potential risks and the immediate adoption of corrective actions and disciplinary measures.

## OFFICIAL REGISTERS OF INSTITUTIONS

TABLE 2.1

Year-end data. Number (a)

	2012	2013	2014	2015
<b>INSTITUTIONS WITH AN ESTABLISHMENT</b>	<b>305</b>	<b>288</b>	<b>273</b>	<b>264</b>
Credit institutions	258	244	227	220
Banks	75	72	70	67
Savings banks	27	18	5	2
Credit cooperatives	70	67	65	65
ICO	1	1	1	1
Branches of EU institutions	77	78	79	79
Branches of non-EU institutions	8	8	7	6
Controlling companies	1	1	3	3
Representative offices	46	43	43	41
<b>Institutions operating without an establishment</b>	<b>538</b>	<b>548</b>	<b>560</b>	<b>578</b>
EU CIs operating without an establishment (b)	534	544	555	573
Non-EU CIs operating without an establishment	4	4	5	5

SOURCE: Banco de España.

- a The number of institutions also includes those that are non-operational and in the process of deregistering.  
b Including financial subsidiaries of EU CIs.

GRANTING AND WITHDRAWALS OF BANKING LICENCES  
Changes in 2015

TABLE 2.2

Number

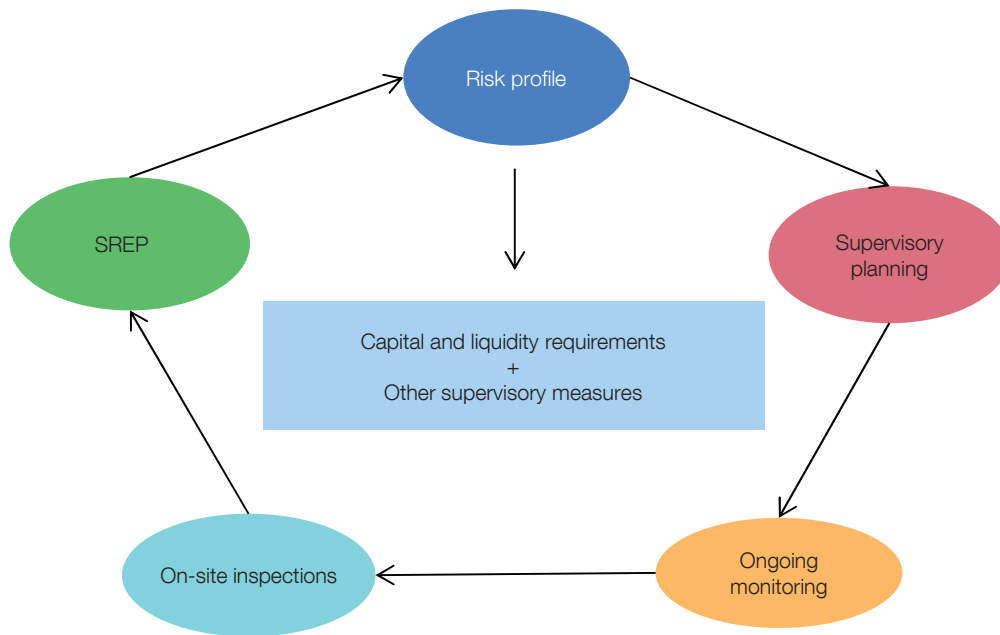
	Credit institutions	Branches of EU institutions	Branches of non-EU institutions
Registrations (a)	0	5	0
Deregistrations (b)	6	5	1
<i>Of which: savings banks converting into foundations</i>	3		
<i>Of which: owing to mergers</i>	1		

SOURCE: Banco de España.

- a ABN AMRO Bank, CM-CIC BAIL, Bank of América Merrill Lynch International, Banca Farmafactoring SPA, China Construction Bank (Europe).  
b Banks: Barclays Bank, S.A.; General Electric Capital Bank, S.A.; Banco Financiero y de Ahorros, S.A. Saving banks: Caja de Ahorros y Monte de Piedad de las Baleares, Caja de Ahorros y Monte de Piedad de Gipuzkoa y San Sebastián y Caja de Ahorros de Murcia. Branches of EU institutions: Europe Arab Bank PLC; JCB Finance, S.A.S.; MCE Bank GMBH; ING Belgium, S.A.; Cortal Consors. Branches of non-EU institutions: Bank of America, National Association.

This intensive and intrusive supervisory approach makes it possible to obtain deeper knowledge of the institution, and at the same time facilitates the early identification of problems, and the assessment of its recovery and resolution capacity in crisis scenarios. Proximity to the institution facilitates the flow of information and promotes dialogue with managers and the swift transmission of requirements of preventative and corrective actions.

The supervisory cycle, described in Schema 2.3, is based on the institution's risk profile. The latter shapes the planning of supervisory activities, which comprise ongoing monitoring and on-site inspections. The Supervisory Review and Examination Process (SREP) is conducted on the basis of the conclusions obtained from the aforementioned activities. That process involves updating the assessment of the institution's risks and controls that determine its risk profile and at the same time assessing the adequacy of the institution's



SOURCE: Banco de España.

capital and its liquidity position. Depending on the assessment made, additional capital and liquidity requirements (Pillar 2) and any other supervisory measures deemed appropriate are imposed on the institution. The SREP is ongoing and, therefore, the risk profile is updated constantly using the results of the supervisory activity.

The start-up of the SSM has not involved a break with the approach of the supervisory model traditionally applied by the Banco de España. However, there has been a considerable change in the supervisory methodology and processes relating to the supervision of significant institutions.

2.2.1 ONGOING SUPERVISION OF SPANISH SIGNIFICANT INSTITUTIONS

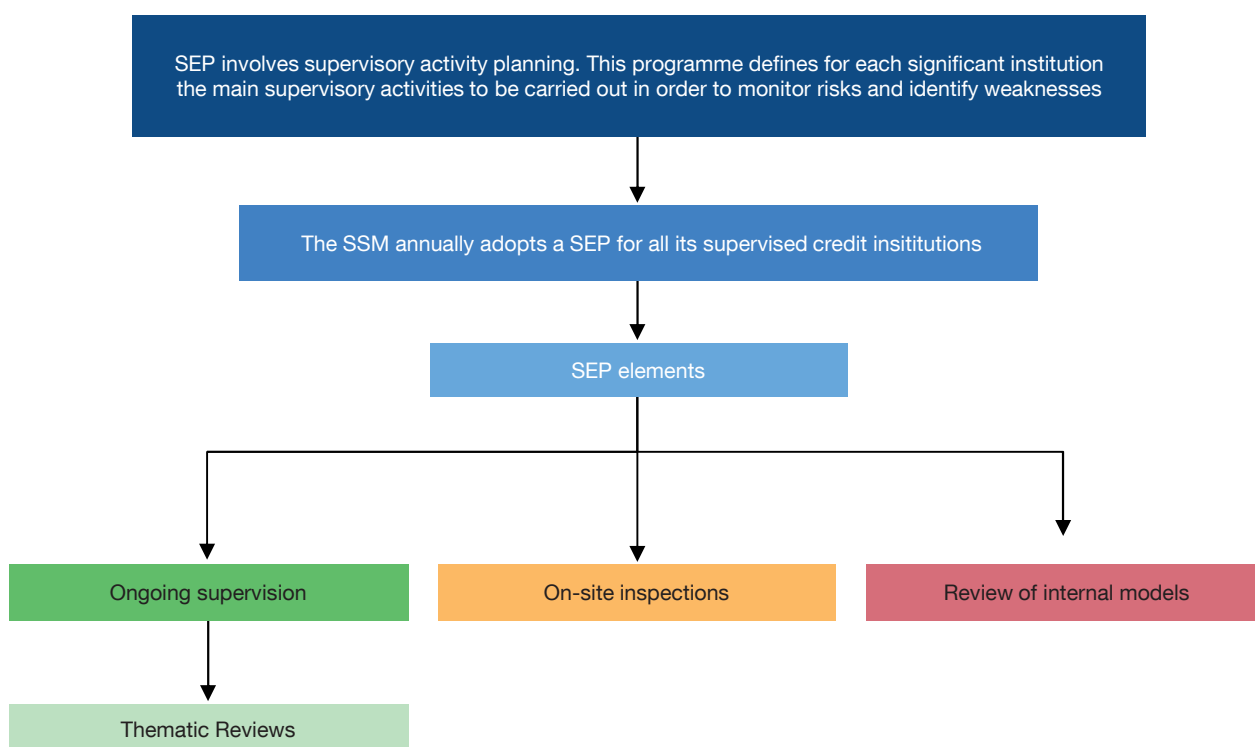
As regards significant credit institutions, within the SSM there are supervisory tasks led by the ECB and performed with the intense participation of the Banco de España through the JSTs, among other mechanisms; other supervisory tasks are the joint responsibility of the ECB and the Banco de España; and lastly; some supervisory tasks are the sole responsibility of the Banco de España.

For the purpose of planning supervisory tasks, annual Supervisory Examination Programmes (SEPs) are prepared, with the participation of the Banco de España. These programmes, described in Schema 2.4, are drawn up based on the institutions' risk profiles and on the SSM-defined supervisory priorities. The programmes establish the main supervisory ongoing monitoring tasks, their objectives and their frequency and timetable, along with the need for on-site inspections and for reviews of internal models.

Supervisory Review and Examination Process

The performance of these supervisory tasks is structured by means of the SREP, which concludes with an evaluation of the risk profile and of the adequacy of the solvency and liquidity of the institutions under supervision.

For operational purposes, the supervisory tasks are distributed among various areas: analysis of the business model; evaluation of internal governance and global controls; assessment of the risks affecting capital and of capital adequacy to cover those risks; and



SOURCE: Banco de España.

assessment of the risks affecting liquidity and of the adequacy of liquidity sources to cover those risks.

In order to conduct those reviews, as part of the ongoing supervision, the JSTs analyse the institution's regulatory reports, financial statements, management information and internal documentation; they hold regular and one-off meetings with managers at different hierarchical levels; they review recovery plans, analysing their complexity, quality and credibility; and they perform validation tasks checking the correct application of policies and procedures, and the correct valuation of risks.

Also, the JSTs participate in the significant institutions' supervisory colleges. In the case of Spanish institutions, these colleges are presided over by the ECB. The Banco de España participates as an observer.

Cross-functional thematic reviews

The SEP's tasks include cross-functional thematic reviews, planned on the basis of the SSM's supervisory concerns. Their purpose is to assess and compare practices in the system and to feed the SREP.

In 2015 the JSTs carried out three cross-functional thematic reviews. Their scope and the main conclusions reached for the European significant institutions as a whole are as follows:

- *Review of internal governance and risk appetite*: the board's involvement in decision-making and its knowledge of the risks to which the institutions are exposed were evaluated, along with the correct implementation of the risk appetite frameworks in management. The review enabled the JSTs to improve their knowledge of institutions' internal governance and to identify the best



practices at the level of euro area institutions. In general, the significant institutions still have room for improvement in this area and can draw closer to international best practices. The main areas of attention are: the capacity of boards of directors to act as a counterweight to the executive function; the inclusion of the risk perspective in the discussions of governing bodies; and the increased interaction between the institution's risk appetite and its long-term strategy.

- *Review of institutions' leveraged financing portfolios*: the scope of this review covered products such as collateralised loan obligations and bonds rated as “high risk”. The review was intended to achieve greater knowledge of transactions, management practices, governance and profit maximising strategies. Moreover, it served as a comparison exercise among institutions and enabled the main financial backers to be identified. Areas of improvement were detected in risk control and, in addition, an increase in the granting of those operations was observed.
- *Review of cyber risk*: the aims were: i) to assess the institution's risk profile in view of external IT threats and its capacity to handle those threats; ii) to identify good practices in the SSM among similar institutions; and iii) to support the identification of corrective actions. The review revealed certain security weaknesses, in particular in institutions involved in mergers. Also, on-site inspections were conducted, which led to the issuance of recommendations. All the information obtained following this review will be of use for the subsequent implementation of the methodology to be applied in the review of cyber risk.

#### Other tasks

Also, the JSTs respond to mandatory applications for authorisation made by the supervised institutions, preparing reports for the adoption of resolutions at the SSM level (Supervisory Board and Governing Council). Some examples of applications are those relating to the authorisation to include instruments as prudential capital or the granting of certain exemptions from prudential requirements provided for in the legislation.

It should be noted that the JSTs can perform specific tasks and activities on top of those in the supervisory plan, especially in order to swiftly address possible emerging risks or circumstances that might affect the institution.

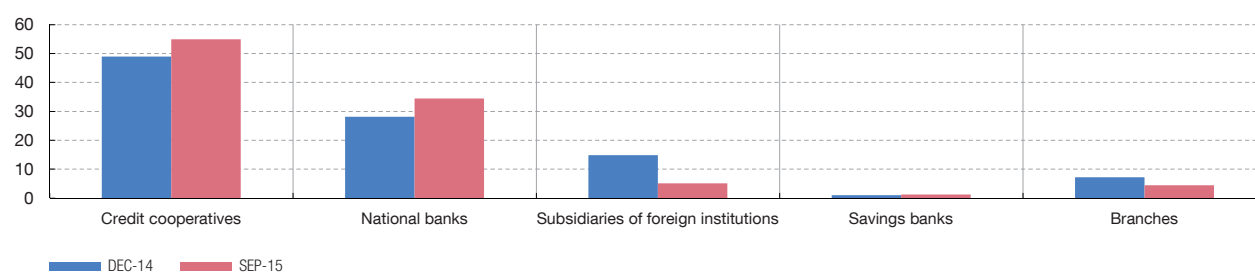
Lastly, the Banco de España also participates, together with the ECB, in the supervision of foreign banking groups with a presence in Spain, 8 of them with subsidiaries and others with branches, the parents of which are classified as significant.

#### 2.2.2 ONGOING SUPERVISION OF SPANISH LESS SIGNIFICANT INSTITUTIONS

The Banco de España is responsible for the direct supervision of less significant institutions (LSIs), while their indirect supervision falls to the ECB, as explained below. The Banco de España performs general monitoring actions and other actions relating to specific areas of less significant institutions.

The general monitoring actions of Spanish less significant credit institutions are performed quarterly or half-yearly and they cover, at least, the areas of financial monitoring, credit risk and liquidity. The objective of those actions is to update the risk profile, identify weaknesses and detect areas or matters which should be explored in greater depth. Smaller institutions, with an insignificant volume of deposits raised on the retail market, are

WEIGHT IN TOTAL ASSETS BY TYPE OF INSTITUTION



SOURCE: Banco de España.

subject to simplified remote monitoring in the form of quarterly alerts based on information from confidential financial statements and the Central Credit Register. The purpose of that remote monitoring is to detect potential future liquidity, solvency or profitability problems.

Given that the branches of institutions with head offices in European Union Member States that are not under the supervision of the SSM are not subject to prudential or liquidity requirements at the branch level, the supervision of the Banco de España is based on simplified remote monitoring and on the regular exchange of information with the authorities of the home country of the branch, under the terms established in Commission Implementing Regulation (EU) No 620/2014 laying down implementing technical standards with regard to information exchange between competent authorities of home and host Member States.

An annual report on the monitoring of less significant institutions is prepared on the basis of all the general and specific monitoring actions performed throughout the year.

In 2015 supervisory actions were performed consisting of the comprehensive ongoing monitoring of 19 of the 62 groups of LSIs that were under the supervision of the Banco de España and the simplified remote monitoring of the remaining 43 groups. Also, more than 200 detailed actions were performed, including, inter alia, reviews of audit reports and reviews of internal capital adequacy assessment reports. In addition to the aforementioned actions, regular meetings were held with persons in positions of responsibility at the institutions.

The Banco de España continued to cooperate with other NCAs in the area of colleges of supervisors of foreign banking groups with LSI parents, participating in three colleges<sup>3</sup> in 2015.

Such direct supervision of the LSIs by the Banco de España is supplemented by the indirect supervision by the ECB, which consists of:

- overseeing the functioning of the LSI sector, and
- ensuring the application of high and harmonised supervisory standards by the NCAs.

<sup>3</sup> A&G Banca Privada, Banco Finantia Sofinloc and Banco Mediolanum.

The ECB's performance of those two functions benefited from the intense cooperation by the Banco de España, which contributed its staff's experience and knowledge of the characteristics of the Spanish less significant institutions.

In particular, the Banco de España cooperates with the ECB in the oversight of the functioning of the LSI sector by submitting regular and ad hoc information on the manner in which the supervisory activity is performed and its results. And this following the procedures laid down by the ECB, which has meant considerable efforts to adapt.

