

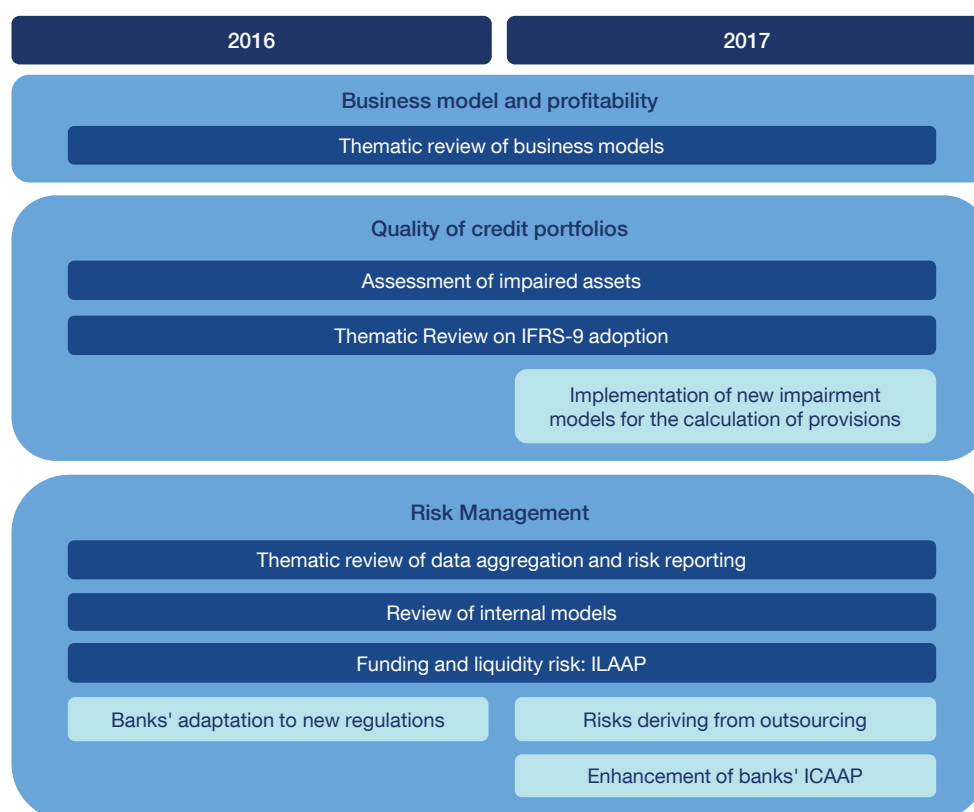
2 MICRO-PRUDENTIAL SUPERVISION

2.1 Supervisory priorities and strategies

As in 2015, the supervisory priorities for 2016 were established jointly under the SSM framework, with the active participation of the Banco de España. The main areas requiring special attention by the supervisor in 2016 and the priorities for 2017 are set out below and summarised in Schema 2.1.

SUPERVISORY PRIORITIES IN 2016 AND 2017

SCHEMA 2.1



SOURCE: Banco de España.

2.1.1 SUPERVISORY PRIORITIES IN 2016

- Adaptation to new regulatory developments:** the legal framework for credit institutions was developed further in 2016, requiring institutions to make a considerable effort to adapt to the new requirements. In particular, the new liquidity and liability requirements with loss absorbing capacity in the event of resolution pose a challenge both for institutions, which must adapt their structure and sources of financing to the new framework, and supervisors, who must ensure compliance with these regulations.
- Sustainability of the business models:** in 2016, credit institutions were faced with a complex economic environment, characterised by low interest rates and high levels of non-productive assets. This affected their profitability and the sustainability of their business models, placing them under the supervisory spotlight. In 2016, a thematic review of the business models was carried out for all the significant credit institutions in the SSM sphere. As indicated in the section below, this work will continue to be a supervisory priority in 2017 and will be based on the analysis already carried out.

- 3 **Quality of the loan portfolio:** as in previous years, particular attention was paid in 2016 to the quality of the loan portfolio. The Banco de España has participated in different areas of supervisory work within the SSM framework, on the one hand, to develop a common methodology for analysing impaired assets and, on the other, to promote the effective management of non-performing assets, to reduce their weight in banks' balance sheets, by ensuring proper identification and provisioning. The latter line of work resulted in the publication of the ECB's Guidance to Banks on Non-Performing Loans in March 2017, following a public consultation which took place from September to November 2016. The guidance document describes best practices to be adopted by credit institutions, relating both to the management of and proper accounting for non-performing loans, bearing in mind the growing importance of integrating credit risk accounting practices into credit risk management procedures. This guidance will serve as the basis for ongoing supervisory dialogue with institutions.

These issues, together with the monitoring of institutions' adaptation to the new International Financial Reporting Standard 9 on financial instruments, which began in 2016, will continue to be a priority in the coming years.

The main scope of around 75% of the 29 on-site inspections carried out in 2016, including significant and less significant Spanish credit institutions, was to review credit risk.

- 4 **Review of internal models:** An in-depth review of the internal capital models applied by institutions within the SSM commenced in 2016. The EBA, as part of its review on the consistency of risk weighted assets (RWAs), has revealed on several occasions that the characteristics of the internal models give rise to a high variability in the level of capital required, not warranted by the different risk profiles of institutions. The work under way will be essential to achieve greater consistency and comparability in the calculation of solvency ratios among the various institutions.
- 5 **Quality of information:** the Banco de España has participated in the thematic review of compliance with the Basel Principles for the effective aggregation of risk data and reports within the SSM, which will continue in 2017. Quality management information will enable institutions' governing bodies to properly assess the risks to which the institutions are exposed.
- 6 **Monitoring of financing and liquidity risk:** within the SSM, there have been efforts to make institutions aware of supervisory expectations regarding the internal liquidity adequacy assessment process (ILAAP), in order to address the weaknesses detected in previous years and promote the adoption of best practices by institutions.

The results obtained by Spanish credit institutions in the EBA stress test show a considerable degree of resilience, since they amply exceed the capital requirements

One of the supervisory instruments used in 2016 to address the aforementioned priorities was the performance of stress tests. Six significant Spanish institutions participated in an EU-wide stress test, based on the single methodology approved by the EBA to assess the resilience of the large European banks in the event of a hypothetical deterioration of the macroeconomic and market conditions. This exercise contributes to transparency, essential to foster market discipline. Box 2.1 describes the methodology used for the exercise and the main outcomes. The ECB has performed similar exercises for other institutions in the SSM.

The stress test included 51 institutions throughout the EU, representing approximately 70% of the EU banking sector assets.

In accordance with the methodology approved by the EBA, institutions made three-year projections of results and capital (from December 2016 to December 2018) under two different macroeconomic scenarios: a baseline scenario designed by the European Commission, and an adverse scenario, approved by the European Systemic Risk Board (ESRB)¹. The methodology establishes certain constraints, such as the assumption of a static balance sheet during the exercise, restrictions on the recognition of new deferred tax assets or the application of compulsory adjustments to the available for sale sovereign debt portfolio. Also, a change in relation to previous exercises is that the assessment of operational risk covers resilience to conduct risk events.

Chart 1 provides details of the results obtained for six Spanish institutions in the adverse scenario, in terms of the highest quality capital, calculated in accordance with the transitional arrangements laid down in solvency regulations (transitional CET1 ratio).

An important part of the estimated decline arises in most cases from the impact of the progressive elimination of the transitional arrangements from the solvency framework over the three-year duration of the exercise. If this effect is excluded, the impact of the exercise is significantly reduced, as seen in the development of the fully loaded ratio detailed in Chart 2.

The results of this exercise will be taken into account by supervisors when determining capital requirements within the framework of the supervisory review and evaluation process.

To conclude, the test results show an appreciable degree of resilience of Spanish institutions, close to the EU average.

¹ The baseline scenario was based on the European Commission's economic projections for the autumn of 2015. The adverse scenario was developed on the basis of assumptions of severe negative alterations in the principal macroeconomic variables (Gross Domestic Product [GDP], unemployment, inflation, interest rate and asset prices).

Chart 1
EBA STRESS TEST RESULTS. CET1 "Phased in"
Adverse scenario results

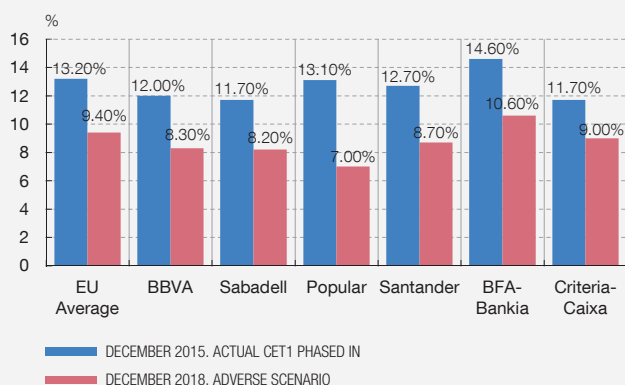
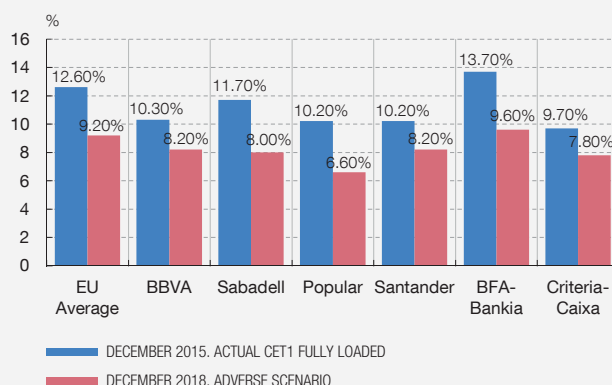


Chart 2
STRESS TEST RESULTS. CET1 «FULLY LOADED»
Adverse scenario results



SOURCES: EBA and Banco de España.

a Results do not include recapitalization measures adopted after December 31st, 2015, such as Banco Popular rights issue.

