Banking supervision in 2015 was marked by the embedding of the activities of the Single Supervisory Mechanism (SSM), the first pillar of European Banking Union and the new framework within which the tasks relating to supervising European credit institutions are undertaken.

Following its first full year of activity, we can affirm that the SSM has overcome the difficult challenges of establishing a common supervisory system in the participating countries and making its management system operational, led by the European Central Bank (ECB) in collaboration with the supervisory authorities of each country.

Under this new framework, the Banco de España is participating most actively in the supervision of significant Spanish institutions and directly leads the supervision of Spanish less significant institutions. Furthermore, through the SSM's Supervisory Board, the Banco de España is involved in the supervisory decisions regarding significant institutions in the other participating countries.

The good results obtained in this first full year of activity should not, however, deflect us from further efforts to foster banking supervision arrangements that are efficient, consistent and guided by best practices. We must therefore consider the benefits of moving ahead with standardising the role of the supervisor in reviewing the quality of institutions' financial information. In particular, this concerns the focus and depth of on-site inspections of credit risk and the supervisory actions resulting from these reviews.

Another significant challenge for the SSM is to continue making progress in integrating its component parts, harnessing synergies and encouraging contributions by all members, regardless of the authority to which they may belong.

Finally, looking back at supervisory activity in 2015, I would highlight the first use of the macroprudential toolkit provided for under the solvency regulations and the European regulations on the recovery and resolution of credit institutions. The latter have led to new tasks being conferred upon the Banco de España in its capacity as supervisor.

In conclusion, while the assessment of supervisory activity in 2015 has been a positive one, the Banco de España will continue to promote the efforts required to overcome the remaining challenges, with the aim of achieving more efficient and effective supervision.

2015 was the first full financial year in which the Banco de España conducted its supervisory activities within the framework of the SSM. Since 4 November 2014, when the SSM officially commenced operations, the ECB has taken on prudential banking supervision tasks for the entire Monetary Union, with the participation and support of the national authorities, which contribute their supervisory expertise and knowledge of the national banking systems.

The SSM, forged out of the serious financial crisis that began in 2008, was created with the aims of improving the quality and uniformity of supervision of credit institutions, fostering the integration of markets and breaking the negative feedback loop between the banking sector and sovereign debt. It is thus designed as a preventative tool and constitutes the first pillar of the Banking Union being built in Europe to safeguard financial stability and minimise the costs of banking crises.

The SSM's first year of operations centred on the "comprehensive assessment" of all the significant banking groups in the euro area countries, which was carried out in 2014. This assessment, which included an asset quality review and a stress testing exercise, enabled the information on and diagnosis of the actual situation of European banks to be improved. As a result, in addition to increasing transparency and investor confidence, corrective measures were adopted which helped bolster the solvency of the banks analysed.

However, the SSM's first year of operations was not without its challenges. The first of these was making progress in establishing a truly common operational framework for the different "supervisory cultures" that coexist in the participating countries. To this end, the Banco de España contributed its supervisory knowledge and expertise, participating in the development of operating procedures and methodologies that can be found in the Supervisory Manual, a living document that requires regular updating to incorporate the lessons learned from accumulated experience. Applying the methodologies described in the Manual in a consistent manner is crucial to completing the convergence towards supervisory best practices.

Along the same lines, and in order to contribute to achieving a common operational framework, throughout 2015 the Banco de España collaborated closely on the comprehensive review of national discretions, as established by the European solvency regulations and exercised by national supervisors, in certain areas such as the phase-in period for progressive adoption of the new standards and the granting of exemptions to compliance with certain prudential requirements. These discretions have been applied differently by each of the national supervisors and have thus given rise to different treatment depending on the country of origin. This situation complicates supervisory action and prevents uniform treatment of credit institutions across Europe. The result of this review process conducted within the SSM framework was an agreement that allows a common approach to be adopted in implementing options and national discretions, reducing their flexibility. The agreement reached to harmonise the application of solvency regulations can be considered to be extremely positive, even though certain divergences in supervisory practices still remain within the SSM, as I will explain at the end of this introduction.

Another of the fundamental challenges that the SSM faced during its first year of activities was achieving a governance structure that is operative despite its extreme complexity. This complexity derives, firstly, from the need to keep the ECB's monetary policy functions separate from its prudential supervision functions and, secondly, from the need to ensure appropriate interaction between the national supervisory authorities and the ECB such that the former play an important role in decision-making within the SSM, under the leadership of the ECB. Indeed, in 2015 the SSM's governance structure proved itself capable of achieving all these objectives, enabling the correct functioning of the mechanism and allowing the Banco de España and the other euro area national supervisors to actively participate.