The Banco de España cooperates with the ECB and the other NCAs in defining high supervisory standards which, once approved in the form of guidelines or recommendations, must be applied or taken into consideration by all the SSM countries in the supervision of their LSIs.

That intense cooperation will be maintained in the coming years, since ensuring that the supervisory standards are consistent and effective and that there is an appropriate level of consistency within the SSM is deemed a priority, without prejudice to the fact that the characteristics of the LSIs of each country must be taken into account.

#### 2.2.3 COMMON SSM PROCEDURES

Among the common ECB-Banco de España procedures, the Banco de España is responsible for making an initial assessment and drafting a proposal on each specific case. Subsequently, on the basis of the report issued by the Banco de España and other additional tasks that it might perform, the ECB must adopt a final decision. The common procedures are authorisations to create institutions and to acquire qualifying holdings in credit institutions, and the withdrawal of licences from credit institutions.

In 2015, ten common procedures were performed relating solely to the acquisition of qualifying holdings in Spanish credit institutions.

#### 2.2.4 ON-SITE INSPECTIONS

As regards both significant and less significant credit institutions, the on-site inspection function is separate from ongoing monitoring for the purpose of reinforcing the independence and objectivity of the conclusions obtained from those tasks. Table 2.3 details the on-site actions performed on credit institutions in 2015.

### ON-SITE SUPERVISORY ACTIVITY AT CREDIT INSTITUTIONS. ACTIONS

TABLE 2.3

Credit Institutions	2015		Total
	Significant institutions	Less significant institutions	
Banks	35	3	38
Of which: on-site on internal models	16		16
Savings banks		2	2
Credit cooperatives		8	8
Foreign branches			–
<b>TOTAL</b>	<b>35</b>	<b>13</b>	<b>48</b>

SOURCE: Banco de España.

#### On-site actions on significant institutions

On-site inspection actions for significant institutions are planned as part of the SEP.

In 2015, 35 on-site inspections of Spanish significant institutions were performed. The Banco de España played a major role in those supervision tasks:

- Of the 35 on-site inspections, 32 were led by Banco de España staff and the remaining 3 were led by a person responsible at the ECB.
- Almost all of the other personnel who participated in the inspection visits were from the Banco de España.

Of note among the tasks performed in 2015, together with the normal reviews of internal controls and loan portfolio quality, were the supervisory efforts in the area of IT (information technology). In the wake of the cyber-attacks on two Finnish banks at the end of 2014, the SSM deemed cyber risk to be one of its supervisory objectives. Against this background, the Banco de España staff who are experts in this matter completed two on-site actions on cyber risk in 2015 and they started two further thematic reviews on cyber security which will be completed in 2016.

To uniformly apply on-site inspections in all SSM countries, in 2015 the ECB Centralised On-Site Inspection Division organised a series of working meetings, normally on a monthly basis, between the ECB and the various national supervisors. The meetings were intended to coordinate the on-site inspection actions relating to matters such as reporting models, inspection plans and recommendations for institutions.

The Banco de España participated actively in these meetings, and in several working groups on various specific matters relating to inspections such as, for example, technological matters, the inspection manual and the review of the custody activity or market risk.

For the purpose of boosting the efficiency of inspections, efforts were made to develop mechanisms and routines reducing inspection turnaround times, and to precisely define the scope of each of the actions that must be performed.

Also noteworthy within the SEP of Spanish significant institutions are the reviews of internal risk models. In 2015, 16 of those reviews were started. With the exception of one review, in which ECB resources were involved, they were performed by Banco de España staff. The Banco de España also participated intensely in 2015 in the planning of the across-the-board review of internal models that the SSM will undertake on in 2016. Those actions gave rise to 13 authorisations relating to the validation of internal models, of which 12 related to credit risk models.

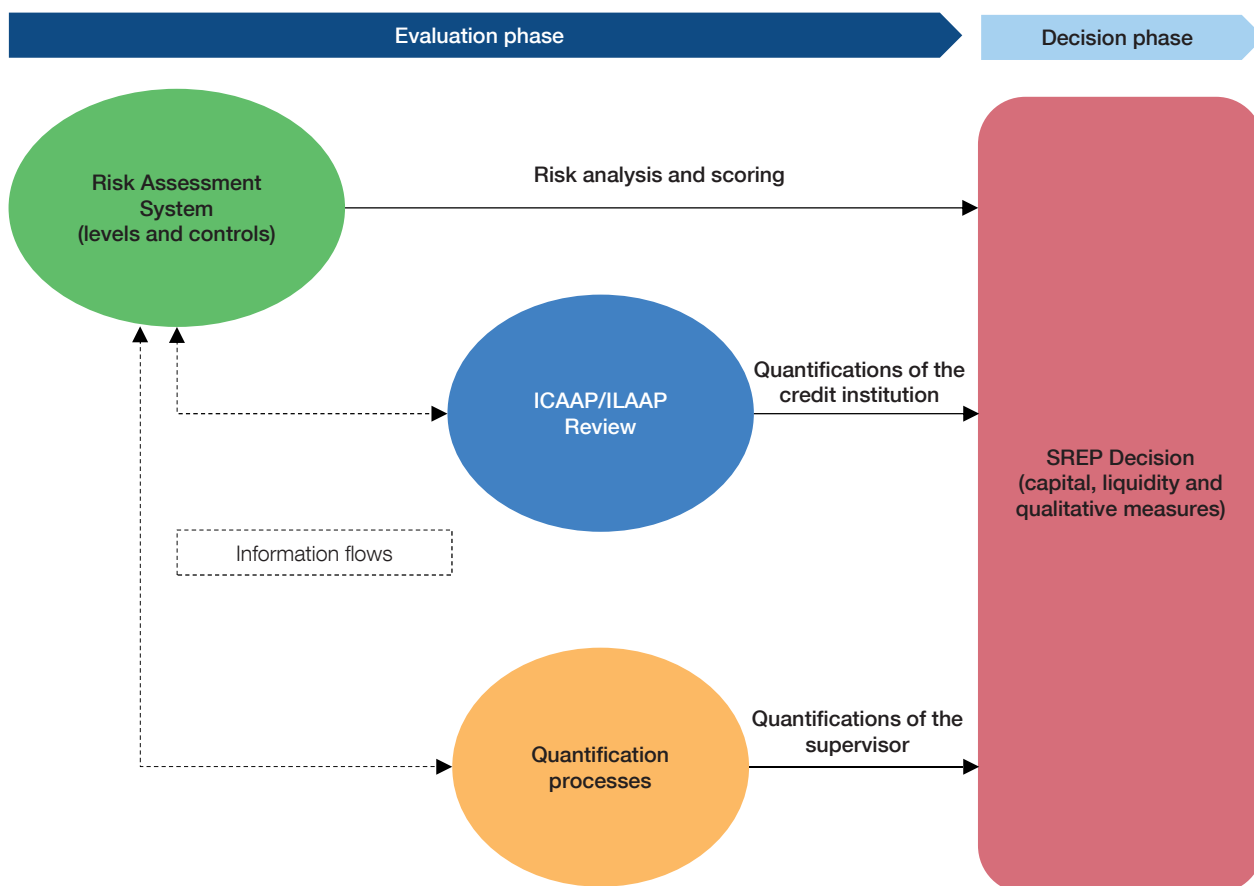
In the last quarter of 2015, the Banco de España participated in the preparation of the 2016 SEP, which established the on-site inspections to be performed throughout the year.

On-site actions on less significant institutions

A total of 13 actions were performed in the year. The SEP approved by the Banco de España Executive Commission foresaw the performance of 12 on-site inspections in 2015. The SEP was prepared taking into consideration the supervisory risk profile of the various institutions and the years elapsed since the last action. 11 of the 12 on-site inspections planned were conducted in 2015, and the inspection of one bank was postponed to 2016 because it was in the process of migrating its IT system. Also, a further two inspections were conducted that did not feature in the SEP.

2.2.5 THE OUTCOME OF THE SUPERVISORY REVIEW AND EXAMINATION PROCESS

The knowledge of the institution obtained through remote and on-site reviews makes it possible to complete the supervisor's assessment of each credit institution. The capital and liquidity decision that the supervisor will demand of each credit institution is adopted on the basis of this assessment. Most progress in 2015 was made in connection with the capital decision.



SOURCE: ECB.

This requirement of each institution of capital additional to the minimum regulatory requirement (Pillar 1) is called, in the terms of the Basel accords, “Pillar 2”. By means of the capital decision, the supervisor formally requires the institutions to have a minimum level of capital in order to adequately cover all their risks, including those with regulatory requirements, i.e. Pillar 1 risks (credit, counterparty, market and operational risks), and those without regulatory requirements, i.e. Pillar 2 risks (basically business risk, balance sheet interest rate and exchange rate risk, concentration risk and reputational risk).

To take the capital decision, the supervisor has two sources of information:

- The assessment that the institution itself makes of its risks and its capital base in accordance with its internal process. This process is called “Internal Capital Adequacy Assessment Process” (ICAAP);
- The Supervisory Review and Examination Process (SREP), which includes the examination of the institution’s risks, controls and governance.

Until 2015, the ICAAP and the SREP had been carried out following national guidelines, but as from this year they must take into consideration the guidelines prepared by the EBA and published in December 2014 (EBA/GL/2014/13).

Capital decision of significant institutions

With regard to significant institutions, 2015 saw for the first time the full application of the methodology implemented within the SSM for determining the capital decision and,

therefore, Spanish credit institutions were assessed using the same methodology as other European significant institutions. That common framework covers:

- i) a system for the assessment of credit institutions' risks;
- ii) a review of the ICAAP and ILAAP applied by the institutions; and
- iii) a methodology for calculating the capital and liquidity needs on the basis of the assessment of their risks.

In short, in 2015 the SSM adopted the first capital decisions resulting from the full application of the common SREP methodology. The preparation of the SSM capital decisions is based on a first draft prepared by the JSTs, taking into account the conclusions of the ongoing monitoring and any other relevant information on the institution, such as, for example, the outcome of the on-site inspections. Next, the ECB conducts various horizontal reviews, with the aim of applying a uniform degree of strictness in the level of capital required of the institutions. Subsequently, the draft capital decision is communicated to the institutions and they are given the opportunity to make representations. Once approved by the Supervisory Board, those capital decisions are communicated to the institutions and will be in force until the next capital decision, which will foreseeably be adopted in December 2016.

It should be noted that the 2015 SREP capital decisions of the SSM were expressed solely in terms of the highest quality capital (CET1) and that they took into account the new macroprudential buffers introduced in the European solvency legislation.

Capital decisions of less significant institutions

With respect to less significant institutions under the direct supervision of the Banco de España, a similar though simpler arrangement was applied in 2015, taking into account the Banco de España guidelines on the ICAAP and the SREP.

The supervisory practices of the Banco de España are adapted, in all material respects, to the new framework established by international agreements, European legislation, EBA guidelines and the SSM cooperation framework. In particular, the traditional supervisory approach followed by the Banco de España based on the institutions' risk profile and systemic importance is very similar to that currently established under EBA guidelines.

At the end of 2015, once the corresponding SREPs had concluded, the Banco de España adopted capital decisions for the less significant institutions by means of a procedure that includes the consideration of institutions' representations. The decisions have resulted in the setting of a specific capital level, in CET1 terms, which each institution or group must achieve.

2.2.6 SUITABILITY

The purpose of the supervision of the suitability regime for senior officers is to assess compliance with the requirements that the persons appointed to occupy the positions of board members, managing directors or similar officers must fulfil in accordance with the applicable legislation: commercial and professional repute, appropriate knowledge and experience to exercise their functions, capacity to dedicate sufficient time, compliance with the incompatibilities and limitations regime (where applicable) and, in the case of board members, willingness to exercise good governance. The suitability assessment by the supervisor is conducted mainly upon the appointment of the senior officer, but also in an ongoing manner, when there are significant events or changes which might affect it.

Competence in the case of significant institutions corresponds to the ECB, in close cooperation with the NCAs, whereas competence in the case of less significant institutions corresponds to the Banco de España.

The supervision of the suitability regime by the Banco de España was characterised by two events in 2015:

- the incorporation into supervisory practice of the new legislative developments and guidelines and reports that continue to be published on the subject of corporate governance, and
- the adaptation of the credit institutions' supervisory procedures and criteria to the report published by the EBA, referred to below, and to the guidelines issued by the SSM in its first year in operation.

The Banco de España develops and puts into practice all the tools and measures that make it possible to contribute depth to the analysis of the assessment and greater rigour to the conclusions. Thus, *inter alia*, interviews have started with candidates in the cases in which it is deemed appropriate from a monitoring standpoint, taking into account the characteristics of the post to be held and the importance of the institution. Also, particular emphasis is placed on the suitability assessment of non-executive directors, especially independent directors, and of executives responsible for the credit institutions' control functions. Their work is considered to be essential to ensure correct decision-making, efficient management and adequate risk control by the credit institutions.

Also, the use of measures to redress the shortcomings identified is becoming widespread. For example, when there is a rectifiable lack of knowledge or experience, the institutions are required to provide adequate training or integration courses. Similar steps are taken with the suitability assessment files which point to the existence of potential conflicts of interest, requiring, for example, the institutions to adopt an appropriate policy for the management of such conflicts. In some cases the application of the incompatibilities and limitations regime involves the need to resign from a post or the impossibility of assuming additional responsibilities.

The situations in which there is a failure to comply with the reputation requirement have led, in general, to the voluntary resignation of the person in question. In other cases, where this requirement is not deemed to be absent but there is a situation which, depending on how it develops, might affect the person's reputation, the institution is required to perform a specific and ongoing monitoring of the situation and to keep the Banco de España duly informed.

It can be concluded from the foregoing that this is a constantly developing area. The approval of Circular 2/2016, which completes the transposition of Capital Requirements Directive IV (CRD IV), will allow this process to move forward. In this regard, for example, more detail will be required on the data contained in the Banco de España Senior Officers Register, which will facilitate the review of incompatibilities in the simultaneous exercise of posts.

All of these matters will be affected considerably by the outcome of the work currently being carried out by the EBA on the definition of the holders of key functions and the preparation of guidelines in accordance with the CRD IV.

Harmonisation of supervisory practices among the SSM countries	In the context of the first year of functioning of the SSM, the ECB Authorisations Division created a working group, comprising experts from each of the participating countries, including the Banco de España. That group has worked intensely on the harmonisation of supervisory practices, taking the best practices identified by the various European supervisors and by the EBA as a reference. The work of the group has centred on the following criteria: assessment of repute, dedication capacity, potential conflicts of interest and the suitability of the board as a whole.
European Banking Authority Report	<p>Lastly, we turn to the results of the EBA report, <i>On the peer review of the Guidelines on the assessment of the suitability of members of the management body and key function holders</i>, published on 16 June 2015. The report analyses the amendments made to national bodies of law as a result of the publication of the EBA suitability guidelines in 2012, the best supervisory practices in the European Union, the degree of convergence achieved and the measures adopted when the suitability requirements are not met, identifying the best supervisory practices among the participating countries.</p> <p>Spain was found to comply with all the criteria included in the Guidelines.</p>
2.2.7 OTHER ACTIONS AND LETTERS	In addition to the tasks described above, the Banco de España's supervisory tasks also include, for both significant and less significant institutions: the common SSM procedures, the microprudential supervisory tasks not transferred to the SSM, the handling of certain procedures provided for in legislation and the issuance of letters.
Other supervisory tasks of the Banco de España	<p>Among the other supervisory tasks not transferred to the SSM which are performed by the Banco de España, the following are worthy of note:</p> <ul style="list-style-type: none"> <li>– The Banco de España is the competent body to authorise the opening of third-country branches in Spain. In 2015 no new authorisations were granted and there were two withdrawals due to branch closures.</li> <li>– As indicated in the Chapter 1, the supervision of the prevention of money laundering and terrorist financing (PML&amp;TF) at credit institutions in Spain is the competence of SEPBLAC, with which the Banco de España cooperates in the supervision of those procedures. In 2015 the Banco de España completed the plan commenced in 2013 to review the PML&amp;TF risk prevention and assessment measures at all significant institutions and some less significant institutions. Also, 2015 saw the start of a second cycle of assessment of the effectiveness and degree of implementation of the measures adopted by institutions to redress the deficiencies detected by the inspection.</li> </ul>
Procedures performed	Moreover, in 2015 the Banco de España, both as a member of the SSM and in the exercise of its exclusive supervisory powers, performed the procedures summarised in the table below:
Letters	In the performance of its supervisory tasks, the Banco de España sent 15 letters to credit institutions containing 37 requirements and recommendations, as detailed in Table 2.5. The most significant subject matters of those letters were: credit risk, both accounting and the quality of credit risk controls (41% of the total); management and internal control policies (27%); and capital and solvency (16%).



