Supervision on a consolidated basis of international Spanish banking groups[1]

As well as supervising Spanish CIs on an individual basis, the BE supervises Spanish CGs on a consolidated basis. The definition of the scope of consolidation used in Spain is sufficiently broad and enables aggregate solvency to be adequately overseen. There are also additional solvency requirements for non-consolidated mixed groups, i.e. groups containing CIs and insurance companies, that do not consolidate their balance sheets.

In this respect the supervision of Spanish banking groups that have recently expanded significantly, especially in Latin America, has become particularly important. The internationalisation of banks involves a change in the profile of their risks and a need for measures to prevent a potential crisis in any of the institutions of an international CG having undesired effects on its parent bank and group and, by extension, on the stability of the Spanish banking system.

Accordingly, the BE has defined a framework of good practice for the organisation and management of these banking groups. This framework is based, inter alia, on the following principles that guide supervision on a consolidated basis by the BE, which have been notified to the Spanish parent CIs:

> ***Group culture and management information.*** The board of directors of the parent institution must establish criteria for organisation, management, internal information system and controls, appropriate to its status as an international group. In this respect, Spanish parent CIs must effectively assume the responsibility of overseeing the management of their subsidiaries. To do this they need comprehensive information and systems based on integrated computer platforms enabling them to monitor their subsidiaries, harmonise their accounts in the consolidation process, analyse their business and control their risks, both at the individual and aggregate levels.
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> For these purposes, comprehensive internal audits of each of the institutions of the group shall be carried out by the parent bank, at least once a year, to ensure that the data are reliable and that the internal rules and procedures are being complied with. This shall be in addition to the internal audit performed by each component of the group itself. At the same time, every effort shall be made to ensure that the external auditors are independent and of suitable quality. The important role played by the external auditor of the parent institution and the consolidated group in the process of consolidation shall also be monitored.
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> Irrespective of co-operation with local supervisors, supervision on a consolidated basis by the BE shall be carried out primarily from the group's parent institution, paying special attention to knowing and checking the reliability of the information systems established by the parent institution and its control over them, as well as the quality of the subsidiary's assets. Accordingly, the parent institution shall make

[1] REPORT ON BANKING SUPERVISION IN SPAIN IN 2001. Chap. II.7.3, Pages 82 to 84

available to the BE all the necessary information for the latter to be able to carry out its supervision tasks and to reach an opinion on the situation of the group.

Prudent accounting policies. Companies set up in other countries subject to their own legal and accounting rules must harmonise their balance sheets before they can be consolidated with Spanish banking groups. This involves adapting the financial statements of the foreign subsidiaries to Spanish standards by means of the relevant adjustments that shall be properly documented and based on prudent criteria. The prior harmonisation of accounts shall not entail any provisions for bad debts in the individual statements of subsidiary companies being recorded as revenues in the consolidated statements (CBE 4/91, provision 20.ª 7) or, therefore, being offset in the consolidation process.

Moreover, Spanish banking groups with business abroad shall follow a policy of maximum prudence, speeding up the amortisation of goodwill and making provisions to mitigate any losses arising from unforeseen future events.

Group solvency and solvency on an individual basis. The amount, quality and structure of the group's own funds should be strengthened. As regards its distribution, each bank of a consolidated group shall have in each country sufficient own funds to cover its risks, with sufficient margin for its business to grow and comply with local rules. That is to say, even if the necessary measurement of the solvency of the groups is carried out on a consolidated basis, appropriate risk management requires that the distribution of own funds among their various components should reflect the distribution of the risk.

Group chart. The chart representing the structure of the group (complete set of holdings in share capital and of voting rights between the various group companies) shall be clear and public.

Financial autonomy. Each credit institution subsidiary of a Spanish banking group must be financially independent of the parent institution and of the other institutions in the group and, therefore, shall manage its own financing and liquidity autonomously. This facilitates the proper valuation of each counterparty and contributes to the financial strength of the group. In other words, each institution shall obtain its financing on the market and shall pay the risk premium corresponding to its individual situation. Likewise, any hedging they decide to provide for their risks shall be obtained on the market without the parent or any other institution in the group being the counterparty.

Intra-group operations, unless they have a commercial basis (e.g. documentary credit), shall be limited to exceptional situations, and the prices applied shall be market prices.

Accordingly, it shall be made clear that the strength of the consolidated balance sheet of the group is a result of aggregating the individual strength of each of its components and market knowledge of such circumstance shall be facilitated.

Control of liquidity. Crisis situations highlight the importance of liquidity in bank management and test the mechanisms designed for its control. Consequently, the group shall design adequate contingency plans for its consolidated position in the currencies in which it operates, especially in euro and dollars. At the same time, each banking subsidiary shall have a system that continuously measures its own liquidity, both in local currency and in dollars, with appropriate mechanisms to neet ordinary needs for liquid funds, and with contingency plans for extraordinary circumstances.