

1 EXERCISE OF SUPERVISORY FUNCTIONS

1 EXERCISE OF SUPERVISORY FUNCTIONS

This chapter is structured as follows. Section 1 describes the supervisory activity during 2013, indicating the supervised institutions, the main supervisory actions in the year and the details of the requirements and recommendations letters sent to institutions as a result of such actions. Section 2 summarises the main actions in the exercise of sanctioning powers. Section 3 refers to the exercise of other powers of the Banco de España which supplement its supervisory responsibilities. Section 4 on supervisory policies addresses the criteria and recommendations on refinancing, transparency rules and the suitability of directors of credit institutions. Lastly, the legal and organisational framework of the new European Single Supervisory Mechanism is described.

1.1 Supervisory activity

At end-2013, the institutions subject to prudential supervision by the Banco de España numbered 423, of which 292 were credit institutions. 16 of these credit institutions were savings banks pursuing their activity indirectly in accordance with the provisions of Article 5 of Royal Decree-Law 11/2010.

The ultimate aim of the Banco de España's ongoing supervisory process is to determine and keep up-to-date the supervisory risk profile of each institution and to take the necessary measures to help improve it, including, where appropriate, the adoption of corrective measures.

A total of 452 supervisory actions were carried out in 2013, compared with 306 in 2012. Of them, 96 were in progress or outstanding as at 31 December. These supervisory actions can be divided into traditional on-site inspection of institutions and continuous monitoring, in many cases with a permanent presence at the institution.

To these should be added another 753 actions relating to CIs, including: verification of accounting policies on loan forbearance in accordance with the criteria sent to institutions on 30 April 2013; periodic general monitoring; review of credit institution audit reports; yearly review of internal capital adequacy assessment reports; liquidity monitoring; analysis of contributions to the determination of Euribor; and assessment, in close cooperation with European Banking Authority, of the capital plans of the main institutions, in accordance with the European Banking Authority's recommendations on capital preservation.

The requirements made of institutions following supervisory actions numbered 134, contained in 47 letters. The main recommendations and requirements related to credit risk and internal management and control policies, which accounted for 67% of the total.

In January 2014 Spain's final compliance was verified with the conditions set in the Memorandum of Understanding on Financial-Sector Policy Conditionality (MoU) approved by the Eurogroup on 20 July 2012, which since then and throughout 2013 has been the driving force of bank restructuring and recapitalisation.

The Memorandum included specific horizontal conditionality which entailed a comprehensive revision of the regulatory and supervisory frameworks of the Spanish banking sector. The practical exercise of the supervisory function was affected by this revision because at end-September 2013 the Executive Commission of the Banco de España approved a new internal circular on procedures applicable to the Directorate General Banking Supervision.

Number

	On-site supervisory actions							
	Completed				Under way			
	2010	2011	2012	2013	2010	2011	2012	2013
Credit institutions	136	133	216	349	39	68	82	94
Banks	79	110	180	225	28	53	70	55
Savings banks	51	12	4	80	5	1	5	36
Credit cooperatives	2	10	28	19	6	13	6	2
Foreign branches	2	—	2	—	—	—	—	—
EU credit institutions	1	—	2	—	—	—	—	—
Specialised credit institutions	2	1	2	25	—	1	1	1
Other institutions	4	5	4	7	0	3	4	2
Appraisal companies	1	3	—	2	—	—	1	—
Mutual guarantee companies	—	—	2	1	—	2	1	—
Payment institutions and other	3	2	2	4	—	1	2	2
TOTAL	140	138	220	356	39	71	86	96

SOURCE: Banco de España.

Among other things, these procedures require a regular report on on-site and off-site continuous monitoring, expedite notification to institutions of the conclusions drawn from on-site work, detail the procedure for verifying compliance with requirements letters, simplify tasks and improve allocation of resources.

The aforementioned processes relating to the MoU were carried out in close coordination by the Spanish authorities (Ministry of Economic Affairs and Competitiveness, Fund for the Orderly Restructuring of the Banking Sector and Banco de España), the European authorities (European Commission, European Central Bank and European Banking Authority) and the relevant international authority (International Monetary Fund).

2013 also saw rapid progress in the definition and preparation of the Single Supervisory Mechanism (SSM), which will substantially change the current framework of supervisory responsibilities and procedures in the euro area (see Section 1.5).

The number of Spanish credit institutions authorised to use internal ratings based (IRB) approaches to calculate regulatory capital requirements for credit risk was unchanged in 2013, as was the number of institutions with internal models for calculating capital requirements for operational risk.

As regards international cooperation with other supervisory authorities, the Banco de España organised meetings for three supervisory colleges as the supervisory authority of the parent institution and participated as the host supervisory authority in seven colleges of banking groups with foreign parents. All this was accompanied by the usual bilateral contacts with the supervisory authorities of other countries.

Furthermore, within the Financial Stability Board (FSB) framework for the resolution of systematically important financial institutions (G-SIFIs), the Banco de España, as authority responsible for the consolidated group, heads together with the FROB the two Crisis Management Groups (CMGs) set up for the two Spanish G-SIFIs. In 2013 the respective meet-

SUPERVISORY ACTIVITY. LETTERS SENT TO INSTITUTIONS

TABLE 1.2

Number	2010	2011	2012	2013
Credit institutions	38	19	37	41
Banks	16	10	14	26
Savings banks	14	—	5	2
Credit cooperatives	4	8	13	12
Foreign branches	2	—	5	—
EU credit institutions	1	—	2	—
Non-EU credit institutions	1	—	3	—
Specialised credit institutions	2	1	—	1
Other institutions	4	1	4	6
Appraisal companies	1	—	—	—
Mutual guarantee companies	—	1	2	—
Payment institutions and other	3	—	2	6
TOTAL	42	20	41	47

SOURCE: Banco de España.

SUBJECT MATTER OF LETTERS SENT TO SUPERVISED INSTITUTIONS

TABLE 1.3

Number	2010	2011	2012	2013
Credit risk	108	31	54	62
Accounting for credit risk, borrower weakness and higher coverage requirements	79	14	27	31
Quality of credit risk controls (origination, monitoring and other procedures)	29	17	27	31
Management and internal control	36	21	27	28
Management and internal control in general	25	16	22	24
Capital market activities	11	5	5	4
Capital and solvency	8	5	7	12
Solvency ratio	8	5	7	12
Other regulations	0	0	0	32
TOTAL (a)	152	57	88	134

SOURCE: Banco de España.

a Includes requirements on transparency and customer relations, compensation of directors, the prevention of money laundering and the mortgage market, among other aspects.

ings and various teleconferences were held. It also participated as host authority in a meeting of the CMG of foreign G-SIFIs with a subsidiary operating in Spain.

In 2013 a new bilateral cooperation agreement was concluded with the supervisory authority of Turkey and an agreement was entered into with the Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias (Commission for the Prevention of Money Laundering and Monetary Offences).

In 2013 the supervisory services of the Banco de España continued cooperating in the last phase of the restructuring of the Spanish financial sector: the MoU group 2 institutions were recapitalised; their problem assets were transferred to Sareb and hybrid instrument burden-sharing exercises were conducted at all institutions so requiring. In December the FROB's holding in NCG Banco, SA, was sold by a competitive process.

On 14 January 2014, as a result of an inspection carried out in December 2013, the Banco de España Executive Commission replaced the board of directors of Caja Rural de Mota del Cuervo by a provisional administrator from the FROB and authorised its award to Globalcaja within the framework of its resolution, as proposed by the FROB. This was the only bank which required the adoption of precautionary or resolution measures.

Also, the Banco de España recommended that banks limit dividend payments in 2013 and that, in any event, cash dividend pay-outs should not exceed 25% of attributable consolidated profit. This recommendation, which was observed by all banks and contributes to boosting their solvency, has been extended to 2014.

1.2 Exercise of the sanctioning power in 2013

The sanctioning power exercised over the financial institutions whose control and inspection are the responsibility of the Banco de España is the final step in its supervisory activity. It is intended as a means of ensuring compliance with the organisational and disciplinary regulations applicable to institutions operating in the financial sector. And indeed, as established in the preamble to Law 26/1988 of 29 July 1988 on discipline and intervention of credit institutions, the effectiveness of these organisational and disciplinary regulations depends on whether the supervisory authorities of financial institutions have sufficient coercive powers.

The exercise of this sanctioning power is directed at all individuals, institutions and markets subject to supervision by the Banco de España, which include not only credit institutions and any other financial institutions subject to its control and inspection, but also their directors and managers, who can be sanctioned for very serious or serious infringements when these are attributable to wilful misconduct or negligence. Also, sanctions can be imposed on the owners of qualifying holdings in Spanish credit institutions and on Spanish nationals that control a credit institution of another EU Member State.

