2 MICROPRUDENTIAL SUPERVISION

1902. La fragua de Vulcano, Diego Velázquez (reverse).

2.1 Supervisory policies: priorities and dividend distribution and variable remuneration policies

The supervisory priorities are established jointly within the framework of the SSM, with the active participation of the Banco de España. They are the outcome of a process of analysis of the risks the financial system faces. The Banco de España likewise sets its supervisory priorities for the LSIs annually. This section outlines the main areas on which supervision was focused in 2018 and the priorities for 2019.

There is also a reference in this section to credit institutions' dividend distribution and variable remuneration policies, which must comply with the precautionary principle and be designed to ensure an adequate level of capitalisation at all times. To achieve these objectives, the ECB and the Banco de España have made recommendations to credit institutions.

2.1.1 SUPERVISORY FOCAL POINTS IN 2018

The analysis carried out for the purpose of establishing the supervisory priorities of the SSM in 2018 showed that the main risks the financial system would be facing had already been present in previous years. Accordingly, in 2018 the supervisory focus remained on:

— Business models: the interest rate environment justified continuing in 2018 with the cross-cutting thematic review that was commenced in 2016 to assess how interest rate risk affects institutions' profitability and business models.

— Credit risk: as in previous years, particular attention was paid in 2018 to credit quality developments and, more specifically, the strategies adopted by institutions to reduce non-performing exposures and the criteria for their recognition and provisioning continued to be reviewed. In March 2018 the ECB published an addendum to its *Guidance to banks on non-performing loans*, setting out its supervisory expectations with regard to the coverage of exposures reclassified as non-performing since the publication of that guidance.

  One aspect of particular importance in relation to loan loss provision estimates is the valuation of collateral for credit exposures. In this respect, and in order to inform appraisal companies of best practice in the use of automated models to value real estate, the Banco de España in 2018 released for public consultation the *Guía supervisora para la utilización de modelos automatizados de valoración de inmuebles* (Supervisory Guide to the use of automated models to value real estate).

— Risk management: especially notable in this area in 2018, along with the review of models to calculate own funds requirements, was the publication of the ECB guides to internal capital and liquidity planning (ICAAP and ILAAP respectively), with the aim of contributing to improving institutions' internal management procedures. Within the framework of the thematic review of the IFRS 9, the assessment of the progress made by institutions in applying this standard was continued.

In addition, work was carried out in 2018 to assess institutions' preparedness for Brexit and new EBA-led stress tests were performed on SIs. The results of these tests – published in November 2018 – were used as an input for the Supervisory Review and Evaluation Process (SREP).

On 1 January 2018, Circular 4/2017 came into force. The main change it has made, as a result of incorporating the criteria of IFRS 9, is to require recognition of the expected loss on the loan portfolio, instead of the incurred loss, as was required by Circular 4/2004.

The new accounting arrangements require greater use of professional judgement by institutions, as a larger number of metrics are estimated by the institution itself. This means, in turn, that the internal controls that prevent the rules from being applied arbitrarily need to be strengthened.

Although the Circular has only been implemented very recently, several areas for improvement have been identified as a result of the initial interaction with institutions and the enquiries made. These relate mainly to data quality, policies and processes, and the scope of the internal audit review.

With regard to **data quality**, it should be noted that the existence of an up-to-date appraisal of the collateral is an essential requirement for this to be taken into account when provisions are estimated. The Circular lays down minimum frequencies, in different cases, for updating the appraisals of real estate collateral, and these frequencies must be complied with for the collateral to be considered effective. When the date of the appraisal of an item of collateral means that it is older than the limit set in the Circular, such item cannot be taken into account to reduce the amount of provisions.

As regards **policies and processes**, the internal process for validating models to calculate provisions, which has to be followed before they are used by the institution, must be fully defined. At the same time, institutions must ensure that their provisioning models are fully integrated into the bank's daily management, that their assumptions are consistent with those of the institution's business plan, that they form part of their price setting processes, etc.

Lastly, the **internal audit** review must be global in scope, covering the data used, the calculation processes and, finally, the reasonableness of the results. Backtesting and benchmarking must also be reviewed.

2.1.2 SUPERVISORY PRIORITIES IN 2019

When preparing the supervisory priorities for 2019 the main risks facing the SSM banking system and the recently completed supervisory actions were taken into account. The most important risks that the financial system will have to face have mostly been present already in previous years. Notable among them are the geopolitical uncertainties, the management of high levels of impaired loans and technology and cyber risk.

Institutions' business models are no longer considered a supervisory priority for 2019, given that the thematic review of these models and of profit sources has been completed. However, two new areas of supervisory focus were introduced for 2019: i) the evaluation of technology and cyber risk; and ii) trading risk and asset valuations, which are included as risk management priorities.

As a result, supervision in 2019 will focus on the following priorities:

— Credit risk: institutions' strategies to ensure that non-performing exposures are further reduced and adequately covered will continue to be evaluated in 2019.

  At the same time, particular attention will be given to reviewing the criteria, policies and procedures that institutions follow when originating new loans, and when assessing the quality of such loans.

— Risk management: the review of models for calculating own funds requirements will continue. Also work will continue on the improvement of institutions' internal management procedures, given that 2019 is the first year of application of the ECB Guides to ICAAP and ILAAP referred to above, and on the mechanisms the institutions have to manage, control and mitigate technology

A total of 48 groups of European credit institutions took part in the EBA's 2018 stress test, representing approximately 70% of banking sector assets. Four Spanish banks took part in the exercise: Santander, BBVA, CaixaBank and Sabadell. Bankia did not take part because it was in the process of merging with Banco Mare Nostrum.

The purpose of the stress tests is to assess the resilience of banks to an adverse macroeconomic scenario. They also represent an exercise in transparency that seeks to strengthen market discipline. Charts 1 and 2 show the results of the tests in terms of the phase-in[1] and fully-loaded[2] Common Equity Tier-1 (CET-1) ratio.

The results show a satisfactory level of resilience of the Spanish banks to an adverse scenario, with an average decline in the CET-1 ratio that is lower than that observed overall for the European banks taking part in the exercise, owing among other factors to the improvements in Spanish banks' balance sheet restructuring.

As in 2016, no minimum capital thresholds were set. However, the results were assessed in the framework of the SREP

1 The phase-in CET-1 ratio is the CET-1 capital ratio calculated according to the transitional arrangements established in the prudential regulations.

2 The fully-loaded CET-1 ratio is the CET-1 capital ratio calculated without applying the transitional arrangements established in the prudential regulations.

Chart 1
PHASE-IN CET-1 RATIO ADVERSE SCENARIO

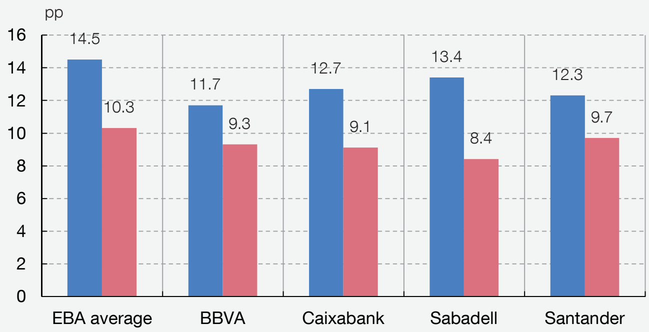
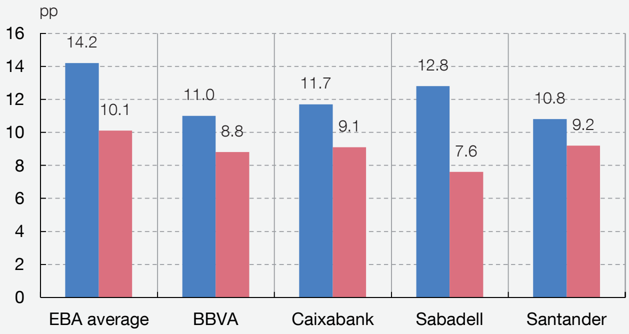


Chart 2
FULLY LOADED CET-1 RATIO ADVERSE SCENARIO



DECEMBER 2017 DECEMBER 2020 ADVERSE

SOURCE: Banco de España.

risk. Cyber and liquidity risks will also be subject to supervisory attention in the form of inspections and specific stress tests.

— Other: implementation of institutions' plans will continue to be monitored in 2019, to ensure they are prepared for the United Kingdom's departure from the European Union, and particular attention to trading risk and asset valuations will be paid.

The supervisory priorities established by the Banco de España for LSIs in 2019 are: the business model and profitability; credit risk; governance and risk management; and capital adequacy. Special attention will be given to institutions' profitability, taking into account the pressure the low interest rate environment is exerting on margins. Credit risk monitoring will include monitoring plans to reduce non-performing and foreclosed assets, and reviewing origination policies and standards. Focusing on the governance of the new institutional protection scheme (IPS), which include 29 credit cooperatives, will play an important part in the monitoring of the credit cooperative sector. Technology risk and capital adequacy, especially in the case of LSIs with a smaller margin over requirements, will also be focused on.

CYBERSECURITY BOX 2.3

Cybersecurity risks are a growing concern in the financial industry, both for institutions, which consider them to be among the five most important risks, and for the regulatory and supervisory authorities. The materialisation of these risks (also known as cyber risks), could mean that financial institutions are unable to provide services to their customers or fail to fulfil their contractual or legal obligations, with the consequent adverse impact on their reputation and brand value. The financial industry is a particularly attractive target for attackers, given the media coverage of attacks and the possibility of initiating fraudulent payments.