2.1.2 SUPERVISORY PRIORITIES IN 2017

Work will focus on three priority areas in 2017. The first two relate to business models and profitability factors, and credit risk, already identified as priorities in 2016. The third priority area for 2017, namely risk management, covers new aspects as well as areas which were previously included as independent priorities, but which are all closely related to the issue of risk management.

- 1 Business models and profitability.** Oversight of the business model and of the effects of low profitability continues to be a supervisory priority in 2017, especially in light of the historically low and even negative interest rates.

Given the challenges posed by the macroeconomic environment and regulatory developments, management of bank profitability remains complex. Moreover, the emergence of new non-banking competitors (Fintech) will contribute to banks having to continue to revise their business models in order to assess the extent to which they need to adapt to maintain a sustainable and profitable performance. The possible impact of Brexit on the business models of euro area banks will also be considered.

In this context, more in-depth work will be carried out on the thematic review of banks' business models initiated in 2016 spanning two years.

2 Quality of the loan portfolio:

- **Assessment of the impaired risks portfolio:** this will continue in 2017, since there are still institutions with high levels of impaired assets.
- **Review of adaptation to IFRS 9:** the thematic review initiated in 2016 to assess the potential impact on banks of the IFRS 9 and their level of preparedness will continue and conclude in 2017. This is an area of particular supervisory concern, since it is considered that the new standard will have an impact on the measurement of institutions' impaired assets and the valuation of financial instruments, and thus on own funds.
- **Implementation of new models to calculate provisions:** the recent amendment of Annex IX of Circular 4/2004 on the accounting of credit institutions has introduced new models for identifying loan losses, which will represent a significant challenge for credit institutions and the need to ensure that the models are properly implemented.

The individual review of loan files and the reconciliation of accounting and credit risk databases are indispensable supervision tools to ensure consistency of supervisory activities

- 3 **Risk management.** In a setting such as the present, with low interest rates and scant profitability, proper risk management becomes essential, and the review of this area is thus a supervisory priority in 2017. It will centre on three lines of supervisory action First, the thematic review which commenced in 2016 to assess compliance with the Basel Principles for the effective aggregation of risk data and risk reporting will continue. This review pays special attention to the quality of risk data provided and suitability of the related technological infrastructure. Second, in order to restore the credibility and adequacy of the internal models approved under Pillar 1 and, therefore, of banks' risk management, work will continue on the specific review on internal models initiated in 2016, with on-site supervisory actions in the first half of 2017. Lastly, as regards banks' internal risk management activities and in keeping with the measures adopted in 2016, in 2017 supervisors will promote the continuous improvement of the internal capital adequacy (ICAAP) and liquidity (ILAAP) assessment processes and will examine how banks are managing the risks derived from outsourced activities.

Credit risk is the main risk arising from the financial intermediation of credit institutions. Essential to credit risk management is the identification and provisioning of non-performing loans. It is therefore no surprise that the review of credit risk, in general, and of non-performing loans, in particular, is a recurrent supervisory priority.

The first step in a supervisory review of non-performing loans is to identify and define a non-performing loan, so as to be able to draw consistent and comparable conclusions on the quality of the balance sheets of different institutions and, ultimately, on their solvency position. Annex IX of Circular 4/2004, recently updated by Circular 4/2016, defines non-performing loans as those with amounts more than 90 days past due or for which, although the loans are not doubtful due to borrower arrears, there are doubts as to the borrower's ability to repay as and when required.

This accounting definition of non-performing is fully aligned with that established by the EBA for the supervisory reporting (known as FINREP), and used in its stress tests and transparency exercises for the banking sector. Spanish credit institutions must therefore apply the same definition of non-performing loan when preparing financial statements and in their financial reporting to the supervisor. Although International Accounting Standard (IAS) 39 provides an ample margin for institutions to apply a definition of "non-performing" or "impaired" in their accounting policies, would it make sense to use different definitions?

The Banco de España, as the accounting regulator, has opted to align the accounting definition of "non-performing" with that which European credit institutions must use to report to the supervisor on their non-performing loans. This complies fully with the SSM guidance on non-performing loans, published in March 2017, which strongly recommends that credit institutions use the EBA's definition of "non-performing" when preparing their financial statements.

Once the non-performing loans have been identified using a uniform definition for all banks, another key aspect of the supervisory review of non-performing loans are the practices pursued by institutions for the adequate coverage of their credit risk losses. For this review to be consistent and comparable, it is essential that guidelines are applied in addition to the general principles established under the IFRS accounting framework adopted by the EU, especially when expert judgement plays such an important role in the estimation of allowances and provisions to cover credit risk losses. In this connection, Annex IX of Circular 4/2004 contains principles and requirements for the estimation of allowances and provisions by institutions, thus specifying sound and consistent alternatives for applying the IFRS accounting framework. Moreover, having regard to the principle of proportionality, the aforementioned Annex IX offers solutions for estimating allowances and provisions in the IFRS framework for institutions or less complex portfolios.

Notwithstanding the foregoing, having accounting regulations containing a uniform definition of non-performing loans and consistent principles and requirements for the estimation of inherent losses is not enough: they must also be appropriately applied by institutions. That is why the supervisory review of their application is essential for supervisors to make their own diagnosis of the credit quality of bank balance sheets. A correct and updated diagnosis will depend on the supervisory review of institutions' accounting practices having sufficient scope, depth and frequency. This review is a necessary complement to the analysis of strategies, policies, procedures and controls designed by institutions to manage credit risk, since their effectiveness cannot be assessed without verifying their implementation in specific operations. In this sense, the individual review of loan files and the reconciliation of accounting and credit risk databases are very useful supervision tools, both in the course of on-site inspections and ongoing monitoring (offsite) of institutions.

SUPERVISION OF INTERNAL METHODOLOGIES FOR CALCULATING PROVISIONS IN THE FRAMEWORK OF THE NEW ANNEX IX

BOX 2.3

At the end of 2016, the Banco de España approved the creation within the DG Banking Supervision of a new cross-departmental group for "Centralised lending analysis".

This new group seeks to provide support for other specialist and operational groups, both in the monitoring and on-site inspections of credit institutions, to coordinate the review of compliance with the new principles and requirements (introduced by Circular 4/2016), which must be met in institutions' methodologies for estimating provisions to cover credit losses.

The functions assigned to the new group most notably include:

- First, centralisation of databases relating to credit risk, such as those connected with the loan portfolio, appraisals and internal methodologies.
- Second, validation and verification of the information contained in the above.
- Third, comparative analyses or benchmarking exercises and creation of risk indicators and reports enabling comparison of institutions.

2.2 Supervision of credit institutions

As indicated above, credit institutions are subject to supervision within the framework of the SSM. At end-2016, the SSM framework covered 125 groups of significant institutions (a total of 955 individual institutions, including holding companies) and 3,304 individual less significant institutions. Of the 125 largest banking groups, 14 are headed by a Spanish institution¹. The 14 Spanish groups, which represent 15% of the total assets of significant institutions in the SSM, only behind Germany and France, comprise 78 individual institutions from euro area countries, 54 of them Spanish. The institutions directly supervised by the ECB account for around 94% of the Spanish banking system's assets. In addition, there are another eight significant foreign groups partly owned by Spanish subsidiaries. Spanish credit institutions also encompass 69 less significant groups or individual institutions, including branches directly supervised by the Banco de España within the SSM framework.

SPANISH CREDIT INSTITUTIONS

TABLE 2.1

Figures at December 2015 and 2016

	2015		2016	
	Groups	Assets	Groups	Assets
Spanish groups of significant institutions	14	94.4%	14	94.3%
Foreign groups of significant institutions in which Spanish subgroups participate	8	1.1%	8	1.2%
Groups of less significant institutions (a)	73	4.5%	69	4.5%
TOTAL	95		91	

SOURCES: European Central Bank and Banco de España.

a Including groups, individual institutions not belonging to a group and branches of EU banking groups outside the euro area (11 branches in 2015 and 10 branches in 2016).

Table 2.2 shows a breakdown of credit institutions operating in Spain by type of institution, and changes in their number over time.

OFFICIAL REGISTERS OF INSTITUTIONS

TABLE 2.2

Number. Year-end data (a)

	2013	2014	2015	2016		
				Registrations	Deregistrations	Final
Credit Institutions	244	227	220	5	17	208
Banks	72	70	67	0	7	60
Saving banks	18	5	2	0	0	2
Credit cooperatives	67	65	65	0	2	63
ICO	1	1	1	0	0	1
Branches of EU institutions	78	79	79	5	7	77
Branches of non-EU institutions	8	7	6	0	1	5
Controlling companies	1	3	3	1	0	4
TOTAL	245	230	223	6	17	212

SOURCE: Banco de España.

a The number of institutions also includes those that are non-operational and in the process of deregistering.

As already mentioned, although the ECB is responsible for the direct prudential supervision of significant Spanish credit institutions, the Banco de España participates both in the ongoing monitoring and on-site inspections of these institutions. Less significant

¹ Santander, BBVA, Critería (CaixaBank), BFA (Bankia), Sabadell, Popular, Unicaja, Bankinter, Kutxabank, Ibercaja, Abanca Holding (Abanca), Liberbank, BMN and Banco de Crédito Social Cooperativo.

institutions are directly supervised by the Banco de España, although the ECB exercises indirect supervisory powers over them.

The supervision of both significant and less significant institutions is performed by means of two procedures: ongoing supervision and on-site inspections.