Finally, the Banco de España's sanctioning powers extend also to persons and entities, not included among the aforementioned supervised parties, that seek to enter the financial market without meeting the conditions of access, whether it be through the exercise of activities legally restricted to credit institutions, payment services providers or other types of supervised institutions, or through the use of generic names restricted to such institutions or any other name that may be confused with them.

In this regard, the Banco de España has competence to bring and conduct disciplinary proceedings against the aforementioned parties. With the amendment to Article 18 of Law 26/1988 of 29 July 1988 on discipline and intervention of credit institutions introduced by Law 9/2012 of 14 November 2012 on restructuring and resolution of credit institutions the Banco de España has, since 1 January 2013 had the competence to impose sanctions for all types of offences, whether minor, serious or very serious. Prior to this amendment, the imposition of sanctions for very serious offences was the competence of the Minister of Economic Affairs and Competitiveness, upon the proposal of the Banco de España, except for withdrawal of authorisation to operate as a credit institution, which had to be imposed by the Council of Ministers. Since 1 January 2013 the competence to sanction supervised institutions has been placed exclusively in the hands of the Banco de España.

1.2.1 PROCEEDINGS INITIATED IN 2013

In 2013 the governing bodies of the Banco de España decided to initiate six disciplinary proceedings against six institutions and their respective directors and managers, as detailed below.

Number	Institutions	2010	2011	2012	2013
Banks		—	—	—	1 (c)
Savings banks		1	—	1	—
Specialised credit institutions		—	—	—	—
Branches of EU foreign credit institutions		—	—	—	—
Payment institutions		—	—	2	3
Unauthorised payment institutions		—	—	1	1
Owners of significant holdings in credit institutions		1	1 (a)	1 (b)	—
Appraisal companies		—	—	—	—
Currency-exchange bureaux and money transfer agencies		1	—	1 (b)	—
Use of names or pursuit of activities reserved for credit institutions		1	1	—	—
Unauthorised currency-exchange bureaux		3	—	—	—
Appraisal company revocations		—	—	—	—
Currency-exchange bureaux revocations		2	2	—	—
Non-compliance with ECB minimum reserve requirements		1	1	—	1
Electronic money institutions		—	—	—	1
TOTAL		10	5	6	7

SOURCE: Banco de España.

- a Extension to two parties of a proceeding initiated in 2010.
b Proceedings recommenced following a stay to avoid prejudicing criminal proceedings.
c Stayed by an agreement of the Governing Council of the Banco de España of 24 May 2013.

First, the Executive Commission decided to initiate proceedings against a credit institution (a bank) and the members of its board of directors and general managers (a total of 20 persons) for alleged breaches of sectorial rules relating to: submission to the Banco de España of an action plan designed to alleviate the economic and financial weaknesses of the institution which threatened its viability; minimum capital requirements; and the internal control and risk management mechanisms of the institution. In accordance with the provisions of Article 21 of Law 26/1988 of 29 July 1988 on discipline and intervention of credit institutions, it was decided to initiate a single disciplinary proceeding against the credit institution and its directors and managers. In accordance with Article 2 of Law 26/1988, this proceeding had to be stayed in May 2013, so as not to prejudice criminal proceedings.

Second, the Executive Commission decided to commence three proceedings against three payment institutions, for alleged breach of the rules regulating their activity, especially those contained in Law 16/2009 of 13 November 2009 on payment services and in Royal Decree 712/2010 of 28 May 2010 on the legal regime for payment services and payment institutions. The three proceedings were also brought against the sole directors of each of these institutions.

It was also decided to commence a proceeding against an institution and its sole director, which had been carrying out activities restricted to payment institutions, without having the required authorisation or being on the official register of such institutions kept by the Banco de España.

PROCEEDINGS RESOLVED, BY TYPE OF INFRINGEMENT

TABLE 1.5

Number

Numbers of proceedings		Sanctioning procedures								Non-sanctioning proceedings	
		Against supervised institutions				Intruders			ECB	Revocation	
		Infringement			Proceeding dismissed	Name / Activity reserved for credit institutions	Unauthorised currency exchange bureaux	Unauthorised payment institutions	Minimum reserve requirements	Appraisal companies	Currency exchange bureaux
		Very serious	Serious	Minor							
Against institutions											
2010	9	4	6	2	—	3	1	—	1	—	1
2011	9	4	3	4	—	1	2	—	1	—	2
2012	1	—	1	—	—	—	—	—	—	—	—
2013	5	5	5	—	1	—	—	2	1	—	—
Against particular directors of institutions or owners of qualifying holdings											
2010	25	38	28	—	11	—	—	—	—	—	—
2011	52	66	28	—	—	—	—	—	—	—	—
2012	1	—	1	—	—	—	—	—	—	—	—
2013	7	9	4	—	4	—	—	—	—	—	—

SOURCE: Banco de España.

Finally, it was also resolved to commence a sanctioning proceeding against an electronic money institution and the members of its board of directors (a total of 7 persons) for alleged breaches of the rules regulating such activity, basically to be found in Law 21/2011 of 26 July 2011 on electronic money and Royal Decree 778/2012 of 4 May 2012 on the legal regime for electronic money institutions.

In addition it should be noted that, under Article 19 of the Statute of the European System of Central Banks, the Governing Council of the European Central Bank is authorised to require credit institutions to maintain a certain minimum level of reserves. In the event of failure to comply with this requirement, sanctions may be imposed through a procedure for which the Banco de España is responsible. In this context, as seen in Table 1.4, a procedure of this nature is included.

1.2.2 PROCEEDINGS RESOLVED IN 2013

In 2013, five proceedings were concluded by decisions to impose sanctions. Four of these proceedings had been initiated in previous years and one in 2013 itself.

These decisions imposed sanctions on:

- A currency-exchange bureau and the members of its board of directors for two very serious infringements. Notable were the sanctions of withdrawal of authorisation from the institution, and of disqualification from serving as a director or manager in any currency-exchange bureau, imposed on the members of its board of directors.
- Two payment institutions and their respective sole directors for serious and very serious infringements. Notable were the sanctions of disqualification from serving as a director or manager in any payment or financial institution imposed on the sole director of one of the institutions concerned.

- Two companies that carried out activities legally restricted to payment institutions, without the required authorisation and without being on the relevant registers, were fined.
- Two institutions and one individual were fined for breach of the rules on qualifying holdings in credit institutions.

1.3 Other supervisory activities of the Banco de España

1.3.1 TRANSPARENCY AND PROTECTION OF BANK CUSTOMERS

Financial transparency legislation is, without prejudice to the freedom of contract, generally aimed at counteracting the information asymmetries between two parties in the financial services markets. These asymmetries, together with the opposition of interests, may cause malfunctions in these markets, putting users at an informational disadvantage and making it necessary to provide them with additional protection to safeguard their economic interests.

The current general regulatory landscape is currently set out in Order EHA/2899/2011 of 28 October 2011 on transparency and protection of customers of banking services (which came into force on a general basis on 29 April 2012) – and in the related implementing Circular 5/2012 of 27 June 2012, addressed to credit institutions and payment service providers, on the transparency of banking services and responsibility in the extension of loans (which came into force on a general basis on 6 October 2012). The Order and the Circular together constitute a new comprehensive transparency code designed to protect banking service customers.

The previous Spanish general transparency legislation had been rendered obsolete by progress in sectoral regulation (in areas such as consumer credit, payment services or advertising) and the extensive transformation experienced in the marketing of banking services.

The new legal framework, designed on the basis of the experience gained during the period the previous legislation was in force, represents a new approach to and a major advance in banking transparency intended, among other things, to provide solutions to some of the problems and shortfalls noted in the last few years. Thus the information that has to be provided before contracts are entered into has been clearly improved so that customers can properly understand products and their characteristics, compare different offers and rationally decide which best suits their needs, preferences and financial situation.

In the area of internal organisation, the new Market Conduct and Claims Department was created as part of the Bank's strategy to ensure accurate information is available to financial service users, promote good practices in the market, offer effective conflict-resolution arrangements and foster financial education. Experience has shown that the Bank's competences in relation to market conduct, reporting transparency, good practices, consumer information, financial education, conflict resolution and other similar matters are closely interrelated. Therefore it has been considered advisable to bring them under a single roof so as to efficiently address the current major social impact of financial institutions' relations with their customers.

Within this remit, the Market Conduct and Claims Department resolved queries in 2013 made mainly by institutions and professional associations on the interpretation and application of Circular 5/2012.

