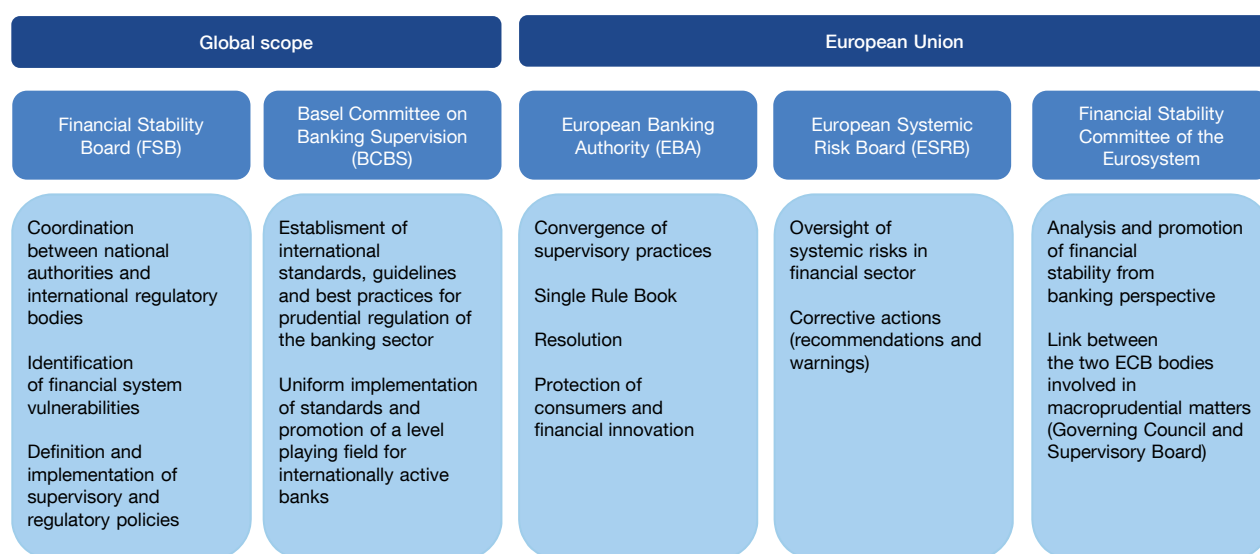


## 6 THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

The international and European dimension of financial stability, regulation and supervision is fundamental to the Banco de España. The decisions taken by international bodies play a major role in the area of regulatory and supervisory responsibilities and have a direct impact on Spanish credit institutions. Therefore, it is essential to be able to participate actively in the decisions taken by those bodies. As in other years, 2015 was noteworthy because of the Banco de España's significant involvement in those tasks.

INTERNATIONAL REGULATORY AND SUPERVISORY BODIES AND COMMITTEES IN WHICH THE BANCO DE ESPAÑA PARTICIPATES

SCHEMA 6.1



SOURCE: Banco de España.

### 6.1 Global fora

In November 2008, the G20 asked the FSB to overhaul financial regulation, in coordination with other committees. A major factor was the establishment of a framework to address the problem of the too-big-to-fail institutions.

#### 6.1.1 FINANCIAL STABILITY BOARD (FSB)

##### TLAC

As part of that framework, the FSB published a new total loss-absorbing capacity (TLAC) requirement for global systemically important banks (G-SIBs)<sup>1</sup>. The Banco de España has been involved in this regulatory development from the start, since it considers it to be strategically important for the purposes of minimising the potential negative impact on financial stability of the resolution of those institutions.

The Banco de España considers it to be important, following the adoption of that agreement at the global level, that the inclusion of TLAC in the regulations of the various jurisdictions and its practical application ensure the homogenous treatment of the G-SIBs regardless of their origins or their resolution strategy. To this end, the practical work carried out by the Crisis Management Groups will also be important.