In this regard, the SSM's first year of operations put to the test not only its own management bodies but also the internal bodies of the ECB and the national supervisors. At the Banco de España, in 2014 the departments of the Directorate General Banking Supervision were reorganised, and a structure mirroring that of the ECB was adopted to facilitate the relationship between the two institutions. Furthermore, a unit specialised in coordinating the Banco de España's participation in the SSM's decision-making bodies was created. 2015 demonstrated how this new structure has aided interaction with the ECB in supervisory tasks.

The year also witnessed the full development of the activities of the joint supervisory teams, which comprise staff from the ECB and the national authorities and are responsible for the day-to-day supervision of the significant institutions. These teams are coordinated by an ECB staff member with the support of a sub-coordinator from each national authority concerned, who helps to organise the work and manage the local teams. This is a new model that responds to the need to combine centralised management with the greater proximity to the local financial system provided by national supervisors. It is important to note that the Banco de España provides around 70% of the staff of the joint supervisory teams for the Spanish significant institutions.

Along with the joint supervisory teams, the SSM has a series of horizontal groups that undertake specialised tasks affecting the supervision of all institutions. In order to develop these horizontal functions, several expert working groups have been set up, in which the Banco de España is actively participating.

There are two more fields in which the Banco de España contributes. First, an extremely high percentage of the staff who carry out the on-site inspections of significant institutions in Spain are from the Banco de España. These staff are usually tasked with leading these inspections. Second, the Banco de España continues to be responsible for direct supervision of the less significant institutions.

In short, following the SSM's commencement of operations, the supervisory activity of the Banco de España is just as demanding and resource intensive now as it was in the past. Furthermore, we have had to address the challenge posed by these efforts to adapt to and participate in the implementation of this new mechanism against a backdrop of a significant loss of human resources to the ECB. So far, almost 100 staff from the Banco de España have joined the new SSM structure (around 80 of them from the Directorate General Banking Supervision), including a Director General and three Deputy Directors General, meaning the loss of approximately a quarter of the supervisory staff.

Moreover, it must be noted that the launch of the SSM has not affected the supervision of other financial institutions different from credit institutions. Thus, the Banco de España fully maintains its supervisory powers, within the scope set by Spanish law, in relation to specialised lending institutions, mutual guarantee companies, reguarantee companies, appraisal companies, payment institutions, electronic money institutions, currency-exchange bureaux, banking foundations and Sareb.

The Banco de España also retains responsibility for supervising the market conduct of all the institutions under its control, including credit institutions, as this has not been transferred to the SSM. In this area, the Banco de España attaches the utmost importance to bank transparency, customer protection and the proper functioning of customer service and conflict resolution mechanisms, in line with the widespread heightened awareness internationally of the importance of ensuring the proper conduct of financial agents. 2015 was the first full financial year in which this supervisory work was undertaken by the Market Conduct and Claims Department, hierarchically and functionally independent from the Directorate General Banking Supervision. In 2015, as well as designing its own procedures, the supervision of conduct was essentially focused on reviewing the marketing and settlement of mortgage loans and carrying out checks on the implementation of the urgent measures for protecting mortgage debtors who have no resources, on the use of floor clauses and on the response strategies of institutions to complaints from customers related to these clauses.

It is worth highlighting certain new regulations that were introduced in 2015 regarding tools for supervising credit institutions, such as those related to monitoring liquidity risk and to macroprudential supervision.

In October 2015 the formal requirement for a short-term liquidity coverage ratio entered into force, which lays down quantitative requirements concerning the liquid assets institutions must hold to cover net cash outflows under stressed conditions for a period of 30 days. This was the first step in standardising the requirements for mitigating liquidity risk, and the process will be completed in the coming years with the obligation to comply with a net stable funding ratio.

Another new development in European solvency regulations concerns the macroprudential toolkit. Most notable here is the introduction of capital buffers for systemically important institutions and a counter-cyclical capital buffer applicable to credit exposures in Spain. In 2015 the Banco de España for the first time worked on determining the levels at which these buffers should be set. At the end of 2015 the levels necessary for the 2016 financial year were announced.