Apart from the observed increase in the volume of attacks and their sophistication, there is also the difficulty that institutions have adapting to a landscape in constant flux. Rapid technological change, combined with changes in the expectations of customers, who demand personalised products and services accessible through all kinds of channels, means that institutions have to adapt their complex systems continuously. Another external factor that has raised the pressure on banks has been the impact of the Second Payment Services Directive (PSD2), which has boosted disintermediation and the appearance of firms that adopt new technologies more rapidly and compete with banks by offering particular services.

Given the high degree of interconnectedness and dependence between the various participants in the financial system, including suppliers who may be located in other jurisdictions and may not be regulated, it is clear that cyber risks, beyond their impact on each individual institution, may even affect the stability of the system as a whole, spreading rapidly to many sectors of activity and affecting different jurisdictions.

As a result, the capacity of the financial system to absorb and recover from adverse shocks (resilience), depends not only on each participant, but also on the connections between them. Thus, it is essential to improve the ability of each agent to prevent, detect, respond to and recover from cybersecurity incidents. It should be noted that this ability refers not only to technological systems, but also to the related people and processes, since all three dimensions are equally important where cyber risks are concerned.

The financial authorities must lead these efforts, providing institutions with appropriate frameworks and guidelines, and facilitating the necessary international cooperation, all of which is essential to achieve a resilient financial system.

2.1.3 DIVIDEND DISTRIBUTION POLICIES AND VARIABLE REMUNERATION

The ECB, exercising the functions assigned to it by Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, has recommended that significant institutions adopt a conservative dividend policy. In particular:

— Institutions that, as at 31 December 2018, satisfied the applicable capital requirements and had already reached their fully-loaded capital ratios (i.e. applying Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, without applying the transitional arrangements) should distribute dividends in a conservative manner in 2019.

— Institutions that, as at 31 December 2018, satisfied the applicable capital requirements but had still not reached their fully loaded capital ratios should distribute dividends in a conservative manner, securing, furthermore, at a minimum, a linear path towards the fully-loaded capital ratios, with respect to the IFRS 9 transitional period envisaged in the new Article 473a inserted into the CRR by Regulation 2017/2395 in the case of institutions that have chosen to apply it.

— Institutions in breach of the applicable capital requirements should in principle not distribute any dividend.

This recommendation is addressed to institutions defined as significant on the basis of Regulation (EU) No 1024/2013, although the ECB requested national supervisory authorities to apply these recommendations to less significant institutions.

Also, in January 2019, from the ECB, by means of a letter addressed to institutions, it was recommended the application of a variable remuneration policy compatible with a conservative path, that is at least linear, towards compliance with the fully-loaded capital requirements.

In line with these criteria, the Banco de España in February 2019 made a recommendation to less significant institutions on their dividend and variable remuneration policies. This recommendation included the main aspects of the ECB's recommendations.

2.2 Supervision of credit institutions

The supervision of credit institutions within the framework of the SSM is the responsibility of the ECB and the NCAs participating in this mechanism. Although the ECB is ultimately responsible for the supervision of all the credit institutions of the participating Member States, supervisory tasks are divided up, in such a way that the ECB directly supervises those institutions defined as significant and the NCAs the less significant institutions within their respective jurisdictions (see Section 1.1).

As at 31 December 2018, the SSM supervised 119 groups of SIs, corresponding to 822 individual institutions, and 3,008 LSIs. In Spain there are 12 groups of SIs,[1] 58 less significant groups or institutions, and subsidiaries and branches of foreign SIs and LSIs. In terms of the total assets of the banking system in Spain, SIs account for 91,4%, LSIs for 4.5%, subsidiaries and branches of foreign significant institutions for 3.5% and branches of foreign less significant institutions, branches of EU institutions not participating in the SSM and branches of non-EU credit institutions for 0.6% (see Table 2.1).

Table 2.2 shows the institutions operating in Spain classified by type of institution.

The supervision of both significant institutions and less significant institutions is carried out through two complementary channels: ongoing monitoring and on-site inspections.

The intensity of ongoing supervision depends on the size of the institution, its systemic importance, its complexity and nature, and its risk profile, in accordance with the principle of proportionality.

Ongoing supervision is complemented by on-site inspections, which review specific areas of institutions' activity or particular risks. On-site inspections are scheduled in accordance with institutions' risk profiles and the analysis performed by the supervisory teams in the exercise of ongoing supervision and, on occasions, in order to conduct transversal analyses of certain types of risk considered relevant to the system, or of certain methodologies applied by institutions.

Since the creation of the SSM, progress has been made in harmonising the supervisory methodologies and practices existing in the participating Member States, in accordance with the guidelines issued by the EBA, the principles and standards in the CRD IV and the CRR and the experience that has been accumulated. In the case of the supervision of significant institutions the application of the *SSM Supervisory Manual*, which is updated as methodologies and processes are improved and harmonised, plays a very important role.

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1 Santander, BBVA, Caixabank, Bankia, Sabadell, Unicaja, Bankinter, Kutxabank, Ibercaja, Abanca, Liberbank, and Banco de Crédito Social Cooperativo.

SPANISH CREDIT INSTITUTIONS

TABLE 2.1

	2017		2018	
	Groups	Assets	Groups	Assets
Groups of Spanish significant institutions	13	91.4	12	91.4
Subsidiaries and branches of foreign significant institutions	23	3.8	22	3.5
Groups of Spanish less significant institutions	59	4.4	58	4.5
Branches of EU institutions not participating in the SSM	10	0.2	10	0.2
Branches of foreign less significant institutions	29	0.3	33	0.4
TOTAL	**134**		**135**	

SOURCES: ECB and Banco de España.

REGISTER OF CREDIT INSTITUTIONS

TABLE 2.2

Data at 31 December. Number (a)

				2018		
	2015	2016	2017	Registrations	Deregistrations	Year-end
Credit institutions	220	208	207	5	14	198
Banks	67	60	59		7	52
Savings banks	2	2	2			2
Credit cooperatives	65	63	63		1	62
ICO	1	1	1			1
Branches of EU credit institutions	79	77	78	5	5	78
Branches of non-EU credit institutions	6	5	4		1	3
Controlling companies	3	4	3	2		5
	223	212	210	7	14	203

SOURCE: Banco de España.

a The number of institutions includes non-operational institutions in the process of deregistering.

As regards the supervision of LSIs, although NCAs are responsible for their direct supervision, methodologies, guidelines and standards continue to be developed to secure convergence of supervisory practices, while respecting the national regulatory frameworks. In 2018, work was undertaken to ensure that standards that have already been approved in guidelines are applied, and new standards were prepared – for example on the determining that an LSI is failing and on cooperation between the NCAs and the national resolution authorities.

Working groups and expert networks, which analyse and develop technical and supervisory policy proposals, are also key elements of the SSM's operation, enabling the functioning of the single supervisory mechanism to be improved. The Banco de España participated in approximately 90% of these groups in 2018. The proposals made by these groups are discussed in the Supervisory Board and, where applicable, approved by the Governing Council of the ECB.

The SREP is a risk-based supervision methodology which is applied at least annually to SIs and LSIs, in accordance with the principle of proportionality. SREP methodology enables the main risks of each institution to be assessed, with the assignment of an overall score based on the risk profile assumed. The supervisor, on the basis of this assessment, determines whether the institution's levels of capital and liquidity are adequate, or whether additional capital or liquidity requirements, or some other qualitative kind of supervisory measure should be imposed. This supervisory approach contributes to the early detection of risks that may affect an institution's viability, and facilitates the early implementation of recovery measures.

MERGERS AND OTHER SPANISH BANK CONCENTRATION PROCESSES BOX 2.4

Table 2.2 shows that in 2018 the number of institutions decreased from 210 to 203.

In the case of banks, the reductions are mainly due to consolidation processes, specifically those of Bankia and BMN, Banco Santander and Banco Popular, Liberbank and Banco de Castilla-La Mancha, and Unicaja Banco and Banco CEISS (España-Duero).

The merger of Bankia and BMN arose from the reorganisation of the holdings of the Spanish Executive Resolution Authority (FROB), the majority shareholder of both banks, in order to maximise their value in a subsequent divestment of its stakes. Although the merger of Bankia and BMN took place for accounting purposes in December 2017, its legal effects came into force on 2 January 2018 upon registration of the merger deed in the Mercantile Register.

The other three mergers are the consummation of integration processes of banks acquired previously in banking crises.

Banco Popular was acquired by Banco Santander during its resolution in June 2017. Following a preparatory phase, the merger by acquisition of Banco Popular by Banco Santander was approved by their respective boards on 24 April and executed on 28 September 2018. The deregistration of the acquired institution was recorded in the Credit Institutions Register with date of effect as 26 September 2018.

Banco CEISS was undergoing a restructuring and recapitalisation process when it was acquired by Unicaja Banco in March 2014. The General Meetings of the two banks approved the merger-by-acquisition transaction on 27 and 26 April 2018, respectively, and the transaction was entered in the Mercantile Register on 21 September 2018. The deregistration of the acquired institution was recorded in the Credit Institutions Register with date of effect as 10 September 2018.

Lastly, the merger of Liberbank and Banco Castilla-La Mancha brought to an end the integration process initiated in 2009. The boards of directors of both banks approved the common draft terms of merger on 6 February, and the merger-by-acquisition deed was registered on 8 October 2018, on which date the transaction became fully effective. The deregistration of the acquired institution was recorded in the Credit Institutions Register on 1 October 2018.

Against the current backdrop of low interest rates and narrow bank margins, bank mergers are an alternative for improving profits. These transactions are accompanied by the rationalisation of corporate structures that helps to increase efficiency. Moreover, they are a means of attaining a market share and geographical presence which, given the high competition in banking, are difficult to achieve through organic growth. However, the appropriate balance must be found in order to avoid concentration problems.