	In exercise of the exclusive competence of Banco de España	As part of the SSM	Total number
Suitability	181	85	266
Loans to senior officers	54	—	54
Reduction, repurchase or redemption of own funds	3	4	7
Other procedures relating to own funds (a)	9	3	12
Reports to Ministry of Economy on structural changes	10	—	10
Acquisition of credit institutions in third countries	8	—	8
Amendments of articles of association	73	—	73
Issuance of reports for other Spanish authorities	16	—	16
Other procedures	19	—	19
<b>TOTAL</b>	<b>373</b>	<b>92</b>	<b>465</b>

SOURCE: Banco de España.

a Including exemptions from deductions provided for in Regulation (EU) 575/2013, authorisations relating to the scope of that regulation and joint decisions on capital.

Additionally, the Banco de España sent a joint letter to all the credit institutions for them to examine entertainment expenses or similar costs over the last four years.

#### SUPERVISORY ACTIVITY. LETTERS ADDRESSED TO CREDIT INSTITUTIONS

TABLE 2.5

Number

Credit institutions (a)	
Banks	7
Savings banks	—
Credit cooperatives	7
Foreign branches	1
<b>TOTAL</b>	<b>15</b>

SOURCE: Banco de España.

a Of these letters, 12 relate to LSIs and 3 to SIs, arising from competencies that the SSM has not assumed.

Intervention of credit institutions

On 10 March 2015, as a consequence of the intervention of Banca Privada d'Andorra (BPA), an Andorran bank, by the INAF (the Andorran supervisor), the Banco de España resolved to intervene Banco de Madrid, a credit institution wholly owned by BPA. That precautionary measure was replaced, two days later, when the board of directors of the institution was replaced. Following the court decision to initiate insolvency proceedings, Banco de Madrid is now in the winding-up phase and the Deposit Guarantee Fund has reimbursed deposits up to €100,000.

### 2.3 Supervision of institutions other than credit institutions

The Banco de España has exclusive supervisory powers over the following institutions other than credit institutions that provide services or perform functions related to the financial sector: specialised lending institutions, mutual guarantee and reguarantee companies, appraisal companies, payment institutions, electronic money institutions, currency-exchange bureaux, banking foundations and Sareb. Table 2.6 contains the detail of those institutions.

Number. Year-end data (a)

	2012	2013	2014	2015
Institutions with an establishment	203	188	184	180
Specialised lending institutions (b)	54	48	47	44
Mutual guarantee companies	24	24	24	21
Reguarantee companies	1	1	1	1
Appraisal companies	57	46	40	36
Foreign currency-exchange bureaux (c)	10	9	10	13
Payment institutions	46	48	45	43
Hybrid payment institutitons	—	—	—	2
Branches of EU payment institutions	7	6	8	12
Agent networks of EU payment institutions	2	2	3	3
Electronic money institutions	2	3	4	3
Branches of EU electronic money institutions	—	1	2	2
Banking foundations	—	—	13	14
Sareb	1	1	1	1
Institutions operating without an establishment	181	265	317	400
Electronic money institutions	29	44	55	75
Payment institutions (d)	152	221	262	325

SOURCE: Banco de España.

- a The number of institutions also includes those that are non-operational and in the process of deregistering.  
b Includes 5 SLIs that have proved their hybrid status, pursuant to Law 5/2015 on the promotion of business financing.  
c Not including establishments only authorised to purchase foreign currency with payment in euro.  
d In application of Directive 2007/64/EC and of Law 16/2009 on payment services.

The legal basis under which the Banco de España supervises those institutions and the approach behind the tasks differs from case to case. However, the supervisory concern is always the same: to ensure the proper functioning of those institutions, considering the role they play and customer protection. Also, the senior officers at all those institutions are subject to suitability requirements.

#### Specialised lending institutions

The Banco de España is granted powers to supervise these institutions under Article 12.1 of Law 5/2015 of 27 April 2015 on the promotion of business financing.

The main characteristics of these institutions are: i) the specialisation of their activity, which is confined to the performance of lending activities by various means and the granting of bank and other guarantees; and ii) they are not allowed to take customer deposits. Setting aside these characteristics, their operations are subject to an administrative regulatory regime overseen by the Banco de España that is similar to that of credit institutions, in particular with regard to minimum capital.

The supervisory tasks regarding specialised lending institutions consist basically of the review of the quality of their loan portfolio, their profitability and their internal controls, which is performed through monitoring actions or on-site inspections.

Law 5/2015 of 27 April 2015 on the promotion of business financing established the regulatory framework for those institutions, which ceased to be classed as credit institutions on 1 January 2014. Under this new legislation, these institutions are subject to Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit

institutions and its implementing regulations, together with any special features provided by the regulations. Law 5/2015 exempts these institutions from certain requirements applicable to credit institutions.

Until the entry into force of the new law, the Banco de España had the powers to grant and revoke the licences of specialised lending institutions, but since that date the power to authorise has been held by the Ministry of Economy and Competitiveness, with a prior report from the Banco de España, whereas revocation and withdrawal remains the competence of the Banco de España, pending the approval of the planned royal decree on the rules governing specialised lending institutions.

#### Mutual guarantee companies

The Banco de España's supervisory powers over these institutions are established in Article 66 of Law 1/1994 of 11 March on the rules governing mutual guarantee companies.

Mutual guarantee companies are financial institutions that behave like corporate promotion instruments, helping provide small and medium enterprises (SMEs), which play a major role in creating wealth and generating employment, with access to financing in line with their possibilities. In particular, they grant bank guarantees to SMEs that enable them to access bank financing and they provide them with other complementary services, such as advice on negotiations with credit institutions for better credit conditions and on the assessment of investment projects. The supervisory work on mutual guarantee companies consists of the analysis of the quality of the guarantee portfolio and their liquidity, profitability and solvency by means of monitoring actions and, where appropriate, on-site inspections.

#### Appraisal companies

The Banco de España's supervisory powers over these institutions are established in Article 15 of Royal Decree 775/1997 of 30 May 1997 on the rules governing the approval of appraisal services and companies.

Also, the Banco de España officially recognises appraisal companies so that their valuations have effect in the cases envisaged in Article 1 of Royal Decree 775/1997 of 30 May 1997 on the rules governing the approval of appraisal services and companies.

The supervisory tasks regarding appraisal services and companies consist of the analysis of the procedures used to conduct the appraisal of assets that serve, in general, as collateral for the mortgage loans granted by credit institutions.

In addition to the annual monitoring of licensed appraisal companies, a tool was developed for the review, by statistical means, of the appraisals conducted by those companies. The theoretical implementation of this tool, the pilot scheme for which was completed in 2014, was conducted on 8 appraisal companies, and in 2015 it was applied to the entire sector for the appraisal of homes. That enabled the comparative analysis of 875,000 appraisals of homes, all of which were performed in 2014 by approved companies.

#### Payment companies, electronic money institutions and currency exchange bureaux

The Banco de España's power to control and inspect these institutions is established in Article 15 of Payment Services Law 16/2009 of 13 November 2009; Article 20 of Electronic Money Law 21/2011 of 26 July 2011; and Article 6 of Royal Decree 2660/1998 of 14 December 1998 on the changing of foreign currency in establishments open to the public other than credit institutions.

Payment service providers play a major role in the functioning of an effective, efficient and secure payment system, which in turn is an essential element in the correct functioning of

economic and commercial relationships. The safeguarding of the users' funds that the payment institutions and electronic money institutions receive for the performance of payment operations and the issuance of electronic money, respectively, and, in short, the safeguarding of the operating and financial stability of that payment system, ultimately impacts the proper functioning of the economy as a whole.

The supervisory tasks regarding these institutions consist of reviewing the correct safeguarding of the funds received from customers, the solvency of the institutions and their internal control.

#### Banking foundations

The Banco de España analyses the influence of banking foundations on the sound and prudent management of the credit institution in which they participate. There are currently 14 banking foundations<sup>4</sup>. Also, banking foundations that own a holding equal to or greater than 30% of the capital of a credit institution or a holding which grants them control over a credit institution must prepare a management protocol and a financial plan regarding the holding that are submitted to the Banco de España for authorisation. Also, in the cases in which the holding reaches 50% or grants control, the banking foundations are obliged to reinforce the financial plan and create a reserve fund to cover possible capital requirements of the investee credit institution or to submit a divestment programme detailing the measures to be adopted and implemented by the banking foundation in order to reduce its holding in the credit institution to below the levels indicated in Article 44.3 of Law 26/2013 over a maximum period of five years.

#### Sareb

The Banco de España's supervisory powers over this institution are provided for in the Seventh Additional Provision of Law 9/2012 of 14 November 2012 on credit institution restructuring and resolution. The supervisory tasks consist of verifying the correct application of the procedures approved for the disposal of the assets received from certain credit institutions and the correct appraisal thereof.

Although the weighting of the institutions discussed in this section with respect to the financial system as a whole cannot be compared to that of credit institutions, their supervision is conducted by the Banco de España with the conviction that an effective regulatory and supervisory model for these institutions promotes the fluidity of financial intermediation mechanisms and generates a climate of confidence in financial institutions.

The following sections of this chapter refer, firstly, to the supervisory activity carried out in 2015 on the above-mentioned institutions. Secondly, mention is made of the authorisations and other procedures relating to the exercise of their activity. And thirdly, a description is given of the actions relating to the oversight of vetted access to activity.

#### 2.3.1 SUPERVISORY ACTIVITY

In 2015, 282 off site monitoring actions were performed by various means: annual monitoring, periodic general monitoring, simplified monitoring, reviews of audit reports and reviews of internal capital adequacy assessment reports, as detailed in Chart 2.2.

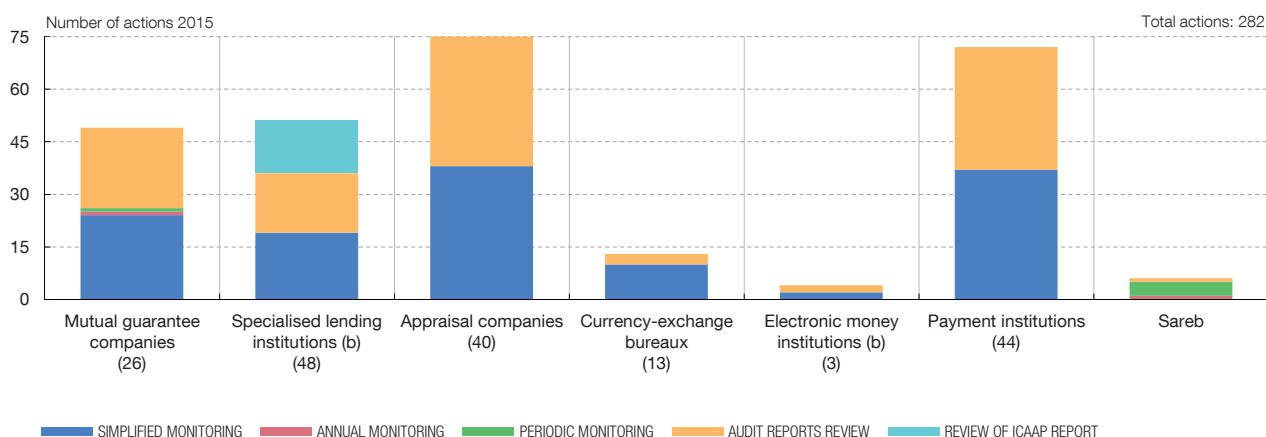
Also, 10 inspections were performed in 2015, the detail of which is shown in Table 2.7.

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<sup>4</sup> The banking foundations of BBK, Caja Vital, Kutxa, La Caixa, Unicaja, Cajastur, Santander y Cantabria, Ibercaja, Caja de Extremadura, Caja Círculo, Caja Canarias, Caja Burgos, Caja Castilla-La Mancha and Caja Navarra.

## SUPERVISORY ACTIONS TAKEN ON OTHER INSTITUTIONS (a)

CHART 2.2



SOURCE: Banco de España.

a The number of supervised institutions in 2015 is indicated in the legend to the chart.

b Not included here are 21 supervisory actions for specialised lending institutions and 1 electronic money institution, all of which belong to national banking groups.

## ON-SITE INSPECTIONS AT OTHER INSTITUTIONS

TABLE 2.7

Number

	Actions			
	2012	2013	2014	2015 (a)
Specialised lending institutions	1	2	—	3
Appraisal companies	—	—	—	—
Mutual guarantee companies	1	—	—	2
Payment institutions	3	3	5	3
Foreign currency-exchange bureaux	—	—	—	—
Electronic money institutions	1	—	—	1
Sareb	—	—	1	1
<b>TOTAL</b>	<b>6</b>	<b>5</b>	<b>6</b>	<b>10</b>

SOURCE: Banco de España.

a Of these inspections, 4 were in progress as at year-end.

### 2.3.2 AUTHORISATIONS AND OTHER PROCEDURES

The Banco de España participates in the granting and withdrawal of licences to open those institutions and to perform other procedures relating to the exercise of their activities.

#### Granting and withdrawal of licences

The Banco de España is the competent authority for granting and withdrawing licences for currency exchange bureaux.

However, it must issue the mandatory report on the authorisation of the following types of institutions, which is granted by the Ministry of Economy and Competitiveness.

- Specialised lending institutions.
- Electronic money institutions or branches in Spain of non-EU electronic money institutions.

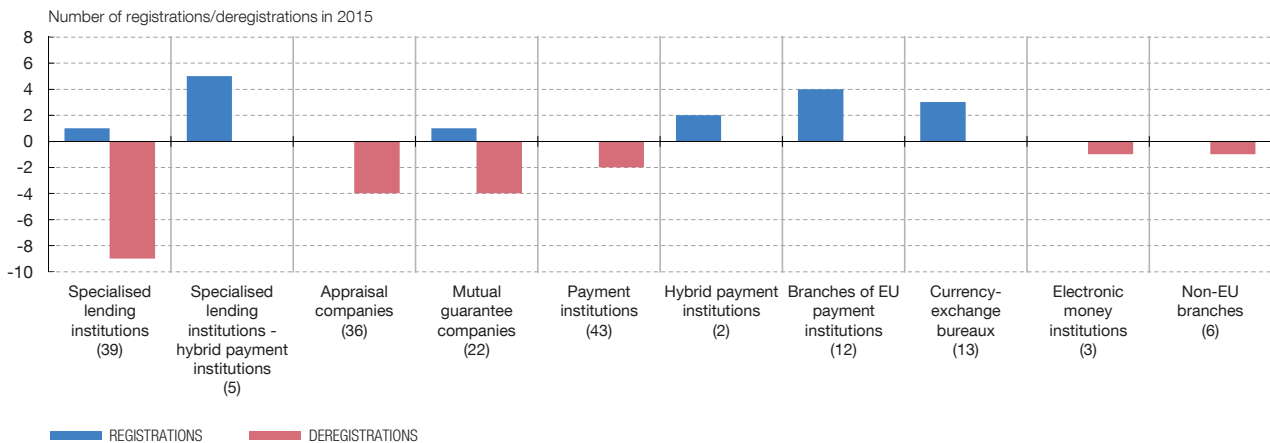
- Payment institutions or branches in Spain of non-EU payment institutions.
- Mutual guarantee companies.

In 2015, 16 requests to open institutions were processed, of which one related to credit financial intermediaries, five to hybrid payment institutions-credit financial intermediaries, one to mutual guarantee companies, two to hybrid payment institutions, four to branches of payment institutions and three to currency exchange bureaux.

Chart 2.3 shows the number of additions and deletions in the registers in 2015, broken down by type of institution.

REGISTRATIONS AND DEREGISTRATIONS OF OTHER INSTITUTIONS (a)

CHART 2.3



SOURCE: Banco de España.

a The number of institutions as at 31.12.15 is indicated in the legend to the chart.

#### Other procedures

The Banco de España holds various prudential supervisory powers over those institutions, relating to both the access to the activity and the exercise thereof. As indicated above, the Banco de España's specific powers over each of those institutions differ somewhat depending on the provisions of the legislation applicable to them.

In 2015, 232 procedures relating to those powers were performed, as detailed in Table 2.8. Additionally, two procedures were handled relating to consultations with other supervisors in the sphere of cross-border activity.

