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"There is no room for complacency"
Interview with Margarita Delgado, Deputy Governor of the Banco de España and Member of the Supervisory Board of the ECB

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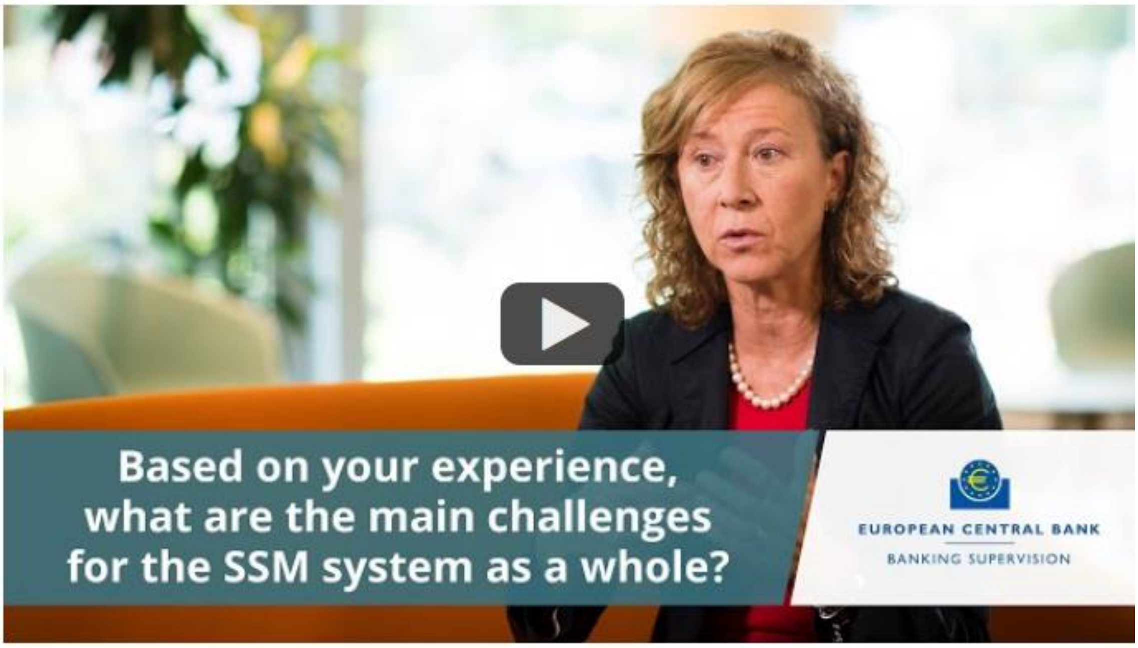
Margarita Delgado, Deputy Governor of the Banco de España and ECB Supervisory Board member, talks about her unique experience in European banking supervision, the progress made and challenges for European and Spanish banks, and fostering women's leadership.

You are the first Supervisory Board member who has worked in ECB Banking Supervision as well as in national supervision – now in the position of Deputy Governor of the Banco de España. How did this experience shape your perspective on banking supervision?

After many years as a supervisor at the Banco de España, I had the privilege of contributing to the start-up of European banking supervision under the Single Supervisory Mechanism (SSM). That was an exceptional experience because it is not that often that you can set up a new international authority from scratch: creating the structures, hiring the staff, establishing a common supervisory model to achieve the level playing field and beginning supervisory activities, all in roughly one year. Like the rest of the managers who joined this project, I tried to contribute with the best of my previous experience while maintaining a truly European perspective.

Initially, there were significant national specificities concerning banking systems and supervisory approaches. The challenge was to overcome unwarranted differences and contribute to the progress towards a single banking system by ensuring that the rules were applied consistently and creating a common supervisory culture, drawing on the best practices of national supervisors. The progress towards a common state-of-the-art supervisory approach has been enormous, and we're now close to a steady-state situation in this regard.



Back at the Banco de España, as Deputy Governor and member of the Supervisory Board I benefit greatly from my four-plus years of experience at the ECB. In that time, I've gained a very broad view of the European banking system. I've benefited from my first-hand knowledge of the common supervisory culture and approach and of the risk profile of many banks on which we adopt decisions in the Supervisory Board. And my experience at the ECB has shown me that national competent authorities are a key pillar of the SSM and that it is essential that we all work as one team, applying the same strategy. I am firmly committed to go on working in this direction.

Many supervisors from the Banco de España joined the ECB when the SSM was established in 2014. What do you think they brought to European Banking Supervision, especially given their experience from the banking crisis in Spain?

From the outset of the SSM, the Banco de España has encouraged its staff to play an active role in European banking supervision. Some of the best members of our staff decided to contribute directly to this European project by joining the ECB. I am convinced that their contribution has been very positive, as is the case for other national authorities that provided similar or even bigger staff contingents.

For example, supervisors from Banco de España brought their expertise in the area of credit risk, paying particular attention to the accuracy of asset classification, collateral valuations and provisioning levels in the credit portfolio. They contributed to introducing a quantitative approach to these issues in the supervisory toolbox of the SSM. Their contribution was also very valuable in several other areas including, for instance, the enhancement and homogenisation of internal models or the acquisition of knowledge about a number of international markets where Spanish banks have been operating for years.

So far, we've made huge progress. The SSM is no longer a sum of individual contributions, with substantial differences in supervisory approaches and experiences. Spanish supervisors work in Frankfurt and Madrid in Joint Supervisory Teams and on on-site inspections, internal model investigations, cross border missions and various horizontal tasks. In the last few years I've witnessed the learning process for staff and a progressive improvement in our supervisory practices. We’ve been able to develop a common methodology on the basis of the joint effort of the ECB and the NCAs.