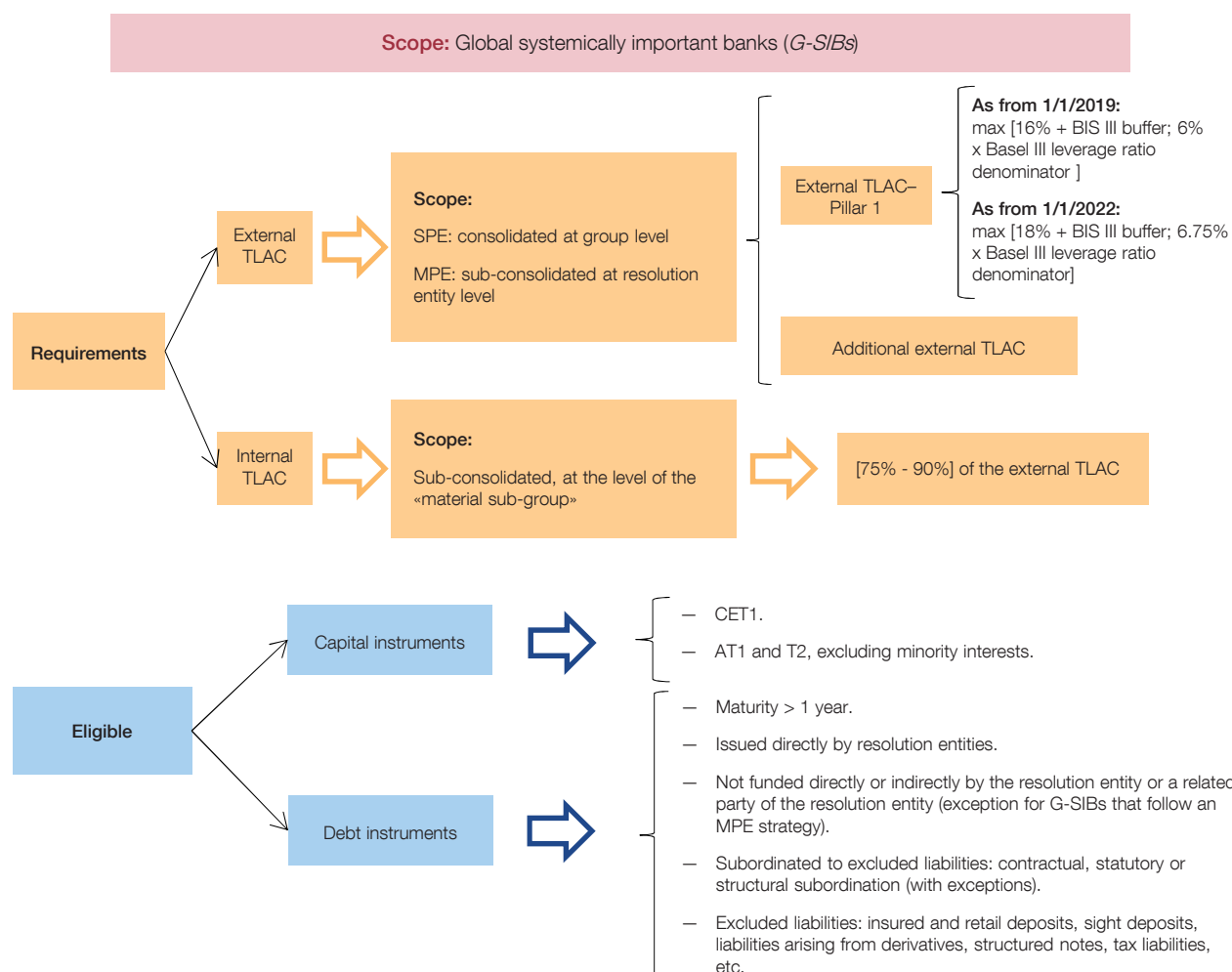
<sup>1</sup> "Principles on Loss-Absorbing and Recapitalization Capacity of G-SIBs in Resolution. Total Loss-Absorbing Capacity (TLAC) Term Sheet", FSB, 9 November 2015.