#### Letters

Following the supervisory actions, 10 letters were sent to those institutions containing 29 requirements and recommendations. The most significant subject matters were credit risk, both accounting and the quality of controls (34%); general internal control and management policies (21%); and capital and solvency (17%).

In addition to the figures in Table 2.9, 28 letters containing requirements were sent to appraisal companies for them to amend their internal codes of conduct, as they did not satisfy the minimum content of the provisions of Rule Five of Circular 7/2010.

**OTHER PROCEDURES PERFORMED BY THE BANCO DE ESPAÑA RELATING TO OTHER ENTITIES**
**TABLE 2.8**

Number of procedures in 2015

	Payment institutions	Electronic money institutions	Specialised lending institutions	Mutual guarantee companies	Appraisal companies	Currency-exchange bureaux	Sareb	Foundations	Total other institutions
Acquisition of qualifying holdings			1		2				3
Cross-border activity of Spanish credit institutions	7	2	2						11
Branches in the European Union	4		2						6
Branches in third countries									0
Freedom to provide services	3	2							5
Suitability	45	18	88		14	4			169
Other procedures relating to own funds (a)			1	1					2
Structural changes	5		5	3					13
Amendments of articles of association	5		14	8					27
Management Protocol								1	1
Other procedures	1		3	2			1		7
<b>TOTAL</b>	<b>63</b>	<b>20</b>	<b>114</b>	<b>14</b>	<b>16</b>	<b>4</b>	<b>1</b>	<b>1</b>	<b>233</b>

SOURCE: Banco de España.

a Includes exemptions from deductions provided for in Regulation (EU) 575/2013, authorisations relating to the scope of that regulation and joint decisions on capital.

**LETTERS ADDRESSED TO OTHER INSTITUTIONS**
**TABLE 2.9**

Number

	2012	2013	2014	2015
Specialised lending institutions	–	1	1	3
Appraisal companies	–	–	–	–
Mutual guarantee companies	2	–	2	2
Payment institutions	–	5	5	5
Currency-exchange bureaux	1	–	–	–
Electronic money institutions	1	1	–	–
Sareb	–	–	2	–
<b>TOTAL</b>	<b>4</b>	<b>7</b>	<b>10</b>	<b>10</b>

SOURCE: Banco de España.

**2.3.3 COMPLIANCE WITH VETTED ACCESS TO ACTIVITY**

Spanish legislation establishes that several financial activities are subject to vetted access to activity, i.e. they can only be carried out by the institutions legally authorised to do so. The Banco de España's functions include overseeing compliance with this legislation, taking action on persons seeking to break into the financial market without meeting the conditions of access, whether it be through the exercise of activities legally restricted to credit institutions, payment service providers or other types of supervised institutions, or through the use of generic names restricted to those institutions or any other name that may cause confusion with them.

2015 saw the initiation of supervisory actions relating to 32 natural or legal persons who might be carrying out restricted activities without authorisation, the outcome of which might lead to the adoption of penalties.



### 3 MACROPRUDENTIAL SUPERVISION



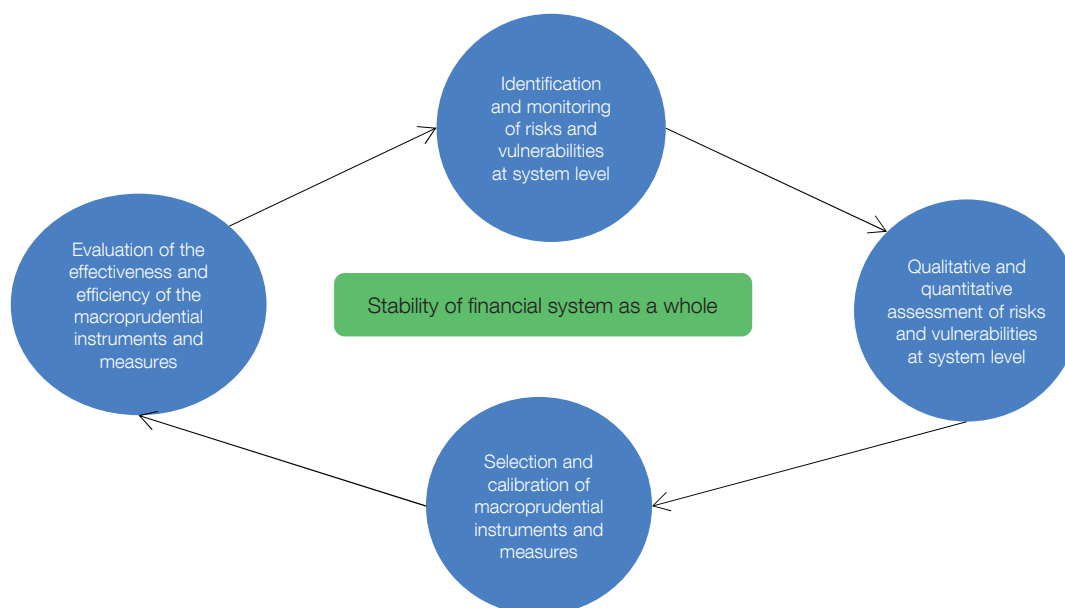
### 3 MACROPRUDENTIAL SUPERVISION

Macroprudential tools are one of the principal new developments introduced by international legislation –Basel III, CRD IV and Capital Requirements Regulation (CRR)– as a result of the recent financial crisis. The ultimate objective of macroprudential policy is to contribute to safeguarding the stability of the financial system as a whole, by reinforcing its resilience and mitigating systemic risks, with the aim of ensuring a sustainable contribution by the financial sector to economic growth. Fulfilment of this objective requires the use of macroprudential indicators and instruments. Macroprudential indicators facilitate the monitoring and assessment of risks and vulnerabilities on a systemic scale, which may then give rise to the selection, calibration and implementation of the macroprudential instruments and measures deemed most appropriate. Subsequently, the information arising from the analysis of the efficiency and effectiveness of the implementation of these instruments and measures contributes to creating a feedback loop with the initial analysis (see Schema 3.1).

The macroprudential requirements shall be in force from 2016 and, therefore, in 2015 the Banco de España worked on determining and setting the various instruments defined in the applicable legislation.

#### MACROPRUDENTIAL SUPERVISION

SCHEMA 3.1



SOURCE: Banco de España.

#### 3.1 Macroprudential instruments

As a result of the international progress made in the implementation of macroprudential legislation, the Banco de España currently has in place a series of instruments that should facilitate greater control over systemic risks that may appear in the future (see Table 3.1). Some of these instruments stem from CRD IV, which was recently transposed into Spanish legislation (Law 10/2014 of 26 June 2014 and Royal Decree 84/2015), while others are established in the CRR.

Instrument	Legal basis	Application	Description
Countercyclical capital buffer	Law 10/2014, article 45	Mandatory	Additional capital buffers accumulated during expansion periods to absorb losses during recessions.
Capital buffers for systemically important institutions	Law 10/2014, article 46	Mandatory for G-SIs Optional for O-SIs	Additional capital buffer to deal with SIs' externalities, both global (G-SIs) and also national (O-SIs).
Systemic risk buffer	Law 10/2014, article 47	Optional	Capital buffer to prevent and mitigate non-cyclical systemic risks not covered by the CRR.
Pillar 2 capital requirements	Law 10/2014, article 42	Optional	Liquidity systemic risk approach based on liquidity surcharges.
Other macroprudential uses of Pillar 2	RD 84/2015, article 76	Optional	Approach for systemic risks from institutions with a similar risk profile.
Additional measures	CRR, article 458	Optional	Stricter requirements for capital, conservation buffer, liquidity, large exposures, information and risk-weighted assets.
Higher risk-weighted assets and stricter criteria for granting credit to the property sector	CRR, article 124	Optional	Capital instruments focused on a specific sector. The motivation is similar to the countercyclical capital buffer, but applied to the real estate sector.
Higher minimum LGDs	CRR, article 164	Optional	

SOURCE: Banco de España.

a The CRD (Capital Requirements Directive) has been transposed into national legislation through Law 10/2014 and Royal Decree 84/2015, while the CRR (Capital Requirements Regulation) is directly applicable.

### 3.1.1 COUNTERCYCLICAL CAPITAL BUFFER

The principal macroprudential instruments are the so-called “capital buffers”, which are a series of Common Equity Tier 1 capital requirements additional to those established in the CRR, which are determined as a percentage of the institutions’ risk exposures. One of those buffers is the countercyclical capital buffer. It was introduced in the Basel III framework with the objective of ensuring that the banking sector as a whole has an additional capital buffer so that its solvency is not called into question in stress situations caused by a prior period of excessive lending growth, thus helping maintain the flow of credit to the economy. In this respect, it is an instrument designed to handle the temporary nature of the systemic risks triggered by excessive growth in aggregate lending.

This buffer became applicable in January 2016. It is set by the Banco de España following a “guided (or limited) discretion” approach, whereby the activation and deactivation of the buffer is guided by specific quantitative indicators and by qualitative information and expert opinion. In this regard, the initial reference indicator, also recognised by the ESRB, is the so-called “credit-to-GDP gap”. That indicator is calculated as the difference between the ratio of total credit vis-à-vis the private non-financial sector to GDP, less the long-term trend of that ratio (estimated using a statistical methodology). Following the initial reference rule proposed by the Basel Committee on Banking Supervision, the buffer will be activated when this indicator exceeds the 2% threshold and it will reach a value of 2.5% when this indicator is 10%.

Following the guided discretion approach, and given that the credit-to-GDP gap does not function in the same way in all contexts and all countries, in setting the buffer level the Banco de España can also consider other possible specifications of that gap and quantitative and qualitative indicators.

Each quarter the Banco de España sets the percentage of the buffer for credit exposures in Spain, taking into account the initial reference indicator described above and the recommendations and guidelines issued by the ESRB, as well as any other variables it deems relevant.

In that framework, the Banco de España agreed to set the countercyclical capital buffer applicable from 1 January 2016 at 0% and it has ratified that decision for the quarter started on 1 April, since the analysis of the indicators of systemic risk associated with excessive growth in lending (the credit-to-GDP gap stood at -58% in June 2015, far off the reference threshold for activating the buffer) advised against setting it above that percentage for the time being.

### 3.1.2 CAPITAL BUFFERS FOR SYSTEMICALLY IMPORTANT INSTITUTIONS

One of the other buffers available is the buffer relating to the additional requirements for global or domestic systemically important institutions. These systemically important institutions are institutions whose insolvency or poor functioning may cause a disruption which could have serious negative consequences for the financial system and the real economy and that, therefore, merit special prudential treatment.

The objective of this additional capital buffer is to handle macroprudential risks from the cross-sectional or structural standpoint, and thus reinforce the solvency of systemically important institutions in order to reduce the negative externalities that their insolvency might have on the banking system as a whole. Also, that measure should mitigate the moral hazard entailed by these too-big-to-fail institutions by means of a capital surcharge with respect to others, and at the same time it would offset their potential competitive advantage due to the public support they might receive in the event of solvency problems.

As for global systemically important institutions (G-SIIs), a methodology that permits their identification and the assignment of a capital surcharge based on objective criteria was established on an international scale. However, the national supervisor can designate institutions that fall below the quantitative cut-off threshold as global systemically important institutions, provided there is justification for doing so (supervisory judgement). The additional requirements will begin to be phased in gradually as from 2016, with 25% of them having to be met by 2016, 50% by 2017, 75% by 2018 and 100% by 2019.

Also, as from 2016 the Banco de España identifies the other systemically important institutions (O-SIIs) by applying the guidelines implemented by the EBA (EBA/GL/2014/10). This is also an identification methodology based on general quantitative criteria, together with a certain degree of national discretion so that it is better adapted to the profile of the local banking system. Each systemically important institution will be required to have a capital buffer, determined by the Banco de España, of up to 2% depending on the degree of systemic importance and the particular situation of the institution.

In 2015 the Banco de España determined the levels at which the capital buffers should be set for systemically important institutions, and at the end of 2015 it announced the applicable levels for 2016 (see Table 3.2).

Institution	Systemic importance	Capital buffer (after the phase-in period) (%)
Santander	G-SIIs (sub-category 1) and O-SIIs	0.25
BBVA	G-SIIs (sub-category 1) and O-SIIs	0.25
Caixabank	O-SIIs	0.0625
Bankia	O-SIIs	0.0625
Popular	O-SIIs	0
Sabadell	O-SIIs	0

SOURCE: Banco de España.

### 3.1.3 OTHER INSTRUMENTS

The other available instruments are optional and supplementary and their purpose is similar to those described above.

In particular, CRD IV permits the introduction of a systemic risk buffer to prevent and mitigate structural systemic risks by increasing the loss-absorbing capacity of the system and its components. This is a flexible and cross-sectional instrument that can be applied to the entire system or to a sub-group of banks. Additionally, CRD IV also permits the macroprudential use of the tools available under Pillar 2, such as capital surcharges or greater reporting transparency requirements.

The CRR recognises domestic flexibility in order to be able to impose stricter prudential requirements in a series of instruments, such as the capital conservation buffer, liquidity surcharges or large exposures, and it also permits increases in risk weights and loss given default (LGD) in the property development sector. Those measures must only be applied when the national authority determines that the other available instruments cannot control systemic risk adequately.

Lastly, solely on the basis of domestic legislation, measures may be implemented to control the granting of credit by means of limits on the amount borrowed based on the value of the collateral or the borrower's ability to pay.

## 3.2 Macroprudential indicators

In order to operationally define macroprudential policy, the ESRB recommends combining the intermediate objectives of that policy with the appropriate instruments and indicators (ESRB/2013/1 Recommendation C) for the monitoring and guidance of decision-making on that matter.

The Banco de España has implemented a risk monitoring tool using a series of macroprudential indicators.<sup>1</sup> To this end, it gathered information from a wide range of economic variables using aggregate information available to the Banco de España. The methodology applied makes it possible to transform that large amount of information into a risk map that issues warnings on risks to the financial system and, more specifically, the banking system.

Information is available on many of the indicators dating back to the first quarter of 1971, which allows an assessment of their behaviour in the banking crises that have affected the Spanish economy over the last 45 years, some of which can be classed as systemic.

<sup>1</sup> As detailed in Macroprudential policy: objectives, instruments and indicators, Occasional Papers, no. 1601, Banco de España.

The methodology used draws on past experience to study which indicators are capable of detecting risks ahead of the crisis, which may prove very useful for identifying latent risks in the future and for being able to activate macroprudential instruments to prevent them from appearing and/or to absorb their negative effects.

There are currently more than 100 indicators available and they are organised into a series of categories which provides for a better ordering of the information (see Table 3.3).

## CLASSIFICATION OF MACROPRUDENTIAL INDICATORS

TABLE 3.3

Category	Type of indicator
Credit growth and leverage	Credit: intensity, imbalances, leverage. Housing market: prices, overvaluation. Borrower debt-to-income ratio.
Transformation of maturities and market illiquidity	Banking assets. Banking liabilities. Imbalances in the banks' foreign currency exposure.
Concentration	Sectoral concentration. Sovereign exposure. Credit exposure in foreign currency.
Incentives and moral hazard	Risks at the tail of the distribution. Systemic stress.
Macroeconomic imbalances	External dependence. Fiscal imbalances.
Materialised risks	Real economy. Non-performing loans and dependence on central bank.

SOURCE: Banco de España.

With regard to those categories, some of the indicators were classified on the basis of the four intermediate objectives defined by the ESRB with the aim of mitigating, preventing and limiting:

- i) The risks arising from excessive growth in lending and indebtedness.
- ii) The risks arising from excessive maturity mismatches and from market illiquidity.
- iii) The risks arising from the concentration of direct and indirect exposures.
- iv) The systemic impact of the misalignment of incentives with the objective of reducing moral hazard that leads to the excessive assumption of risk.

In addition, there is another group of indicators that includes a series of measures on the Spanish economy's external fragility and fiscal imbalances.

Lastly, the final group of indicators falls under the category of materialised risks. They are not indicators capable of giving early warning of potential risks, but are variables that permit the assessment of the position of the economy and the banking sector within the macroeconomic and credit cycle. That knowledge is also essential for guiding macroprudential policy at any given time, since the measures to be adopted may vary considerably depending on whether the economy is in expansion, recession or stagnation.





#### 4 SUPERVISION OF INSTITUTIONS' CONDUCT



## 4 SUPERVISION OF INSTITUTIONS' CONDUCT

2015 was the first full year of application of the institutional changes within the Banco de España whereby the powers relating to the oversight of institutions' conduct were assigned to the Market Conduct and Claims Department in October 2014 following its creation in 2013. Those changes meant that such oversight was performed by the aforementioned department with functional and organic independence with respect to microprudential supervision.