Another area of competence relating to transparency is the verification of *internal rules of institutions' customer service departments and customer ombudsmen*, except for those of local or regional savings banks and credit cooperatives, the verification of which (sometimes following non-binding consultation of the Banco de España by the competent body) is carried out by the competent agency of the autonomous region in which the relevant institution's registered office is located. In all cases the institutions communicate the designations of the persons responsible for their customer services and ombudsmen departments, and allow the ongoing updating of the registers kept for the use of the public, where their names, contact data and verified rules governing activities are recorded. However, the main task consisted in verifying the rules of some of the institutions originating from the former savings banks, of new institutions (mainly payment institutions), of mergers between credit cooperatives and of amendments to existing internal rules, mostly to update them in line with the applicable legislation. In addition to this, statistical information sent voluntarily by the respective institutions' customer service departments and ombudsmen on a half-yearly basis is used to assess their work and thus their level of operability and effectiveness.

Another noteworthy task is that of *the monitoring and control of institutions' advertising*. Control work focussed on the review of advertising in the press and of that placed by institutions on their websites. When anomalies or inaccuracies are detected, the institution in question is required to withdraw or correct the offending advertising message or supplementary information is requested to investigate whether the advertising complies with sectoral regulations.

1.3.2 INFORMATION FOR BANK CUSTOMERS

In accordance with the legislation in force – Order EHA/2899/2011 of 28 October 2011 on transparency and protection of customers of banking services – institutions must, as from January 2013, make available to customers a document (updated quarterly) setting out the *interest rates and fees and commissions* usually charged for the services most frequently provided by them. This obligation to inform is in addition to another one to inform customers, among other things, of the cost of the service to be provided before the contract for its provision is executed.

As a result of this mandate, the Banco de España receives said information quarterly from the institutions and publishes it on its website and, at the same time, the information is available in all the offices and on the website of each institution. Customers should not confuse this information with the old brochures on fee and commission charges which, under the legislation that has been repealed, were submitted by institutions to the supervisor for prior verification.

Another very important task, within the information provided to bank customers, is resolving *enquiries* made by the public to the Banco de España. The number of enquiries received in 2013 increased to 3,584 internet enquiries and 43,246 telephone enquiries, up 129.48% and 162.79%, respectively, from 2012.

A different matter in its own right, given its significance within information for banking customers, is the *banking customer portal*, which was created in 2005 and is accessed from the Banco de España website. The portal's main function is to guide customers and to provide those who are interested with basic training so that they can become familiar with how this sector works. Furthermore, the banking customer portal handled 3,524 requests for information from the public in the first six months of 2013.

The number of visitors to the portal is striking, given that in 2013 there were 3,854,960 viewings of the portal, compared with 3,049,879 in 2012, representing an increase of 26.4%. Also noteworthy is the increase of 33.7% in the number of visitors, up from 736,617 in 2012 to 984,835 in 2013, almost 250,000 more. The “Bank products” section received most visits, followed by “Simulators” and “Interest rates”.

1.3.3 OFFICIAL REGISTERS AND INSTITUTIONAL INFORMATION

Under Spanish law the Banco de España is responsible for keeping various public registers. Not only credit institutions and other financial intermediaries and auxiliaries subject to supervision must be recorded in these registers, for various purposes, but also certain elements of their corporate governance and organisational structure. These registers are as follows:

a. Register of Institutions

Diverse institutions operating on Spain’s financial markets must be recorded in the Register of Institutions before they commence activities. The purpose of this Register is twofold: first, it seeks to implement the “vetted access” principle governing the presence of those institutions in the market; and second, it aims to publicise adequately the fact that those institutions are subject to supervision by the Banco de España or by the competent authority in their respective home countries¹.

Table 1.6 shows the number of institutions included in this Register,² both Spanish and foreign, including those operating in Spain under the freedom to provide services.

Most notable in 2013 was the continuation of the downward trend initiated in 2012 in the number of registered credit institutions, which stood at 292 (20 fewer than in 2012) by the end of the year. The percentage declines in the various categories of credit institutions were very similar to those of the previous year (see Table A.2.1).

All of the decrease in the number of banks in the year was due to mergers in their respective groups, as follows: (i) Banco Español de Crédito, SA, and Banco Banif, SA (merged into Banco Santander, SA), (ii) Banco de Valencia, SA (merged into Caixa Bank, SA), (iii) Bankia Banca Privada, SA (merged into Bankia, SA), and (iv) Unnim Bank, SA (merged into Banco Bilbao Vizcaya Argentaria, SA).

In 2013, nine of the savings banks engaging in credit activities indirectly through commercial banks were deregistered from the relevant register owing to their transformation into foundations.

The number of registered credit cooperatives fell by three as a consequence of the merger by acquisition of these institutions into the parent of the Cajas Rurales Unidas group.

Specialised credit institutions also saw a reduction in their number, this time by six, half of them due to mergers into other institutions.

Notably, in 2013 the number of institutions operating in Spain under the freedom to provide services without an establishment increased by 13.07% to stand at 813, basically due to a considerable rise in the number of payment institutions (45.39%) and of electronic

¹ This register and the register of agents described below are available to the public and can be consulted through the Banco de España’s website (by clicking on “Services” in the navigation menu). The register of institutions is available not only as it currently stands, but as it stood at past dates, and selective searches can be made using different criteria. Also, subscriptions can be taken out to RSS feeds which notify of changes in this register.

² For more details of the institutions that have to be entered in this register, see Section A.3.2 of the 2013 *Report on Banking Supervision in Spain*.

Number, Year-end data (a)

	2010	2011	2012	2013
Institutions with an establishment	538	534	508	476
Credit institutions (b)	339	336	312	292
Controlling companies of credit institutions	1	1	1	1
Representative offices	54	55	46	43
Mutual guarantee companies	24	24	24	24
Reguarantee companies	1	1	1	1
Appraisal companies	55	58	57	46
Currency-exchange bureaux and money transfer agencies (c)	61	14	10	9
Payment institutions	2	41	46	48
Branches of EU payment institutions	—	2	7	6
Agent networks of EU payment institutions	1	1	2	2
Electronic money institutions (d)	—	1	2	3
Branches of EU electronic money institutions	—	—	—	1
Institutions operating without establishment	556	640	719	813
EU CIs operating without an establishment	506	520	533	543
Non-EU CIs operating without an establishment	3	3	4	4
Financial subsidiaries of EU CIs	2	1	1	1
Electronic money institutions	—	14	29	44
Payment institutions (e)	45	105	152	221

SOURCE: Banco de España. Data available at 31 December 2013.

- a The number of institutions also includes those that are non-operational and in the process of deregistering.
- b Includes ICO and branches of EU and non-EU credit institutions. For the period 2009-2010 also includes one electronic money institution; in 2011, the promulgation of Law 21/2011, which amended the regulatory framework of ELMIs, meant that they lost their credit institution status.
- c Not including establishments only authorised to purchase foreign currency with payment in euro. From 2011, after the transformation of money transfer agencies into payment institutions, only includes currency-exchange bureaux (buying and selling of currencies).
- d In the period 2009-2010, the existence of an electronic money institution was registered under the "credit institutions" heading.
- e In application of Directive 2007/64/EC and of Law 16/2009 on payment services.

money institutions (51.72%). The nationality of the institutions operating without an establishment is as follows: (i) in credit institutions: United Kingdom: 101 institutions (18.46%), France: 81 (14.81%), Germany: 75 (13.71%), Luxembourg: 51 (9.32%) and the Netherlands: 43 (7.86%); (ii) in payment institutions: United Kingdom: 167 (75.57%); and (iii) in electronic money institutions: United Kingdom: 28 (63.64%).

As regards the other financial intermediaries and auxiliaries that need to be entered in this Register, the most noteworthy development was the decrease of 19.3% in the number of licensed appraisal companies as a result of the fall in real estate activity in recent years.

b. Register of Senior Officers

The reason for this register, in which information is entered on the directors and senior managers of the institutions supervised by the Banco de España, is to keep up-to-date information on the main officers responsible for the activity of such institutions. This is done with the dual purpose of, firstly, acting as an ancillary tool for the Banco de España and other agencies in checking the requirements that have to be accredited by the senior officers of financial institutions; and, secondly, providing a means of monitoring the restrictions and incompatibilities applicable to such officers whenever that verification has to be

carried out by the Banco de España. This monitoring was strengthened by Royal Decree 256/2013 of 12 April 2013, which writes into Spanish banking law the guidelines set by the European Banking Authority on 22 November 2012 for assessing the suitability of board members and of key function holders.

At the end of 2013, the number of senior officers in this register³ was 3,464, 13.31% fewer than in 2012. This reduction is in line with the smaller number of registered credit institutions.

c. Information on shareholder

The Banco de España also receives confidential information on the shareholders of banks and specialised credit institutions and on the members of credit cooperatives.⁴ This information is vital for the supervisory tasks of the Banco de España, in which it is essential to know the shareholder structure of the institutions under its supervision, and for checking compliance with the law on qualifying holdings, a task entrusted to the Banco de España.

