

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



1936. Alegoría de la Industria (reverse).

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Participating in international banking regulation and supervision fora is a strategic priority for the Banco de España. In an environment in which banks provide their services in multiple jurisdictions, the financial system's regulatory and supervisory standards are determined at these international and European fora. It is therefore of vital importance to preserve and enhance the bank's capacity to influence the debates that lead to the adoption of such policies.

### 6.1 Global fora

In 2018, the FSB continued to work on completing the reforms undertaken in response to the international financial crisis, while focusing on evaluating their effects and reviewing their consistent implementation. In parallel, it continued to monitor new risks for financial stability.

#### 6.1.1 FINANCIAL STABILITY BOARD (FSB)

**The FSB made progress in 2018 in the priority areas of the G-20 reform agenda still pending.** First, it published a discussion paper on the financial resources available to support central counterparty (CCP) resolution. It expects to issue a new consultation paper in 2020. Second, it issued a package of measures that firms and supervisors can use to help prevent misconduct by financial intermediaries. In the area of cybersecurity, it published a cyberlexicon to harmonise terminology in the financial sector.

**The FSB completed the first two projects of the new framework for evaluating the effects of the reforms.** First, it analysed the reforms on the incentives to centrally clear OTC derivatives, and concluded that this goal had been furthered, although some concerns were noted regarding access for some types of clients, as well as a higher concentration of clearing service providers. Among the factors that might be affecting client access, it identified the leverage ratio treatment of client-cleared derivatives under the Basel framework. In this respect, the Basel Committee undertook to study the possibility of reviewing this treatment (see section 6.1.2). Second, it evaluated the effects of the reforms on infrastructure finance, concluding that regulation is a secondary factor relative to the macrofinancial environment, government policy and institutional factors. In 2019, it will analyse the effects of the reforms on financing to SMEs and will start examining the effects of the reforms targeted at institutions which are "too big to fail".

**The monitoring conducted by the FSB on new risks included crypto-assets and non-bank financial intermediation.** The FSB concluded that crypto-assets do not, for the time being, pose a major risk for global financial stability. However, it pointed out that crypto-assets could entail risks for financial stability if they were to become more widely used. The FSB also referred to other potential implications of crypto-assets, for instance, in relation to consumer protection and the prevention of money-laundering and terrorist financing. In connection with non-bank financial intermediation, in February 2019, the FSB published its eighth annual monitoring report on non-bank financial intermediation.

#### 6.1.2 BASEL COMMITTEE ON BANKING SUPERVISION

**In 2018, the Committee continued to develop various regulatory measures,** such as the review of the market risk framework, which was endorsed in January 2019 by its oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS). This review aims to implement a series of specific changes with respect to the framework approved in 2016, including the introduction of a simplified framework for institutions with a small and

straightforward trading portfolio. Also noteworthy was the review of the methodology used for the identification and evaluation of global systemically important banks. The new framework, which will enter into force in 2021, maintains the same categories and weightings, but introduces changes regarding the indicators in each category.

**Other regulatory initiatives concluded in 2018** include the review of the third phase of Pillar 3, which establishes additional disclosure requirements relating to the finalisation of the Basel III reforms. In addition, the Committee completed the capital treatment of short-term securitisations qualifying as simple, transparent and comparable, complementing the criteria drawn up for their identification, and it defined guidelines and additional requirements for applying preferential prudential treatment.

**The Committee also focused on assessing the impact of the reforms, in line with the FSB.** First, it reviewed the impact on the leverage ratio treatment of the initial margin received by institutions for providing client-clearing services. As a result of this work, a document for consultation was published on the advisability of changing the current treatment.

**Another aspect of the leverage ratio that the Committee has been analysing are the possible adjustments that institutions might make at the end of each quarter to improve their leverage ratios (*window dressing*).** As a first step, the Committee issued a statement expressing its concern for such practices, recalling that they are not standard and indicating measures that supervisors can adopt to address them. Also, the Committee published a consultative document to gather feedback on the possible disclosure requirements for daily averages in the case of certain exposures, and on the possible undesired consequences of publicly disclosing the daily average of reserves at central banks.