These changes reinforce the Banco de España's strategic commitment to prevent systemic risk associated with institutions' improper conduct and to safeguard banking customer protection in order to restore confidence in the financial system.

The Market Conduct and Claims Department has other functions assigned to it that are closely related to the oversight of conduct, such as the promotion of best market practices, the resolution of complaints and claims filed with the Banco de España by customers of supervised institutions, and financial education.

### 4.1 Methodology

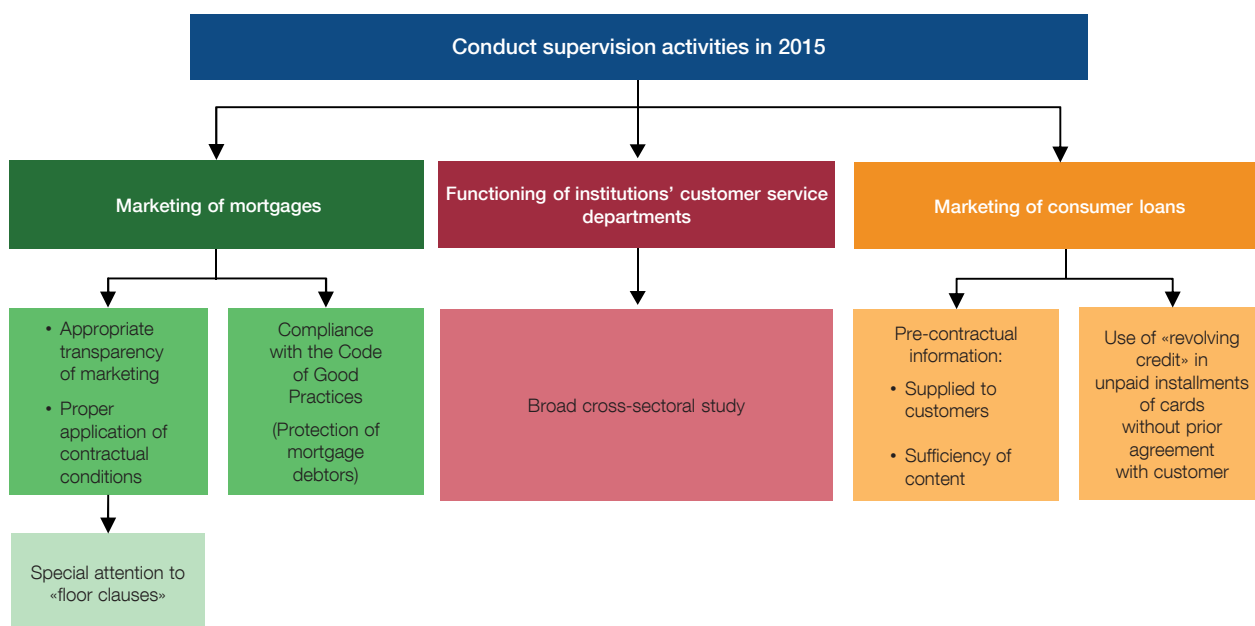
Along with the supervisory activity, in 2015 a series of procedures and methodologies applicable to such tasks was established. Thus, the Banco de España implemented a methodology aimed at providing a uniform framework for the supervisory classification of the risk associated with each institution which allows supervisory priorities to be established and resources to be allocated. The supervisory priority lies in the selection of the most appropriate supervisory method and intensity for each institution, which might consist of monitoring actions (individualised or aggregate) or on-site inspections (with different target scopes, durations and frequencies). The methodology is based on determining and maintaining two parameters: the conduct category and profile of each institution.

The conduct category classifies supervised institutions into five groups on the basis of the relative importance of their businesses and activities. Assignment to each group will be determined by the institutions' market share for certain financial products and services, their type and whether or not they provide banking services to individuals.

The conduct profile involves an estimate of the market conduct risk profile, based on the knowledge that is acquired of the institutions' conduct in the course of the supervisory activity and the information held by the Market Conduct and Claims Department. One of the most valuable sources of information for these purposes is the analysis of the claims filed with the Banco de España, which is a good indicator of the problems each institution has with its customers and of its level of commitment towards tackling those problems. Valuable information is also obtained from the regular statements the institutions must submit to the Banco de España and the allegations made by any agent. All of this is supplemented by the knowledge acquired on the functioning of the institutions' customer care services.

### 4.2 Supervisory actions

As a result of the above assessment, a supervision programme is drawn up, which includes both on-site inspections to institutions and off-site activities designed to check compliance with obligations that are the competence of the department. However, without prejudice to the content of the aforementioned programme, it is also necessary to carry out "reactive" supervisory actions, i.e. those not envisaged ex ante, which are intended to verify conducts or events brought to the attention of the Banco de España by means of the other sources of information described above. Those activities are summarised in Schema 4.1.



SOURCE: Banco de España.

Table 4.1 contains a summary of the supervisory actions carried out in 2015.

## OVERSIGHT OF INSTITUTIONS' CONDUCT IN 2015

TABLE 4.1

Number

	Off-site monitoring (a)	Inspections (b)
Mortgages (Code of Good Practices, floor clauses, transparency)	21	10
Consumer loans	4	3
Customer service departments	7	0
Transparency (reporting obligations, commissions and payments)	23	1
Other	8	0
<b>TOTAL</b>	<b>63</b>	<b>14</b>

SOURCE: Banco de España.

**a** Of these actions, 12 were initiated in 2014.

**b** Of these inspections, 1 was initiated in 2014.

In addition to the data in Table 4.1, mention should be made of the supervisory activity of the Market Conduct and Claims Department in the monitoring and control of the advertising of banking services and products. In 2015 there were 197 requirements for the withdrawal or rectification of press and Internet advertisements, all of which were complied with.

In this first full year of activity, conduct oversight was focussed on institutions' behaviour regarding mortgages, which are perhaps the most socially important of all banking products and services because of the large section of society they affect, the large amount they usually represent for individual customers, their long duration (without prejudice to the possibility of early repayment) and the subsequent loyalty they tend to imply with the lender, the detrimental consequences they can have for the customer in the event of failure

to meet obligations or, in short, the impact on such a valuable asset that is one's home or business premises.

Unquestionably, too, the importance of mortgages has been particularly affected by the recent economic crisis. The last few years have been noteworthy because various different strata of society have been urging the public authorities to adopt measures to protect mortgage debtors and requiring lenders to be especially clear and prudent in marketing those products.

Against this backdrop, the supervisory actions were focused on verifying the transparency in marketing and the correct application by institutions both of the contractual terms and conditions of mortgages and of the protective measures from which mortgage debtors without means benefit.

#### 4.2.1 MARKETING OF MORTGAGE PRODUCTS

The most intense work has been in relation to the supervision of compliance with the transparency requirements laid down in Ministry of Economic Affairs and Finance Order EHA/2899/2011 of 28 October on transparency and customer protection in banking services, regarding loans secured by mortgages on homes located in Spain granted to individuals resident in Spain. To this end, 8 on-site inspections were initiated at credit institutions which, based on the information available, were considered priority and are among the largest in that market. At 2015 year-end, those inspections were fully under way and, due to their wide-reaching scope (a portfolio comprising 61.14% of mortgage loans to households in Spain for house purchase is under review) and the various verification factors involved, they have lasted in some cases until the second quarter of 2016.

#### 4.2.2 "FLOOR CLAUSES"

Of the matters under review in the inspections, mention should be made of the correct inclusion of the clauses limiting interest rate fluctuations known as "floor clauses". In accordance with the legal grounds of the Supreme Court judgment of 9 May 2013, when such clauses form part of a contract entered into with consumers, they are subject to a double transparency filter, whereby formal compliance with the requirements of the "transparency and banking customer protection" regulation and the legislation relating to the "general contractual conditions" is not sufficient, and the "true comprehensibility" of the clause in question is also essential. Of the foregoing criteria, only the formal compliance with the requirements of the transparency and banking customer protection regulation falls under the direct competence of the Banco de España. Any possible classification and declaration of the contractual clauses as void corresponds to the courts, rather than to the Banco de España.

Accordingly, the supervisory tasks performed in this area have consisted of checking that those "floor clauses" meet the transparency requirements of the regulatory and disciplinary regulations and that their effective application by the institutions responds to the content of the corresponding contracts.

#### 4.2.3 PROTECTION MEASURES FOR MORTGAGE DEBTORS WITHOUT MEANS

Also, numerous actions were performed with the aim of verifying the correct application of the Code of Good Practices (CGP) contained in the annex of Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgage debtors without means (RDL 6/2012) by the institutions subject to it.

In particular, two on-site inspections are in progress at credit institutions, the scope of which is the verification of compliance with the aforementioned RDL 6/2012. Both inspections are expected to be completed in 2016. Also, as a result of the claims submitted

by different agents against various credit institutions due to alleged breaches of said RDL, 19 supervisory checking and monitoring actions were performed, 15 of which were concluded at the end of 2015 with eight recommendations and observations letters and four requirements letters being sent.

The on-site inspections and the other supervisory actions on this matter are centred on verifying the following:

- Information with which the participating institutions must mandatorily provide their customers on the possibility of having recourse to the CGP when they detect a failure to pay mortgage payments or general difficulties.
- Application of the CGP forecasts from the moment when the customer states that he/she has reached the exclusion threshold.
- Internal procedures defined to control the correct application of the RDL.
- Information submitted to the Banco de España on the application of the CGP measures.

Those inspections involved simultaneous visits to the branches of the network of institutions in various locations in Spain, without prior appointment. 42 visits were made with the purpose of verifying the information and knowledge of the network's employees as well as the application of their internal procedures relating to the CGP (in short, the information that the institution is in a position to offer its customers).

#### 4.2.4 CONSUMER CREDIT

The oversight of institutions' conduct in 2015 was also affected by the proliferation of institutions specialised in offering and marketing personal loans. That product causes concern because of the immediacy and ease with which it is arranged, which can make it difficult, in the pre-contractual stage, for the customer to correctly assess the conditions offered. In many of these cases it is particularly important that the customer is aware of the consequences of the potential failure to pay the instalments, since this can trigger a spiral of late-payment interest and costs which end up pushing certain customers into economic and social exclusion.

Three inspections and four supervisory actions were performed in this area with the focus on verifying the pre-contractual information with which the institutions must provide their customers under Law 16/2011 of 24 June 2011 on credit agreements for consumers. In this regard, the supervisory focus was on the verification of both the effective delivery to the customer of that pre-contractual information in the terms provided for in the legislation and the transparency and sufficiency of the content of that information in relation to the interest conditions of the financing granted.

The correct and complete inclusion in the pre-contractual information of all the costs comprising the total cost of the loan in addition to interest and late-payment interest was specifically reviewed. Also, in relation to revolving credit cards (which allow two methods of payment, at the end of the month and on credit), a practice was identified whereby, upon the non-payment of the monthly settlement of a credit card arranged with the month-end method of payment, the institution automatically switches the unpaid amount to the revolving credit method, without giving the customer the opportunity to consent to that change. The actions in this regard have focused solely on reinforcing customer transparency.

4.2.5 FUNCTIONING  
OF INSTITUTIONS'  
CUSTOMER CARE  
SERVICE

The Banco de España considers that the correct functioning of customer care departments or services and customer ombudsmen is a key element of conflict resolution between institutions and their customers. The good functioning of customer care has an impact on both customer protection and the institution's reputation.

Consequently, with a view to analysing the functioning of the aforementioned departments or services of the institutions in more depth and identifying the best practices in that area, a supervisory check and monitoring was performed on 226 institutions subject to the Banco de España's supervision. The conclusions of that study, which will be published in the second quarter of 2016, will offer a far-reaching view of these departments or services while facilitating the identification of institutions whose customer care services might function inadequately with respect to the regulatory requirements and the diligent and responsible protection of their customers.

4.3 Adoption of  
supervisory  
measures

The supervisory actions carried out may lead, in ascending order of importance, to recommendations, observations or other letters being sent to the institution by the Market Conduct and Claims Department, to requirements previously approved by the Executive Commission of the Banco de España being sent or, potentially, to sanctioning proceedings being initiated. Table 4.2 shows the type of measures in which the actions concluded in 2015 culminated.

SUPERVISORY MEASURES TAKEN

TABLE 4.2

Number

	Measures taken after off-site actions (a)	Measures taken after inspections (b)
Initiation of penalty procedures	0	1
Letter of requirements (c)	5	2
Recommendation and observation letters	25	2
Other letters	12	0
Cases closed	16	0
<b>TOTAL</b>	<b>58</b>	<b>5</b>

SOURCE: Banco de España.

a Of these actions, 11 were initiated in 2014.

b Of these inspections, 1 was initiated in 2014.

c 5 requirement letters issued in the field of verification actions contain 12 specific requirements for entities. The requirements formulated in respect of inspections contain 15 specific requirements.

It should be noted that one inspection concluded with a proposal for the initiation of sanctioning proceedings against the institution as a result of possible breaches observed in the pre-contractual and contractual information made available to its customers. That proposal was accompanied by a letter of requirements and recommendations. Another inspection concluded in 2015 with the formulation of requirements, recommendations and observations.

In any case, it should be highlighted that the initiation of proceedings is not restricted to situations in which major irregularities are identified, since the sanctioning regime applicable to credit institutions (and, in general, to the other supervised institutions) provided for in Title IV of Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions, categorises, in the area in question, some occasional or

isolated breaches as minor infringements. Accordingly, following an assessment of the adequacy of the measure in the terms expressed in the aforementioned law, the Banco de España may also initiate sanctioning proceedings due to breaches that are not systematic or widespread.



5 ROLE OF THE BANCO DE ESPAÑA'S SUPERVISION IN THE FRAMEWORK  
OF THE RECOVERY AND RESOLUTION OF CREDIT INSTITUTIONS



## 5 ROLE OF THE BANCO DE ESPAÑA'S SUPERVISION IN THE FRAMEWORK OF THE RECOVERY AND RESOLUTION OF CREDIT INSTITUTIONS

### 5.1 New area in the prudential framework: resolution

The financial crisis that broke in 2008 revealed the weaknesses of banking crisis resolution systems. At the European level, the absence of a harmonised banking resolution framework gave rise to differences in the management of the crisis across countries, the extensive use of the bail-out of problem banks and the resulting perverse link between the perception of sovereign risk and banks' health.

Hence the need to define a new resolution framework, with the aim of laying the foundations for the orderly resolution of banks, bearing in mind that anticipation and preparation will be key factors.

In order to understand the new resolution approach, one must turn first to the work of the Financial Stability Board (FSB) carried out at the request of the G-20 following the Lehman Brothers insolvency in 2008. In 2011 the FSB published the *Key Attributes of Effective Resolution Regimes for Financial Institutions*<sup>1</sup>, which set out the minimum standards and principles that every resolution regime should have in order to facilitate the orderly resolution of systemic banks:

- i) *Preparation for resolution.* To this end the institutions are obliged to prepare recovery plans and the authorities are obliged to prepare resolution plans. The two documents constitute "living wills" or roadmaps that would enable the institutions and authorities to be prepared to handle potential critical situations or resolutions.
- ii) *Shareholders and creditors should bear the costs of the crisis (bail-in).* Taxpayers should not assume the mistakes of private arrangements.
- iii) *Attribution of powers to administrative authorities and establishment of tools* that ensure the orderly resolution of institutions, preventing repercussions of individual crises on financial stability and enabling the critical and essential functions that institutions perform for the financial system to be maintained.
- iv) *Promote cooperation among authorities from different countries* in order to present a coordinated solution in the resolution of cross-border banking groups.

At the European level, this international initiative has materialised in the Banking Recovery and Resolution Directive (BRRD), which ensures a harmonised resolution framework in the EU. That framework was completed, as part of the creation of the Banking Union, with the institution of the Single Resolution Mechanism (SRM), which has twin objectives: i) to centralise the resolution decision-making process, with the creation of the Single Resolution Board (SRB); and ii) to ensure the uniformity of resolution funding practices, with the creation of the Single Resolution Fund.

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<sup>1</sup> Document updated in 2014.

The BRRD addresses how to define the institutional framework responsible for managing crisis episodes. To this end, the countries must designate one or, exceptionally, several national resolution authorities<sup>2</sup>, which may be: national central banks, competent ministries, public administrative authorities or supervisory authorities. With regard to supervisory authorities, in order to ensure the necessary independence between the prudential supervision function and the resolution function, there must be functional separation between the two activities and independence in the assigned staff.