So far there have only been mergers between Spanish banks, but as the Banking Union becomes more firmly entrenched, the likelihood of cross-border mergers in the euro area will increase.

In the area of credit cooperatives, an institutional protection scheme (IPS) was set up in the first quarter of 2018 as permitted by Article 113(7) of Regulation (EU) No 575/2013. The participants are 29 credit cooperatives and Banco Cooperativo Español.

The agreement provides for the creation of an ex ante fund to ensure that the IPS has funds directly at its disposal for liquidity and solvency support measures useful in forestalling resolution. Also, the agreement is expected to help strengthen the risk management and control of its members because the scheme should have risk monitoring and classification mechanisms, so that a clear picture of each member's situation and of the scheme as a whole will be provided, along with the possibility of influencing the risk management of the members of the IPS.

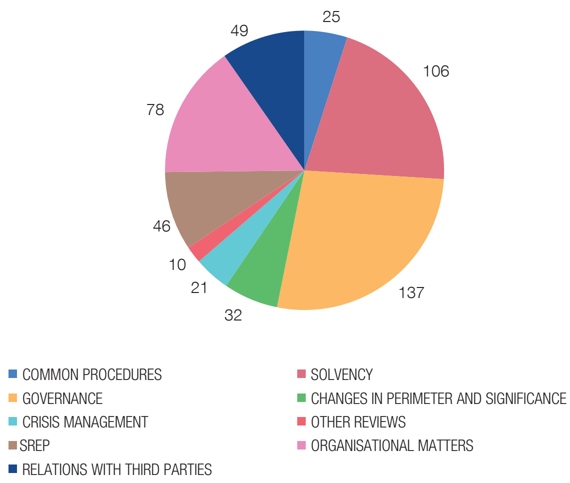
The Supervisory Board, in which the Banco de España participates, adopted 1,920 supervisory decisions, either at meetings or using written procedures. Chart 2.1 gives a breakdown, by category and type of institution, of the number of decisions and other supervisory actions, both specific and general, which affect Spanish institutions.

2.2.1 ONGOING SUPERVISION OF SPANISH SIGNIFICANT INSTITUTIONS

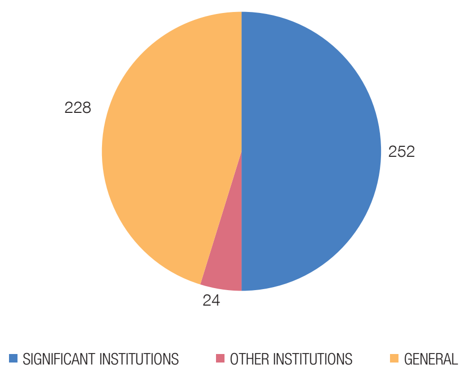
The Banco de España is an integral part of the JSTs responsible for the ongoing supervision of SIs. The Banco de España participates in the JSTs of the 12 groups of Spanish credit institutions classified as significant in accordance with the SSM's criteria and in some of the JSTs of 22 foreign significant banking groups operating in Spain through subsidiaries and/or branches. At end-2018 the Banco de España contributed a total of 163 examiners, IT auditors, model experts and specialists.

BREAKDOWN OF SUPERVISORY DECISIONS AND ACTIONS IN 2018 CHART 2.1

1 BY CATEGORY



2 BY TYPE OF INSTITUTION



SOURCE: Banco de España.

Ongoing supervision applies the SREP methodology referred to above. Under this supervisory approach, the conclusions of the SREP and other supervisory activities are shared with the SIs.

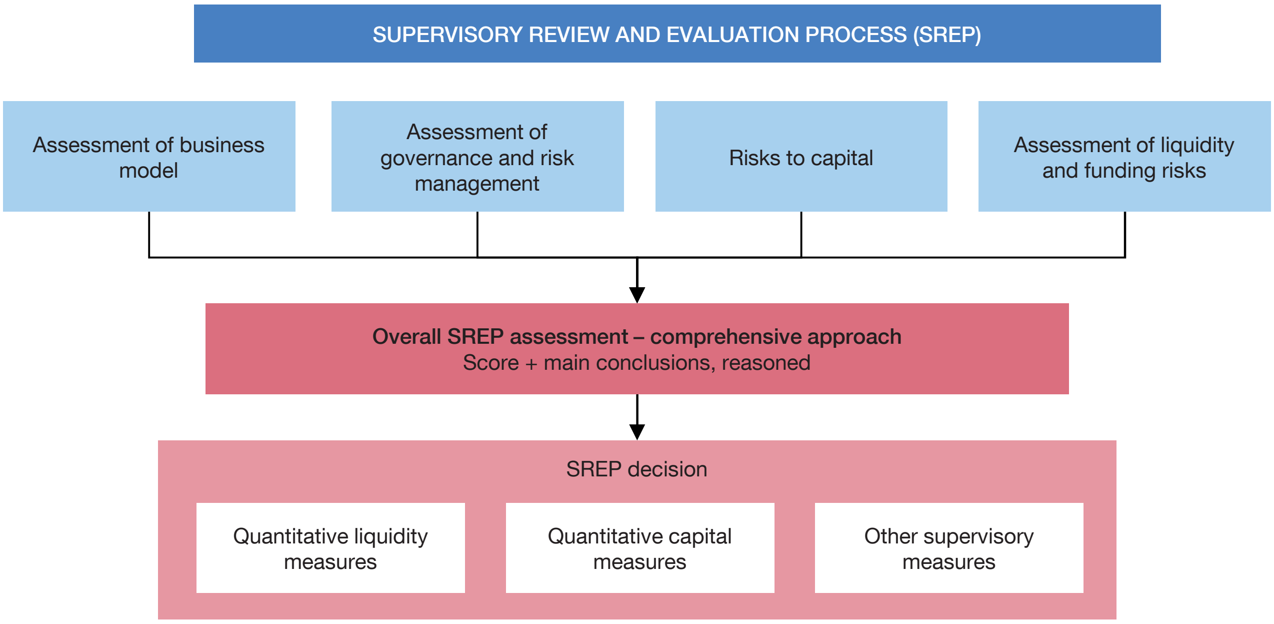
The supervisor-supervised dialogue is a key part of the ongoing supervision approach. This is an essential instrument for the flow of information on the weaknesses detected, the assessment of the institution and the supervisory priorities and expectations, as well as for fostering an exchange of opinions and discussion of the main supervisory areas. The JSTs maintain direct ongoing contact with the institution at various hierarchical levels, including the board of directors and top management. Moreover, in the case of large Spanish SIs, the JSTs are based at their premises, providing ready access to management and information.

The supervisory priorities of the SSM, set out in Section 2.1, determine the focus of the various supervisory tasks of the JSTs. In this respect, plans for the strategic supervision of SIs were introduced in 2018 in order to adjust the lines of action to the specific circumstances of each institution, with a medium-term view (3 years): on the basis of the risk profiles and characteristics of the institutions, specific supervisory priorities are identified that, together with those already defined by the SSM and the circumstances of the banking system, determine the supervisory strategy applicable to each institution in the medium term. The planned tasks include: on-site inspections, cross-cutting thematic reviews, internal model reviews, reviews of specific matters and special courses. The strategic plans are live documents that will be revised and updated annually.

The strategic plans are, in turn, translated into annual supervisory plans, documents that are more operational and set out the different tasks of the JSTs, whose frequency and intensity are determined by the supervisory importance assigned to the institutions. The planned activities include: the annual SREP; meetings with independent directors, senior management and key position holders of the institutions; periodic monitoring of the main risks to which they are exposed; analysis of recovery plans; special reviews of particular areas; and on-site inspections and model investigations. The supervised institutions are

SINGLE SUPERVISORY MECHANISM

FIGURE 2.1



SOURCE: Banco de España.

informed of these plans so that they are aware of and can handle the information requirements generated by these activities.

In 2018, the supervisory plans included the following cross-cutting thematic reviews, most of which had been commenced in previous years:

— Thematic review of business model and profitability risk, continuing the work carried out in 2016 and 2017. In 2018 the JSTs formally reported the weaknesses detected and informed the institutions of the conclusions of the review.

— Intensive monitoring of institutions with high NPL rates, the review has focused on the analysis of the divestment strategies proposed by the institutions.

— Completion of the review of the level of preparedness for and implementation of IFRS 9 on Financial Instruments.

— Review of internal models. In 2018, credit and market risk models were reviewed and the review of portfolios with low probability of default, to be carried out in 2019, was planned.

— Review of the preparedness of institutions for Brexit, with special focus on contingency plans and the impact on customers.

Also in 2018, the JSTs participated in the stress tests organised by the EBA and the ECB to assess the resilience of banks to a hypothetical deterioration of macroeconomic and market conditions. As in previous years, the results of the exercise were used, along with institution-specific considerations, to determine the Pillar 2 guidance (P2G).

SALE OF NON-PERFORMING ASSETS BOX 2.5

As a result of the recent financial crisis, the balance sheets of most Spanish credit institutions have built up a high level of non-performing assets which weaken their (already low) profitability and threaten the soundness of the system. Despite banks' efforts in recent years to recoup the quality of their assets, the management of non-performing or written-off loans and of foreclosed real estate assets continues to pose a challenge which they have to address.

This explains why in 2018 Spanish banks continued their impaired asset sales to wholesale investors, which allowed them to:

— Reduce their exposure to the risks associated with assets of this type and thus increase their resilience to the challenges posed by the current environment or future crises.

— Improve asset quality ratios, putting Spanish banks in a better competitive position relative to their European peers.

— Increase future profitability indicators by reducing the non-performing assets on balance sheets. At those banks whose risks are prudently provisioned, these transactions will moreover supplement their income statements.