**As part of the work towards promoting sound supervision,** the Committee published a document entitled *Stress testing principles*, which provides a list of principles defining best practices for stress testing by banks. A set of best practices relating to the possible impact on banks and supervisors of the new technologies applied in the financial sector (*fintech*) was also published.



Supervisory team working meeting. Sala Basílica.

The Committee continues to work on achieving full and consistent implementation of the reforms. In this respect, it began evaluating the implementation of the liquidity requirement known as the “net stable funding ratio” (NSFR) and the supervisory framework for measuring and controlling large exposures.

Accounting Experts  
Group (AEG)

The Banco de España is a member of and chairs the Basel Committee’s Accounting Experts Group. Consequently, it has played a very active role in the Group’s two areas of activity, namely accounting and auditing.

As regards accounting, the Banco de España has participated in monitoring the implementation of the new expected loss accounting framework and in developing general criteria for the classification of financial instruments into liabilities and equity.

With respect to auditing, the Banco de España has contributed to establishing a position on the draft audit standard which regulates the way in which auditors should identify and assess a potential risk of material misstatement, and to analysing the standard on how accounting estimates should be audited (including impairments and estimating the fair value of assets).

## 6.2 European fora

### 6.2.1 EUROPEAN BANKING AUTHORITY (EBA)

In 2018, the EBA continued to contribute to the Single Rulebook. It also participated in key tasks relating to the convergence of supervisory practices, *fintech* or the prevention of money laundering and terrorist financing. Also noteworthy was the resumption of work to assess the regulatory equivalence of third countries.

It should be mentioned that, in 2018, European institutions worked on the review of the European supervisory framework, which includes changes to the governing bodies, tasks, powers and financing of the three European supervisory authorities (ESAs). The EBA will be faced with major challenges in the coming years as a result of these changes.

Prudential regulation

In the field of prudential regulation, the EBA practically completed the regulatory process to review internal models, with the publication of technical standards on the specification of an economic downturn. In addition, the guidelines on the estimation of loss given default in a situation of economic downturn (downturn LGD) will be published in the coming months. As regards the standardised approach, guidelines have been drafted to specify which type of high-risk exposures should receive a risk weight of 150%. These guidelines do not address the speculative financing of immovable property, although the EBA did respond to a number of Q&As on this issue in 2018, pointing out that speculative immovable property financing should maintain a risk weight of 150% where future contract agreements signed are not irrevocable.

Another notable initiative in 2018, which will be finalised in 2019 Q1, are the guidelines on outsourcing.<sup>1</sup> These guidelines define outsourcing in line with MiFID II and specify the criteria to assess whether or not an outsourced activity, service or function can be classified as critical or important, as well as the criteria that apply to the governance framework, the outsourcing process and obligations vis-à-vis the supervisory authorities. They also consider the application of the principle of proportionality in the case of non-critical activities, services or functions, of intragroup or IPS outsourcing arrangements, or of outsourcing by payment and electronic money institutions.

<sup>1</sup> These guidelines, which will foreseeably enter into force on 30 September 2019, include, amend and repeal the recommendation on cloud computing (EBA/REC/2017/03) and the outsourcing guidelines of the Committee of European Banking Supervisors (CEBS) of 2006.



In addition, it has started preparing its response to the European Commission's call for advice on the implementation in Europe of the final Basel agreement of December 2017. Lastly, the EBA is working on the mandates it has been assigned in connection with securitisations and covered bonds.

The European Council's  
action plan for NPLs

**Also central to the work of the EBA in 2018 was the Council's action plan to reduce NPLs.** The EBA participated in several initiatives aimed at improving the supervision and transparency of NPLs, and promoting the development of secondary markets.

**In the area of supervision, guidelines were drafted on the management of non-performing and forborne exposures, and guidelines on loan origination, monitoring and internal governance are being prepared and will foreseeably be published in 2019 Q2.** The final version of the updated NPL templates with the periodic information to be submitted to the supervisor are also expected to be ready by 2019 Q2. As regards transparency, at the end of 2018 the EBA published guidelines on the disclosure by credit institutions of their non-performing and forborne exposures. In addition, with respect to secondary markets, the EBA updated the templates developed in 2017. All these measures should contribute to achieving a sustainable reduction of non-productive assets and to improve monitoring thereof.