In 2013, while at commercial banks the number of significant shareholders increased by 9%, the members of credit cooperatives and the shareholders of specialised credit institutions decreased by 5% and 23%, respectively.

The increase in significant shareholders at commercial banks interrupts the downward trend of previous years, although some of this increase is due to the measures contained in the restructuring plans of these institutions.

The downtrend of previous years in the number of members of credit cooperatives and shareholders of specialised credit institutions continued due to decline in the number of registered institutions.

d. Reporting of agents

Credit institutions operating in Spain are obliged to report to the Banco de España those agents whom they have authorised to operate habitually with their customers, in the name of and on behalf of the principal, in negotiating or entering into transactions typical of their activity.⁵ In addition, they must report to the Banco de España the list of foreign credit institutions with which they have entered into agency agreements or agreements to provide financial services to customers.

It has also been compulsory to enter in this Register, since 2010 and in accordance with the specific regulations thereon, the agents of Spanish payment institutions and their branches, and those of the branches of foreign payment institutions and those belonging

3 All the statistical information in this Register and the others reported in this section, other than that relating to the number of registered institutions, is included in Annex 3.1 of the digital edition published on the Banco de España's website. In that annex, the information relating to the Register of Senior Officers is based on the identity thereof, without regard to the number of posts that each of them may hold, i.e. the stated figure is the total number of senior officers registered and not the total number of posts in the institutions supervised by the Banco de España.

4 These institutions are required to report data quarterly on all their shareholders or holders of contributions that are deemed to be financial institutions, and on those who, while not deemed to be such, hold shares or contributions representing a percentage of the share capital of the institutions equal to or more than 0.25% in the case of commercial banks, 1% in credit cooperatives and 2.5% in SCIs.

5 From 2011, as a result of the entry into force of Banco de España Circular 4/2010 of 30 July 2010, CIs must also report those natural or legal persons whom they have appointed to perform regularly, on a professional basis and in the name of and on behalf of the institution, activities to promote and market transactions or services typical of the activity of a credit institution, including the investment and ancillary services referred to by Article 63 of the Securities Market Law.

to the agent networks of EU payment institutions, when they are located and provide their services in Spain.⁶

Notable in 2013 was the high number of agents reported by payment institutions, which stood at 31,218.

This large number, much higher than that of agents recorded for credit institutions, is explained by the business model followed by payment institutions, which carry on their activity basically through agents. Further, there is no requirement for the agents of payment institutions or of electronic money institutions providing payment services to be exclusive, which means that not infrequently the same agent is reported as working with more than one payment institution.

e. Special Register of Articles of Association

The Banco de España also keeps an up-to-date register of the articles of association of supervised institutions to ensure continuity in the exercise of prudential supervision in relation to such institutions and to monitor the changes in their articles of association, which are sometimes subject to administrative authorisation by the Ministry for Economic Affairs and Competitiveness or the corresponding body of the relevant regional government, following a report from the Banco de España.⁷

In 2013, the upward trend in the total number of analysed applications to amend articles of association continued, the growth rate of 42.6% standing well above that of the previous year (7.6%). A large number of the amendment applications were by commercial banks (42), as compared with those by specialised credit institutions (20), mutual guarantee companies (19), payment institutions (19) and appraisal companies (16). The amendments to commercial banks' articles of association were for many purposes, although notably 50% of them related to capital increases. Most of the amendments to appraisal companies' articles of association related to the process of deregistration mentioned in Section a) above.

Although the number of amendments recorded remained relatively high (219), it fell by 12.4%. This was related to the end of the initial stages of the process of transformation of savings banks.

1.3.4 OTHER AUTHORISED ELIGIBLE CAPITAL FOR SOLVENCY PURPOSES

The regulatory capital of credit institutions may include certain preference shares, mandatorily convertible debt instruments⁸ and subordinated debt instruments. The Banco de España verifies whether these financial instruments – issued by credit institutions themselves, by their special purpose vehicles or by other subsidiaries – are eligible as own funds in accordance with the law applicable,⁹ which requires them to have certain features specific to capital, such as an indefinite presence on the balance sheet of the institution, the capacity to absorb losses and flexibility insofar as payments to their holders are concerned.

⁶ In Table A.3.1 they are all included under the heading “Agency agreements – Payment institutions”.

⁷ All these powers have been transferred to the Banco de España pursuant to Law 9/2012 and its implementing regulations.

⁸ Mandatorily convertible debt instruments may be mandatorily convertible on a set date or when certain trigger events occur (contingent conversion), or else both together.

⁹ Law 13/1985 of 25 May 1985 on investment ratios, own funds and reporting requirements of financial intermediaries and implementing legislation; as well as Royal Decree-Law 2/2011 of 18 February 2011 on the strengthening of the Spanish financial system, as worded by Law 9/2012 of 14 November 2012 on credit institution restructuring and resolution, and implementing legislation, in relation to core capital.

2013 was a period of transition towards the new capital requirements rules that entered into force on 1 January 2014.¹⁰ Although the texts of the relevant Regulation and Directive were published in summer 2013, a number of uncertainties remained regarding the requirements that would apply to capital instruments in the new framework, which had already been hampering issuance in 2012. This uncertainty, along with the persistent difficulty accessing capital markets linked to the financial crisis, led to a notably low level of activity on the part of potential issuers both in Spain and the rest of Europe.

Against this background, the total amount subscribed in 2013 of the 17 issues of instruments whose eligibility as own funds was subject to verification by the Banco de España was €5,776 million. The number of issues was in line with the preceding three years, but far below the level of activity recorded in 2009 (75 issues, totalling €26,314 million), while the amount subscribed was even lower than in the preceding three years and substantially below the 2012 figure of €13,411 million.

Part of the issuance of eligible instruments by Spanish credit institutions in 2013 stemmed from the exchange of existing instruments that would probably cease to be eligible under the new regulatory framework. At the same time, other issues incorporated the requirements envisaged in the new rules to be fully eligible from January 2014.

Eight of the 17 issues made in 2013 were of instruments mandatorily convertible into shares on a set date that was in every case before 2019. These issues accounted for one third of the total issuance in 2013. All these issues, made by just three different institutions, were exchanged for previous issues of other eligible instruments, and six of them were included in the recapitalisation plans of such institutions. These instruments will be eligible as additional tier 1 capital from January 2014, under the new regulatory framework, and as common equity tier 1 capital when conversion takes place.

Within capital instruments the weight of convertible instruments has been increasing, in line with the regulatory tendency to give capital instruments loss absorption mechanisms. This tendency was first apparent in the amendments that Law 6/2011 and CBE 4/2011 introduced into the treatment of preference shares in Law 13/1985 and CBE 3/2008, and continued with the definition of instruments eligible as core capital, in accordance with Law 9/2012 and the detailed specification in CBE 7/2012.

These loss absorption mechanisms will be compulsory in the new regulatory framework applicable from 2014 for additional tier 1 capital instruments. Should a trigger event arise such loss absorption may take place either through conversion into shares or through a total or partial reduction in the nominal value of the instrument. Up until now, instruments issued in Spain have only had loss absorption mechanisms involving conversion into shares.

Thus, as in 2012, those instruments issued in 2013 in the form of preference shares (two issues, totalling €1,588 million) already incorporate loss absorption mechanisms (conversion) envisaged by the new Regulation. In addition, they have anticipated the re-

¹⁰ Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

Yearly data (€m)

	Number				Amount			
	2010	2011	2012	2013	2010	2011	2012	2013
Total	14	16	13	17	6,465	9,012	13,411	5,776
Subordinated debt	12	9	5	7	5,497	2,984	9,011	2,154
Standard fixed-term	11	9	4	7	5,477	2,984	4,511	2,154
Commercial banks and savings banks	10	9	4	5	5,475	2,984	4,511	2,129
Credit co-operatives	1	—	—	—	2	—	—	—
SCIs	—	—	—	2	—	—	—	25
<i>Of which: Loans</i>	<i>1</i>	<i>3</i>	<i>—</i>	<i>2</i>	<i>1</i>	<i>21</i>	<i>—</i>	<i>25</i>
Standard with no agreed maturity	—	—	—	—	—	—	—	—
Undated	1	—	1	—	20	—	4,500	—
Commercial banks and saving banks	—	—	1	—	—	—	4,500	—
SCIs	1	—	—	—	20	—	—	—
Preference shares	—	1	—	2	—	200	—	1,588
Commercial banks and saving banks	—	1	—	2	—	200	—	1,588
Mandatory convertible debt	2	6	8	8	968	5,828	4,400	2,034
Commercial banks and saving banks	2	6	8	8	968	5,828	4,400	2,034

SOURCE: Banco de España.

a Does not include issues subscribed by the FROB since, in accordance with Article 33.1.c of Law 9/2012 of 14 November 2012 on credit institution restructuring and resolution, when the FROB subscribes or acquires capital or convertible instruments, the limits established in law for eligibility as own funds and as core capital or, in general, the limits set from time to time relating to solvency requirements will not apply to it.

quirements that will be in force from January 2014, so that they will be eligible as additional tier 1 capital from that date. From this viewpoint, these instruments may also be considered “mandatorily convertible”, although, unlike the eight issues referred to above, they are not mandatorily convertible on a set date. Rather they are perpetual instruments that will be converted if certain trigger events, related to a deterioration of the solvency of the institution and, more specifically, to a fall in common equity tier 1 capital, should occur.