— Save management costs which adversely impact the income statement and financial ratios.

— Focus on the management of new lending.

— Dissipate market misgivings and thus reduce funding costs.

The main wholesale sales of non-performing and foreclosed assets agreed in 2018, some yet to be executed, were those of Caixabank, Banco Sabadell and Bankia for a gross amount of approximately €12,800 million, €11,400 million and €3,070 million, respectively.

It should be noted that in March 2018 the ECB published an addendum to its Guidance to banks on non-performing loans of 20 March 2017, which supplements the qualitative approaches to NPLs and specifies the supervisory expectations on prudent provisioning levels for transactions classified as non-performing subsequent to the publication date.

In the case of significant institutions with a presence in countries outside the scope of the SSM, the JSTs take part in the colleges of supervisors (presided over by the ECB, with the Banco de España acting as observer), collaborating and sharing information with other supervisory authorities.

At the same time, 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 supervening circumstances that might affect the institution.

2.2.2 THE ONGOING SUPERVISION OF SPANISH LESS SIGNIFICANT INSTITUTIONS, BRANCHES OF OTHER LESS SIGNIFICANT INSTITUTIONS, NON-EU BRANCHES AND OF THE ICO

The Banco de España is responsible for the direct supervision of less significant institutions, which account for approximately 4.5% of the Spanish banking system's assets, while the ECB is responsible for their indirect supervision.

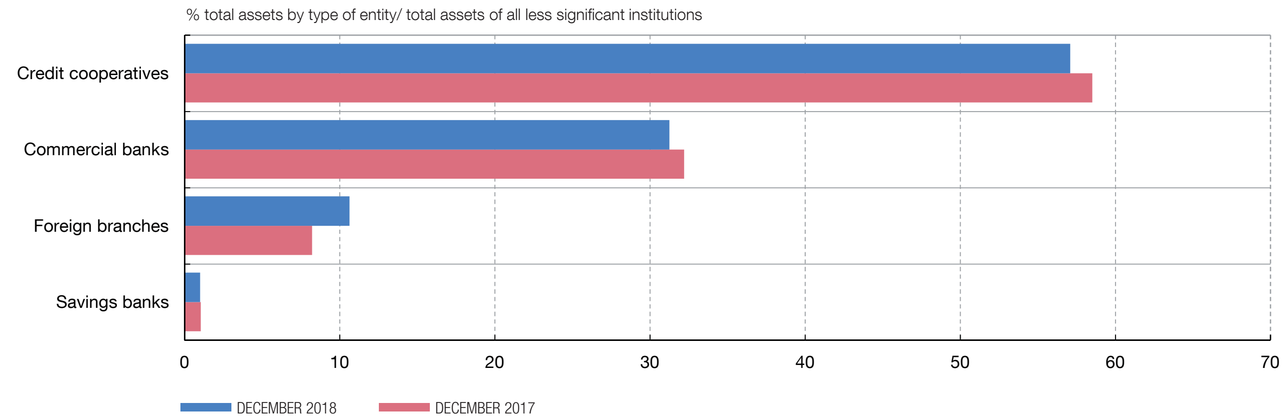
In the exercise of its supervision of these institutions, the Banco de España conducts general monitoring actions on a quarterly or half-yearly basis. Among other areas, these cover financial monitoring, credit risk, liquidity and internal control and governance.

Chart 2.2 shows the relative size of each of the types of less significant institution in terms of total assets.

The annual supervision plan, which details the following year's supervisory activities, is prepared each year on the basis of the supervisory priorities. As in the case of significant institutions, the SREP is one of the central tasks of ongoing monitoring. Also, quarterly or half-yearly monitoring is performed in accordance with the principle of proportionality,

WEIGHT OF THE VARIOUS TYPES OF LESS SIGNIFICANT INSTITUTIONS

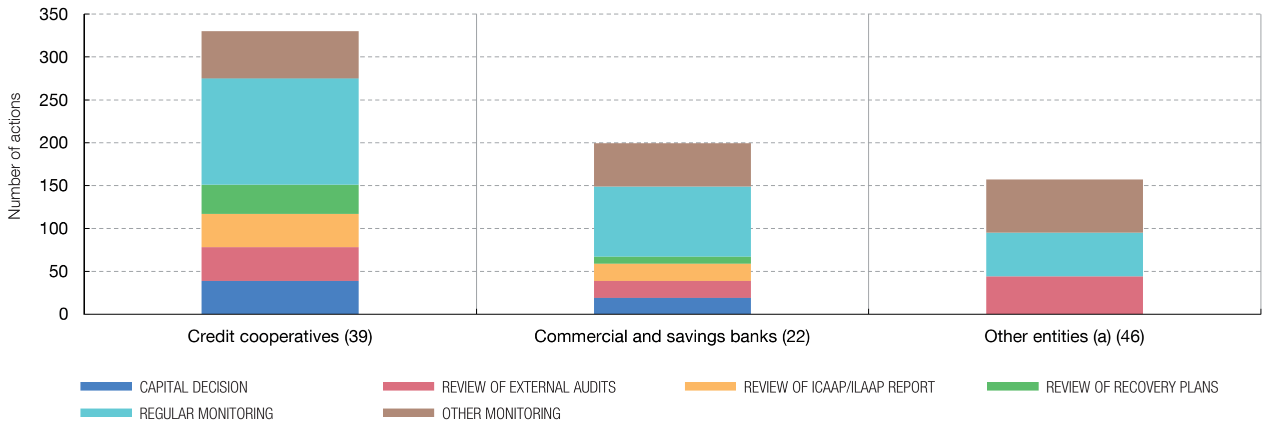
CHART 2.2



SOURCE: Banco de España.

MONITORING SUPERVISORY ACTIONS

CHART 2.3



SOURCE: Banco de España.

a "Other entities" includes branches of less significant institutions, non-EU branches and the ICO.

considering for this purpose various factors such as the risk profile, size, the volume of deposits raised on the retail market and the business model. Institutions with a lower risk profile, smaller size or whose model so allows are subject to simplified off-site monitoring, based on quarterly alerts using the information in the confidential returns and the Banco de España's central credit register, in order to detect potential future problems of liquidity, solvency or sustainability of the business model.

In 2018, comprehensive off-site monitoring was carried out for 23 of the 59 groups of LSIs, accounting for around two thirds of LSIs' total assets, with simplified off-site monitoring being performed for the remaining 36 groups. A total of 529 supervisory monitoring actions were undertaken, as detailed by type of LSI and by matter in Chart 2.3.

The planned actions also include, apart from the SREP and the above-mentioned monitoring, more than 300 detailed actions consisting inter alia of reviews of audit reports, meetings with auditors, reviews of internal capital adequacy assessment reports and regular meetings with persons in positions of responsibility at the institutions.

The Banco de España continued to work with other NCAs in the colleges of supervisors for foreign banking groups, participating in four colleges in 2018.

In the case of branches in Spain of institutions with head offices in other EU Member States not participating in the SSM and also branches of institutions that, being under the supervision of the SSM, are less significant, as they are not subject to prudential or liquidity requirements at the branch level, the Banco de España carries out off-site monitoring, holds meetings with the management and regularly exchanges information with the authorities of the home country of the branch, under the terms established in Commission Implementing Regulation (EU) No 620/2014.

Direct supervision of LSIs by the Banco de España is backed up by indirect supervision by the ECB, with the aim of:

— Ensuring the uniform application of high supervisory standards, and

— Guaranteeing the consistency of supervisory outcomes in the Member States participating in the SSM.

The ECB's performance of those two functions benefited, as in previous years, from the cooperation provided by the Banco de España. The Banco de España is working with the ECB and other NCAs on the definition of supervisory standards. Once approved in the form of guidelines or recommendations, these must be applied or taken into consideration by all SSM countries in the supervision of their LSIs. Considerable human resources are dedicated to that task.

As regards the branches in Spain of institutions with head offices in non-EU countries, the Banco de España's supervision also includes half-yearly monitoring and regular meetings with the branch management.

Lastly, the Banco de España exercises supervision of the Instituto de Crédito Oficial (Official Credit Institute, ICO by its Spanish abbreviation), which has the legal status of a credit institution.

Regarding the branches of less significant institutions, the non-EU branches and the ICO, a total of 127 supervisory actions were carried out in 2018.

2.2.3 THE OUTCOME OF THE SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

The supervisory assessment of each credit institution is based on the conclusions of the off- and on-site reviews and determines the annual capital decision (known as "Pillar 2"). Institutions are notified each year of the decision they have to comply with in the following year.

To make this decision, the supervisor conducts the SREP applying the methodology defined in the supervisory manual, which is organised around four basic elements: analysis of the business model; evaluation of internal governance and risk management; assessment of the risks affecting capital and of capital adequacy to cover those risks; and assessment of the risks affecting liquidity and of the adequacy of the liquidity position to cover those risks. The SREP also comprises the supervisory review of the assessment that the institution itself makes of its risks and its capital base and liquidity in accordance with its internal processes. As regards LSIs, a review was conducted in 2018 of the first ICAAP and ILAAP prepared following the publication by the Banco de España of its new *Guía sobre Adecuación de Capital y Liquidez* (Capital and Liquidity Adequacy Guidelines).

The EBA guidelines on the SREP, published in 2014 and in force since 1 January 2016, **were updated in 2018** and were adopted by the Banco de España on 19 February 2019. They are to be applied for the first time in the 2019 SREP cycle.

The most important changes are as follows:

— **Pillar 2 capital recommendation (P2G)**: this is a supervisory measure that sets capital expectations above the total capital requirement. It is not legally binding and is set on the basis of the assessment of own funds adequacy (quality and quantity) under stressed conditions. The P2G is notified to the institution and is expected to be covered with CET-1 capital.