- Ongoing supervision is based on supervisory activities aimed at thoroughly analysing and assessing institutions to establish their risk profile and viability, and to determine their specific capital and liquidity prudential requirements. It adopts a prospective risk-based approach that is intensive in terms of supervisory activities, scope and resources.

Although all credit institutions apply an ongoing supervision approach, the frequency and intensity varies applying the proportionality principle depending on the size, systemic importance, nature, complexity and risk profile of the institutions.

- These activities are complemented by the performance of on-site inspections focusing on the review of specific areas previously identified by the ongoing monitoring team, the conclusions of which feed back into the assessment of the institution.

Just over two years after the start-up of the SSM, the ongoing supervision model continues to develop and adapt to changes in the regulatory environment and banking system. In this respect, the SSM has developed a common methodology (known as the Supervisory Review and Evaluation Process or SREP), based on the guiding principles defined in the Capital Requirements Directive IV and the EBA guidelines, which is proportionally applied both to significant and less significant institutions.

2016 saw the consolidation of common supervisory and authorisation processes and the fine-tuning of the supervisory review and evaluation methodology applied in the SSM sphere. In particular, changes were made in the methodology, and the SSM Supervisory Manual was updated to expand upon certain areas, such as internal governance. In addition, in relation to liquidity, a stress test exercise was included. As regards the capital decision, the composition and calculation of capital requirements was modified, as explained in Section 2.2.5 below.

An assessment of all credit institutions is performed every year

An overall SREP assessment of all credit institutions is conducted every year. On the basis of the SREP conclusions, the institutions' risks, their capital adequacy and liquidity to cover such risks are assessed. Depending on the SREP assessment made, the level of capital and liquidity considered adequate by the supervisor for the institution's risk profile is determined, and additional capital and liquidity requirements are imposed, as well as any other supervisory measures deemed necessary. Lastly, any shortcomings detected and capital and liquidity decisions are notified to and discussed with the institution's managers.

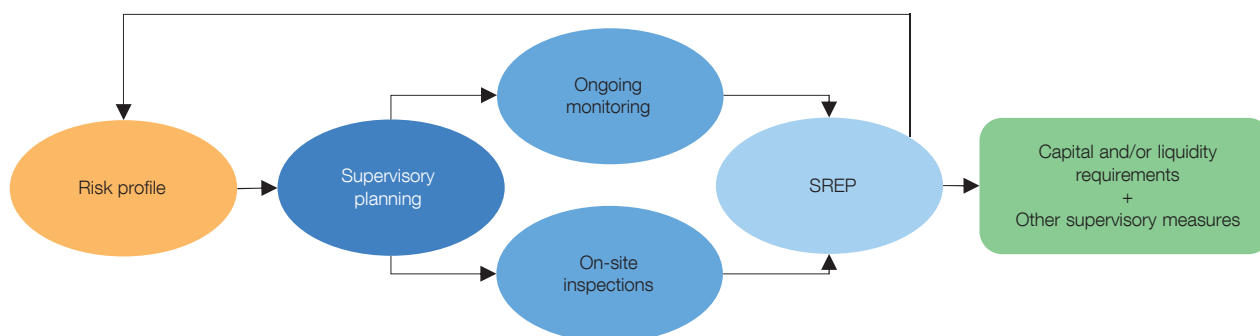
Establishing supervisory dialogue with the supervised institution is an essential feature of ongoing supervision

This approach enables the supervisory team to constantly update the institution's risk profile, to detect early potential areas of risk that may affect it and to identify factors which may trigger recovery and resolution measures envisaged in the legislation. Establishing a dialogue between the supervisor and the supervised institution is essential for the supervisory priorities and the weaknesses detected to be swiftly notified to the appropriate level, for the rapid and effective adoption of the corresponding preventive or remedial measures.

The intensity of the supervisory cycle depends on the supervisory priority assigned to the institution. This supervisory process is based on the institution's risk profile of the previous year, which is used to plan the intensity of supervisory actions, both relating to ongoing monitoring and to on-site inspections. The Supervisory Examination Programme (SEP) determines the supervisory tasks, their distribution, estimated timetable and frequency, and the necessary resources to carry them out.

SUPERVISORY CYCLE

SCHEMA 2.2



SOURCE: Banco de España.

The following sections discuss the main areas of supervision undertaken by the Banco de España in the framework of the SSM, both in relation to significant and less significant institutions, and the actions performed in 2016.

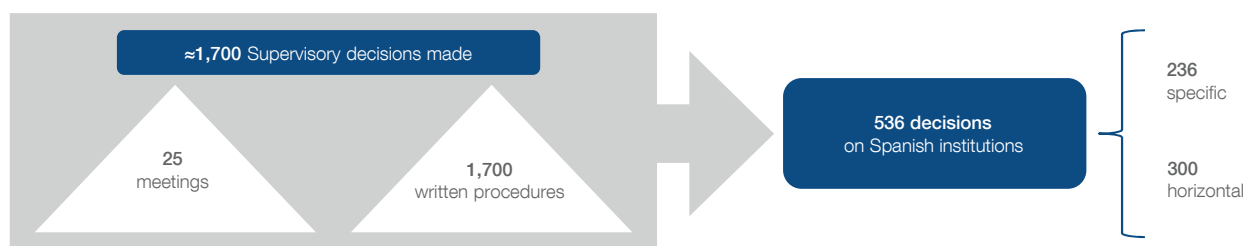
The Banco de España is actively involved in the SSM working groups.

Furthermore, the Banco de España participates in various working groups and numerous expert networks coordinated by the ECB or by one or several NCAs, for the discussion and proposal of supervisory policy and technical criteria relating to all the areas of work of the SSM. In 2016 the Banco de España participated actively in 63 of the approximately 80 horizontal groups organised within the SSM sphere.

Lastly, it should be mentioned that the Banco de España participates in decision-making in the framework of the SSM through its representation on the mechanism's Supervisory Board. Such decision-making is based on the outcome of the supervisory activities described above and is channelled via its governing bodies. In 2016, the Supervisory Board adopted (or proposed for final approval by the Governing Council under the so-called "non-objection procedure") a large number of supervisory decisions (see Schema 2.3). The bulk of those decisions have to date been adopted through written procedures, which supplement physical meetings of the governing bodies, enabling the decision making process to be expedited, particularly with respect to recurring or previously addressed matters.

DECISIONS MADE BY THE SUPERVISORY BOARD IN 2016

SCHEMA 2.3



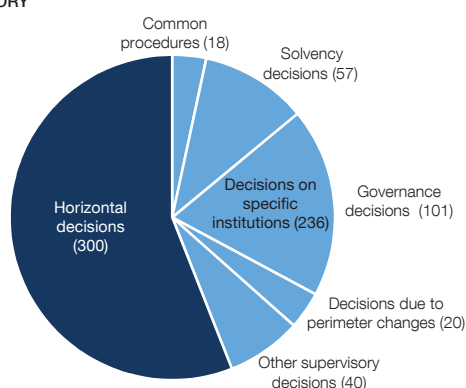
SOURCE: Banco de España.

The decisions adopted may either address specific credit institutions or be horizontal in nature, relating to organisational matters or supervisory policies and methodologies. Chart 2.1 shows the distribution of the 536 decisions adopted in 2016 affecting Spanish institutions in those categories. In addition, the chart illustrates how the bulk of the decisions affecting specific institutions relate to significant Spanish institutions, and only a small proportion to other types of institutions (less significant institutions and subsidiaries and branches of significant foreign banking groups established in Spain).

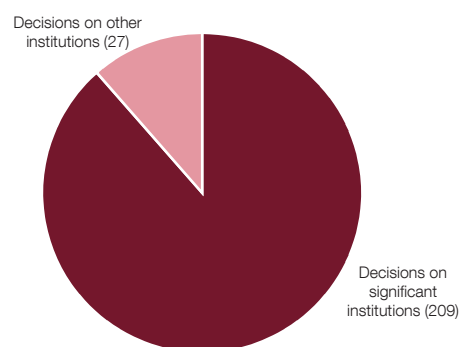
DISTRIBUTION OF DECISIONS

CHART 2.1

1 BY CATEGORY



2 BY TYPE OF INSTITUTION



SOURCE: Banco de España.

2.2.1 ONGOING SUPERVISION OF SIGNIFICANT SPANISH INSTITUTIONS

Since the start-up of the SSM in November 2014, the ECB exercises microprudential supervisory powers over significant institutions and performs supervisory tasks with the active participation of the Banco de España through the JSTs.

The Banco de España participates in the JSTs of the 14 groups of Spanish credit institutions classified as significant based on the SSM criteria and in the JSTs of 24 significant foreign banking groups established in Spain (8 subsidiaries and 16 branches). At 2016 year-end, the Banco de España contributed a total of 163 bank examiners and junior analysts to the JSTs of the Spanish banks.

Supervisory Review and Evaluation Process

As mentioned earlier, the SREP of significant institutions is carried out in accordance with the methodology defined by the SSM. The tasks are organised around four basic elements: analysis of the business model; evaluation of internal governance and global controls; assessment of the risks affecting capital and of capital adequacy to cover those risks; and assessment of the risks affecting liquidity and of the adequacy of liquidity sources to cover those risks.

The JSTs maintain ongoing and direct contact with credit institutions

In the performance of their supervisory functions, the JSTs periodically monitor risk indicators, with the frequency and intensity required by the supervisory significance assigned to the institutions. They also analyse regulatory reports, financial statements, management information, strategic and financial plans, frameworks, policies, manuals and procedures, the minutes of the institution's different decision-making and management bodies, and other relevant internal documentation. This wide range of documents most notably include the ICAAP and ILAAP, which are essential for determining the sufficiency and adequacy of capital and liquidity, together with the performance of stress tests.