In line with recent years, there were only seven subordinated debt transactions in 2013, although the total amount issued was only €2,154 million. These seven transactions were made for various different reasons. As seen in Table 1.7, two of them correspond to subordinated loans, the amounts of which are very low, to a single specialised credit institution that replace other subordinated loans. Among the five other transactions there is another subordinated loan to the parent entity of the lender’s group.

The other four transactions are structured as subordinated debt. Of these, three were issued by operational subsidiaries of credit institutions in other countries, where they are subject to specific capital requirements, and in currencies other than the euro. One of these transactions accounts for 50% of the total subordinated debt issued during the year. It was carried out towards the end of 2013 and incorporates features that should enable it to meet the requirements to be eligible as tier 2 capital of the group from 2014, when the new European Regulation and Directive will apply. The other issue of subordinated debt, accounting for almost 35% of the total subordinated debt issued in the year, was aimed at

wholesale investors on the international market. Practically all of the subordinated debt instruments issued had a maturity of 10 years.

1.4 Supervisory policies

1.4.1 SUPERVISORY APPROACH TO REFINANCING AND RESTRUCTURING CRITERIA

Banco de España Circular (CBE) 6/2012 of 28 December 2012, which amends CBE 4/2004, requires institutions to disclose in their annual accounts specific information relating to refinancing and restructuring transactions (amounts; classification as standard, sub-standard or non-performing exposures; provisioning; and breakdown by loan purpose). Also, it introduces a precise definition of this type of transaction, which is already envisaged in CBE 4/2004 as a factor to consider in the assessment of possible loan impairment.

In accordance with CBE 6/2012, a refinancing transaction is defined as one that is granted for economic or legal reasons relating to (current or foreseeable) financial difficulties of the borrower to repay one or more transactions already granted, or under which the payments on such transactions are brought totally or partially up to date, in order to enable borrowers under repaid or refinanced transactions to pay their debt (principal and interest) because they are unable, or it is foreseeable that they will be unable, to comply in time and in form with its conditions.

A restructuring transaction is defined in a similar manner to a refinancing transaction but refers to the modification of the financial conditions of the transaction (partial acquittance, receipt of assets to reduce debt, lengthening of maturity, etc.) in order to facilitate payment of the debt. Circular 6/2012 distinguishes these refinancing and restructuring transactions from others, such as rolled-over or renegotiated transactions, in which the borrower is not expected to have financial difficulties in the future.

The data reported by the institutions pursuant to CBE 6/2012 presented, in the Banco de España's opinion, differences between institutions which might be driven by diverse business and management profiles but also by discrepancies in the accounting policies used. For this reason, the Banco de España decided to develop a set of criteria that institutions must take into account in preparing and approving their refinancing policies and in the accounting classification of the transactions affected. These criteria are not a new regulation on this subject but a reference which institutions must follow so as to comply with CBE 4/2004. The objective is to ensure consistent and uniform application of the rules throughout the banking industry so that reporting differences between institutions are only caused by different business and management models and not by divergent interpretations of the same accounting rules.

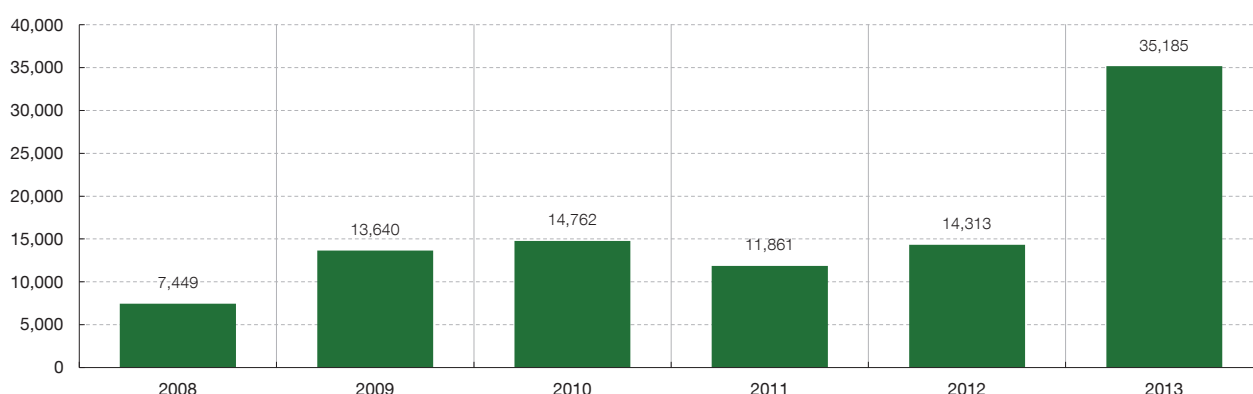
The criteria on refinancing and restructuring mainly envisage aspects such as determining the borrowers' ability to pay and the up-to-date valuation of the collateral provided and, furthermore, other factors such as the grace period of transactions. In accordance with the provisions of Annex IX of CBE 4/2004 and the above-mentioned criteria, transactions shall be classified as substandard if there are no objective circumstances for them to be classified as non-performing or standard.

When the criteria on refinancing and restructuring were published, the Banco de España urged institutions to review, through a study on an individual basis of their transactions, the accounting classification of refinanced portfolios and the related accounting effects which might arise from that review. The institutions were informed that they should report this exercise to the Inspection Services by 30 September

2013. Institutions disclosed the effect of applying these criteria in their 2013 annual accounts.

1.4.2 NON-COMPLIANCE WITH REGULATIONS ON TRANSPARENCY AND BEST PRACTICES

The Market Conduct and Claims Department has, among other functions, that of receiving and resolving the claims and complaints lodged by users of institutions supervised by the Banco de España relating to their legally recognised interests and rights and deriving from presumed non-compliance of institutions with regulations on transparency and customer protection or on good financial practice and conduct. In 2013, the number of *claims and complaints* received by the Department reached levels never seen before: 35,185¹¹ were received, up 246% on the previous year when 14,313 were recorded. A large part of this significant increase, somewhat more than 18,000 (provisional data), related to borrowers' discrepancies with the application of interest rate limits (floor clauses) in their mortgage loans.



The report by means of which claims and complains are resolved conclude by evaluating whether there has been an infringement of regulations on banking transparency or good practices. Pursuant to Article 30.1 of Law 44/2002 of 22 November 2002 on financial system reform measures,¹² *the claims services shall inform the relevant banking supervision services whenever they note signs of serious or repeated infringements of regulations on transparency and customer protection or on good financial practices and conduct by a particular institution.* That report is drafted at the Banco de España in accordance with pre-established internal procedures.

1.4.3 ASSESSMENT OF THE SUITABILITY OF DIRECTORS AND MANAGERS OF CREDIT INSTITUTIONS

In April 2013 Royal Decree 256/2013 incorporated into Spanish law on credit and other financial institutions the European Banking Authority's guidelines on assessing the suitability of members of the management body and key function holders. The purpose of this Royal Decree is to ensure the existence and application of appropriate guidelines for selecting such individuals, given their importance for the sound and prudent management of credit institutions. These regulations is also intended to establish an awareness of the responsibilities assumed by credit institutions in selecting senior officers to manage the institution and by senior officers in accepting those appointments.

This Royal Decree forms part of much broader wave of amendments contained in Directive 2013/36/EU of 26 June 2013 (known as CRDIV), which prescribes substantial changes to

¹¹ Data as at 25 March 2014.

¹² As amended by the eleventh final provision of Sustainable Economy Law 2/2011 of 4 March 2011. This article applies to the lodgement of claims and complaints to the Banco de España, the Spanish National Securities Market Commission and the Directorate General of Insurance and Pension Funds.

the corporate governance of credit institutions and aims to strengthen the supervisory function of boards of directors and foster an appropriate culture of risk prevention at all levels of banking organisations. Although it was a customary practice of credit institutions and supervisory authorities to analyse the suitability of credit institutions' board members and senior managers, the crisis made it plain that the procedures used by some institutions were inappropriate. These deficiencies particularly prevented the proper functioning of certain boards of directors in which the members were unaware of the major responsibilities they had assumed by accepting their positions and, owing to their lack of expertise or inability to commit sufficient time to their functions, failed to analyse and assess sufficiently some decisions made by managers, thereby allowing or not properly controlling excessive risk-taking by credit institutions.