— **Supervisory stress tests**: guidelines on their design and conduct have been included. The option of using fixed thresholds is included.

— **Institutions' stress tests**: criteria for their assessment in line with the EBA guidelines in this respect, published in July 2018 (EBA GL/2018/04), have been included.

— **Supervisory assessment system**: the scores to be assigned by the supervisor have been clarified, distinguishing between scores for: (i) individual risks and (ii) the institution's viability.

— **Interest rate risk in the banking book:** its assessment has been reviewed to update it in light of the new version of the EBA guidelines on this risk published in July 2018 (EBA GL/2018/02).

— **Capital decision and expectations**: the coordination between the various capital requirements in place and the notification of supervisory capital expectations to institutions has been improved.

— **SREP and other processes**: The relationship between the SREP and other supervisory processes, such as recovery plan assessment and early intervention and resolution measures, has been clarified.

— **Internal governance**: An analysis has been made to determine how consistent the text of the guidelines is with the new rules on internal governance.

The basic supervisory criteria governing these tasks are set out in the guidelines prepared by the EBA on the SREP, published in December 2014 (EBA/GL/2014/13). These guidelines have been revised recently with a view to applying them, as changed, in the 2019 SREP cycle. The main changes in the revised version of these guidelines (EBA GL/2018/03) are set out in Box 2.6. Also, in November 2018 the ECB published its *Guidelines on the internal capital adequacy assessment process (ICAAP)*.

The formal structure of the 2018 capital decision has not changed with respect to that of 2017 as far as its main features are concerned, which in principle affect both SIs supervised by the ECB and LSIs, and are as follows:

— the 2018 capital decisions continue to establish the amount of CET-1 required to comply with Pillar 2.

— the 2018 decision also refers to the level of the combined buffer required at institutions in accordance with the phasing-in period envisaged in the regulations.

As regards SIs, the methodology developed within the framework of the SSM has been applied since 2015 to determine the capital decision, which ensures a uniform assessment in all European SIs. This common framework covers:

a) a system for risk assessment at credit institutions;

b) a review of the ICAAP and ILAAP applied by institutions; and

c) a methodology for calculating capital and liquidity needs on the basis of the assessment of their risks.

The P2G recommendation is maintained in the 2018 capital decisions issued by the ECB for SIs. This supervisory tool sets capital expectations above the total capital requirements. These expectations are not binding and supplement the Pillar 2 requirements. This recommendation is linked to the outcome of the supervisory stress test exercises conducted during 2018 and is expressed in terms of CET1. The ECB expects banks to comply with the minimum regulatory requirements (Pillar 1), the Pillar 2 requirement and the combined capital buffer requirement.

If a bank fails to comply with this expectation, there will be no automatic supervisory actions. Instead, supervisors will consider adopting supervisory measures on a case by case basis, with the approval of the SB of the ECB. Such measures may include transformation of the capital expectation into a Pillar 2 capital requirement, which the bank in question would be obliged to comply with.

Once the period for making representations had expired, the 2018 SREP capital decisions approved by the SSM's decision-making bodies were notified to banks in early 2019. These new decisions will remain in force until the next capital decision, which will foreseeably be adopted in December 2019.

With respect to LSIs under the direct supervision of the Banco de España, in 2018 the SREP methodology approved by the ECB's Supervisory Board in January 2018, which envisages a similar arrangement to that for significant institutions, was applied.

Once the corresponding 2018 SREPs had concluded, the Banco de España adopted capital decisions for the relevant LSIs by means of a procedure that included the consideration of institutions' representations.

The supervisory practices of the Banco de España are adapted, in all material respects, to the current framework established by international agreements, European legislation, the EBA guidelines adopted by the Banco de España and the SSM cooperation framework.

2.2.4 ON-SITE INSPECTIONS

The on-site inspection function is separate from continuous monitoring in order to reinforce the independence and objectivity of the conclusions obtained from these inspections. Table 2.3 details the on-site actions performed at credit institutions in 2018.

On-site inspection actions at SIs are planned as part of the SEP. In 2018, 32 on-site actions were carried out at SIs, of which 29 were at Spanish institutions and 3 were at financial groups from other SSM Member States.

The Banco de España played a major role in these supervision tasks. Of the 29 on-site actions at Spanish SIs, 22 were led by Banco de España staff, two by ECB staff and five by staff from another SSM Member State. Moreover, a significant proportion of the personnel who participated in the aforementioned on-site inspections were from the Banco de España.

As regards the inspection methodology, in 2018 work continued to improve the conduct of on-site inspections, particularly to boost implementation efficiency by establishing procedures to shorten their duration, and mechanisms and practices that reduce the time between one inspection and the next.

ON-SITE SUPERVISORY ACTIVITY AT CREDIT INSTITUTIONS. ACTIONS

TABLE 2.3

	2018		
	Significant institutions	Less significant institutions	Total
On-site inspections	24 (a)	12	36
Internal model investigations	8 (b)	—	8
TOTAL	**32**	**12**	44

SOURCE: Banco de España.

a Of which, six were led by staff from other authorities.
b Of which, one was led by staff from other authorities.

The Banco de España is also participating actively in the working groups set up in the SSM to develop the most suitable techniques for on-site supervision of the various risks (credit, technology, market, etc.) and to continue making progress on the uniform application of on-site inspection in all SSM Member States.

The Banco de España has played an active role in drawing up the SEP for 2019, which defines the on-site inspections that are to be carried out over the course of the year. The main points are:

— More numerous cross-border missions in order to foster harmonisation in the application of SSM methodology in on-site inspections. Four inspections led by Banco de España staff are planned, as well as participation in another two inspections of institutions from other SSM countries. In this regard, in 2018 Banco de España staff led three inspections of institutions belonging to financial groups from other SSM Member States.

— As in 2018, the 2019 programme includes investigations as part of an in-depth review of the internal capital models in place in the SSM. In 2019, the TRIM investigations will concentrate on portfolio models with small numbers of non-compliances.

Finally, 13 inspections of LSIs are envisaged in 2019.

2.2.5 COMMON PROCEDURES

The common procedures, set out in Regulation (EU) 468/2014 of the ECB, relate to authorisations to take up the business of a credit institution, withdrawals of such authorisations and the acquisition of qualifying holdings. In these procedures the Banco de España makes an initial assessment and draws up a proposal for a decision in each specific case, both for SIs and LSIs. The ECB then makes a final decision on the basis of this proposal and any additional work it considers appropriate to undertake.

Table 2.4 lists the procedures concerning credit institutions in which the Banco de España has taken part.

2.2.6 INFORMATION SUBMITTED PERIODICALLY TO THE EXECUTIVE COMMISSION

Although supervisory decisions relating to significant credit institutions are adopted by the Governing Council of the ECB, supported by the SB, the Directorate General Banking Supervision informs the Executive Commission of the Banco de España of these decisions and other relevant SSM matters. The Director General of Banking Supervision reports to the Executive Commission on:

PROCEDURES IN RESPECT OF CREDIT INSTITUTIONS INVOLVING THE BANCO DE ESPAÑA

TABLE 2.4

	Total number
Qualifying holdings, merger, spin-off and other significant acquisitions	15
Cross-border activity of Spanish credit institutions	36
Branches in the EU	10
Branches in third countries	7
Freedom to provide services	19
Cessation of business	1
Loans to senior officers	31
Suitability of senior officers	241
Procedures relating to own funds	13
Amendments of articles of association	24
Communications with other supervisory authorities or institutions	6
Other procedures	19
TOTAL	**386**

SOURCE: Banco de España.

— The supervisory decisions regarding Spanish significant institutions, including capital decisions.

— The supervisory priorities and the SEP for the coming year.

— General SSM matters which may be of particular interest.

— Relevant decisions relating to foreign SSM institutions.

— Periodically, on the situation of Spanish institutions.

2.2.7 THE QUALITY FUNCTION

The quality function is responsible for ensuring the excellence of the activity of the Directorate General Banking Supervision. Its ultimate purpose is to contribute to the ongoing improvement of supervisory activity so that it is conducted effectively, consistently and efficiently. To this end, it has numerous complementary tools, including most notably its reviews of the quality of specific aspects of supervisory activities.

In the SSM, the SI supervisory quality function is the responsibility of the ECB, and the Banco de España may cooperate voluntarily in quality reviews of the supervision of Spanish SIs. In addition, the Banco de España is responsible for the quality of LSI supervision.

In 2018, the Banco de España quality function conducted various quality reviews envisaged in the annual LSI supervision plan and cooperated actively in various ECB-led quality reviews of SI supervision.

In addition to this division of responsibilities, the ECB and the NCAs cooperate through a cooperation and consultation group known as the *SQA Network*. The dialogue within the framework of this group allows the participants to share the experience of the SSM quality functions and to identify sound practices and possible areas for improvement. The *SQA Network* meets regularly several times a year and its members are in permanent contact. The Banco de España participated actively in the organisation of the 19th meeting of the *SQA Network* in Madrid in September 2018.

2.2.8 SUITABILITY

At all times during which they hold office, and not just at the time they take it up, all senior officers of credit institutions are required to meet the suitability requirements stipulated in the regulations. Thus, they must have commercial and professional integrity, possess appropriate knowledge and experience for the exercise of their functions, comply with the rules on conflicts of interest and limitations (where applicable), and in the case of the members of the board of directors, be in a position to exercise good governance, i.e. i) have sufficient time to carry out their duties, and ii) be free from conflicts of interest.

The Banco de España – in the case of LSIs – and the ECB, acting in close collaboration with the Banco de España – in the case of SIs – supervise compliance with the rules on the suitability of credit institutions' senior officers at all times during which they hold office.