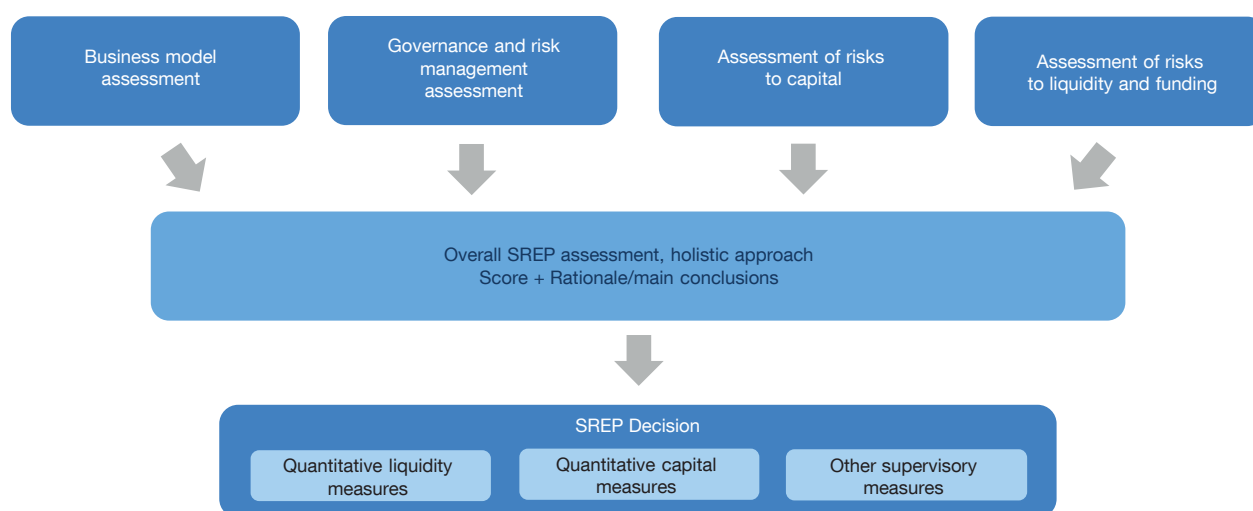
The JSTs maintain ongoing and direct contact with the institutions at different hierarchical levels. The heads of the JSTs attend board meetings or meet with independent directors

who chair control committees, as well as with executive directors and senior managers of institutions. The JSTs also hold regular and one-off meetings with management at different hierarchical levels. In the case of large Spanish significant institutions, the JSTs are based at their premises, and provide access to management and information. This communication is vital for conveying the identified shortcomings, the assessment of the institution and the supervisory priorities, and any other information relevant to the supervisor-supervised institution relationship, and favours the exchange of opinions and debate about the main supervisory areas.

SINGLE SUPERVISORY MECHANISM

SCHEMA 2.4

SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP). 2016 METHODOLOGY



SOURCE: Banco de España.

Also, the JSTs participate in the significant institutions' supervisory colleges present in countries outside the SSM context. In the case of Spanish institutions, these colleges are presided over by the ECB and the Banco de España participates as an observer.

The programme of supervisory activities at significant institutions in 2016 included both the tasks relating to the SREP and other tasks in line with the supervisory priorities defined by the SSM and the Banco de España, mentioned in section 2.1, or by the JST, based on the supervised institution's risk profile. The plans also encompassed the monitoring of the shortcomings detected by on-site inspections, the reviews of internal models used for calculating capital or the previous year's thematic reviews, such as that relating to internal governance and risk appetite.

Participating in the EBA and ECB stress tests has used up a significant portion of supervisory resources. These exercises have revealed the loss-absorbing capacity and resilience of the capital of European institutions to stress events. Moreover, in 2016, the results of the stress tests were, for the first time, taken into account in the capital decision, together with other considerations, specifically to define the Pillar 2 guidance (P2G).

Also, a review of management practices for non-performing exposures and foreclosed assets was conducted at institutions with high levels of problem assets, which has resulted in the drafting of guidelines for supervisors and supervised institutions. Finally, the scheduled

activities included the review of the recovery plans and cooperation with the Single Resolution Board (SRB) in the review of the resolution plans of significant institutions.

Thematic and specific reviews

As mentioned earlier, the SEP's tasks include thematic reviews and other, specific cross-sectional reviews. These reviews focus on the SSM's supervisory concerns which are to be addressed in greater depth. As well as serving to assess and compare practices in the system, they are also used to identify best practices and to convey supervisory messages and expectations and their conclusions feed back into the SREP assessment.

In 2016, in line with the strategic priorities detailed in section 2.1.1, the JSTs participated in various thematic reviews, some of which will extend into 2017.

In 2016, the thematic reviews covered the business model, implementation of IFRS 9, internal capital models and data aggregation

- Review of business model and profitability risk. This is a two-year project, centred on the analysis of the profitability levers both at institution level and by business model segment, in a setting of low interest rates. This review aims to verify whether institutions are assuming greater risks to compensate for the decline in profitability. During 2016, it involved preparatory work, such as the design of tools and preparation of guidelines, and in 2017, the JSTs will participate more actively, performing the field work.
- Review of IFRS 9 on Financial Instruments. The purpose of this review is to assess the potential impact on the provisioning policies of credit institutions of applying the new accounting standard, and the preparatory measures for its entry into force in 2018. As with the previous review, it will be conducted over two years, with greater intensity in 2017.
- Review of internal capital models (Targeted Review of Internal Models, TRIM). This review addresses the supervisory concern relating to the quality and composition of banks' own funds, and also seeks to harmonise national options and discretions (OND). The primary objective is to assess the adequacy of the Pillar 1 internal models to measure risks. The multi-year review commenced in the second quarter of 2016.
- Review of compliance with the Basel Committee principles for effective risk data aggregation and risk reporting. This review focuses on global systemically important institutions.

Following the thematic reviews of 2015, the SSM issued a statement in June on governance and risk appetite, with reference to the main conclusions of the thematic review and the supervisory expectations in these areas. Also, in November 2016, it published draft guidelines on leveraged finance for consultation, providing guidance on the subject for credit institutions. The definitive version shall be published in 2017.

Other tasks

The JSTs also participate in authorisation processes initiated by the supervised institutions, preparing assessment reports for the adoption of resolutions in the SSM sphere. Some examples of such processes are issues, amortisations and repurchase of capital items, changes to internal capital models, exclusion of identified staff, payment of variable remuneration, corporate operations, and outsourcing processes.

It should be noted that the JSTs can perform specific tasks and activities on top of those in the supervisory plan, especially in order to swiftly address possible emerging risks or circumstances that might affect the institution.

The JSTs also cooperate with various European and international authorities and bodies, conducting surveys or impact studies, either by mediating between these authorities and the participating institutions, or responding to them.

Lastly, the Banco de España also participates, together with the ECB, in the supervision of foreign banking groups with a presence in Spain, eight of them with subsidiaries, the parents of which are classified as significant.

2.2.2 ONGOING SUPERVISION OF LESS SIGNIFICANT SPANISH INSTITUTIONS

Supervisory processes at less significant institutions observe the principle of proportionality

As mentioned above, the Banco de España is responsible for the direct supervision of less significant institutions (LSIs), which account for around 6% of the Spanish banking system's assets, while their indirect supervision falls to the ECB.

In the exercise of its supervisory tasks, the Banco de España performs quarterly or half-yearly general monitoring actions of less significant Spanish credit institutions, covering, inter alia, the areas of financial monitoring, credit risk and liquidity

PERCENTAGE OF THE DIFFERENT TYPES OF LESS SIGNIFICANT INSTITUTIONS TABLE 2.3

	% total assets/sector	
	December 2015	December 2016
Domestic Banks	33.94	31.50
Subsidiaries of Foreign Banks	3.83	4.30
Credit Cooperatives	57.25	59.50
Saving Banks	1.23	1.18
Foreign Branches	3.75	3.48
TOTAL	100.00	100.00

SOURCE: Banco de España.

The objective of those actions is to update the institution's risk profile, identify weaknesses and detect areas or matters which should be explored in greater depth. All these actions follow the principle of proportionality, so smaller institutions, with an insignificant volume of deposits raised on the retail market, are subject to simplified remote monitoring in the form of quarterly alerts based on information from confidential financial statements and the Central Credit Register. The purpose of that remote monitoring is to detect potential future liquidity, solvency or profitability problems. In 2016, there was comprehensive ongoing monitoring of 19 of the 69 groups of LSIs that were under the supervision of the Banco de España (around two thirds of LSIs total assets), and the simplified remote monitoring of the remaining 50 groups.

Also, more than 450 detailed actions were performed, including reviews of audit reports and reviews of internal capital adequacy assessment reports and capital decisions. In addition, regular meetings were held with persons in positions of responsibility at the institutions.

The Banco de España continued to cooperate with other NCAs in the area of colleges of supervisors of foreign banking groups with LSI parents, participating in three colleges² in 2016.

² A&G Banca Privada, Banco Finantia Sofinloc and Banco Mediolanum.

Such direct supervision of the LSIs by the Banco de España is supplemented by the indirect supervision by the ECB, which consists of:

- overseeing the functioning of the LSI sector, and
- ensuring the application of high and harmonised supervisory standards by the NCAs.

The ECB's performance of those two functions benefited from the cooperation by the Banco de España, which contributed its staff's experience and knowledge of the characteristics of the less significant Spanish institutions. In particular, the Banco de España cooperates with the ECB by submitting regular and ad hoc information on the manner in which the supervisory activity is performed and its results, following the procedures laid down by the ECB.