The Royal Decree addresses three areas of particular importance:

First, it requires institutions to have suitable internal procedures and bodies for selecting and assessing members of the management body, key function holders and those responsible for internal control. This assessment must be made not only when selecting the person involved, but also, under an important new requirement, it has to extend over time, i.e. the assessment effectively has to be ongoing.

Second, it develops and broadens the criteria to be assessed. As regards commercial and professional integrity, the matters examined are: professional conduct, looking particularly at past track record, relationship with other supervisors, history of creditworthiness, etc.; convictions or penalties for crimes, misconduct or administrative infringements; and, finally, although they are not situations which in themselves determine the lack of suitability, the existence of relevant criminal or administrative investigations relating to crimes or infringements of an economic or financial nature or relating to money laundering or taxes, among other things. As regards knowledge and experience, the criteria are tightened, particularly for board members, since now each one of them (rather than a majority, as before) have to have the appropriate knowledge and experience to carry out their functions and, in addition, the profile of the board as a whole must be such as to ensure its ability to take decisions independently and autonomously, all to the benefit of the institution. This means that it is not necessary for each member to have a detailed, in-depth knowledge of all areas of banking but, taken together, they must be able to assess and, if appropriate, question managers when they pose complex matters to them. Lastly, the Royal Decree adds a new requirement to be met by board members: they must all be in a position to exercise good governance. This requirement broadens the regime governing conflicts of interest and means that the ability of directors to commit sufficient time to their functions must be assessed.

Lastly, the Banco de España is endowed with the powers necessary to exercise its function of ongoing control of the suitability of members of the management body, key function holders or those responsible for internal control. In the exercise of these powers, the Banco de España has strengthened this function by creating a cross-departmental unit within the Technical Secretariat Department, for the purpose of gaining an overall view of the situation and ensuring that implementing regulations are applied consistently. In this same line, the Banco de España has also set up a committee of independent experts to assist it in the task of assessing the integrity of directors and senior managers who have been convicted for a crime or misconduct or are subject to a relevant criminal investigation.

Also, the functions of the Register, which also comes under the Technical Secretariat Department, have been strengthened. An analysis of suitability is compulsory before a board member or senior manager is entered in the Register and takes up office. In most cases it will be his first contact with the supervisory authority and the rigorousness of the procedure should serve to make him aware of his responsibilities and obligations to the Banco de España. The recent financial crisis has again evidenced that there is a banking culture, in many cases fostered by committee-based decision-making, which limits the sense of personal responsibility felt by board members and senior managers of credit institutions'. This makes it vital to ensure that those responsible for key functions in the management of a credit institution are properly identified and fully aware of their responsibilities.

1.5 Single Supervisory Mechanism¹³

INTRODUCTION: BANKING UNION

The creation of a "banking union" which strengthens the institutional framework of the EU and makes progress towards greater European integration is the biggest challenge the EU has faced since the Maastricht Treaty was signed.

As indicated in the previous report on Banking Supervision in Spain,¹⁴ in June 2012, the Heads of State or Government of the European Union promoted the creation of a single supervisor as the first step towards the aforementioned banking union with the immediate aim of improving the quality of supervision in the euro area, encouraging market integration and breaking the negative link between confidence in banks and doubts over the sustainability of public debt. Underpinning the foregoing was a special legislative procedure included in Article 127.6 of the Treaty on the Functioning of the European Union.¹⁵

The banking union should contribute to creating an integrated financial framework to safeguard financial stability and minimise the cost of banking crises. In order to build the banking union, in addition to the creation of the Single Supervisory Mechanism (SSM), the following elements are required:

- A single rulebook based on the new capital requirements framework set up by Regulation (EU) 2013/575 and Directive 2013/36/EU. The EBA is responsible for further developing the rulebook and has received the mandate to prepare a series of technical standards which will be legally binding once they have been approved by the European Commission.¹⁶
- A single resolution mechanism, on whose legal framework, the Bank Recovery and Resolution Directive (BRRD), an agreement was reached on 20 March 2014. This resolution framework will come into operation in January 2015, will have a similar scope to that of the SSM and, at institutional level, will comprise:

¹³ In addition to the references included in this chapter, the following Banco de España publications are available on this subject:

a) *Financial Stability Report*. May 2013. 3.1 Current situation regarding the single banking supervisor (pp. 51 and 52) (<http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/InformesEstabilidadFinancera/13/IEF-Ing-Mayo2013.pdf#page=51>).

b) *Financial Stability Report*. November 2013. 4.1 Developments concerning the Single Supervisory Mechanism (pp. 51 to 53) (http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/InformesEstabilidadFinancera/13/IEF-Ing_Noviembre2013.pdf#page=51).

¹⁴ *Report on Banking Supervision in Spain, 2012*. Box 3.1 The Single Supervisory Mechanism (pp. 57 and 58) (<http://www.bde.es/f/webbde/Secciones/Publicaciones/PublicacionesAnuales/MemoriaSupervisionBancaria/12/MBS2012.pdf#page=57>).

¹⁵ See http://app.bde.es/clf_www/leyes.jsp?id=117978&fc=17-03-2014&idart=118138&tipoEnt=0.

¹⁶ See Box 3.3 of the *Report on Banking Supervision in Spain, 2012* (p. 62).

- A Resolution Board which will be responsible for applying the common BRRD rules including, among others, bail-in measures for the distribution of losses among shareholders and creditors of the CIs under resolution so as to reduce the need for public funds.
 - A Single Resolution Fund, which will make the mechanism credible by providing financial support in orderly resolution processes. This fund will begin to receive contributions from 2016 and its capital, following an eight-year period during which national compartments will exist, will be completely shared.
 - A system of National Resolution Authorities.¹⁷
- A system of deposit guarantee schemes. After ruling out the creation of European deposit insurance, an agreement was reached to make progress in the harmonisation of the current deposit insurance system by reforming the Directive in force (Directive 94/19/CE). The proposal approved by the European Parliament on 15 April 2014 sets net assets equivalent to 0.8% of the deposits covered as a target for national guarantee schemes (with a harmonised level of coverage of €100,000) and envisages a reduction of payment periods from 20 working days at present to seven working days in 2024.

The SSM and these three pillars spearhead the banking union. The implementation of the SSM will or, rather, does represent a very important change which supervised institutions and supervisors will have to adapt to swiftly and efficiently. This need to adapt to new circumstances is not unprecedented in recent history.

THE ROAD TO THE SINGLE SUPERVISORY MECHANISM

The supervision of credit institutions has developed significantly since its origins, slightly more than 90 years ago, when the first Banking Law was approved in Spain and the Bank Commission was created which meant, in the words of one author of the time, “the formation of a corporate conscience of discipline to avoid abuse by badly organised and poorly managed banks”. This Law already envisaged that banking supervision, aimed at checking the observance of regulations, would be the responsibility of the Banco de España.

Subsequently, the Basic Law on Credit and Banking Organisation of 1962 drew up new rules which the Banco de España had to conform to in the performance of its functions of discipline and supervision of private banks.

In 2014, powers in the area of supervision will be assumed by a European authority, under the direction of the European Central Bank (ECB), with the participation of relevant national authorities which include the Banco de España. This transfer of supervisory powers from a national to a European sphere has actually been the outcome of a gradual process in which the most notable milestones have been:

- The Maastricht Treaty which was signed in 1992. This treaty already envisaged the conferral upon the ECB of powers concerning prudential supervision, thus

¹⁷ For more information on the Single Resolution Mechanism, see the *Financial Stability Report* of May 2014, Chapter 3.3, “The Single Resolution Mechanism (SRM) in Europe. Latest developments” (pp. 47 and 48) (<http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/InformesEstabilidadFinanciera/14/IEF-Ing-Mayo2014.pdf#page=47>).

avoiding a long and uncertain process of amending the Treaty on the Functioning of the European Union, which would have otherwise been required.

- The “Larosière Report” on financial supervision in the European Union was published in 2009. At the same time as the report acknowledged that it was impossible to completely avoid the occurrence of crises, it established specific measures to improve the regulatory and supervisory framework, proposing stronger macro and micro prudential supervision, more effective crisis management procedures and enhanced cooperation within the EU and globally. The report did not rule out attributing micro-prudential supervisory tasks to the ECB, but focused on bolstering the role of the level 3 committees of the Lamfalussy process, which were conceived in 2001 to draft legislation for financial services (securities, banking and insurance).