The European Commission recently started to work towards incorporating that new requirement into the European regulatory framework.

The following basic aspects of the TLAC requirement for G-SIIs in resolution are worthy of note:

## TLAC

## SCHEMA 6.2



SOURCES: FSB and Banco de España.

### 1 Application on the basis of the resolution strategy

The requirement applies to each resolution entity of the G-SII, i.e. to the legal entities of the group to which the resolution actions are applied. Thus, the distribution of loss-absorption capacity is determined by the resolution strategy, according to which the resolution group may have one or more resolution entities (thus following the single point of entry (SPE) strategy in the first case and the multiple point of entry (MPE) strategy in the second case).

In accordance with the SPE strategy, the resolution measures will be adopted in relation to a single legal entity (which is generally the parent institution of the group), which must have sufficient external TLAC (held by non-group third parties). Additionally, all significant subsidiaries must have a certain loss-absorbing capacity. The new framework establishes

a minimum internal TLAC requirement (issued by the subsidiary and acquired by the parent), with the aim of ensuring that potential losses at significant subsidiaries are absorbed by the institution in resolution, preventing those subsidiaries from being subject to a separate resolution to the rest of the group.

The SPE strategy involves a greater distribution of the loss-absorbing capacity, since the resolution instruments are applied separately in the group's various resolution entities (parent and subsidiaries), on the assumption that the connections between them are limited.

## *2 Characteristics of TLAC-eligible instruments*

Capital instruments and liabilities must meet a series of characteristics to be eligible as TLAC, including: i) being issued by the resolution institution; ii) being acquired by a non-group third party; iii) not being secured; iv) being subordinated to excluded liabilities (e.g. covered or retail deposits, derivatives, structured bonds, tax liabilities, etc.); and v) having a residual maturity of more than one year.

The framework contains some exceptions to those general criteria, such as:

- 1 The eligibility of Common Equity Tier 1 capital (CET1) issued by subsidiaries to third parties (instead of the resolution entity), provided that it is recognised at the consolidated level under the Basel III framework.
- 2 TLAC issues by subsidiaries designated as resolution institutions under the MPE strategy that have been acquired by the parent (rather than by a non-group third party) are recognised as external TLAC when the relevant authorities in the Crisis Management Group agree that this is consistent with the resolution strategy.
- 3 It permits the inclusion of some liabilities even though they do not comply with the subordination requirement, namely: a) senior debt that is pari passu with excluded liabilities is permitted up to a limit of 2.5% of risk-weighted assets (RWAs) (3.5% of RWAs when the minimum requirement is 18% of RWAs); or b) excluded liabilities that are pari passu with external TLAC are permitted up to a limit of 5% of the resolution entity's external TLAC.

## *3 Calibration and application date*

The minimum TLAC requirement (which the national authorities could tighten) will be applicable as from 1 January 2019 and will be phased in gradually. Thus, in 2019 it will be calculated as the higher of 16% of the RWAs associated with the resolution group's consolidated balance sheet and 6% of the Basel III leverage ratio denominator. As from 1 January 2022, the requirement will increase to 18% and 6.75%, respectively.

TLAC will be required independently of the Basel III minimum capital requirements. The capital buffers will be additional to the minimum TLAC requirement. Institutions will start to publish their level of compliance upon its entry into force on 1 January 2019.

Other areas of work by the FSB

Progress continues on the regulatory reforms in other sectors (insurance companies, central counterparties and other non-banking and non-insurance institutions). The FSB is

pursuing a strategy that includes both the monitoring and analysis of so-called “shadow banking” (engaging in credit intermediation without being subject to the regulatory framework and security networks applicable to banks) and the introduction of regulatory measures where potential systemic risk clusters are detected.

The Banco de España participated actively, in coordination with the CNMV and other Spanish authorities, in the FSB-led analysis of institutions potentially belonging to the shadow banking sector and, together with other foreign authorities, in the exchange of information on measures to mitigate their potential risks.