The Banco de España cooperates with the ECB and the other NCAs in defining high supervisory standards which, once approved in the form of guidelines or recommendations, must be applied or taken into consideration by all the SSM countries in the supervision of their LSIs. That cooperation will be maintained in the coming years, since ensuring that the supervisory standards are consistent and effective and that there is an appropriate level of consistency within the SSM is deemed a priority, without prejudice to the fact that the characteristics of the LSIs of each country must be taken into account.

Lastly, given that the branches of institutions with head offices in European Union Member States that are not under the supervision of the SSM are not subject to prudential or liquidity requirements at the branch level, the supervision of the Banco de España is based on simplified remote monitoring and on the regular exchange of information with the authorities of the home country of the branch, under the terms established in Commission Implementing Regulation (EU) 620/2014.

2.2.3 COMMON PROCEDURES

The common procedures, established in Regulation (EU) 468/2014 of the ECB, are those relating to authorisations to take up the business of a credit institution, withdrawals of such authorisations and the acquisitions of qualifying holdings. Among these procedures, the Banco de España is responsible for making an initial assessment and submitting a draft decision on each specific case. Subsequently, on the basis of this proposal and other additional tasks that it might deem appropriate, the ECB must adopt a final decision.

In 2016, five common procedures were performed relating to the acquisition of significant holdings and five to withdrawals of authorisations.

2.2.4 ON-SITE INSPECTIONS

As regards both significant and less significant credit institutions, the on-site inspection function is separate from ongoing monitoring for the purpose of reinforcing the independence and objectivity of the conclusions obtained from those tasks. Table 2.3 details the on-site actions performed on credit institutions in 2016.

ON-SITE SUPERVISORY ACTIVITY AT CREDIT INSTITUTIONS. ACTIONS

TABLE 2.4

	2016		TOTAL
	Significant institutions	Less significant institutions	
On-site inspections	16 (a)	13	29
Internal risk-model reviews	14	—	14
Anti-money laundering inspections	3	—	3
TOTAL	33	13	46

SOURCE: Banco de España.

a Of which, 12 were led by Banco de España.

On-site actions
for significant institutions

On-site inspection actions for significant institutions are planned as part of the SEP. Apart from the three inspections on the prevention of money laundering mentioned below, in 2016, 28 on-site inspections of significant Spanish institutions were performed. The Banco de España played a major role in those supervision tasks:

- Of the 30 on-site inspections, 24 were led by Banco de España staff, 3 by ECB staff and 3 by staff from another SSM Member State.
- A significant proportion of the personnel who participated in the aforementioned inspection visits were from the Banco de España.

In 2016, Banco de España staff participated for the first time in inspections of institutions from other SSM Member States

In addition, Banco de España staff participated for the first time in inspections of two financial groups from other SSM Member States.

In 2016, work continued to improve on-site inspections, particularly to boost their efficiency by developing mechanisms and routines to reduce inspection turnaround times.

As part of the aforementioned significant and active participation of the Banco de España in the many working groups set up in the SSM framework, it participated intensively in the development of the most appropriate techniques for the on-site inspection of different risks (credit, technological, market...). In this respect, to continue uniformly applying on-site inspections in all SSM countries, in 2016 the ECB Centralised On-Site Inspection Division organised a series of working meetings between the ECB and the various national supervisors.

In the last quarter of 2016, the Banco de España participated actively in the preparation of the 2017 SEP, which established the on-site inspections to be performed throughout the year. The main new features should be noted:

- An increase in the number of joint inspections (performed by staff from different countries), including some headed by Banco de España staff in institutions in other SSM countries.
- There will be an ambitious programme of reviews of internal models in 2017, which will cover a total of 19 Spanish institutions and will notably include an in-depth review of the internal capital models in force within the SSM (Targeted Review of Internal Models, TRIM).

A substantial increase in supervisory actions by multinational teams is expected in 2017

The Banco de España will continue cooperating with SEPBLAC, which is responsible for the supervision of the prevention of money laundering

Since the supervision of the prevention of money laundering and terrorist financing has been excluded from the SSM's supervisory action, the Banco de España continues to cooperate with SEPBLAC in the supervision of this area. In 2016, three inspections were carried out at significant institutions, and the Banco de España continued to take part in various international working and cooperation groups on this issue.

On-site actions for less
significant institutions

A supervisory action plan is prepared every year for less significant institutions, which, together with monitoring actions, makes up the plan of on-site actions for less significant institutions, taking into consideration the supervisory risk profile of the various institutions and the years elapsed since the last action. This plan is approved by the Banco de España's Executive Commission. A total of 13 actions were performed in the year.

The supervisory assessment of each credit institution contains the conclusions of the remote and on-site reviews and determines the annual capital decision (known as “Pillar 2”) which is notified in December each year and which institutions must comply with the following year.

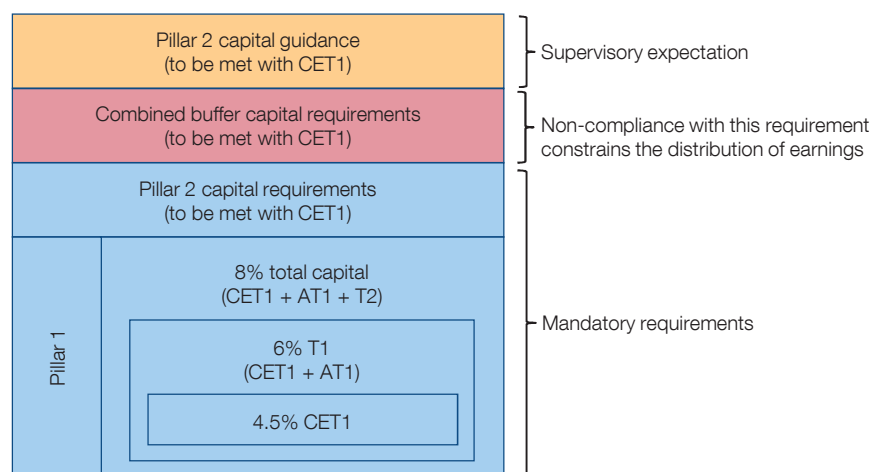
The supervisor adopts this decision essentially on the basis of the SREP, which includes the examination of the institution’s risks, controls and governance. The SREP also takes into account the supervisory review of the assessment that the institution itself makes of its risks and its capital base in accordance with its internal processes, in a process called “Internal Capital Adequacy Assessment Process” (ICAAP).

It should be taken into consideration that the guidelines prepared by the EBA in relation to the SREP, which were published in December 2014 (EBA/GL/2014/13), have been in force since 2015. Also, at the end of 2016, the EBA published guidelines on the ICAAP and ILAAP (EBA/GL/2016/10), which will be formally implemented following the adoption by the Banco de España of the definitive version of the guidelines translated into Spanish.

The formal structure of the 2016 capital decision has changed substantially with respect to that of 2015, in the terms set out below. In principle, this change affects both significant institutions supervised by the SSM and less significant institutions.

- The first change is a formal one: the 2015 capital decision indicated the total level of CET1 which institutions must have at all times and which covered both the minimum regulatory requirement (Pillar 1) and Pillar 2 risks (basically business risk, balance sheet interest rate and exchange rate risk, concentration risk and reputational risk). However, the 2016 capital decisions only include the amount of CET1 required to cover Pillar 2 risks.
- The 2015 capital decision required institutions to cover, in relation to Pillar 2, the portion of the capital conservation buffer not yet directly enforceable at the time, in application of the transitory adjustment regulations (that is, the equivalent of a 2.5% buffer was required). The 2016 capital decision only refers to the combined buffer requirement enforceable at institutions in accordance with the phasing-in period envisaged in the regulations, by virtue of which Spanish banks need to cover 1.25% in 2017.
- The capital decisions issued by the SSM in 2016 introduced a new element, the so-called “Pillar 2 guidance” or P2G. This supervisory tool sets capital expectations above the level of overall capital requirements, which are not binding and supplement the Pillar 2 requirements. This guidance relies on the outcome of the stress test exercises conducted during the year and is expressed in terms of CET1. The SSM expects banks to comply with P2G, on top of the minimum regulatory requirements (Pillar 1), the Pillar 2 requirement and the combined buffer requirement. If a bank fails to comply with this expectation, there will be no automatic supervisory actions. Instead, supervisors will consider adopting supervisory measures on a case by case basis, with the approval of the Supervisory Board of the SSM. Such measures may include the transformation of this capital expectation into a Pillar 2 capital requirement, which the bank in question would be obliged to comply with.

The SSM’s capital decision for significant institutions in 2016 includes a capital requirement and recommendation for the first time



SOURCE: Banco de España.

Capital decision of significant institutions

With regard to significant institutions, 2016 saw for the second time the application of the methodology implemented within the SSM for determining the capital decision, which guarantees that all significant European institutions are assessed on a uniform basis. This common framework covers:

The level of capital communicated to significant institutions by the SSM in 2016 remained stable in overall terms.

- a) a system for risk assessment of credit institutions' risks;
- b) a review of the ICAAP and ILAAP applied by the institutions; and
- c) a methodology for calculating the capital and liquidity needs on the basis of the assessment of their risks.

In material terms, the inclusion of the capital expectation (P2G) in the capital decision has been a particularly significant factor in the overall reduction of the Pillar 2 capital requirement with respect to that of the 2015 capital decision. However, if the capital expectation and capital conservation buffer are included, the total capital requirement notified by the supervisor to institutions does not change overall.

Once the period granted to institutions for making representations has expired, the 2016 SREP capital decisions approved by the SSM Supervisory Board will be in force until the next capital decision, which will foreseeably be adopted in December 2017.

Capital decisions of less significant institutions

With respect to less significant institutions under the direct supervision of the Banco de España, a similar, though simpler, arrangement was applied in 2016, taking into account the SREP methodology already developed by the SSM for LSIs and the Banco de España's guidelines on the ICAAP and the capital review process.