Tables 2.4 and 2.5 set out the procedures for assessing the suitability of credit institutions' senior officers in which the Banco de España has taken part.

In 2018 the Executive Commission of the Banco de España adopted the *Guidelines on the assessment of the suitability of members of the management body and key function holders* (EBA/GL/2017/12). These guidelines, in the application of which the proportionality principle has to be taken into account, specify the suitability requirements for members of credit institutions' management bodies and set out criteria regarding: sufficient time commitment; honesty, integrity and independence of mind of a member of the management body; adequate collective knowledge, skills and experience of the management body; adequate human and financial resources devoted to the induction and training of such members; and the diversity to be taken into account for the selection of members of the management body.

The Guidelines also specify requirements regarding the suitability of the heads of internal control functions and the chief financial officer of credit institutions, where they are not part of the management body, and, where identified on a risk-based approach by those institutions, of other key function holders; and the requirements regarding assessment processes and governance policies and practices, including the principle of independence applicable to certain members of the management body in its supervisory function.

There are two exceptions to the Banco de España's agreement to adopt the guidelines, namely (partially) Guideline 91(g) in respect of the period of three years applicable to the relationship between a credit institution and a director acting as a material professional adviser or a material consultant for such director to be deemed to be independent, and (partially) Guideline 186 in respect of the maximum period of six months for taking a suitability assessment decision where the suitability assessment procedure has been suspended.

Also, in 2018 the *Guide to Fit and Proper Assessment,* drafted by the ECB was modified as a result of the entry into force of the aforementioned guidelines.

Finally, it was decided **that less significant institutions and the branches in Spain of credit institutions from non-EU countries should start to use the same questionnaire that is used by significant institutions to compile information on candidates.** This questionnaire is intended to systematise in a single document all the information needed to assess the suitability of senior officers. It does this by helping institutions to prepare their requests for assessment so that the applications received are as complete as possible from the onset, thereby harmonising the procedures and reducing the time taken to conclude them. The questionnaire can be found at the Banco de España's Virtual Office and replaces all other documents previously sent to the Banco de España together with the request for a suitability analysis.

Supervision Department III.

2.2.9 ROLE OF THE BANCO DE ESPAÑA'S SUPERVISION WITHIN THE CRISIS MANAGEMENT FRAMEWORK

The EU has instituted a crisis management framework. The financial crisis of 2007 showed that banks and authorities did not have suitable mechanisms for the orderly management of a crisis like that which hit the world financial system at that time.

The international standards destined to underpin the bank crisis management frameworks for these to be effective were proposed by the Financial Stability Board (FSB) in 2011 and written into European legislation in 2014 in the form of the Bank Recovery and Resolution Directive and in 2015 into Spanish law via Law 11/2015 and Royal Decree 1012/2015.

This crisis management framework comprises three phases: i) the preventive phase, which incorporates into banks' day-to-day routines the ongoing analysis of their ability to recover from a shock (or to be resolved, where applicable); ii) the early intervention phase, where a major role is played by the supervisor, on which enhanced powers are bestowed to take action at banks showing signs of weakness but still viable, and iii) the resolution phase.

Recovery plans

In the preventive phase the recovery plan obliges banks to stand ready to address a situation of severe stress. This is an exercise of internal reflection by banks, backed by their Boards of Directors, on their ability to recover from significant distress.

All banks have the obligation to prepare, at least yearly,[2] a recovery plan. They are divided into five broad sections,[3] the two most notable ones being those which include key factors for assessing their effectiveness and credibility:

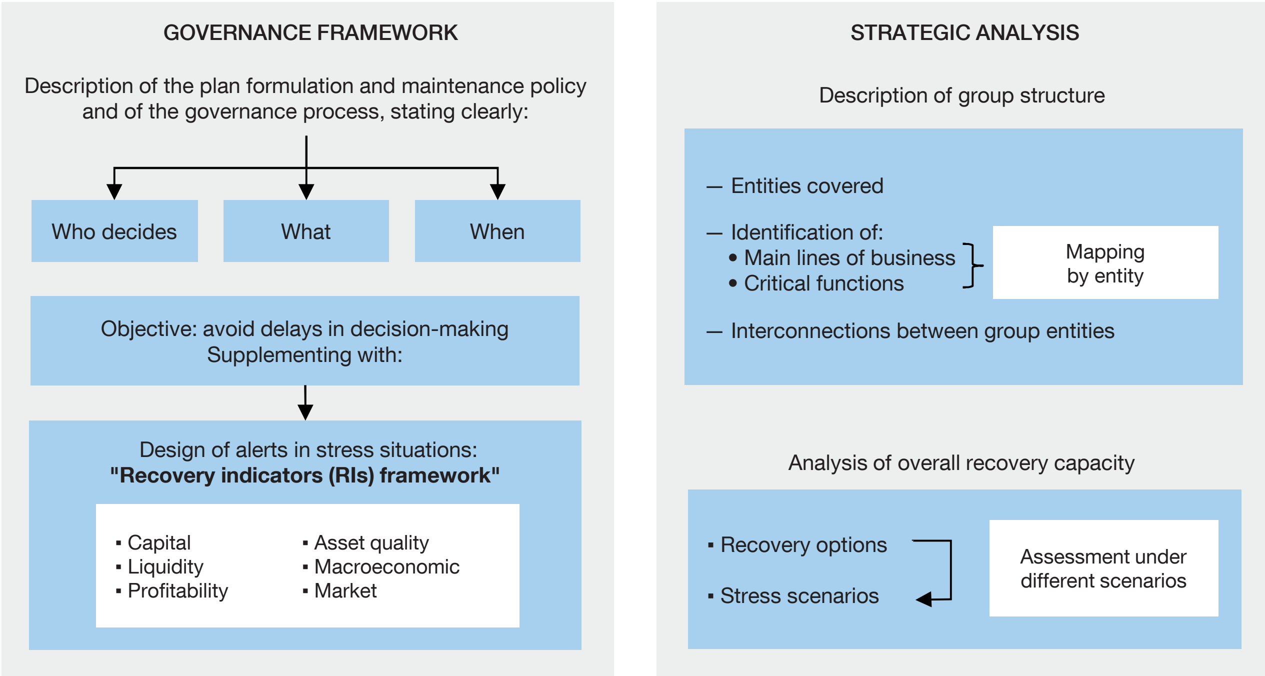
— "Governance framework": focused on the definition of plan drafting and maintenance policies and on the decision-making process for activating each phase of the plan.

2 Recovery plans must be updated whenever a significant change affects the bank. The rule allows certain banks to apply simplified obligations which, among other things, provide for updating to be done less frequently than yearly.

3 A plan summary, governance information, a strategic analysis section, the envisaged communication plan and a description of preparatory measures.

MAIN COMPONENTS OF RECOVERY PLANS

FIGURE 2.2



SOURCE: Banco de España.

To enable banks to react in time and adopt the required preventive measures before they reach the point of failure, it is necessary to define a set of indicators to help in the early identification of critical situations ("recovery indicators framework").

The calibration of these indicators is the bank's decision. Although the rule is not prescriptive in this respect, it does stipulate that the threshold set for indicators based on regulatory requirements must be calibrated at a sufficient distance from non-compliance with them.

The indicators framework is not automatic; rather, the process established for deciding on the adoption of recovery measures is activated when the thresholds are reached.

— "Strategic analysis": This section has two broad elements of particular value for both managers and the supervisor:

- A description of the group's structure, which lists the entities covered by the plan and the interconnections (financial and operational) between the various group entities and identifies the main lines of business and critical functions which it is essential to maintain.
- An assessment of the bank's overall recovery capacity. It includes, firstly, an exhaustive list of the recovery options available for successfully dealing with a situation of severe stress. It gives a detailed analysis of which options would be most effective under various crisis scenarios defined by the bank.

A recovery plan is an exercise which offers extreme transparency to the supervisor, which assesses it with a threefold objective: i) to verify that its content is regulatorily compliant;

ii) to assess its quality and iii) to evaluate its credibility, in order to conclude whether the bank has sufficient capacity to effectively execute the measures envisaged in the plan for re-establishing its financial position.

If the supervisor detects significant deficiencies in the plan, it will require a new one to be submitted. If deficiencies persist in the newly submitted plan, supervisor may require measures to be taken.[4]

A recovery plan is an iterative process which allows a bank to reflect continuously on its resilience and to improve its readiness to react effectively to situations of stress. This in turn contributes to raising the financial system's overall resilience to a crisis.

To increase the effectiveness of recovery plans, the ECB, in cooperation with NCAs, has drafted a document setting out the lessons learnt and the best practices identified in the assessment of the recovery plans. The main ideas gathered are set out in Box 2.7.

Supervisory activity within the crisis management framework in 2018

With respect to the groups of SIs, the JSTs performed the following activities within the crisis management framework:

— The 2017 recovery plan review cycle, initiated in the fourth quarter of the preceding year, was completed. As a result of the assessments, letters were sent to institutions notifying them of the aspects in which they have to improve and, in the case of more serious deficiencies, requesting the remittance of specific action plans to remedy them within a reasonable period.

  In general the quality of Spanish SIs' plans continued to improve, although they have to continue their efforts to make their plans more operational so that they are useful in crisis situations.

— The JSTs participated in the prior consultation of resolution plans with the SRB. In 2018 the SRB established for the first time binding MREL targets at consolidated level for the Spanish institutions with resolution colleges (Santander, BBVA and Sababell).

With regard to LSIs, the Banco de España:

— Completed in 2018 its assessment of the recovery plans sent by obliged entities in the fourth quarter of 2017. As a result of the review, wherever appropriate, letters were sent to the institutions either requesting that the deficiencies detected be remedied by them in the next plan sent or requiring that a new plan be sent by the legally established deadline in the case of significant deficiencies.