As a result of the foregoing, in 2011 the three micro-prudential European Supervisory Authorities were created: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA), which make up the European System of Financial Supervision (ESFS). These authorities are responsible for preparing technical rules and promoting cooperation and coordination.¹⁸

The aforementioned political initiative of June 2012 took shape in the approval by the Council of the European Union on 15 October 2013 of Regulation (EU) 1024/2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions and the Single Supervisory Mechanism Regulation (SSMR). The SSMR defines the SSM as a European supervisory system comprising the ECB and the competent national authorities (NCAs) of the euro area countries (which include the Banco de España) and those of other Member States of the European Union that wish to join and establish a close cooperation with the ECB.

The ECB will be responsible for the effective and coherent functioning of the SSM and, when exercising the functions attributed to it by the SSMR, both the ECB and the NCAs, will act independently and objectively in the interests of the EU as a whole, and may not request or accept any instruction from any Member State government or public or private entities.¹⁹

Under Article 33.2 the ECB shall assume the tasks conferred on it by the SSMR on 4 November 2014, unless it is shown that it is not ready for exercising in full its tasks, in which case it will set a later date. In any event, Article 33.4, permits the ECB to require, from 3 November 2013, the submission of all the relevant information to enable it to carry out a comprehensive assessment²⁰ of the participating Member States’ credit institutions whose direct supervision it plans to assume.

18 See “El informe del grupo de alto nivel sobre supervisión financiera en la UE: el informe Larosière”, by Linette Field and Daniel Pérez, *Estabilidad Financiera*, No. 16, pp. 41 to 62 (<http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/09/May/Fic/ief0316.pdf>).

19 Similarly, the ECB will undertake these tasks totally independently from its monetary policy functions (Article 30 of the SSMR).

20 Further information on this matter is available on:

- a) The Banco de España website: Home > Press room > Useful information > Single Supervisory Mechanism (SSM) > Comprehensive assessment of the institutions under the supervision of the SSM (http://www.bde.es/bde/en/secciones/prensa/infointeres/Mecanismo_Unico_/Evaluacion_globa/).
- b) The ECB website: Home > Banking Supervision > Comprehensive assessment (<http://www.ecb.europa.eu/ssm/assessment/html/index.en.html>).

The obligations of the Banco de España as a Member State participating in the SSM are laid down not only in the SSMR, but also in the Regulation of the ECB that implements the SSMR,²¹ in particular, regarding the framework of cooperation between the ECB and the national competent authorities and the national designated authorities (SSM Framework Regulation).

The Banco de España, in its capacity as an NCA of a participating Member State, will co-operate with the ECB in the exercise of the tasks conferred on the latter by the SSMR, in accordance with the provisions of Article 6.7 of the SSMR. To this end, both the ECB and the national authorities will be subject to a duty of cooperation in good faith and an obligation to exchange information in the exercise of their respective supervisory and investigatory powers.

The Banco de España, for its part, will continue to cooperate with other authorities (those which make up the ESFS; the authorities empowered to resolve credit institutions; public financial assistance facilities; the competent authorities of non-participating Member States; competent authorities of third countries; etc.) in relation to the powers it holds. Since the ECB will also work together with the above-mentioned authorities, the mechanisms and arrangements required to ensure coordinated action of the SSM vis-à-vis these authorities have been put in place.

According to the SSMR the Banco de España will maintain those supervisory functions not conferred on the ECB by the SSMR. The SSMR clearly states that the ECB will be exclusively competent to carry out, for prudential supervisory purposes, the following tasks in relation to all CIs established in participating Member States:²²

- 1 To authorise and, if appropriate, to withdraw the authorisation of the CIs as well as to assess notifications of the acquisition and disposal of qualifying holdings in CIs, with certain caveats in the case of bank resolutions.²³
- 2 To act as the host competent authority for credit institutions established in a participating Member State which wish to establish a branch or provide cross-border services in a non-participating Member State.
- 3 To ensure compliance with EU law and, where this Union law is composed of Directives, the national legislation transposing those Directives on prudential requirements (Pillar 1), supervisory review procedures (Pillar 2) and market disclosure (Pillar 3),²⁴ which comprises, among other matters, the analysis of: own funds requirements, large exposure limits, liquidity, leverage, governance arrangements, the fitness and properness of senior management, internal control mechanisms, remuneration policies, capital adequacy, including the assessment of internal risk models and carrying out stress tests.
- 4 To carry out supervision on a consolidated basis over CIs' parents established in one of the participating Member States, including over financial holding

21 See the ECB website: Home > Legal Framework > Banking Supervision > General Framework > (<http://www.ecb.europa.eu/ecb/legal/ssm/framework/html/index.en.html>).

22 See Articles 4 and 5 of the SSMR.

23 See Articles 14 and 15 of the SSMR.

24 See Article 4.1, subparagraphs d), e) and f).

companies and mixed financial holding companies. Where the parents are not established in one of the participating Member States, the ECB will participate in colleges of supervisors, without prejudice to the participation of national competent authorities as observers.

- 5 To participate in supplementary supervision of financial conglomerates in relation to the CIs included in them, assuming, if appropriate, the task of coordinator of the financial conglomerate.
- 6 To supervise recovery plans and early intervention measures and, if appropriate, request the adoption of the measures required to address problems, excluding any resolution powers.
- 7 To impose more stringent requirements, in close coordination with the national authorities of participating Member States in respect of own funds requirements, additional capital buffers and systemic or macro-prudential measures.

These tasks exclude the supervision of non-credit institutions (e.g. payment institutions, appraisal companies, electronic money institutions, mutual guarantee companies, etc.), including specialised credit institutions (which, with the entry into force of Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, are no longer deemed to be CIs), matters relating to money laundering and terrorist financing and consumer protection.

SIGNIFICANT AND LESS SIGNIFICANT INSTITUTIONS

Notwithstanding the description above of the ECB's competences, given the enormous number of CIs established in the euro area, the aforementioned tasks will be preformed differently based on the size of the CIs. Thus, the SSMR distinguishes between significant and less significant institutions based on certain objective and subjective criteria²⁵ whereby an institution will be deemed significant if:

- Its consolidated total assets exceed €30 billion.
- The ratio of its assets over the GDP of the country where it is established exceeds 20%, unless its consolidated total assets are below €5 billion.
- It is considered significant by the NCA following confirmation of the CI's relevance by the ECB, after a comprehensive assessment of the corresponding institution has been performed. Unless circumstances advise otherwise, the three largest credit institutions in each of the participating Member States shall be deemed significant.
- It has subsidiaries in more than one of the participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities.
- It has received or requested directly financial assistance from the European Financial Stability Facility (EFSF) or the ESM.

²⁵ Article 6.4 of the SSMR.

The methodology applicable for determining significance (calculation criteria, definition of the scope of consolidation, etc.) is described in Part IV of the Framework Regulation.

Institutions deemed significant will be subject to direct supervision by the ECB (which includes all the tasks indicated above) and the other institutions will be directly supervised by the NCAs and indirectly supervised by the ECB.

In the case of Spain, it is envisaged that 16 institutions will be considered significant: Banco Bilbao Vizcaya Argentaria (BBVA); Banco Sabadell; Banco Financiero y de Ahorros (Bankia); Banco Mare Nostrum; Banco Popular Español; Banco Santander; Bankinter; Caja de Ahorros y M. P. de Zaragoza, Aragón y Rioja (Ibercaja Banco); Caja de Ahorros y Pensiones de Barcelona (La Caixa); Caja España de Inversiones, Salamanca y Soria, CAMP (CEISS);²⁶ Cajas Rurales Unidas; Catalunya Banc; Kutxabank; Liberbank; MPCA Ronda, Cádiz, Almería, Málaga, Antequera y Jaén (Unicaja); and NCG Banco.

The Banco de España will assist the ECB when the latter performs direct supervision by sending information, participating in joint supervisory teams (JSTs) and in on-site inspection teams, preparing draft decisions to send to the ECB for consideration and implementing decisions adopted by the ECB.

When the Banco de España directly supervises less significant institutions (LSIs), it will have to notify the ECB ex-ante of any material supervisory procedure and report on the other measures it adopts. The ECB may, furthermore, since it is responsible for the functioning of the SSM and in order to ensure the consistency of supervisory outcomes within the SSM, issue regulations, guidelines or general instructions whereby the Banco de España and other NCAs must directly supervise LSIs; request NCAs to perform on-site inspections of these institutions and to provide any information considered necessary about them.²⁷

Irrespective of the type of institution (significant or less significant), the ECB will be responsible for decisions on processes in respect of authorisations or the withdrawal of authorisations and those regarding significant holdings.

The distribution of work explained in this section – based on the significance of the CIs – will also apply to credit institutions established in a non-participating Member State which establish a branch or provide cross-border services in Spain or in another participating Member State.