Moreover, the FSB has also issued warnings on the potential systemic impact of misconduct by financial institutions; the impact on the stability of the financial system stems not only from the deterioration of solvency due to the penalties imposed because of misconduct, but also from the loss of confidence in financial institutions and markets associated with such actions. The FSB’s concerns are shared by the Banco de España. The action plan designed by the FSB considers, *inter alia*, a review of the role played by the corporate governance and remuneration frameworks, assessing whether they include appropriate incentives that contribute to creating a culture which avoids such conduct.

#### 6.1.2 BASEL COMMITTEE ON BANKING SUPERVISION

The Basel Committee has been working to correct the deficiencies revealed by the financial crisis in the banking sector. The Banco de España has maintained an active stance, participating in the work that has led to the change in approach introduced by Basel III. The new capital framework has evolved from an approach founded on one sole metric — the risk-based capital ratio— to entailing a series of metrics that interact with one another, including: risk-based capital ratio, leverage ratio, liquidity ratios and, lastly, several measures to reduce systemic risk (capital buffers for global systemically important institutions and countercyclical buffers).

##### Review of risk measurement

In relation to the risk-based capital ratio, and after publishing the regulations on the quality and level of capital, the Committee has focused on reviewing the regulations on risk measurement (the ratio denominator). The Banco de España has argued that this review must favour the achievement of a triple objective: maintaining the capital framework’s sensitivity to risk, enhancing its simplicity and comparability, and avoiding significant increases in capital requirements, as a result of the foregoing.

To this end, given the strategic importance of the capital framework review, the Banco de España has participated in the Basel Committee’s internal groups that have been reviewing the treatment of risk measurement.

##### Credit risk

In December 2015 the Committee published a second consultative document on the standardised approach for measuring credit risk, a task in which the Banco de España was involved. One of the main new developments with respect to the previous consultative document is the reintroduction of external ratings as an important —but not exclusive— criterion for determining the capital requirements in the jurisdictions that permit their use. Moreover, the Banco de España continues to work very directly on the internal model method review tasks being carried out by the Committee, which published a consultative document in this regard in March 2015.

##### Operational risk

As for operational risk, in March 2016 a new consultative document was published which, along with including changes in the treatment of the standardised approach, proposes the elimination of the advanced measurement approach.

Lastly, in January 2016 the Committee completed and published the new framework of capital requirements for market risk, both for the standardised approach and for internal models.

The Committee's objective is to finish the above-mentioned reviews by the end of 2016. The Banco de España considers that for those purposes the appropriate overall calibration of all the measures will be very important, including the final calibration of the standardised approaches for risk measurement, the quantitative and qualitative restrictions on estimating parameters in internal models and their relationship to the leverage ratio<sup>2</sup>.

The Banco de España continued to participate directly in the various tasks and areas of work of the Basel Committee, for example those relating to the implementation of improvements in supervisory practices and principles. In this regard, the Banco de España presided over the work to ensure the correct implementation of the principles for an effective aggregation of risk data, and the third and final report on that matter was published in December 2015. Other Basel Committee work to which the Banco de España has contributed includes the drawing up of criteria for identifying simple, transparent and comparable securitisations and their capital treatment (published in July and November 2015), and assessing the implementation of the Basel legislation.

## 6.2 European fora

### 6.2.1 EUROPEAN BANKING AUTHORITY (EBA)

The European Banking Authority (EBA) is a European agency which works to ensure effective and coherent prudential regulation and supervision across the European banking sector. Its overall objectives are to maintain financial stability in the European Union and to safeguard the integrity, efficiency and orderly functioning of the banking sector. Its objectives include convergence towards common rules (the so-called "Single Rulebook") and supervisory practices in the entire European Union, not only in the countries participating in the SSM.