— Also, the Banco de España participated in three colleges of supervisors of less significant European groups with a presence in Spain, and all of them reached joint decisions on recovery plans.

— It participated in the legally envisaged prior consultation phase on resolution plans of LSIs.

4 Among these measures, the supervisor may require a review of the strategy and organisation, changes in corporate governance, reduction of the risk profile and even ad hoc adoption of recapitalisation measures.

The ECB has published a report on recovery plans, detailing the lessons learned and the best practices identified in the processes of assessment and analysis of recovery plans, with the aim of enhancing their quality and making them more operational for effective use in the event of a crisis. The report, which is addressed to SIs and does not impose any additional requirements on them, covers the following aspects:

1 Recovery options

Recovery plans should include a broad range of options, according to the bank's business model and risk profile, and should be available in different stress situations. Inclusion of a detailed analysis of the selection criteria for recovery options is considered good practice.

The plans should contain a comprehensive assessment of the effect of the options on banks' solvency, liquidity and profitability, based on reliable and duly justified valuations. Basing valuations on past experience and on actual values achieved by peer institutions in similar situations is considered good practice.

Recovery plans should include clear evidence of the feasibility of the options. Drawing up a complete plan for the implementation of each option, considering the time required for implementation and for it to take effect, is deemed good practice.

2 Overall recovery capacity (ORC)

Banks should present a credible and realistic view of their overall recovery capacity, understood as an overview of the extent to which they would be able to restore their financial position following significant deterioration. They should consider: i) possible interdependencies between options; ii) the fact that some options are mutually exclusive; iii) their capacity to implement several options simultaneously; and iv) the potential effects on their reputation and business model.

They should test the effectiveness of all the options and of the resultant ORC in a range of scenarios. Analysis of the build-up of the ORC over time and across a range of estimates, both in terms of capital and liquidity, is deemed good practice.

3 Recovery indicators

Banks should establish a comprehensive indicator framework, aligned with the EBA list (save for duly justified exceptions) and should include other indicators relevant to their business model and risk profile. They should include at least all capital and liquidity indicators based on regulatory requirements. Inclusion of a detailed analysis of how the selected indicators reflect their main risks, including how those indicators have evolved in the past, is considered good practice.

They should set indicator thresholds at appropriate levels to allow timely and effective activation of the recovery plan when necessary. Indicator thresholds tied to regulatory requirements should be set at a sufficient distance from breach of those requirements.

The indicator framework should be an integral part of a bank's risk management framework and should be aligned at all times with its contingency and business continuity plans. The ECB encourages banks to use progressive metrics (the "traffic light" approach) to flag deterioration.

Banks should define a process for escalating decisions, to ensure that if an indicator threshold is crossed both the board of directors and the supervisor are informed immediately. The possibility of escalation, not only if an indicator threshold is crossed but also based on expert judgment, is considered good practice.

4 Best practice to make recovery plans more operational

Playbooks: practical and concise guides on recovery plans that sum up the main steps to be taken and the key points for their implementation. They should include: i) clear allocation and distribution of responsibilities; ii) an effective decision-making process; iii) contact details of the main stakeholders; iv) a clear communication strategy; and v) references to the key contents of the plan.

Dry-runs: real-time simulation exercises in which banks test key parts of their recovery plans in hypothetical crisis scenarios. The purpose is to test whether the plan could be implemented in a timely and effective manner in stress situations, to train key staff members and to identify areas of improvement. In particular, the aim is to test: i) the escalation and decision-making procedures; ii) whether sufficient information for decision-making is immediately available; iii) whether the timelines for implementing the key recovery options are plausible; and iv) whether there are fast and reliable communication strategies in place.

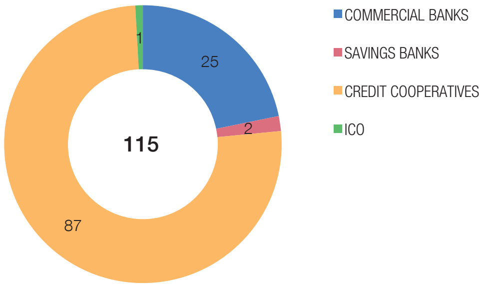
2.2.10 LETTERS

In the performance of its supervisory tasks, the Banco de España sent 115 letters to credit institutions containing requirements and recommendations, as detailed in Chart 2.4. Of these, 57 related to capital decisions, 41 to recovery plans and 16 to on-site inspections and one to monitoring of requirements. Chart 2.5 gives the number of recommendations and requirements sent to credit institutions.

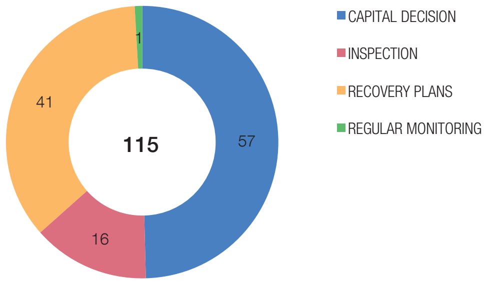
NUMBER OF LETTERS ADDRESSED TO CREDIT INSTITUTIONS

CHART 2.4

1 BY TYPE OF INSTITUTION (2018)



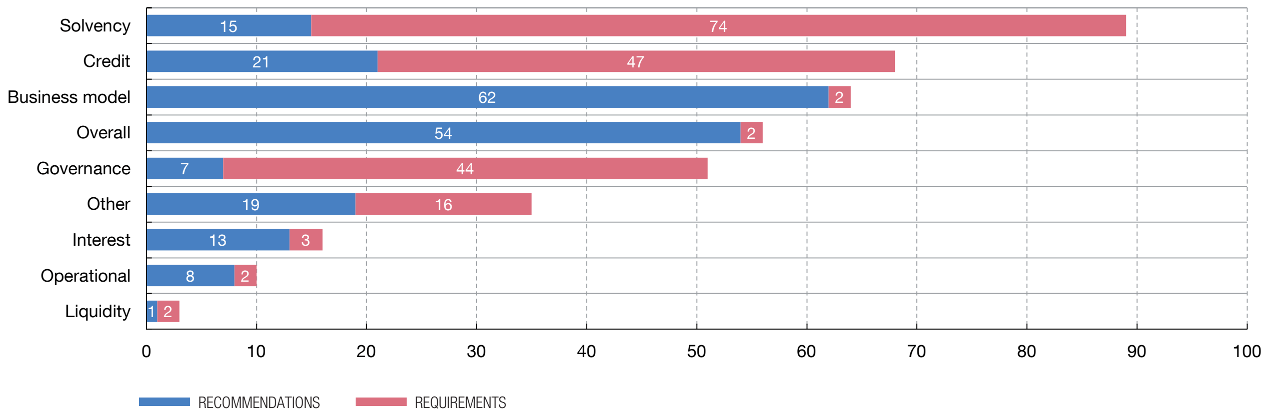
2 BY SUBJECT MATTER (2018)



SOURCE: Banco de España.

NUMBER OF RECOMMENDATIONS AND REQUIREMENTS NOTIFIED TO CREDIT INSTITUTIONS

CHART 2.5



SOURCE: Banco de España.

2.2.11 OTHER ACTIONS

The Banco de España's supervisory tasks include, for both significant and less significant institutions, the microprudential supervisory tasks not transferred to the SSM and the handling of certain procedures envisaged in the applicable legislation.

Noteworthy is the Banco de España's collaboration with:

— SEPBLAC, in the supervision and inspection of anti-money laundering obligations and in the adoption of the necessary measures, within the framework of the Supervision Agreement entered into with the Commission for the Prevention of Money Laundering and Terrorist Financing. In 2018 one of the three inspections undertaken in the fourth quarter of 2017 and the fieldwork of the other two were completed, while the participation in various international working groups on this subject continued, in collaboration with other directorates general.

— Other national supervisors such as the Directorate General of Insurance and the CNMV.

OTHER PROCEDURES CARRIED OUT BY THE BANCO DE ESPAÑA IN RESPECT OF OTHER INSTITUTIONS **TABLE 2.5**

Number of procedures 2018

	Payment institutions	Electronic money institutions	Special lending institutions	Mutual guarantee companies	Appraisal companies	Currency-exchange bureaux	Sareb	Banking foundations	**Total other institutions**
Qualifying holdings, merger, spin-off and other significant acquisitions	1		3		2				**6**
Cross-border activity of other Spanish institutions									**344**
Branches in the EU	22								**22**
Branches in third countries									**0**
Freedom to provide services	111	27							**138**
Agents	181	3							**184**
Cessation of business	1					1			**2**
Suitability of senior officers	75	18	82	49	13	10			**247**
Procedures relating to own funds		1							**1**
Amendments of articles of association	8		6	3					**17**
Authorisation of management protocol and financial plan								13	**13**
Communications with other supervisory authorities or institutions	1		1	1	1				**4**
Other procedures	1			1			1		**3**
TOTAL									**637**

SOURCE: Banco de España.

— The Ministry of Economy and Business.

— International organisations such as the International Monetary Fund (IMF) and the World Bank.

Regarding the latter point, in September and October 2018 the Banco de España cooperated with the IMF in the latter's analysis within the framework of the so-called Article IV of its Articles of Agreement and in the monitoring of the IMF's recommendations made as a result of its exhaustive in-depth assessment of the Spanish financial sector in 2017 within the framework of the Financial Sector Assessment Programme (FSAP).

2.3 Supervision of institutions other than credit institutions

The Banco de España has exclusive microprudential 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.

The legal basis under which the Banco de España supervises those institutions and the approach behind the tasks differ from case to case. However, the supervisory concern is always the same: to contribute to the proper functioning of those institutions, considering the role they play.