What is the priority area in banking that needs to be tackled in Europe to achieve a sustainable and robust sector?

Credit institutions have made significant improvements in recent years, increasing their capital ratios and cleaning up their balance sheets. However, there is no room for complacency, as they are still operating in a demanding environment. Let me highlight some major challenges that are largely shared by EU banking systems.

First and foremost, profitability. The banking industry is like any other sector: it is only sustainable if it is profitable. Nowadays, the compression of margins, together with the low interest rate environment, has become the new paradigm of the banking business. In this context, the goal of profitability and sustainability appears to be particularly challenging.

A second key area for improvement is the transformation of business models. Digitalisation poses significant challenges for banks, but it also provides room for efficiency gains and for exploiting new business opportunities. Banks should also continue their efforts to improve their governance and risk control frameworks. In particular, they should strengthen their data aggregation capabilities, which are essential to identify and manage risks at the group level and across business lines and subsidiaries.

Finally, even though institutions have made a huge effort to deal with the legacy of the crisis, the current aggregate level of non-performing loans (NPLs) remains above pre-crisis levels. Current NPLs are largely the result of weak lending standards and poor risk management functions, so we must ensure that today’s decisions consider all risks, including non-financial ones, and are sound enough to prevent excessive risk-taking and high NPL levels in the future.

Do you see a need for further consolidation in the Spanish banking sector? What other measures do you envisage to strengthen weaker banks?

As a result of the financial crisis, the Spanish banking system has undergone a very significant restructuring and consolidation process. Former savings banks were transformed into commercial banks and the number of credit institutions declined markedly, following a number of mergers. Banks have also made substantial cost-reduction efforts that involved cuts in the number of employees and branches. For domestic business, the number of branches has declined by 46% with respect to the June 2008 peak.

In any event, our role as supervisors in evaluating merger proposals should be to analyse whether there is a business case for the merger and whether the project generates profits and involves tangible synergies. We need to assess the viability and solvency of the resulting institutions.

Some Spanish banks have been relatively successful in reducing their NPLs. Are there any lessons to be learnt from the way they have carried this out?

As in other jurisdictions, Spanish institutions have striven to reduce the high level of NPLs, which soared during the last crisis. NPLs decreased from €135 billion in December 2016 to €89 billion in December 2018 and in the same period we saw a reduction in foreclosed assets from €76 billion to €41 billion. As a result, the average NPL ratio of Spanish banks is now well below 4%.

In my view, the supervisory approach has greatly contributed to the positive developments we have seen with respect to NPLs. The requirement for banks with high NPL levels to prepare ambitious strategies, together with the setting of clear supervisory expectations, has encouraged banks to take decisive action to reduce those levels. Since the creation of the SSM, the need to deal with this problem has been clear to me and I have fully supported the Chair of the Supervisory Board in this regard.

That said, the work is not finished. Spanish banks have been very active in disposing of impaired portfolios and foreclosed real estate assets and have benefited from investors' appetite for them. Nevertheless, I continue to encourage institutions to go on monitoring and managing their legacy assets. NPLs remain above pre-crisis levels and banks should keep up their current momentum in reducing them.

Some Spanish banks seem quite ahead of the curve in terms of digitalisation. Is this mainly about efficiency gains, or is it more fundamentally the realisation by Spanish banks that they need to change their business models?

Efficiency, although important, is not the only driver. The need to address digitalisation, which some Spanish banks indeed identified at an early stage, arises from the assessment that the application of new technologies involves significant challenges in terms of banks' business models. It could have a disruptive impact on the banking industry in the coming years. The arrival of new competitors, such as fintech firms, means that banks need to adopt a proactive stance in this area.

In their strategic planning, banks should ensure they are prepared to align their products and services with the needs of society. Some bank customers would like to interact with the banking sector in different ways – for instance, they would like their bank to be more involved in their economic decisions – and banks should be prepared to meet these demands.

Digitalisation and technological innovation in financial services offer new opportunities in terms of efficiency, new business lines and new ways to access customers. However, they also entail new risks that must be understood, managed and controlled. Our mission is to be prepared to identify those risks and to take measures when necessary. Not just today's risks; we also need to be aware of potential risks that may arise in the future.

Six out of ten board members at the Banco de España are women. What do you do to ensure gender diversity at the level of senior management – and indeed at all levels?

Banco de España has made significant progress towards improved gender diversity in the last few years, and we're very proud of that. Our institution supports a diverse and inclusive work environment, particularly with regard to the proportion of women in managerial positions. Let me give you some figures to illustrate that. At the end of 2018, 49.9% of our overall workforce were women, up from 47.1% five years ago. At the management level figures have also increased significantly. Women currently hold almost 30% of director general positions (there were none in 2015), and roughly 35% of department heads and 40% of division heads are female, compared with 20% and 31% respectively in 2015.

Providing opportunities to ensure a balanced representation at the middle management level is essential if we are to build a sound basis to enable women to reach more senior management positions in the future. We're exploring initiatives in the field of coaching, mentoring and leadership development programmes to identify women's talents and encourage them to apply for management positions. Of course, all the existing work-life balance initiatives, such as teleworking, are also important.

Other efforts have been made to raise awareness and foster women's leadership. The two editions of Fostering Women's Leadership with Bank Al-Maghrib, the national bank of Morocco, are an example. This initiative, which focuses on raising awareness, discussing corrective measures and sharing best practices to drive gender balance, will be extended to other central banks in North Africa and Latin America.

In sum, ensuring diversity, and gender balance in particular, should be a top priority for both private firms and public institutions. The progression of women in their careers, making the best use of their potential, helps to expand the set of skills and talent among all employees. Moreover, progress towards diversity in decision-making positions can bring innovation in strategic thinking and enrich leadership.