The BRRD was transposed into Spanish legislation through the approval of Law 11/2015 and Royal Decree 1012/2015 in June and November, respectively.

The law establishes the new institutional framework for resolution, observing the basic principle underpinning the necessary separation of the supervisory and resolution functions in the BRRD. The model draws a distinction between: i) preventive resolution functions, assigned to the Banco de España (which will perform that task independently from its supervisory functions), and ii) executive resolution functions, assigned to the FROB.

Also, the law assigns new functions (focused essentially on the pre-resolution phase) to the Banco de España as supervisory authority, equipping it with new tools which contribute to compliance with the objectives of safeguarding financial stability and minimising the effects on the system of institutions' individual crises.

## 5.2 Phases of the new resolution framework

The design of the new resolution framework covers three phases: i) *pre-crisis or preventive phase*, which seeks to incorporate ongoing analysis of institutions' resolution capacity into their day-to-day operations; ii) *early intervention phase*, with a major role for the supervisor, which is granted powers that supplement the other measures available to it to take action in relation to institutions when they start to show weakness but are still viable; and iii) *resolution phase*.

The following sections discuss the key elements of each phase and the distribution of the most significant tasks in the Spanish institutional framework, taking into account the new competence structure attributed to the ECB in the framework of the SSM and to the SRB as the single resolution authority in the framework of the SRM.<sup>3</sup> They also contain schemes showing the tasks assigned to each party under this legislation.

Pre-crisis or preventive phase  
(business-as-usual)

In the ordinary course of business of the institution, the institution and the supervisory and resolution authorities must plan how to handle a critical situation or a potential resolution. To this end, the following key elements are drawn up:

- *Recovery plans*. All credit institutions must prepare recovery plans annually, for the purpose of defining the measures they would adopt to restore their financial position following a significant deterioration. The plans must include crisis scenarios, schedule which measures to adopt in each scenario and define a series of indicators that will serve as a reference to activate decision-making. They cannot be designed assuming any access to public financial

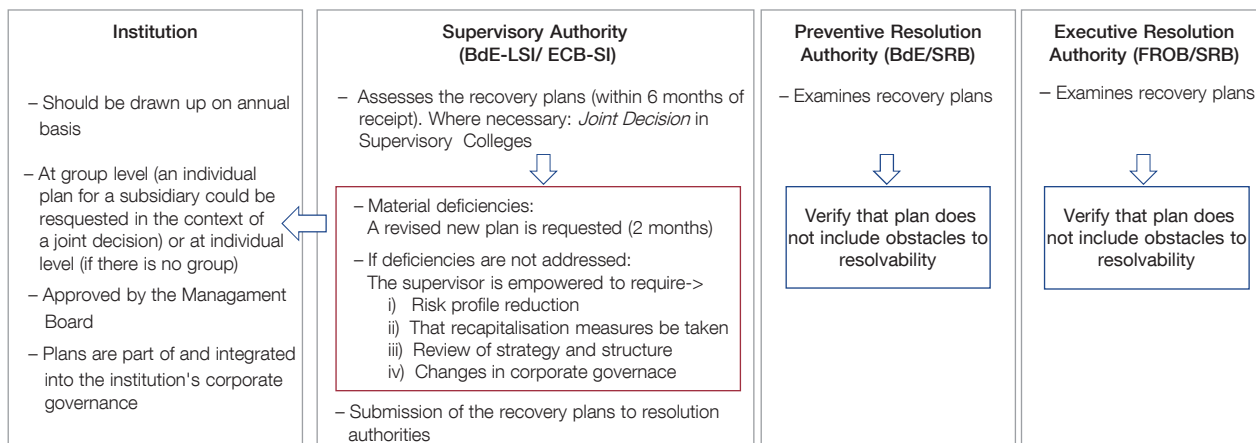
<sup>2</sup> In the case of the euro area countries, those national resolution authorities will act in conjunction with the SRB (the single resolution authority in the euro area, whose powers are extended to the institutions supervised directly by the ECB in the framework of the SSM and other cross-border groups).

<sup>3</sup> In the euro area and in the sphere of resolution, the SRB (which has been fully operational since 1 January 2016) has direct powers over SIs and over other cross-border institutions, and the national resolution authorities have powers over the other institutions.

support. The plans are reviewed by the competent authority, which may require the institution to adopt measures such as a reduction of the risk profile, a review of strategy and organisation, changes in corporate governance and, even, timely adoption of recapitalisation measures. The supervisor will submit the plans to the resolution authority, which will assess whether they include impediments to the institution's resolvability.

## RECOVERY PLANS

SCHEMA 5.1



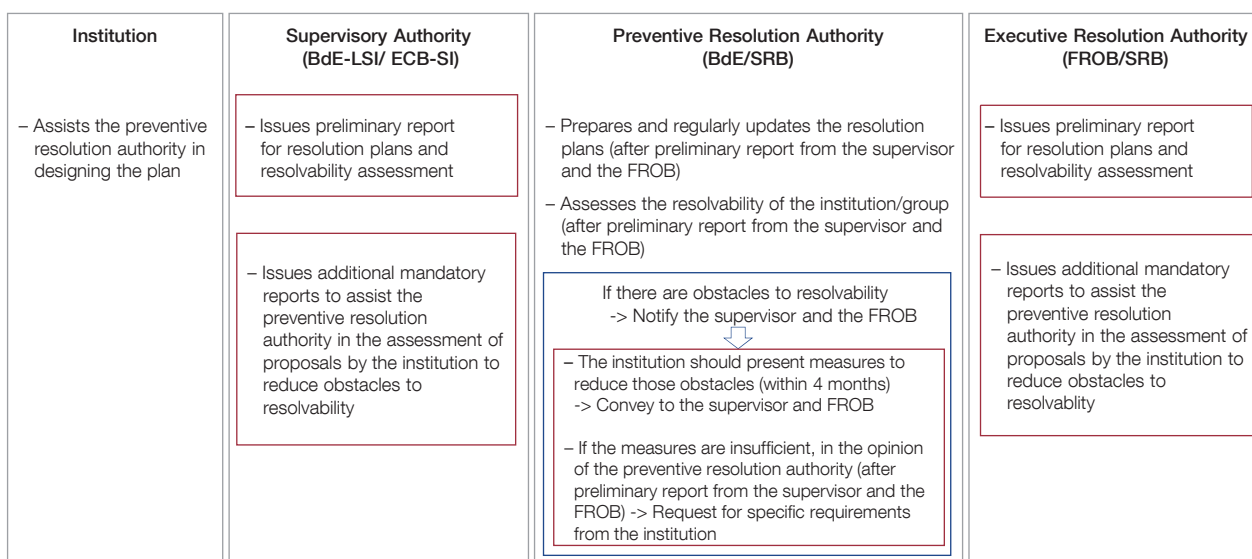
SOURCE: Banco de España.

- *Resolution plans.* The resolution plans are prepared by the preventive resolution authority and they include the likely strategy to be followed to resolve the institution, if necessary, and they describe the actions which, as and when the time comes, may be adopted. They cannot be designed assuming any access to public financial support either.

In the normal course of business of an institution, the institution (or its group) must ensure that it has an operational and legal structure that permits the

## RESOLUTION PLANS

SCHEMA 5.2



SOURCE: Banco de España.

continuity of the critical functions and does not prevent the swift execution of a potential resolution. Accordingly, at the same time as the preventive resolution authority prepares the resolution plan, it conducts resolvability assessments, and it may require the institutions to carry out structural or organisational changes or changes in lines of business in order to ensure that, if the institution becomes non-viable, it can be resolved.

The legislation allows the supervisor and the preventive resolution authority to establish that certain institutions are subject to “simplified obligations” in the preparation of recovery plans and in the design of resolution plans, respectively. To this end, some elements will be assessed with the purpose of analysing the negative effect that the failure of an institution and its winding up under normal insolvency proceedings might have on financial markets, on other institutions, on funding conditions and on the real economy.

- *Minimum requirement for own funds and eligible liabilities* (MREL) to be met by institutions as from January 2016, so that they have a liability structure that ensures sufficient loss-absorbing capacity and, as the case may be, adequate recapitalisation of the institution. The resolution authority will establish a transition period for achieving the MREL target it sets for institutions.

The MREL is to be complied with at consolidated and individual level (parent and subsidiaries).<sup>4</sup> The level is determined by the preventive resolution authority specifically for each institution (following consultation with the supervisor), taking two elements into consideration: “loss absorption” and “recapitalisation”<sup>5</sup> (which may be adjusted according to certain requirements).

In the international area, the FSB implemented a requirement for G-SIIs known as “total loss absorption capacity” (TLAC), the concept of which is similar to that of the MREL, although its calculation and characteristics are different (the details are given in section 1 of Chapter 6).

## SETTING THE MREL

SCHEMA 5.3

<p style="text-align: center;"><b>Supervisory Authority (BdE-LSI/ECB-SI)</b></p> <p>– Advisory task or issuance of preliminary report (depending on cases) for setting the MREL</p>	<p style="text-align: center;"><b>Preventive Resolution Authority (BdE/SRB)</b></p> <p>Sets the MREL:</p> <ul style="list-style-type: none"> <li>– SRB, if it is the group resolution authority (After consulting competent supervisory authority)</li> <li>– BdE, if it is the group preventive resolution authority (After preliminary report from the FROB and after consulting competent supervisory authority)</li> </ul>	<p style="text-align: center;"><b>Executive Resolution Authority (FROB/SRB)</b></p> <p>– Issues preliminary report for setting the MREL</p>
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SOURCE: Banco de España.

- *Intra-group financial support agreements*. These are framework agreements entered into between institutions (parent and/or subsidiaries) of a group subject to supervision on a consolidated basis for the provision of financial

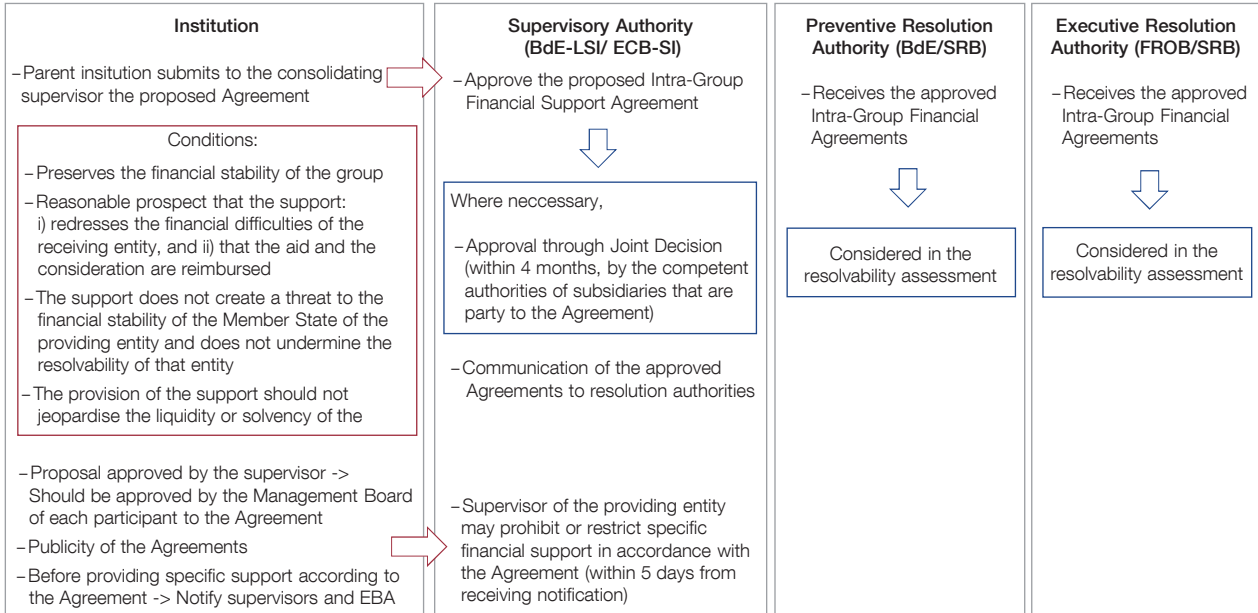
<sup>4</sup> However, exceptions are permitted in the individual requirement if certain requirements are met.

<sup>5</sup> The first element is linked to the current capital requirement applicable to the institution. The second element is determined by the capital requirements needed to meet the authorisation conditions once the resolution tool has been applied and taking into account the optimum level of capital needed to restore market confidence.

support in the event that an institution enters into an early intervention situation.<sup>6</sup> Those agreements must be authorised by the consolidating supervisor in a joint decision-making process with the supervisors of each subsidiary party to the agreement. As an additional precaution, before lending support in the framework of those agreements, the lender's supervisor may prohibit or restrict the granting of such support if it considers that certain premises of the legislation have been breached.

## INTRA-GROUP FINANCIAL SUPPORT AGREEMENT

SCHEMA 5.4



SOURCE: Banco de España.

Early intervention phase (significant deterioration of the institution)

Early intervention is activated at the request of the competent authority when the institution breaches or it likely that it will breach the solvency regulations but it is considered that it may comply with them once again by its own means. It is activated before the institution's resolution becomes necessary and with a view to avoiding it. From the start of the early intervention process (and the resolution process described below), the judges must not give an institution's petitions for insolvency leave to proceed; therefore, from that moment, actions are conducted in the administrative sphere.

The supervisor may, inter alia, force through the adoption of measures included in the recovery plan, require changes in the institution's strategy and the removal of directors and managers and, in extreme cases, decide on the intervention of the institution if the other measures prove to be insufficient.

The measures imposed are subject to monitoring to check the degree of compliance. The supervisor will inform the resolution authorities that the conditions for triggering early intervention are met<sup>7</sup> and of the measures imposed and their fulfilment.

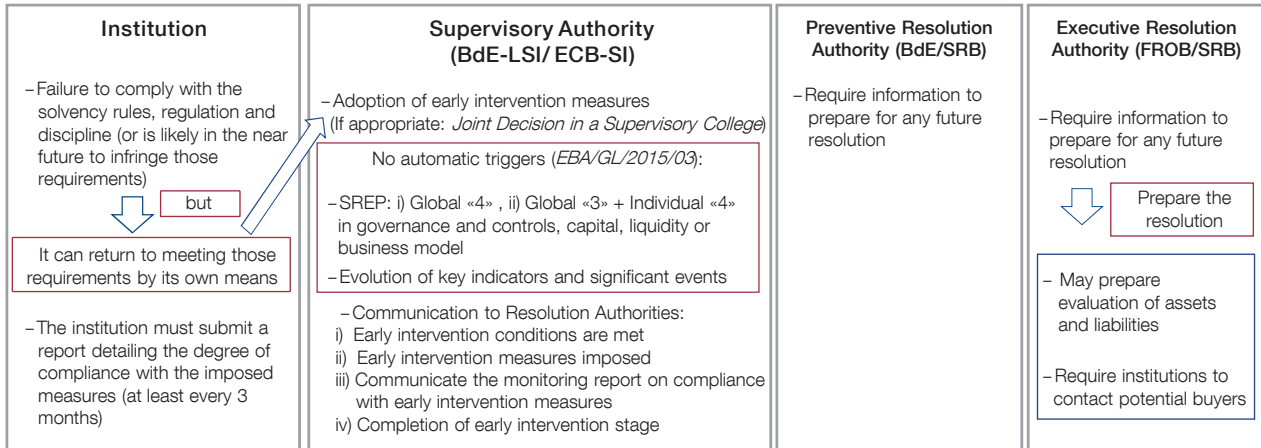
<sup>6</sup> Upon the entry into those agreements, none of the parties must be in a situation that activates early intervention..

<sup>7</sup> The resolution authority, in this phase, even has the power to require the institution to contact potential purchasers in order to prepare for resolution.

Identifying the time at which early intervention should be triggered is essential to avoid the institution's rapid deterioration and its failure. In that connection, the Banco de España has adopted the guidelines issued by the EBA on the thresholds for triggering early intervention (EBA/GL/2015/03). Those thresholds, which are not automatic, are linked to the outcomes of the institution's SREP, to significant events that may have an impact on the institution, and to the outcomes of the monitoring of key indicators of the institution's financial situation.

## EARLY INTERVENTION

SCHEMA 5.5



SOURCE: Banco de España.

Resolution phase  
(point of non-viability)

In order to commence the resolution process the following steps must be taken: i) determine the institution's failure; ii) verify that there are no private alternatives, supervisory or early intervention measures, or the write-down or conversion of capital instruments that might prevent failure; and iii) analyse whether it is in the public interest. If the last-mentioned premise is not met, the institution would be wound up under normal insolvency proceedings.