Once the corresponding 2016 SREPs had concluded, the Banco de España adopted capital decisions for the less significant institutions by means of a procedure that included the consideration of institutions' representations.

The supervisory practices of the Banco de España are adapted, in all material respects, to the current framework established by international agreements, European legislation, the EBA guidelines adopted by the Banco de España as at 31 December 2016, and the SSM

cooperation framework. Given that the SREP methodology for LSIs is currently under preparation, in 2017 the SREP will need to be adapted and brought into line with the guidelines issued by the SSM for LSIs, although entry into force will not be mandatory until 2018.

2.2.6 INFORMATION SUBMITTED PERIODICALLY TO THE EXECUTIVE COMMISSION

Although supervisory decisions relating to significant credit institutions are adopted by the Governing Council of the ECB, supported by the Supervisory Board, the Directorate General Banking Supervision informs the Executive Commission of the Banco de España about these decisions and other relevant SSM matters. The director general of Banking Supervision reports to the Executive Commission on:

- The supervisory decisions regarding significant Spanish institutions, including capital decisions.
- The supervisory priorities and the supervision plan for the coming year.
- General SSM matters which may be of particular interest.
- Relevant decisions relating to foreign SSM institutions.
- Periodically, on the situation of Spanish institutions.

2.2.7 THE QUALITY FUNCTION

The quality function seeks to ensure that banking supervision is consistent and applies the best supervisory practices

The quality function seeks to ensure that banking supervision is consistent and applies the best supervisory practices. Before the SSM was created, the Banco de España's quality function centred on providing support to operational groups, with the aim of standardising supervisory practices. As an example, this standardisation was achieved by unifying technical supervisory criteria, establishing common supervisory procedures and methodologies, using the analytical ratios of similar institutions, ensuring that information was properly filed and assessing the degree of compliance with the action plan.

Following the entry into operation of the SSM, and without abandoning its supportive role, the quality function has been strengthened and geared towards specific ex-post quality reviews, in line with the SSM's approach. In this respect, responsibilities between the SQA (Supervisory Quality Assurance) Division of the ECB and the quality function at the Banco de España (as the Spanish NCA) have been allocated as follows:

- The SQA Division is responsible for exercising the quality function over institutions which are directly supervised by the ECB, that is, significant institutions.
- The Banco de España's quality function is responsible for assuring the quality of supervision of less significant Spanish institutions, and that of all other functions of local institutions. In addition, it may cooperate with the SQA Division in the reviews of significant institutions.

2.2.8 SUITABILITY

The applicable legislation establishes certain suitability requirements for board members and...

The purpose of the supervision of the suitability regime for senior officers is to assess compliance with the requirements that the persons appointed to occupy the positions of board members, managing directors or similar officers must fulfil in accordance with the applicable legislation: commercial and professional reputation, appropriate knowledge and experience to exercise their functions, compliance with the incompatibilities and limitations regime (where applicable) and, in the case of board members, willingness to exercise good governance. The suitability assessment by the supervisor is conducted mainly upon the

appointment of the senior officer, but also in an ongoing manner, when there are significant events or changes which might affect it.

Competence in the case of significant institutions corresponds to the ECB, in close cooperation with the NCAs, whereas competence in the case of less significant institutions corresponds to the Banco de España.

The supervision of the suitability regime for senior officers is constantly being adapted to the new criteria published by regulatory bodies, and to both national and international best practices. In the case of institutions forming part of significant groups, the ECB endeavours to harmonise supervisory criteria among all the SSM countries, always observing the limits established under national legislations.

The Banco de España has not only participated actively in the drafting of criteria and practices which began to be defined in the previous year and which, as discussed below, have culminated in the publication of the ECB and EBA guidelines on suitability assessments, but has also worked to improve the coordination of the ongoing supervision of institutions' corporate governance, and the suitability regime for senior officers, both as individuals and as a group.

In 2016, the collective suitability of the board of directors was further analysed, bearing in mind, for the purpose of taking decisions on suitability, the supervisory teams' conclusions on the corporate governance of some institutions, mainly those forming part of significant groups, when such conclusions are related to the collective suitability requirement of the board. For example, the decisions refer to the level of skills and experience expected by the supervisor in any future appointments made by the institution.

Accordingly, the focus has shifted to ongoing supervision of compliance with the suitability regime, attempting to relate findings or new facts detected, either externally or internally, during the mandate of the senior officers. The circumstances analysed in each specific case may give rise to a suitability reassessment procedure, if it is determined that the new facts are sufficiently relevant (with a positive or negative outcome) or, otherwise, to a supervisory judgement on the lack of relevance of such facts regarding suitability.

The Banco de España has consolidated the practice of i) incorporating into the suitability decisions for significant and less significant institutions conditions, recommendations, requirements or obligations, in line with the measures taken the previous year for institutions forming part of major groups, and ii) interviewing the chair, chief executive officer or, depending on the case, newly appointed independent directors of credit institutions belonging to major groups, consolidated at the highest level within the group or, if this is a corporation, of the credit institution with the highest volume of assets.

**Institutions must
continually improve and
adapt their suitability
assessment procedures
and duly reflect the
outcomes in their reports**

Also, work is under way to systemise the information required by the competent authorities for the suitability assessment files, so as to ensure that the suitability assessment requests submitted by institutions are as detailed as possible and can be dealt with by the competent authority quickly, especially taking into account that, in the case of credit institutions, the exercise of functions by the appointed person is conditional upon registration in the Senior Officers Register, and that the suitability assessment must be performed by the competent authority prior to registration. The ECB, jointly with all the NCAs, has prepared a suitability questionnaire intended to systematise the required information and prevent the competent authorities from having to make additional information requests during the processing of

the files. The Banco de España is expected to implement this questionnaire in the coming year. The Banco de España's Virtual Office is proving to be an essential tool for sharing information about these new developments.

In this respect, the guidelines published by the EBA and the SSM and referred to below provide guidance on the information that institutions must take into consideration when assessing whether each of the suitability requirements has been met. Both sets of guidelines emphasise that the credit institutions themselves have the primary responsibility for selecting and appointing senior officers and ensuring that they adequately comply with the suitability requirements at all times. It is therefore particularly important that they continuously improve and adapt their suitability assessment procedures, duly reporting on the results.

Finally, in early 2016, the Banco de España approved Circular 2/2016, relating to important aspects such as: i) the incompatibilities regime; ii) the possibility, during the processing of the files, of consulting other supervisors, conducting interviews or requesting additional information or documentation, or iii) the adoption of a negative decision, among other reasons, if false or misleading information is provided or relevant information is omitted during the assessment process, or if the shortcomings detected in the process are not remedied. Furthermore, in compliance with the third transitional provision of this circular, information has been provided about board members, managing directors and similar officers of credit institutions, with a view to updating the Register of Senior Officers.

Harmonisation of supervisory practices among the SSM countries

As mentioned above, the ECB has published a Draft guide to fit and proper assessment, the main objective of which is to inform credit institutions under its direct supervision of the supervisory criteria used when assessing the suitability of senior officers. This guide has been submitted for public consultation and will foreseeably be approved by June 2017.

European Banking Authority Guidelines

Also noteworthy is the publication of the *Joint ESMA and EBA Guidelines on the assessment of the suitability of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU*, which have been put to public consultation and whose final version is pending approval. Once these guidelines have been approved, the competent supervisory authorities must inform the EBA of the level of compliance with the guidelines and provide justification in the event of non-compliance.

2.2.9 OTHER ACTIONS

In addition to the tasks described above, the Banco de España's supervisory tasks also include, both for significant and less significant institutions, the microprudential supervisory tasks not transferred to the SSM and the handling of certain procedures envisaged in the applicable legislation.

Other supervisory tasks of the Banco de España

Noteworthy among the microprudential supervision tasks not transferred to the SSM which were performed by the Banco de España in 2016 are the following:

- The Banco de España is the competent body to authorise the opening of third-country branches in Spain. In 2016 no new authorisations were granted.
- As indicated in the Chapter 1, the supervision of the prevention of money laundering and terrorist financing at credit institutions in Spain is the competence of the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC by its Spanish abbreviation) and the Banco de España participates in the supervision of those procedures under the special cooperation arrangements provided.

As mentioned earlier, the division of certain competences between the ECB and the NCAs, not arising from EU legislation, has recently been clarified in the framework of the SSM. Accordingly, the Banco de España assumes supervisory powers which do not correspond to the ECB or which do not support its supervisory functions.

Specifically, the Banco de España pays ongoing attention to developments and changes in the banking activity and to new trends, for example, the emergence of Fintech firms.

Procedures performed

Also, in 2016 the Banco de España, both as a member of the SSM and in the exercise of its exclusive supervisory powers, performed the procedures summarised in Table 2.5 below.

PROCEDURES IN RESPECT OF CREDIT INSTITUTIONS INVOLVING THE BANCO DE ESPAÑA

TABLE 2.5

	Total number
Cross-border activity of Spanish credit institutions	47
Branches in the European Union (a)	11
Branches in third countries	2
Freedom to provide services	34
Suitability	294
Loans to senior officers	68
Other procedures relating to own funds (b)	21
Reports to Ministry of Economy on structural changes	13
Acquisition of credit institutions in third countries	4
Amendments of articles of association	55
Issuance of reports for other Spanish authorities	16
Other procedures	26
TOTAL	544

SOURCE: Banco de España.

a The amount includes one closure and ten modifications of the branches initial notifications.

b Including exemptions from deductions provided for in Regulation (EU) 575/2013, authorisations relating to the scope of that regulation and joint decisions on capital.