**Lastly, the EBA responded to the Commission's call for advice on the impact of using a prudential backstop to counter a provisioning shortfall, based on standard parameters, in the case of new loans that turn non-performing.**

Customer protection  
and financial innovation

**In the area of supervision of institutions' market conduct and bank customer protection, the EBA has continued to work towards achieving greater convergence in the application of standards, to ensure their uniform implementation and supervision.** In this area, in addition to the ongoing work on defining a harmonised interpretation of the guidelines on governance processes and retail banking product oversight, work was notably carried out on the regulatory and implementing technical standards on payment accounts and on the guidelines on remuneration policies and practices related to the provision and sale of retail banking products and services.

**The year 2018 also saw the publication of the EBA's Financial Education Report 2017/2018.** This is the first report issued by the EBA to comply with the mandates conferred on it to review and coordinate financial literacy and education initiatives by the competent authorities. The report reviews the financial education initiatives undertaken by the national supervisory authorities (NSAs) in respect of the supervision of banking products and services in the 28 Member States, providing information about the work performed in this field and the lessons learned by the NSAs.

Payment services

**Following completion in 2018 Q1 of the regulatory mandates conferred under PSD2, the EBA largely focused its efforts on ensuring the correct interpretation and implementation of this directive and its implementing regulations, particularly as regards the regulations on strong customer authentication and secure communication.**

In addition, the EBA undertook the work required, inter alia, to: i) implement a centralised register of payment and electronic money institutions; ii) establish a secure and efficient mechanism to report serious operational or security incidents and iii) develop tools for calculating the amount of professional indemnity insurance to be taken out by payment initiation services or account information services.

Departure of the United Kingdom from the European Union (Brexit) and review of the European framework

The UK's departure from the EU will continue to be a major concern for the EBA in the coming months. In 2018, the EBA published two opinions urging the banking industry to be prepared in the event of the UK leaving the EU without an agreement. It has also been monitoring contingency plans and the possible relocation of institutions.

#### 6.2.2 EUROPEAN SYSTEMIC RISK BOARD (ESRB)

The Banco de España has participated (together with the Spanish National Securities Market Commission and the Directorate General of Insurance and Pension Funds) in the ESRB since it was created at the end of 2010. The ESRB is organised as a forum of working groups, with a General Board composed of central bank governors and the heads of EU financial supervision authorities. With the support of a secretariat located in the ECB, the ESRB's mission is the oversight of the EU financial system "in order to contribute to the prevention or mitigation of systemic risk to financial stability".

In 2018, the ESRB continued to monitor the macroprudential and financial situation of the EU and its Member States by means of specific thematic analyses. Specifically, the ESRB published a report on vulnerabilities in the EU commercial real estate market.<sup>2</sup> Based on various sources of available information (very limited in most countries), the ESRB analysed the importance of this market (encompassing real estate used for business purposes, such as office space and shops) and identified several countries (not including Spain), whose banks would be more exposed to this market. From a forward-looking perspective, the ESRB assessed the appropriateness of macroprudential tools to mitigate the risks associated with this sector.

In the area of banking, the Banco de España contributed to the work of the ESRB on non-performing loans. At the request of the EU Council, the ESRB drafted a report on macroprudential approaches to prevent the emergence of system-wide NPL problems.<sup>3</sup> The study considered a number of factors that trigger and amplify system-wide increases in NPL volumes on banks' balance sheets, bearing in mind that some of them, by their very nature, fall outside the scope of macroprudential policy. The ESRB suggests exploring the preventive use of sectoral capital buffers and limits on lending standards (introduced in a number of EU countries in recent years), and continuing to develop early warning mechanisms for signalling risks.

In 2018, the ESRB issued two recommendations on voluntary reciprocity for macroprudential measures adopted in other EU Member States. Specifically, the ESRB made it possible to broaden the scope of application of the measures adopted by the relevant authorities in Finland and Belgium, pursuant to Article 458 of Regulation (EU) No 575/2013, to address mortgage exposures secured by housing units in those countries by banks using advanced credit risk models. The Banco de España assessed both measures and, in line with the ESRB's recommendations, decided not to apply equivalent measures to Spanish banks operating in those countries.<sup>4</sup>

#### 6.3 Other fora

The Association of Supervisors of Banks of the Americas (ASBA) is a high-level forum in which the banking supervision authorities of 35 countries in the Americas are represented, together with the Banco de España, as the only non-regional associate. The Banco de España has been a collaborator since 1999 and an associate member since 2006. ASBA's mission is to contribute to the strengthening of banking regulation

<sup>2</sup> ESRB, *Report on vulnerabilities in the EU commercial real estate sector*, 26 November 2018.