In Spain, it is the supervisor that determines an institution's failure, following consultation with the preventive resolution authority and the FROB. However, the FROB may urge the supervisor to make such a determination if it considers there are reasons to do so<sup>8</sup>, and the supervisor must give a justified response within three days.

In determining failure, expert opinion is essential. For these purposes, the Banco de España has adopted the guidelines published by the EBA on the circumstances that permit the determination of failure (EBA/GL/2015/07), as described in point 2 of Chapter 6.

The verification that there are no private or supervisory measures or that the write-down or conversion of capital instruments might prevent failure is the joint responsibility of the supervisor and the executive resolution authority.

Lastly, the assessment of public interest falls to the executive resolution authority.

The range of instruments available to the executive resolution authority includes the sale of the business, the transfer of assets or liabilities to a bridge institution or to an asset management vehicle, and the bail-in.

<sup>8</sup> Based on the information provided by the supervisor.



The bail-in, which entered into force Europe-wide as from January 2016<sup>9</sup> and which extends to the bank's creditors the obligation to absorb losses, is one of the cornerstones of the resolution framework; however, deposits guaranteed under the Deposit Guarantee Fund legislation, inter alia, are exempt. A golden rule in the application of that measure is the no creditor worse off principle, which implies that no creditor will bear losses greater than the amount of losses it would have borne if it had been wound up under insolvency proceedings.

The application of the bail-in must be accompanied by a business reorganisation plan, prepared by the institution, which will include measures aimed at restoring long-term viability within a reasonable timescale. That plan must be assessed by the executive resolution authority in cooperation with the competent supervisor.

## RESOLUTION PHASE

SCHEMA 5.6

Conditions for resolution	Functions of the Authorities in the resolution phase	
<p>1 "Fail or likely to fail" determination.</p> <ul style="list-style-type: none"> <li>– Made by the supervisor (after consulting both the preventive resolution authority and the FROB)</li> <li>– The FROB may call on supervisor to determine "fail or likely to fail" status (the supervisor shall reply within 3 days)</li> </ul>	<p>Executive Resolution Authority</p> <ul style="list-style-type: none"> <li>– Evaluation of assets and liabilities</li> <li>– Opens the resolution (discloses it publicly)</li> <li>– May resolve to replace directors</li> <li>– Executes the resolution tools</li> </ul>	<p>Supervisor</p> <ul style="list-style-type: none"> <li>– Depending on the use of resolution tools: intervenes in the process of authorisation/withdrawal of banking licence and evaluation of qualifying holdings</li> <li>– Participate in the approval of the business reorganisation plan (in cooperation with the FROB and the preventive resolution authority)</li> </ul>
<p>2 There are no other private alternative measures, supervisory measures or early intervention measures to resolve the situation (under the judgment of the FROB in cooperation with the supervisor)</p>		
<p>3 There are reasons of public interest (assessment performed by the FROB)</p>		

SOURCE: Banco de España.

### 5.3 Supervisory activity in the resolution framework in 2015

In 2015, practically all the groups of significant Spanish institutions submitted their recovery plans in accordance with the BRRD requirements.<sup>10</sup> The Banco de España is currently assessing these plans in the context of the work performed by the JSTs.

Additionally, in the last quarter of the year meetings were held by the Crisis Management Groups<sup>11</sup> of the two largest Spanish groups (Santander and BBVA), aimed at preparing the coordinated management among authorities of the group's recovery and resolution plans should they have to be activated.

With regard to less significant institutions, the Banco de España, in cooperation with the ECB, is working on the definition of which LSIs will be subject to simplified obligations in the submission of their recovery plans.

<sup>9</sup> Previously, Chapter VII of Law 9/2012 of 14 November 2012 on credit institution restructuring and resolution (partially repealed) provided for the use of the bail-in tool, although it was limited to the sphere of hybrid and subordinated debt instruments. Therefore, unlike the current legislation, it did not provide for its application to senior debt issues, among other liabilities.

<sup>10</sup> The two largest Spanish groups (BBVA and Santander) have already been submitting recovery plans following the FSB guidelines for several years.

<sup>11</sup> The Crisis Management Groups, which were created under the principles and standards implemented by the FSB, are colleges in which various authorities participate with a view to planning and coordinating the crisis management of banking groups with cross-border activities. The participants in those groups are supervisory authorities, central banks, resolution authorities, finance ministries and authorities responsible for deposit guarantee schemes.



6 THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING  
REGULATION AND SUPERVISION BODIES

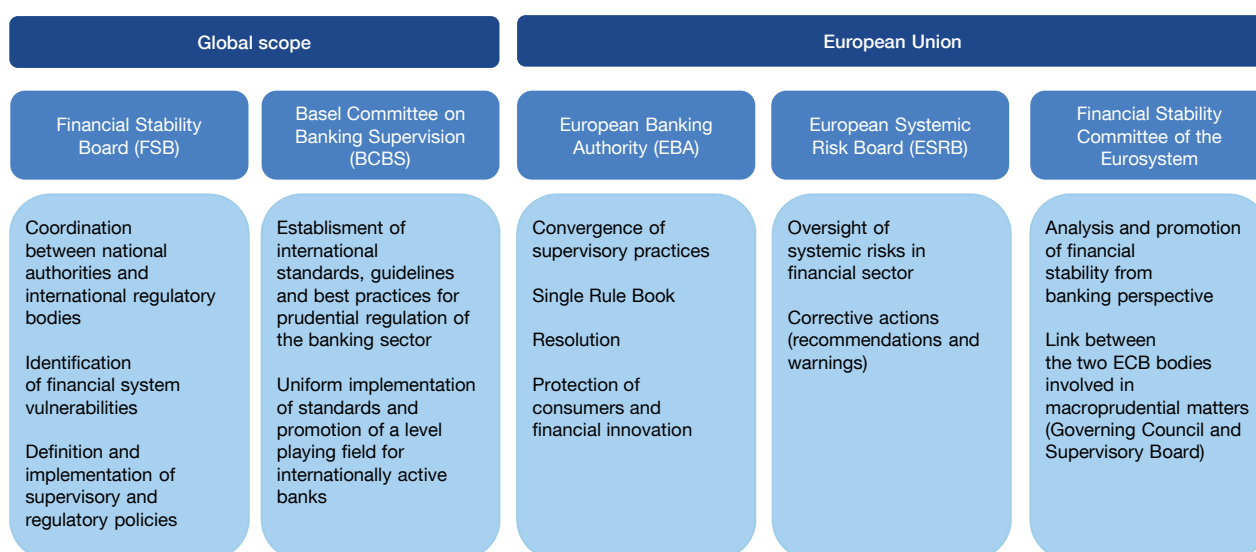


## 6 THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

The international and European dimension of financial stability, regulation and supervision is fundamental to the Banco de España. The decisions taken by international bodies play a major role in the area of regulatory and supervisory responsibilities and have a direct impact on Spanish credit institutions. Therefore, it is essential to be able to participate actively in the decisions taken by those bodies. As in other years, 2015 was noteworthy because of the Banco de España's significant involvement in those tasks.

### INTERNATIONAL REGULATORY AND SUPERVISORY BODIES AND COMMITTEES IN WHICH THE BANCO DE ESPAÑA PARTICIPATES

SCHEMA 6.1



SOURCE: Banco de España.

### 6.1 Global fora

In November 2008, the G20 asked the FSB to overhaul financial regulation, in coordination with other committees. A major factor was the establishment of a framework to address the problem of the too-big-to-fail institutions.

#### 6.1.1 FINANCIAL STABILITY BOARD (FSB)

##### TLAC

As part of that framework, the FSB published a new total loss-absorbing capacity (TLAC) requirement for global systemically important banks (G-SIBs)<sup>1</sup>. The Banco de España has been involved in this regulatory development from the start, since it considers it to be strategically important for the purposes of minimising the potential negative impact on financial stability of the resolution of those institutions.

The Banco de España considers it to be important, following the adoption of that agreement at the global level, that the inclusion of TLAC in the regulations of the various jurisdictions and its practical application ensure the homogenous treatment of the G-SIBs regardless of their origins or their resolution strategy. To this end, the practical work carried out by the Crisis Management Groups will also be important.

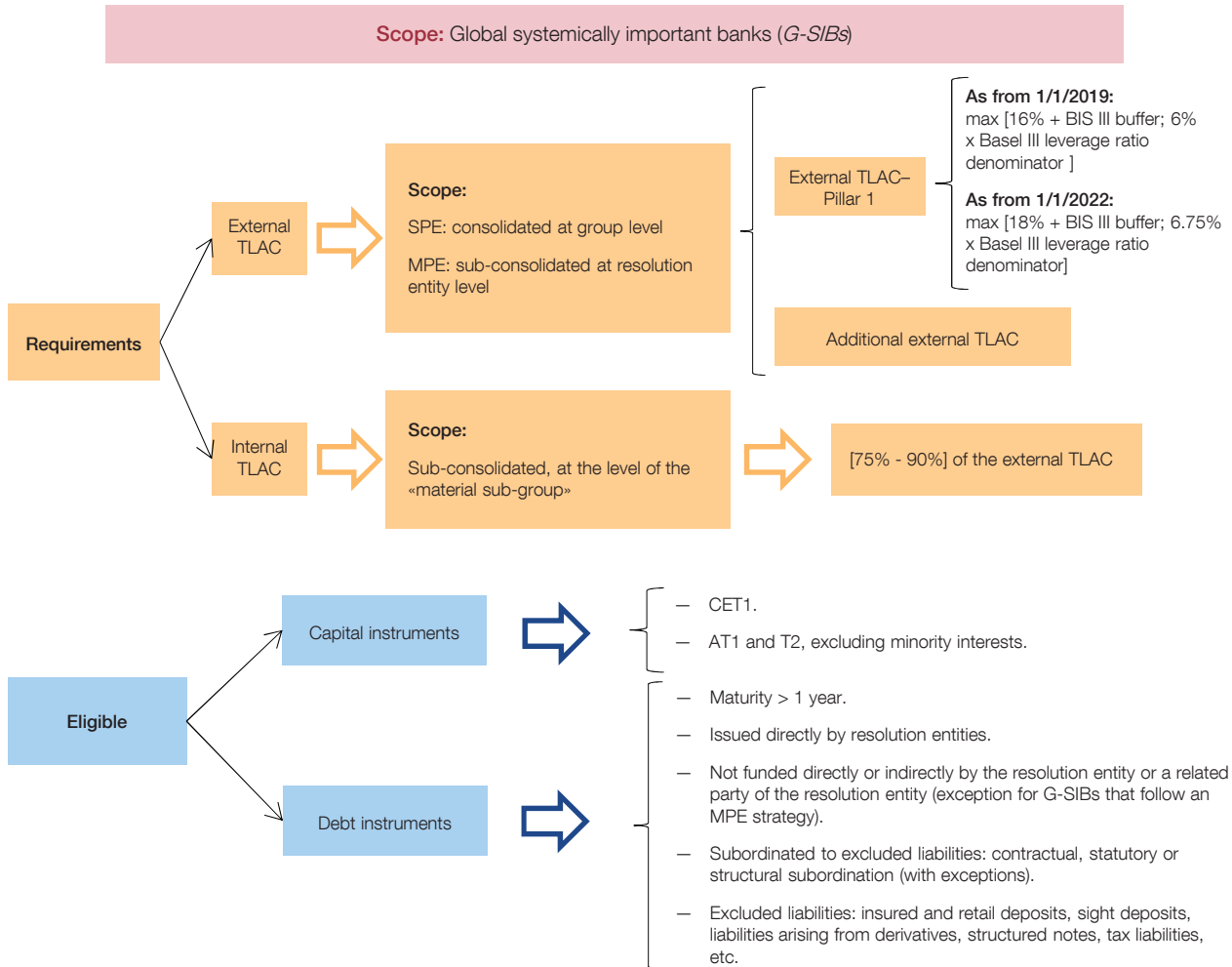
<sup>1</sup> "Principles on Loss-Absorbing and Recapitalization Capacity of G-SIBs in Resolution. Total Loss-Absorbing Capacity (TLAC) Term Sheet", FSB, 9 November 2015.

The European Commission recently started to work towards incorporating that new requirement into the European regulatory framework.

The following basic aspects of the TLAC requirement for G-SIIs in resolution are worthy of note:

TLAC

SCHEMA 6.2



SOURCES: FSB and Banco de España.

### 1 Application on the basis of the resolution strategy

The requirement applies to each resolution entity of the G-SII, i.e. to the legal entities of the group to which the resolution actions are applied. Thus, the distribution of loss-absorption capacity is determined by the resolution strategy, according to which the resolution group may have one or more resolution entities (thus following the single point of entry (SPE) strategy in the first case and the multiple point of entry (MPE) strategy in the second case).

In accordance with the SPE strategy, the resolution measures will be adopted in relation to a single legal entity (which is generally the parent institution of the group), which must have sufficient external TLAC (held by non-group third parties). Additionally, all significant subsidiaries must have a certain loss-absorbing capacity. The new framework establishes

a minimum internal TLAC requirement (issued by the subsidiary and acquired by the parent), with the aim of ensuring that potential losses at significant subsidiaries are absorbed by the institution in resolution, preventing those subsidiaries from being subject to a separate resolution to the rest of the group.

The SPE strategy involves a greater distribution of the loss-absorbing capacity, since the resolution instruments are applied separately in the group's various resolution entities (parent and subsidiaries), on the assumption that the connections between them are limited.

## *2 Characteristics of TLAC-eligible instruments*

Capital instruments and liabilities must meet a series of characteristics to be eligible as TLAC, including: i) being issued by the resolution institution; ii) being acquired by a non-group third party; iii) not being secured; iv) being subordinated to excluded liabilities (e.g. covered or retail deposits, derivatives, structured bonds, tax liabilities, etc.); and v) having a residual maturity of more than one year.

The framework contains some exceptions to those general criteria, such as:

- 1 The eligibility of Common Equity Tier 1 capital (CET1) issued by subsidiaries to third parties (instead of the resolution entity), provided that it is recognised at the consolidated level under the Basel III framework.
- 2 TLAC issues by subsidiaries designated as resolution institutions under the MPE strategy that have been acquired by the parent (rather than by a non-group third party) are recognised as external TLAC when the relevant authorities in the Crisis Management Group agree that this is consistent with the resolution strategy.
- 3 It permits the inclusion of some liabilities even though they do not comply with the subordination requirement, namely: a) senior debt that is *pari passu* with excluded liabilities is permitted up to a limit of 2.5% of risk-weighted assets (RWAs) (3.5% of RWAs when the minimum requirement is 18% of RWAs); or b) excluded liabilities that are *pari passu* with external TLAC are permitted up to a limit of 5% of the resolution entity's external TLAC.

## *3 Calibration and application date*

The minimum TLAC requirement (which the national authorities could tighten) will be applicable as from 1 January 2019 and will be phased in gradually. Thus, in 2019 it will be calculated as the higher of 16% of the RWAs associated with the resolution group's consolidated balance sheet and 6% of the Basel III leverage ratio denominator. As from 1 January 2022, the requirement will increase to 18% and 6.75%, respectively.

TLAC will be required independently of the Basel III minimum capital requirements. The capital buffers will be additional to the minimum TLAC requirement. Institutions will start to publish their level of compliance upon its entry into force on 1 January 2019.

Other areas of work by the FSB

Progress continues on the regulatory reforms in other sectors (insurance companies, central counterparties and other non-banking and non-insurance institutions). The FSB is

pursuing a strategy that includes both the monitoring and analysis of so-called “shadow banking” (engaging in credit intermediation without being subject to the regulatory framework and security networks applicable to banks) and the introduction of regulatory measures where potential systemic risk clusters are detected.

The Banco de España participated actively, in coordination with the CNMV and other Spanish authorities, in the FSB-led analysis of institutions potentially belonging to the shadow banking sector and, together with other foreign authorities, in the exchange of information on measures to mitigate their potential risks.

Moreover, the FSB has also issued warnings on the potential systemic impact of misconduct by financial institutions; the impact on the stability of the financial system stems not only from the deterioration of solvency due to the penalties imposed because of misconduct, but also from the loss of confidence in financial institutions and markets associated with such actions. The FSB’s concerns are shared by the Banco de España. The action plan designed by the FSB considers, inter alia, a review of the role played by the corporate governance and remuneration frameworks, assessing whether they include appropriate incentives that contribute to creating a culture which avoids such conduct.