2.2.10 LETTERS

In the performance of its supervisory tasks, the Banco de España sent 150 letters to credit institutions containing requirements and recommendations, as detailed in Table 2.6. Of these, 57 related to capital decisions, 54 to recovery plans, 19 to the outcome of the comprehensive annual monitoring and 20 to on-site inspections.

SUPERVISORY ACTIVITY. LETTERS ADDRESSED TO CREDIT INSTITUTIONS

TABLE 2.6

Number	Total number
Credit institutions (a)	
Banks	43
Savings banks	6
Credit cooperatives	99
Foreign branches	2
TOTAL	150

SOURCE: Banco de España.

a Of these letters, 3 relate to SIs arising from competencies not assumed by the SSM and the rest relate to LSIs.

The regulation assigns a major role to the supervisor in the recovery and resolution of credit institutions

2014 saw the publication of the Banking Recovery and Resolution Directive (BRRD), which guarantees a harmonised resolution framework in the EU with a view to ensuring that taxpayers do not have to bear the costs of failing banks, and that the shareholders and creditors assume the mistakes of inappropriate private action. The BRRD was transposed into Spanish legislation through the approval of Law 11/2015 and Royal Decree 1012/2015 in June and November, respectively.

On the one hand, a new institutional framework for resolution is defined, drawing a distinction between: i) preventive resolution functions, assigned to the Banco de España (which performs that task independently from its supervisory functions), and ii) executive resolution functions, assigned to the FROB. These functions will be performed bearing in mind the competence structure attributed to the ECB in the framework of the SSM and to the SRB as the single resolution authority in the framework of the Single Resolution Mechanism (SRM)³.

On the other, three key phases are established for the new resolution framework: i) a preventive phase, in which institutions and authorities must plan how to handle a critical situation or a potential resolution; ii) an early intervention phase, in which the supervisor is granted powers that supplement the other supervisory measures available to it to take action in relation to institutions when they start to show weakness but are still viable and, iii) a resolution phase. In addition, under this new crisis management framework, supervisors and resolution authorities are subject to an obligation to cooperate and work closely in the different phases mentioned above.

Preventive phase

In the preventive phase, in its normal course of business, it is particularly important for an institution to ensure that it is prepared to deal with a crisis situation (in the case of institutions, in order to “survive”, and in that of the resolution authorities, in order to “take swift action” to ensure the continuity of critical functions and stave off adverse effects for the economy).

This phase consists of the following key elements: i) the preparation of recovery plans by institutions, defining measures they would adopt to restore their position in times of crisis, and ii) the design of resolution plans by the resolution authority, establishing the roadmap to be followed to resolve the institution, if necessary. Also, under the regulations, as an integral part of the resolution plan, the resolution authority must perform two key tasks: a “resolvability analysis” (to identify and remove, if necessary, any possible obstacles to the swift execution of a potential resolution) and the determination of the “minimum requirement for own funds and eligible liabilities (MREL)” to be met by institutions to guarantee loss-absorbing capacity and, if necessary, the recapitalisation of the institution.

Early intervention phase

The early intervention would be activated at the request of the competent supervisor before the institution’s resolution becomes necessary and with a view to avoiding it. There are some thresholds, which are not automatic, allowing for early intervention, defined by the EBA guidelines and adopted by the Banco de España. Those thresholds are linked to the institution’s SREP, to significant events or to the outcomes of the monitoring of the institution’s financial situation. The supervisor may adopt different measures, from forcing through the adoption of measures included in the recovery plan or requiring the removal of directors, for example, to deciding on the intervention of the institution if the other measures prove to be insufficient. Identifying the time at which early intervention should be triggered

³ The SRB (the single resolution authority in the euro area) has powers over the institutions supervised directly by the ECB in the framework of the SSM and other cross-border groups of less significant institutions.

is essential to prevent the institution from becoming non-viable. In that connection, the Banco de España has adopted the guidelines issued by the EBA on the thresholds for triggering early intervention, on which it bases its analysis to decide on this matter.

Schema 2.6 summarises the main tasks assigned to the supervisory and resolution authorities (prevention and execution) in these two phases of the resolution framework, taking into account the competences attributed to the ECB and the SRB in the framework of the SSM and the SRM, respectively.

MAIN TASKS OF THE SUPERVISOR AND THE RESOLUTION AUTHORITIES DURING THE PREVENTIVE PHASE AND DURING EARLY INTERVENTION

SCHEMA 2.6



SOURCE: Banco de España.

Resolution phase

In order to commence the resolution phase, the following must be determined: i) whether the institution is non-viable; ii) that there are no private alternatives or other supervisory measures that might prevent failure; and iii) whether it is in the public interest. In Spain, it is the supervisor that determines the first premise⁴. Verification of the second premise

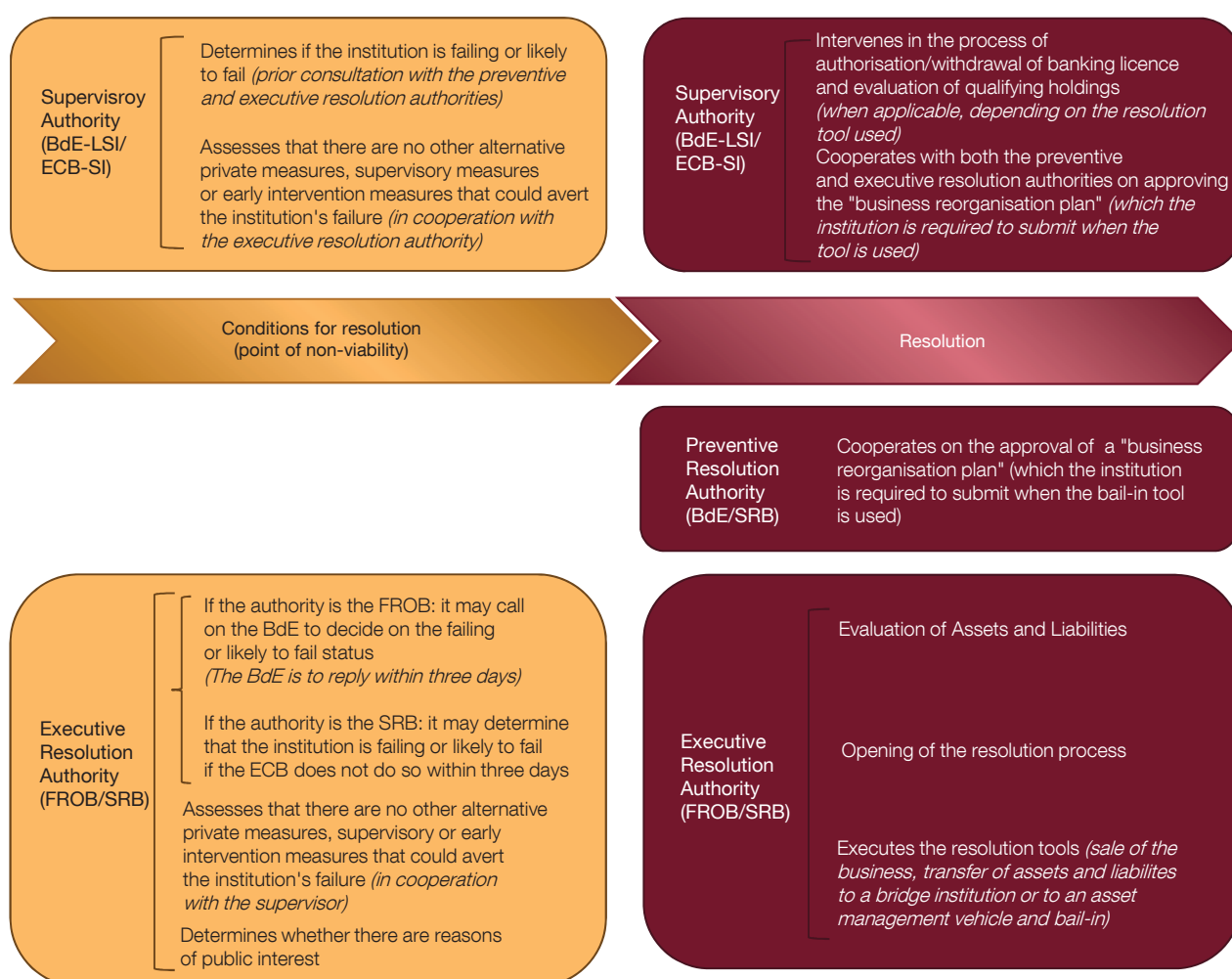
⁴ Although the FROB may urge the supervisor to make such a determination if it considers there are reasons to do so, the supervisor must give a justified response within three days.

(alternatives to prevent failure) is the joint responsibility of the supervisor and the executive resolution authority. Lastly, the assessment of public interest falls to the executive resolution authority. If the resolution cannot be justified for reasons of public interest, the institution would be wound up under normal insolvency proceedings.

Schema 2.7 summarises the main tasks assigned to the supervisory and resolution authorities (prevention and execution) when the institution becomes non-viable and a decision is taken to proceed with the resolution, taking into account the competences attributed to the ECB and the SRB in the framework of the SSM and the SRM, respectively.

MAIN TASKS OF THE SUPERVISOR AND THE RESOLUTION AUTHORITIES WHEN THE INSTITUTION REACHES THE POINT OF NON-VIABILITY AND DURING THE RESOLUTION PHASE

SCHEMA 2.7



SOURCE: Banco de España.

Main supervisory activities of the Banco de España in the resolution framework in 2016

With respect to the groups of significant institutions, the JSTs performed the following activities in the area of recovery and resolution:

- They completed the reviews of the first recovery plans submitted by these institutions in the final quarter of 2015. Institutions were informed of the outcome of the reviews in letters in which they were advised of the aspects to be improved before submitting their plans for 2016.