Although the weight 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

REGISTER OF OTHER INSTITUTIONS

TABLE 2.6

Year end data. Number (a)

	2014	2015	2016	2017	2018
Institutions with an establishment	198	190	190	182	182
Specialised lending institutions (b)	47	39	35	31	31
Mutual guarantee companies	24	21	21	19	18
Reguarantee companies	1	1	1	1	1
Appraisal companies	40	36	37	35	35
Foreign currency-exchange bureaux (c)	10	13	12	14	14
Payment institutions	45	43	41	39	40
Hybrid payment institutions	—	2	3	3	4
Branches of EU payment institutions	8	12	15	14	12
Agent networks of EU payment institutions	3	3	3	3	3
Electronic money institutions	4	3	4	5	5
Branches of EU electronic money institutions	2	2	2	2	4
Agent networks of EU electronic money institutions	0	0	1	1	1
Banking foundations	13	14	14	14	13
Sareb	1	1	1	1	1
Institutions operating without an establishment	318	401	484	556	597
Electronic money institutions	55	75	112	156	187
Payment institutions	263	326	372	400	410

SOURCE: Banco de España.

a The number of institutions also includes those that are non-operational and in the process of deregistering.
b Not including specialised lending institutions that have accredited their status as hybrids, in application of Law 5/2015 on the promotion of business financing (0 in 2014; 5 in 2015; 8 in 2016; 8 in 2017; 8 in 2018).
c Not including establishments only authorised to purchase foreign currency with payment in euro.

carried out 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.

Section 2.3 of the 2016 Report on Banking Supervision describes in detail the supervisory powers of the Banco de España over this type of institutions. Table 2.6 lists these institutions.

The following sub-sections of this chapter refer, firstly, to the supervisory activity carried out in 2018 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 ACTIONS

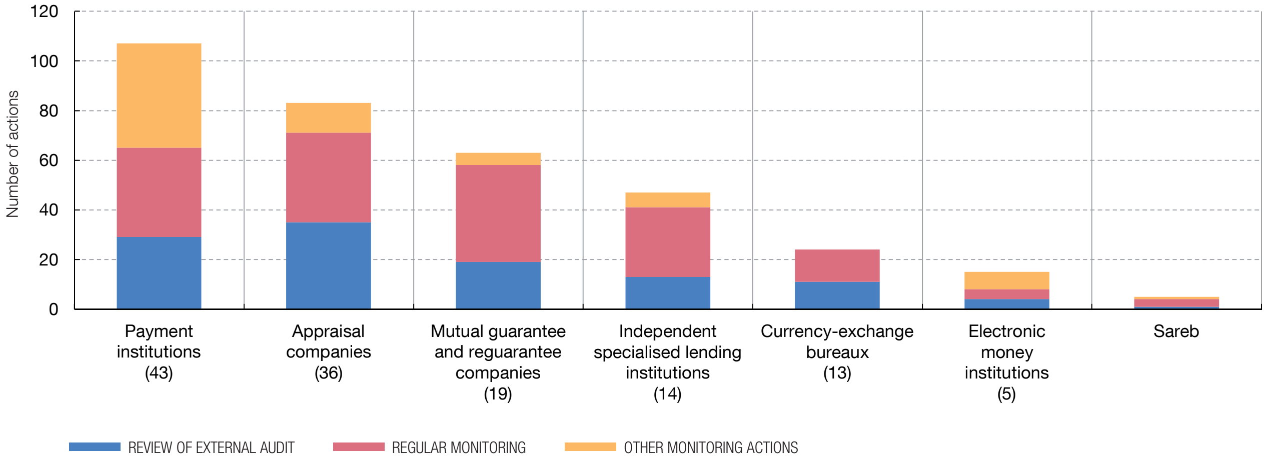
In 2018, 344 off-site monitoring actions were performed by various means: annual monitoring, periodic general monitoring, simplified monitoring, reviews of audit reports and reviews of internal capital adequacy assessment reports, as detailed in Chart 2.6.

Also, a total of two inspections were performed in 2018, one of a currency-exchange bureau and one of a payment institution.

Following the supervisory actions, 37 letters were sent to these institutions, addressed to the parties detailed in Chart 2.7. 31 of the letters relate to the outcome of monitoring actions and six to inspections. Chart 2.8 gives the number of recommendations and requirements sent to other institutions.

NUMBER OF SUPERVISORY ACTIONS AT OTHER INSTITUTIONS (a)

CHART 2.6



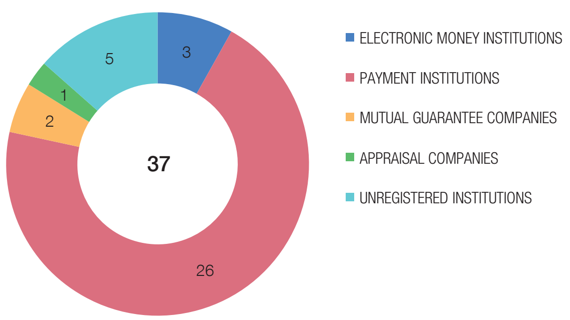
SOURCE: Banco de España.

a The number of institutions supervised in 2018 is shown under the caption for each column.

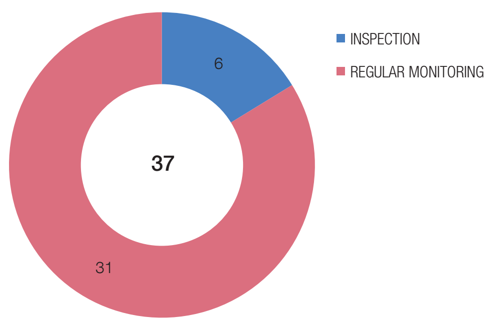
NUMBER OF LETTERS ADDRESSED TO OTHER INSITUTIONS

CHART 2.7

1 BY TYPE OF ENTITY (2018)



2 BY SUBJECT MATTER (2018)



SOURCE: Banco de España.

2.3.2 AUTHORISATIONS AND OTHER PROCEDURES

The Banco de España participates in the granting and withdrawal of start-up licences for these institutions and in other procedures relating to the exercise of their activities. However, the scope of its involvement is not the same for all types of institutions. The Banco de España is the competent authority for granting and withdrawing licences for electronic money institutions, payment institutions, currency exchange bureaux and for the official recognition of appraisal companies. However, it only has to issue a mandatory report on the authorisation of the following types of institutions, the granting of which is the prerogative of the Ministry of Economy and Business, taking also into account, where required by law, the report by the SEPBLAC:

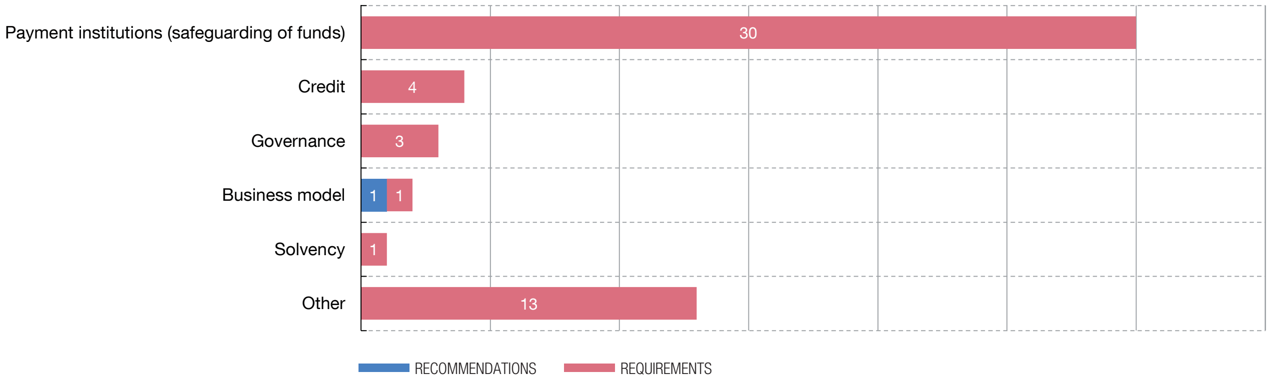
— Specialised lending institutions.

— Mutual guarantee companies.

— Reguarantee companies.

NUMBER OF RECOMMENDATIONS AND REQUIREMENTS ISSUED TO OTHER INSTITUTIONS

CHART 2.8



SOURCE: Banco de España.

CHANGE IN THE NUMBER OF NON-CREDIT INSTITUTIONS. 2018 VS. 2017

TABLE 2.7

	Value at 31/12/2017	Registrations	Deregistrations	Value at 31/12/2018	Change 2018-2017
Specialised lending institutions	31	0	0	31	0
Hybrid payment/specialised lending institutions	8	0	0	8	0
Mutual guarantee and reguarantee companies	20	0	1	19	-1
Appraisal companies	35	0	0	35	0
Currency-exchange bureaux	14	1	1	14	0
Payment institutions	39	4	3	40	1
Hybrid payment institutions	3	1	0	4	1
Electronic money institutions	5	0	0	5	0
Branches of EU payment institutions	14	0	2	12	-2
Branches of EU electronic money institutions	2	2	0	4	2
	171	**8**	**7**	**172**	**1**

SOURCE Banco de España.

In 2018, a total of 8 institution start-up requests and a total of 7 deletions from the register were processed, as shown in Table 2.7.

Similarly, in 2018, a further 637 procedures relating to supervisory powers over these institutions were performed, as detailed in Table 2.5.

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 be confused with them.

The year 2018 saw the initiation of supervisory actions relating to 9 natural or legal persons who might be carrying out restricted activities without authorisation, the outcome of which might lead to the adoption of penalties.