#### 6.1.2 BASEL COMMITTEE ON BANKING SUPERVISION

The Basel Committee has been working to correct the deficiencies revealed by the financial crisis in the banking sector. The Banco de España has maintained an active stance, participating in the work that has led to the change in approach introduced by Basel III. The new capital framework has evolved from an approach founded on one sole metric – the risk-based capital ratio – to entailing a series of metrics that interact with one another, including: risk-based capital ratio, leverage ratio, liquidity ratios and, lastly, several measures to reduce systemic risk (capital buffers for global systemically important institutions and countercyclical buffers).

#### Review of risk measurement

In relation to the risk-based capital ratio, and after publishing the regulations on the quality and level of capital, the Committee has focused on reviewing the regulations on risk measurement (the ratio denominator). The Banco de España has argued that this review must favour the achievement of a triple objective: maintaining the capital framework’s sensitivity to risk, enhancing its simplicity and comparability, and avoiding significant increases in capital requirements, as a result of the foregoing.

To this end, given the strategic importance of the capital framework review, the Banco de España has participated in the Basel Committee’s internal groups that have been reviewing the treatment of risk measurement.

#### Credit risk

In December 2015 the Committee published a second consultative document on the standardised approach for measuring credit risk, a task in which the Banco de España was involved. One of the main new developments with respect to the previous consultative document is the reintroduction of external ratings as an important –but not exclusive– criterion for determining the capital requirements in the jurisdictions that permit their use. Moreover, the Banco de España continues to work very directly on the internal model method review tasks being carried out by the Committee, which published a consultative document in this regard in March 2015.

#### Operational risk

As for operational risk, in March 2016 a new consultative document was published which, along with including changes in the treatment of the standardised approach, proposes the elimination of the advanced measurement approach.





Moreover, the Banco de España has contributed to the updating of the Guidelines on stress testing issued by the Committee of European Banking Supervisors in 2010, in particular in relation to a common taxonomy and the use of quantitative outcomes of stress tests in the assessment of institutions' capital adequacy, and it has defended the idea that those outcomes do not directly involve the application of supervisory measures but rather they are considered as one more element of an institution's overall supervisory assessment.

Lastly, mention should be made of the work performed on the application of Article 141 of the CRD IV on the restrictions applicable to the distribution of dividends, payments in relation to Additional Tier 1 (AT1) instruments and remuneration (the so-called "Maximum Distributable Amount"). The Banco de España has participated actively in the discussions to seek to clarify the framework and reach a common understanding of its application in the EU.

#### Prudential regulation

In the field of prudential regulation, the Banco de España fully shares the EBA's objectives of boosting the reliability of the internal models used for calculating capital requirements and of reducing the variability observed in the results. Its efforts have been focused on the advanced models for credit risk, in relation to which it has defended the need to make progress towards greater consistency in their supervisory assessment and the importance of having clear harmonised definitions in Europe of, for example, the concept of default.

The Banco de España has supported the idea of European legislation being consistent with the work of the Basel Committee, for the sake of greater international regulatory harmony, and the communication to institutions of a plan that it is reasonable to implement with a feasible timetable.

Another priority matter for the Banco de España was the implementation of criteria defining simple, transparent and standardised securitisations, and it backed, among other aspects, a reasonable reduction in the capital requirements associated with those securitisations.

Lastly, the Banco de España participated very actively in the updating of the guidelines on remuneration policies. Among other matters, it participated in the drafting of the criteria that define remuneration components as fixed or variable, definitions which are used in calculating the maximum ratio of variable to fixed remuneration, and in the procedure for identifying (and requesting exclusions from) the group of risk takers.

#### Resolution

Noteworthy in relation to resolution matters is the preparation of regulatory technical standards determining the criteria for calibrating, on a case-by-case basis, the minimum requirement for own funds and eligible liabilities (MREL). The Banco de España has contributed to ensuring that a satisfactory degree of harmonisation is achieved in the calibration of the requirement for each institution, while preserving at all times the flexibility of the authorities involved and the recognition of the diversity among institutions. Also, work has been carried out so that the outcome is in line with other international standards in the case of significant institutions (for example, with the minimum TLAC requirement), the participation of deposit guarantee schemes is taken into account (where appropriate) and the correct interaction between supervision and resolution authorities is outlined.

Moreover, guidelines on the interpretation of the different circumstances in which an institution is considered to be failing or likely to fail were established. Those guidelines ensure a common framework for the declaration of resolution by the competent authority

(in cooperation with the resolution authority), encouraging such declaration to be the result of a case-by-case assessment rather than of an undesired knee-jerk reaction. In particular, the Banco de España has supported the work relating to the establishment of objective factors that enable an institution's failure to be determined, along with the communication process between the supervisory and resolution authorities.

Consumer protection  
and financial innovation

The Banco de España has been very involved in the area of consumer protection and the monitoring of risks arising from financial innovation, two increasingly important activities in the EBA. New tasks are expected to be embarked on in 2016, focussed on supervisory convergence.

As regards consumer protection, the Banco de España participated in the preparation of a series of guidelines. The following are worthy of note because of their special contribution and significance: i) Guidelines on product oversight and governance arrangements for retail banking products; ii) Guidelines on arrears and foreclosures; and iii) Guidelines on creditworthiness assessment.

Lastly, with respect to the EBA's work on financial innovation, the Banco de España cooperated actively in the working groups, which has stepped up the exchange of information on other countries' banking practices, products and markets. That matter is considered essential for the knowledge of their risks and benefits and for determining the regulation that would be ideal at both the domestic and European levels. Of particular note is the specific work relating to the intervention powers in the structured deposit market, together with the work relating to crowdfunding, virtual currency, cloud computing, commercial use of consumer data and innovative means of payment.

6.2.2 EUROPEAN SYSTEMIC  
RISK BOARD (ESRB)

In the five years it has been operating, the ESRB has put into practice, improved and extended tools for analysing, assessing and monitoring the macroeconomic and financial situation of the EU and its potential risks and vulnerabilities. The governor of the Banco de España is a member of the General Board and, since January 2015, he has also been a member of the Steering Committee.

The most significant matters to which the Banco de España has contributed are as follows:

- Analysis of vulnerabilities through the Bottom-Up Survey, for the assessment of the risk of financial instability of the European Union.
- Review of risk indicators.
- Implementation of macroprudential instruments (such as the countercyclical capital buffer, the leverage ratio and those intended to mitigate construction sector risks).
- Study of banking misconduct and its repercussions from the macroprudential standpoint.
- Assessment of the risks and repercussions of the existence of very low interest rates.

Special mention should be made of the Banco de España's contribution to the study on the regulatory treatment of the holding of government debt by credit institutions.

Also, the ESRB analysed the degree of compliance with two recommendations aimed at improving the solvency of the banking system relating to banks' US dollar-denominated funding and lending in foreign currencies. The Banco de España duly adhered to the two recommendations and was classified as "fully compliant", as reflected in the two reports published by the ESRB in March and June 2015, respectively.

#### 6.2.3 EUROSISTEM FINANCIAL STABILITY COMMITTEE

In late 2013, the European Central Bank renewed the Financial Stability Committee's mandate to analyse and promote financial stability from the banking standpoint and, at the same time, to serve as a bridge between the two ECB bodies involved in macroprudential matters: the Governing Council and the SSM Supervisory Board. The Banco de España participates actively on the Committee and in its working groups. Specifically, the main matters on which the Banco de España collaborated in 2015 were the design of the cooperation between the SSM's microprudential supervision and macroprudential policy, the improvement of risk analysis instruments, the creation of macroprudential databases, and the project to create a Eurosystem credit risk dataset (AnaCredit).

### 6.3 Other regional fora

The Banco de España also participates actively in the Association of Supervisors of Banks of the Americas (ASBA), a high-level forum in which the banking supervision authorities of 35 countries in the Americas are represented. The Banco de España has been a collaborator since 1999 and an associate member since 2006, and is the only non-regional associate authority.

The ASBA's mission is to strengthen banking regulation and supervision in the region by disseminating knowledge, raising technical capacity, adopting sound supervisory practices in line with international standards, and establishing and promoting regional and international dialogue channels both in the supervisory sphere and in the banking sector.

In 2015, along with attending the meetings of the ASBA governing bodies, it continued to support the ASBA Continental Training Plan by means of seminars in the region and in Spain.





## 7 REGULATORY CHANGES ON SUPERVISORY-RELATED ISSUES IN SPAIN

### 7.1 Banco de España Circulars

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

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

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

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

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

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

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

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

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

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

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

7.1.3 BANCO DE ESPAÑA  
CIRCULAR 2/2016  
ON SOLVENCY

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

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

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

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

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

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

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

- Banco de España Circular 1/2015, to payment service providers, on information of the merchant service charges and interchange fees received.
- Banco de España Circular 2/2015 on rules for the submission to the Banco de España of the payment and payment system statistics envisaged in Regulation (EU) 1409/2013 of the European Central Bank of 28 November 2013 on payment statistics by payment service providers and payment system operators.
- Banco de España Circular 3/2015, amending Circular 1/2013 of 24 May 2013 on the Central Credit Register, and Circular 5/2014 of 28 November 2014,



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

- Banco de España Circular 4/2015, amending Circular 4/2004 of 22 December 2004, addressed to credit institutions, on public and confidential financial reporting rules and formats, Circular 1/2013 of 24 May 2013 on the Central Credit Register, and Circular 5/2012 of 27 June 2012, addressed to credit institutions and payment service providers, on transparency of banking services and responsibility in the granting of loans.
- Banco de España Circular 7/2015, on the creation and modification of personal data files.
- Banco de España Circular 8/2015, addressed to institutions and branches participating in the Deposit Guarantee Fund for Credit Institutions, on information for determining the calculation basis of the contributions to the Deposit Guarantee Fund for Credit Institutions.
- Banco de España Circular 1/2016, amending Circular 1/2015, of 24 March 2015, to payment service providers, on information of the merchant service charges and interchange fees received.
- Banco de España Circular 3/2016, addressed to institutions owning ATMs and issuers of cards and payment instruments, on information on the commissions for cash withdrawals from ATMs.

## 7.2 Draft Banco de España Circulars

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### 7.3 Other significant regulations

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

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

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

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

- The need for institutions to have sufficient liquidity to survive for 30 days in a stress scenario, similar to that experienced by the international markets in the recent financial crisis. This need is quantified as a short-term liquidity ratio, which relates the institution's liquid assets to the net outflows (outflows minus inflows) in a stress situation.
- The need for institutions to have sufficiently stable sources of funding. This objective is achieved through a structural funding ratio that relates the institution's assets (i.e. its funding requirements) to the stability of the sources of funding.
- The obligation of the institutions to contribute sufficient information to the supervisor so that it can analyse the liquidity risk being assumed by the institution.

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

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

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

#### REGULATION OF CREDIT INSTITUTIONS' LIQUIDITY

SCHEMA 7.1

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Liquidity Coverage Ratio (LCR)					Information on LCR			LCR requirement			
Net Stable Funding Ratio (NSFR)					Information on NSFR					NSFR requirement	
Reporting on Liquidity		BdE liquidity templates		Revised BdE liquidity templates			European liquidity templates				

SOURCES: ECB and Banco de España.

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

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

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

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

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

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

7.3.3 REINFORCEMENT  
OF BANK CUSTOMER  
PROTECTION

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

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

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

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

#### 7.3.4 REFORM OF THE REGIME FOR MONETISATION OF DEFERRED TAX ASSETS

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

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

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

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



8 INTERNAL AUDIT REPORT SPECIFIED IN THE CONSOLIDATED TEXT OF THE  
SECURITIES MARKET LAW, APPROVED BY LEGISLATIVE ROYAL DECREE 4/2015  
OF 23 OCTOBER 2015  
2015





## **1. Introduction**

The Tenth Additional Provision of the Consolidated Text of the Securities Market Law, approved by Legislative Royal Decree 4/2015 of 23 October 2015, establishes that the Banco de España shall prepare an annual report on its supervisory function in relation to the actions and procedures performed in relation to this matter, from which information can be deduced on the effectiveness and efficiency of those procedures and actions. It also establishes that the report shall include a report of the internal control body on how well the decisions adopted by its governing bodies comply with the procedural rules applicable in each case. That report must be approved by the Governing Council of the Banco de España and shall be submitted to the Spanish Parliament and the Spanish Government.

This Provision has replaced what was previously envisaged in the Second Additional Provision of Law 44/2002 on Financial System Reform Measures.

The 2016 Internal Audit Plan of Banco de España, approved by the Governor on 22 December 2015 and acknowledged by the Executive Commission on 15 January 2016, includes the preparation of the report provided for in the aforementioned Securities Market Law, for its inclusion in the Banco de España Annual Report on its supervisory function, as referred to above.

## **2. Objective, scope and methodology of the report**

This report is limited to the legal mandate of the Tenth Additional Provision of the Securities Market Law. As mentioned above, that Provision sets out the scope of the report, with reference to three basic elements:

- 1) The supervisory function of the Banco de España.
- 2) The decisions adopted by the governing bodies in exercising the aforementioned function.
- 3) Whether the aforementioned decisions are in line with the procedural rules applicable.

From a timing point of view, the report refers to the decisions taken by the Executive Commission in 2015, and the decisions taken by delegation of which the Executive Commission was informed in the same year.

From a material standpoint, the report addresses the decisions taken by the Banco de España's governing bodies within the scope of competence of the Directorate General Supervision, the Directorate General Financial Stability and Resolution<sup>1</sup> and the General Secretariat.

The applicable legislation taken into account was as follows: the supervisory powers and procedures contained in Law 13/1994 of 1 July 1994 on Autonomy of the Banco de España and in the Banco de España's Rules of Procedure, together with those established by the legislation relating to the Single Supervisory Mechanism (basically, Council Regulation (EU) No. 1024/2013 of 15 October 2013, and Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014). Also, the Executive Commission established through the Resolution of 8 April 2014 the procedural rules for the proposals on the matters within the competence of the Directorate General Supervision. In addition, it approved through the

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<sup>1</sup> Formerly Directorate General Regulation and Financial Stability until 20 April 2015

Resolution of 30 June 2006 the procedural rules for the proposals in relation to the matters within the competence of the former Directorate General Regulation and Financial Stability, and through the Resolution of 29 September 2014 the procedural rules for the proposals on the matters under the powers of the General Secretariat to the Executive Commission, which were updated through the Resolution of 20 February 2015.

On 2 November 2012 rules were issued on the submission of matters to the Executive Commission by all the directorates general of the Banco de España. These rules are complementary to those of the aforementioned directorates general.

Similarly, through the Resolution of 18 December 2009, the Executive Commission approved the regime for the delegation of powers, which was published in the Official State Gazette on 5 January 2010 and envisages the possibility of proxy signatures as well as the taking back of delegated powers. The aforementioned Resolution has been the subject of successive amendments, the relevant ones for 2015 being those of 5 December 2014 (Official State Gazette of 10 December 2014) and 12 February 2015 (Official State Gazette of 16 February 2015). Lastly, through the Resolution of 22 May 2015 (Official State Gazette of 2 June 2015), the Executive Commission approved new arrangements for the delegation of powers, rendering ineffective the Resolution of 18 December 2009 and its subsequent amendments.

In order to review the decisions adopted by the Executive Commission, stratified sampling was conducted on the decisions adopted by the Directorate General Supervision, the Directorate General Financial Stability and Resolution and the General Secretariat. Different sampling fractions were applied to those strata depending on the relative importance, numerical volume and internal homogeneity of each stratum.

The work was performed in accordance with the Internal Audit Manual, which includes the International Standards for the Professional Practice of Internal Auditing, approved by the Institute of Internal Auditors, including those referring to the Code of Ethics.

### 3. Opinion

In our opinion, the decisions adopted by the governing bodies of the Banco de España in 2015 in the performance of its supervisory function were adopted by bodies with sufficient held or delegated powers, in accordance with the rules established by the Rules of Procedure of the Banco de España and the provisions agreed by its Executive Commission, and they comply, in all material respects, with the current procedural rules applicable in each case.

Madrid, 16 March 2016  
Director, Internal Audit Department,

Juan González Gallegos



GOVERNOR OF THE BANCO DE ESPAÑA  
DEPUTY GOVERNOR OF THE BANCO DE ESPAÑA

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- 1 The publications in this section distributed by the Banco de España [all of them, except those marked (\*) and (\*\*), which are distributed by Alianza Editorial and Macmillan (London)] have been removed from the catalogue.
- 2 Moreover, it is updated daily in the Statistics section.
- 3 A quarterly update of the tables of this publication is also disseminated on the Internet.
- 4 Available only on the Banco de España website until it is included in the publication *Circulares del Banco de España. Recopilación*.

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