<sup>3</sup> ESRB, *Report on macroprudential approaches to non-performing loans (NPLs)*, 28 January 2019.

<sup>4</sup> For more details, see the section on macroprudential policy measures on the Banco de España's website: <https://www.bde.es/bde/es/areas/estabilidad/politica-macrop/>.

and supervision, and to the stability of the region's financial system, actively sharing information and knowledge, promoting the adoption sound supervisory practices and international dialogue. The Banco de España participates actively in the ASBA's activities and provides ongoing support for its Continental Training Plan through seminars in the region and in Spain.

In 2018, the work programme of the ASBA continued to be focused on strengthening the exchange and cooperation relations and the technical and leadership capabilities of its member institutions, and on further implementing best practices and regulatory and supervisory policies. It also directed its efforts to areas such as technological innovation, proportionality or "de-risking", issuing helpful publications in this regard. The ASBA has published its first Financial Stability Report and continues to issue its survey on Banking Regulation and Supervision Expectations on the development of the financial market in the Americas.

#### FinCoNet

The Banco de España, through its Market Conduct and Claims Department, is a member of the Governing Council of the International Financial Consumer Protection Organisation (FinCoNet). FinCoNet was created in 2013 and is an international organisation of supervisory authorities which have responsibility for financial consumer protection.

Most recently, it has focused on the impact on consumers of the digitalisation of banking products and services and on best supervisory practices to mitigate the risks involved. Noteworthy in 2018 was the publication of the report *Practices and tools required to support risk-based supervision in the digital age* (see Box 6.1), and other publications on the digitalisation of payments and short-term lending. In addition, two new lines of work, relating to the advertising of financial products and services and product governance, were introduced in 2018.

#### Network for Greening the Financial System (NGFS)

In April 2018, the Banco de España joined the NGFS, which was established in December 2017 and comprises 18 central banks and supervisors across the globe. The Deputy Governor participates in the Plenary Meeting of the NGFS. The Network's purpose is to help shape the global response from the financial system as a whole to achieve the goals set out in the 2015 Paris agreement. This forum aims to: i) define and promote best practices in environment and climate risk management in the financial sector; ii) develop analytical work on "green finance"; and iii) to mobilise the necessary financing to support the transition toward a sustainable economy.

For this purpose, the NGFS has structured its work into three dedicated workstreams (in which the Banco de España is also represented), which will work on: supervision and microprudential issues; developing an analytical framework for assessing climate-related risk, focusing on the transmission channels of these risks to both the macroeconomy and the financial system as a whole; and analysing the current practices of central banks and supervisors to promote "green finance".

The first Plenary Meeting was held in October 2018, followed by the publication of the first progress report of the NGFS, which briefly describes the risks arising from climate change for the global economy and the financial system, and recognises the need to develop definitions, methodologies and tools for both financial institutions and supervisors to analyse and address these risks.



As part of its 2017/2018 work programme, the Governing Council of FinCoNet decided to create a new committee, chaired by the Market Conduct and Claims Department of the Banco de España, whose mandate was to prepare a report on the practices and tools required to support risk-based supervision in the digital age.

The committee's objective is to identify the supervisory tools used to address the challenges posed by the digitalisation of financial products and services, ensuring adequate consumer protection. To this end, it has based its work on the responses to a comprehensive questionnaire received from different authorities in the second half of 2017.

Following analysis of the information obtained, it published a report in November 2018 entitled *Practices and tools required to support risk-based supervision in the digital age*.

The report analyses the reaction of supervisors to the digitalisation phenomenon, and identifies the supervisory tools used by the different authorities in the digital environment, accompanied by case studies.

Lastly, the report examines two innovative initiatives, namely the “innovation hubs” and “sandboxes”, developed by some authorities.

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