Since the creation of the EBA in 2011, the Banco de España has chaired the Subgroup on Supervisory Effectiveness and Convergence (SCOP), a sub-committee that works on areas relating to supervision and supervisory practices, and since June 2012 it has been a member of the EBA Management Board.

Set out below are the most significant tasks of the EBA, centred on four major areas: i) supervisory convergence; ii) prudential regulation; iii) resolution; and iv) customer protection and financial innovation.

Supervisory convergence at the EU level, which is taken to be a gradual process that is constantly evolving, is based on three pillars: i) regulatory compliance; ii) comparability of supervisory practices; and iii) consistency of outcomes.

Of great importance in this regard are the tasks being performed to implement the Guidelines for common procedures and methodologies for the Supervisory Review and Examination Process (SREP) published in December 2014. One of those tasks has been to harmonise the information that the competent authorities must gather on the internal capital and liquidity adequacy assessment processes (ICAAP and ILAAP) performed by the institutions. The Banco de España has supported their development and the application of the principle of proportionality, so that systemic institutions —and those selected by the supervisor on the basis of their size, nature and complexity— apply it in full.

<sup>2</sup> The leverage ratio is defined as the ratio of the amount of Tier 1 capital to the volume of exposure.

Moreover, the Banco de España has contributed to the updating of the Guidelines on stress testing issued by the Committee of European Banking Supervisors in 2010, in particular in relation to a common taxonomy and the use of quantitative outcomes of stress tests in the assessment of institutions' capital adequacy, and it has defended the idea that those outcomes do not directly involve the application of supervisory measures but rather they are considered as one more element of an institution's overall supervisory assessment.

Lastly, mention should be made of the work performed on the application of Article 141 of the CRD IV on the restrictions applicable to the distribution of dividends, payments in relation to Additional Tier 1 (AT1) instruments and remuneration (the so-called "Maximum Distributable Amount"). The Banco de España has participated actively in the discussions to seek to clarify the framework and reach a common understanding of its application in the EU.

#### Prudential regulation

In the field of prudential regulation, the Banco de España fully shares the EBA's objectives of boosting the reliability of the internal models used for calculating capital requirements and of reducing the variability observed in the results. Its efforts have been focused on the advanced models for credit risk, in relation to which it has defended the need to make progress towards greater consistency in their supervisory assessment and the importance of having clear harmonised definitions in Europe of, for example, the concept of default.

The Banco de España has supported the idea of European legislation being consistent with the work of the Basel Committee, for the sake of greater international regulatory harmony, and the communication to institutions of a plan that it is reasonable to implement with a feasible timetable.

Another priority matter for the Banco de España was the implementation of criteria defining simple, transparent and standardised securitisations, and it backed, among other aspects, a reasonable reduction in the capital requirements associated with those securitisations.

Lastly, the Banco de España participated very actively in the updating of the guidelines on remuneration policies. Among other matters, it participated in the drafting of the criteria that define remuneration components as fixed or variable, definitions which are used in calculating the maximum ratio of variable to fixed remuneration, and in the procedure for identifying (and requesting exclusions from) the group of risk takers.

#### Resolution

Noteworthy in relation to resolution matters is the preparation of regulatory technical standards determining the criteria for calibrating, on a case-by-case basis, the minimum requirement for own funds and eligible liabilities (MREL). The Banco de España has contributed to ensuring that a satisfactory degree of harmonisation is achieved in the calibration of the requirement for each institution, while preserving at all times the flexibility of the authorities involved and the recognition of the diversity among institutions. Also, work has been carried out so that the outcome is in line with other international standards in the case of significant institutions (for example, with the minimum TLAC requirement), the participation of deposit guarantee schemes is taken into account (where appropriate) and the correct interaction between supervision and resolution authorities is outlined.

Moreover, guidelines on the interpretation of the different circumstances in which an institution is considered to be failing or likely to fail were established. Those guidelines ensure a common framework for the declaration of resolution by the competent authority

(in cooperation with the resolution authority), encouraging such declaration to be the result of a case-by-case assessment rather than of an undesired knee-jerk reaction. In particular, the Banco de España has supported the work relating to the establishment of objective factors that enable an institution's failure to be determined, along with the communication process between the supervisory and resolution authorities.