JOINT SUPERVISORY TEAMS

The key element of the future supervisory system will be the JSTs. It has been said of the SSM that it will be a truly integrated mechanism and not a constellation of supervisors acting in coordination. To this end, and in order to ensure high-quality and effective supervision, the following is necessary:²⁸

- That NCAs assist the ECB in the preparation and implementation of any acts relating to the exercise of the ECB's supervisory tasks, including, in particular

²⁶ In mid-March 2014, firstly, the Executive Commission of the Banco de España and subsequently, the European Commission, approved the modification of the resolution plan of Banco CEISS, proposed by the Governing Committee of the FROB, which has meant that this institution was integrated into the Unicaja Group, following the exchange of Banco CEISS capital instruments for similar instruments of Unicaja Banco.

²⁷ For more details, see Article 6.5 of the SSMR.

²⁸ See Article 31 and Recitals 37 and 79 of the SSMR.

the ongoing day-to-day assessment of a credit institution's situation and the related on-site verifications.

- That there are exchanges of impartial, well-trained and highly motivated staff and secondments with and among all the NCAs and the ECB, making it possible to install supervisory teams of geographical diversity with specific expertise and profile, even in relation to the supervision of LSIs.

As a result of the foregoing, a JST will be established to supervise each significant institution and significant consolidated group. Each JST will be composed of staff members from the ECB and the NCAs, working under the coordination of an ECB staff member – who may coordinate several JSTs – and assisted by one or more NCA sub-coordinators, particularly as regards employees appointed by the respective NCA.²⁹

The ECB will be in charge of the establishment and the composition of the JSTs. The NCAs will appoint one or more of their employees as members of the JST and the ECB may request NCAs to modify the appointments they have made.³⁰

The JSTs will be responsible, among other matters, for: planning supervisory activity, which includes the ongoing assessment of risk profiles and of solvency and liquidity adequacy; proposing verifications to on-site inspection teams and managing tie-up meetings with institutions under inspection; submitting draft decisions to the Supervisory Board; and following-up compliance with the recommendations made.

A significant difference with respect to the current model refers to the distinction made between follow-up and verification. The model which is going to be implemented, unlike that currently existing in Spain, assigns each of these tasks to a different team. Furthermore, the on-site verification team will essentially be a national one along with the mission head, who will usually be a member of the national authority. The ECB, will ensure that the quality and the methods used are homogeneous throughout the euro area and has created for this purpose two specialised divisions (the Quality Assurance Function Division and the On-site³¹ Division).

SUPERVISORY COLLEGES³²

The ECB will conduct supervision on a consolidated basis, for the purposes of Article 111 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (known as CRD IV), in respect of credit institutions, financial holding companies or mixed financial holding companies that are significant on a consolidated basis.

Where the ECB is the consolidating supervisor, it will chair the college of supervisors (Article 116 of the above-mentioned CRD IV). The NCAs of the participating Member States, where the parent, subsidiaries and significant branches (if any) are established, will have the right to participate as observers.

Where the consolidating supervisor is not in a participating Member State, if the institutions under supervision in the Member States are significant, the ECB will participate as

²⁹ See Article 3 of the Framework Regulation.

³⁰ See Article 4 of the Framework Regulation.

³¹ http://app.bde.es/clf_www/leyes.jsp?id=126107&fc=06-04-2014&idart=126248&tipoEnt=0.

³² Articles 8 to 10 of the Framework Regulation.

host supervisor and the NCAs will attend as observers unless there are also LSIs, in which case the corresponding NCA will also participate as host supervisor.

MEMORANDUMS OF UNDERSTANDING

As a result of the entry into operation of the SSM, it will be necessary to modify the vast majority of international memorandums of understanding in force,³³ particularly international bilateral agreements, in order to include the ECB as a party in the cooperation and exchange of information between the Banco de España and other authorities responsible for prudential supervision pursuant to the requirements of the Basic Principles for Effective Banking Supervision.³⁴

PENALTIES REGIME

As for the penalties regime,³⁵ the SSMR provides that the ECB will be competent for imposing pecuniary penalties on legal persons as a result of breaching directly applicable European law (regulations and decisions).

For other penalties – due to breaches of European law which has been transposed into national legislation or penalties for individuals performing senior management functions – the ECB may require the Banco de España and other NCAs to initiate the corresponding sanctioning proceedings. In any event, the penalties applied by the ECB and by NCAs, must be effective, proportionate and dissuasive.

LANGUAGE REGIME

The language regime of the SSM was determined in accordance with Council Regulation No. 1 of 1958. A distinction should be drawn between communications between the Banco de España (or the NCAs in general) and the ECB, and communications between natural and legal persons, including supervised institutions, and the ECB.³⁶ In general:

- The former will be in English except for where the NCAs submit draft decisions addressed to a supervised institution, in which case they must always provide a memorandum in English explaining the background, the substance of the matter and deliberations providing the basis for the document submitted, and where they do not refer to LSIs, they must also provide a translation into English of the draft decision.
- The second set of communications may be in any of the official languages of the European Union (currently 24 languages, including Spanish), although the ECB will endeavour to reach agreements with significant entities to exclusively use English. In the absence of such an agreement, the ECB's supervisory decisions will be adopted in English and in one of the official languages of the Member State where each addressee has its headquarters or is domiciled.³⁷

COMMUNICATIONS BETWEEN THE SSM AND SUPERVISED INSTITUTIONS

To maintain efficient communications between the supervisor and supervised institutions, irrespective of the duty of cooperation in good faith and the obligation to exchange information between the ECB and the NCAs, it was agreed that, as a general rule, the ECB will act as the point of entry for receiving ad hoc reports, certain requests and authorisations and waivers, etc. which are within the scope of the tasks assigned to it.

³³ More information is available at: Home> Banking Supervision> Memorandums of Understanding on supervisory matters (http://www.bde.es/bde/en/areas/supervision/funcion/acuerdos/Acuerdos_de_col_6814c51aafcd821.html).

³⁴ See specifically Principle 25.

³⁵ Article 18 of the SSMR.

³⁶ Articles 23 and 24 of the Framework Regulation, respectively.

³⁷ See for these purposes Article 2.1.h) of Royal Decree 1245/1995.

The Banco de España and the other NCAs will act as the point of entry for those communications on requests for licenses and in processes in relation to significant holdings, European passports, assessments of whether managers are fit and proper, and for regular reporting of supervisory information and financial statements.

SUPERVISORY FEES

The introduction of supervisory fees is also a highly significant change for Spanish institutions.³⁸ Before establishing those arrangements, the ECB will conduct public consultations and analyse the potential related costs and benefits, and publish the results of both. The fees will be calculated at the highest level of consolidation within participating Member States – excluding the subsidiaries established in non-participating Member States – and will be based on objective criteria relating to the importance and risk profile of the CI concerned. The purpose of the fee – which will be levied on significant and less significant institutions established in participating Member States and branches established in said States by CIs belonging to non-participating Member States – in order to recoup the costs incurred in the exercise of its supervisory tasks.

In Spain under Additional Provision 19 of the Law on Regulation, Supervision and Solvency of Credit Institutions a fee has been introduced which will be charged to charge Spanish institutions to recoup the cost, amounting to €32.6 million, of the comprehensive assessment of these institutions.

THE FUTURE OF THE REPORT ON BANKING SUPERVISION

The SSMR specifically states that, where national competent authorities take action under this Regulation, accountability arrangements provided for under national law should continue to apply.³⁹ Consequently, in accordance with the Second Additional Provision, paragraph 2, of Law 44/2002 on Financial System Reform Measures, the Banco de España will continue to be required, among other things, to prepare annually a report on the procedures and action undertaken in relation to its function as supervisor.⁴⁰

In the future, the information which is included in the reports on banking supervision in Spain on significant and less significant institutions, will be complemented each year with the report that the ECB will submit to the European Parliament, to the Council, to the Commission and to the Eurogroup on the implementation of the tasks conferred on it by the SSMR.

The ECB's accountability obligations set out in the SSMR⁴¹ have been implemented by an inter-institutional agreement of 6 November 2013, signed by the European Parliament and the ECB within the framework of the SSM. In particular, the agreement provides that the aforementioned annual report will include, inter alia, the following: the execution of supervisory tasks; the sharing of tasks with the national supervisory authorities; cooperation with other national or Union competent authorities; the separation between supervisory and monetary policy tasks; the implementation of the code of conduct; the method of calculation and amount of supervisory fees, and the budget for supervisory tasks.

³⁸ Article 30 and Recital 77 of the SSMR.

³⁹ Recital 56 of the SSMR.

⁴⁰ http://app.bde.es/clf_www/leyes.jsp?id=9321&fc=06-04-2014&idart=9405&tipoEnt=0.

⁴¹ Article 20 of the SSMR.