2015 was also the year in which the Single Resolution Mechanism (SRM), the second main pillar of the European Banking Union, entered into force. The SRM, fully operational from 1 January 2016, aims to provide a way to manage non-viable entities, minimising the need to inject public funds, protecting depositors and ensuring the continuity of the critical functions of the institutions concerned.

In Spain the Banco de España has preemptive resolution powers, while executive resolution functions are entrusted to the Fund for the Orderly Restructuring of the Banking Sector (FROB). This allocation of functions, although different from that generally adopted in Europe, enables the experience acquired by the FROB in recent years to be harnessed and, at the same time, permits closer coordination with the activities of the prudential supervisor.

The Banco de España's responsibilities as the preemptive resolution authority are exercised separately from the supervision of institutions, in the interest of the necessary independence required of these activities under European law. The tasks assigned within the framework of the SRM include most notably the following: i) designing institutions' resolution plans and ii) setting the minimum requirement for own funds and eligible liabilities (MREL) for each institution, with a view to guaranteeing that they have sufficient instruments available to absorb losses and recapitalise themselves.

The tasks conferred on the Banco de España as supervisor under the recovery and resolution regulations include most notably: i) reviewing recovery plans prepared by institutions; ii) adopting early intervention measures supplementary to traditional supervisory measures to intervene in institutions that have started to weaken but are still viable; and iii) ascertaining the non-viability of an institution as a prior step to its possible resolution or liquidation.

Finally, let me touch on four of the main challenges that the Banco de España faces in performing its supervisory tasks within the SSM framework in the next few years.

The first challenge is the need to continue monitoring how credit institutions adjust their business model in order to maintain appropriate profitability levels at a time when interest rates are still at an all-time low and economic activity has not reached the momentum necessary. This adjustment process should lead to the generation of recurring income in a sustainable manner, respecting each institution's appetite for risk and avoiding excessive risk-taking in the pursuit of yield.

The second one is the frequency and impact of changes made to the regulatory framework of credit institutions in recent years, which involve a significant effort both for institutions themselves and for supervisors.Broadly, institutions must comply with new liquidity and leverage ratios, with greater capital requirements and with new resolution demands that will foreseeably give rise to changes in their balance sheet structure. The need to strengthen own funds and liabilities eligible for absorbing losses may give rise to intense competition in raising funds on the capital markets. Supervisors should enforce this new regulatory framework in a consistent manner and check that in practice its implementation contributes to strengthening the soundness of institutions and financial stability. For this purpose, a period of certain regulatory stability would be advisable, during which the possible changes were directed mainly at simplifying the regulatory regime and helping to implement it uniformly.

A third challenge is strengthening bank customer confidence in credit institutions, following the evident reputational damage caused by recent cases of failure to observe, or improper application of, rules of conduct, particularly those on the marketing of financial products.The Banco de España promotes the implementation of international best practices in this area.

Fourth and last is the need to advance in the harmonisation of supervisory practices within the SSM. Despite the efforts made during 2015, it is still necessary to continue fostering the application of the highest quality standards to supervisory activities, avoiding convergence towards less stringent supervisory standards. In this connection, there are two main fields in which it is necessary to move towards greater convergence: the review of internal capital models and the review of financial reporting.

The supervisory review of internal capital models should converge towards best practices for the purpose of increasing their credibility, ensuring consistency in the calculation of capital ratios and applying the same supervisory standards across all credit institutions. Precisely to commence this task, the SSM has designed a plan that will make it possible to carry out more in-depth analyses of internal capital models in the coming years.

The review of financial statements is a basic task that supervisors have to carry out to make their own diagnosis of the financial position and solvency of institutions, regardless of whether or not they have powers relating to accounting regulations. Convergence towards rigorous financial statement review by supervisors in credit risk inspections, through the review of credit risk files for loans granted, is essential for appropriately reflecting asset quality in the accounts and ensuring the reliability of capital ratios, the raw material of which is accounting information. In this respect, the lessons on provisioning policies and identification of best international practices learned during the asset quality review prior to the launch of the SSM, where this approach of reviewing risk files for specific transactions was already used, are relevant starting points to define common methodologies.

In conclusion, in 2015 the Banco de España contributed strongly to the major advances made in erecting European supervision within the SSM framework. These advances have revealed significant challenges that we must tackle promptly in coming years to further pursue a consistent and thorough supervision that complies with the ultimate objective of strengthening the European banking system’s financial stability.