Consumer protection  
and financial innovation

The Banco de España has been very involved in the area of consumer protection and the monitoring of risks arising from financial innovation, two increasingly important activities in the EBA. New tasks are expected to be embarked on in 2016, focussed on supervisory convergence.

As regards consumer protection, the Banco de España participated in the preparation of a series of guidelines. The following are worthy of note because of their special contribution and significance: i) Guidelines on product oversight and governance arrangements for retail banking products; ii) Guidelines on arrears and foreclosures; and iii) Guidelines on creditworthiness assessment.

Lastly, with respect to the EBA's work on financial innovation, the Banco de España cooperated actively in the working groups, which has stepped up the exchange of information on other countries' banking practices, products and markets. That matter is considered essential for the knowledge of their risks and benefits and for determining the regulation that would be ideal at both the domestic and European levels. Of particular note is the specific work relating to the intervention powers in the structured deposit market, together with the work relating to crowdfunding, virtual currency, cloud computing, commercial use of consumer data and innovative means of payment.

6.2.2 EUROPEAN SYSTEMIC  
RISK BOARD (ESRB)

In the five years it has been operating, the ESRB has put into practice, improved and extended tools for analysing, assessing and monitoring the macroeconomic and financial situation of the EU and its potential risks and vulnerabilities. The governor of the Banco de España is a member of the General Board and, since January 2015, he has also been a member of the Steering Committee.

The most significant matters to which the Banco de España has contributed are as follows:

- Analysis of vulnerabilities through the Bottom-Up Survey, for the assessment of the risk of financial instability of the European Union.
- Review of risk indicators.
- Implementation of macroprudential instruments (such as the countercyclical capital buffer, the leverage ratio and those intended to mitigate construction sector risks).
- Study of banking misconduct and its repercussions from the macroprudential standpoint.
- Assessment of the risks and repercussions of the existence of very low interest rates.

Special mention should be made of the Banco de España's contribution to the study on the regulatory treatment of the holding of government debt by credit institutions.

Also, the ESRB analysed the degree of compliance with two recommendations aimed at improving the solvency of the banking system relating to banks' US dollar-denominated funding and lending in foreign currencies. The Banco de España duly adhered to the two recommendations and was classified as "fully compliant", as reflected in the two reports published by the ESRB in March and June 2015, respectively.

#### 6.2.3 EUROSISTEM FINANCIAL STABILITY COMMITTEE

In late 2013, the European Central Bank renewed the Financial Stability Committee's mandate to analyse and promote financial stability from the banking standpoint and, at the same time, to serve as a bridge between the two ECB bodies involved in macroprudential matters: the Governing Council and the SSM Supervisory Board. The Banco de España participates actively on the Committee and in its working groups. Specifically, the main matters on which the Banco de España collaborated in 2015 were the design of the cooperation between the SSM's microprudential supervision and macroprudential policy, the improvement of risk analysis instruments, the creation of macroprudential databases, and the project to create a Eurosystem credit risk dataset (AnaCredit).

### 6.3 Other regional fora

The Banco de España also participates actively in the Association of Supervisors of Banks of the Americas (ASBA), a high-level forum in which the banking supervision authorities of 35 countries in the Americas are represented. The Banco de España has been a collaborator since 1999 and an associate member since 2006, and is the only non-regional associate authority.

The ASBA's mission is to strengthen banking regulation and supervision in the region by disseminating knowledge, raising technical capacity, adopting sound supervisory practices in line with international standards, and establishing and promoting regional and international dialogue channels both in the supervisory sphere and in the banking sector.

In 2015, along with attending the meetings of the ASBA governing bodies, it continued to support the ASBA Continental Training Plan by means of seminars in the region and in Spain.