The recovery plans of significant credit institutions were reviewed for the first time

- They participated in the resolution plan review process, in the legally established prior consultation phase between the resolution authority and the competent supervisory authority (SRB and ECB, respectively). This review was particularly relevant for the analysis of the implications of the resolution strategy adopted by the resolution authority for the different groups, and the measures required for reducing or removing any identified impediments to resolvability. No formal decision was taken in 2016 as regards determining the minimum requirement for own funds and eligible liabilities (MREL).

With regard to less significant institutions, the Banco de España:

- Completed the definition of the institutions which may be subject to simplified obligations, taking into account the framework established in the EBA guidelines on this issue (EBA/GL/2015/16). In fact, these institutions submitted their resolutions plans to the Banco de España for the first time in 2016, by the 30 September deadline. The supervisor reviewed these plans in the first quarter of 2017.
- Has also participated actively with other NCAs and the ECB in the process of harmonising crisis management schemes for less significant institutions in order to ensure consistent procedures and tools in the SSM framework for sound and effective crisis management at these institutions.

2.3 Supervision of institutions other than credit institutions

The Banco de España has exclusive microprudential supervisory powers over the following institutions other than credit institutions that provide services or perform functions related to the financial sector: specialised lending institutions, mutual guarantee and reguarantee companies, appraisal companies, payment institutions, electronic money institutions, currency-exchange bureaux, banking foundations and Sareb. Table 2.7 contains the detail of those institutions.

OTHER INSTITUTIONS

TABLE 2.7

Number. Year-end data (a)

	2013	2014	2015	2016
Specialised lending institutions (b)	48	47	44	43
Mutual guarantee companies	24	24	21	21
Reguarantee companies	1	1	1	1
Appraisal companies	46	40	36	37
Currency-exchange bureaux (c)	9	10	13	12
Payment institutions	48	45	43	41
Hybrid payment institutions	—	—	2	3
Branches of EU payment institutions	6	8	12	15
Agent networks of EU payment institutions	2	3	3	3
Electronic money institutions	3	4	3	4
Branches of EU electronic money institutions	1	2	2	2
Banking foundations	—	13	14	14
Sareb	1	1	1	1
TOTAL	189	198	195	197

SOURCE: Banco de España.

a The number of institutions also includes those that are non-operational and in the process of deregistering.

b Of the total, there are 21 specialised lending institutions that are subsidiaries of banking groups and are supervised through these groups. Also included are the specialised lending institutions that have proven their status as hybrids, in application of Law 5/2015, to promote business financing (0 in 2013, 0 in 2014, 5 in 2015, and 8 in 2016).

c Not including establishments only authorised to purchase foreign currency with payment in euro.

Institution type	Activities conducted	Supervisory powers of the Banco de España	
		Legal basis	Main activities
Specialised lending institutions	Various types of credit transactions and granting of guarantees. They cannot take deposits from the public, however.	Article 12.1 of Law 5/2015, on the promotion of business financing.	Review of credit portfolio quality, profitability, solvency and internal controls. Carried out via monitoring activities or on-site inspections.
Mutual guarantee companies	These act as a means of business promotion, granting guarantees to SMEs to allow them to access bank finance, and providing other complementary services, such as advice on negotiating better borrowing conditions with credit institutions and evaluating investment projects.	Article 66 of Law 1/1994 on the Legal Regime for Mutual Guarantee Companies.	Analysis of the the quality of the portfolio of guarantees, their liquidity, profitability and solvency. Carried out via monitoring activities and on-site inspections, where applicable.
Appraisal companies	Appraisal of assets used as collateral for credit institutions' mortgage exposures in general.	Article 15 of Royal Decree 775/1997 on the rules governing the approval of appraisal services and companies.	Analysis of the procedures used to perform the appraisal of real-estate assets taken as mortgage collateral by credit institutions. This analysis is carried out using a tool based on statistical methods to review the appraisals performed by these companies, and by on-site inspections, where applicable.
Payment institutions	Providers of services and means of payment, performing an important role in the functioning of an effective, efficient and secure payments system, which is in turn crucial to the correct functioning of economic and commercial relations.	Article 15 of Law 16/2009 of 13 November 2009 on payment services.	The work of supervising these institutions focuses on reviewing the adequacy of the safeguards protecting funds received from customers, institutions' solvency and internal control, and their correct identification.
Electronic money institutions		Article 20 of Law 21/2011 of 26 July 2011 on electronic money.	
Currency-exchange bureaux	Two types of establishment exist: those authorised only to buy foreign currency and travellers' cheques against payment in euros, and those authorised to sell foreign banknotes and travellers' cheques against payment in euros or banknotes in other currencies. These range from seasonal tourism establishments licensed to change foreign currency as an extra service for their customers, to joint-stock companies with significant volumes of own funds and turnover, solely engaged in money changing on a professional basis.	Article 6 of Royal Decree 2660/1998 of 14 December 1998 on the changing of foreign currency in establishments open to the public other than credit institutions.	Analysis of a series of alerts (negative margins, significant changes in activity, etc.), the most significant being those affecting compliance with own funds requirements. Generally carried out through monitoring activities, although they may be subject to on-site inspections.
Banking foundations	Foundations with a direct or indirect shareholding in a credit institution accounting for at least 10% of its capital or voting rights, or which entitles it to appoint or dismiss a member of its governing body. It must have social goals as its purpose, and its main focus should be managing and developing its community welfare activities and the appropriate administration of its shareholding in a credit institution.	Article 46 of Law 26/2013 of 27 December 2013 on savings banks and banking foundations.	Analysis and evaluation of banking foundations' influence on the sound and prudent management of those credit institutions in which they have an interest. The Banco de España therefore has powers conferred upon it to: a) carry out inspections and make any checks it deems necessary in the exercise of its functions; b) require that the banking foundation provide it with all such information as is necessary for the performance of its functions. In the implementation of the foregoing, management protocols and annual financial plans were received for approval from the banking foundations subject to this requirement for the first time.
Sareb	Created in November 2012 to assist the Spanish financial sector, and in particular, institutions in difficulties as a result of their excessive exposures to the real-estate sector. 55% of its capital is private, with the remaining 45% being held by the FROB.	Seventh additional provision of Law 9/2012 of 14 November 2012 on credit institution restructuring and resolution.	Verification of the proper application of the procedures applied for the disposal of assets received, and their appropriate valuation. Carried out via monitoring activities and on-site inspections, where applicable.

The legal basis under which the Banco de España supervises those institutions and the approach behind the tasks differ from case to case. However, the supervisory concern is always the same: to contribute to the proper functioning of those institutions, considering the role they play, and customer protection.

Although the weighting of the institutions discussed in this section with respect to the financial system as a whole cannot be compared to that of credit institutions, their supervision is conducted by the Banco de España with the conviction that an effective regulatory and supervisory model for these institutions promotes the fluidity of financial intermediation mechanisms and generates a climate of confidence in financial institutions.

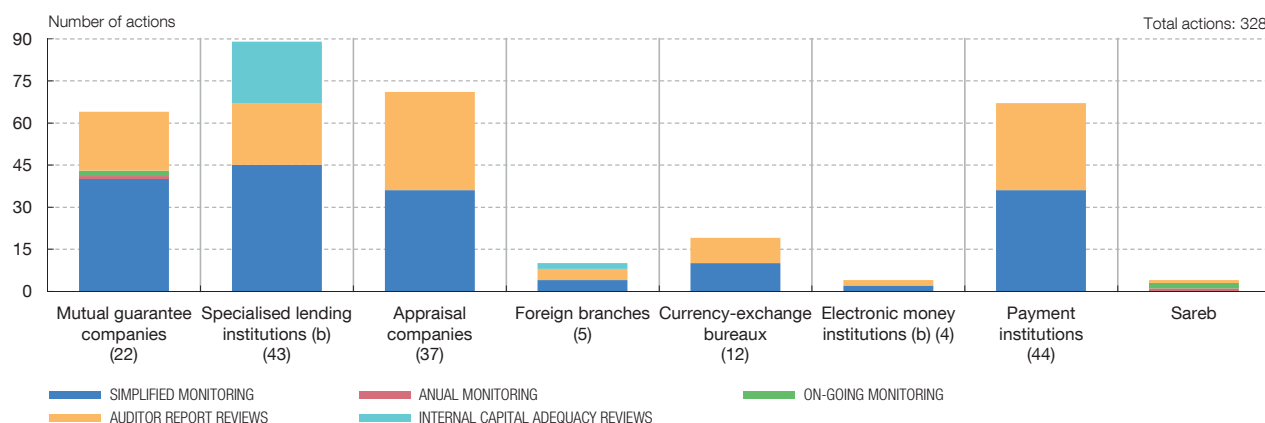
The following sections of this chapter refer, firstly, to the supervisory activity carried out in 2016 on the above-mentioned institutions. Secondly, mention is made of the authorisations and other procedures relating to the exercise of their activity. And thirdly, a description is given of the actions relating to the oversight of vetted access to activity.

2.3.1 SUPERVISORY ACTIVITY

In 2016, 328 remote monitoring actions were performed by various means: annual monitoring, periodic general monitoring, simplified monitoring, reviews of audit reports and reviews of internal capital adequacy assessment reports, as detailed in Chart 2.2.

SUPERVISORY ACTIONS (a)

CHART 2.2



SOURCE: Banco de España.

a The number of institutions monitored in 2016 is shown on the label for each column.

b Supervisory actions are not included in the case of 21 specialised lending institutions and one electronic money institution belonging to a national banking group.

Also, a total of five inspections were performed in 2016, the detail of which is shown in Table 2.9.

ON-SITE INSPECTIONS AT OTHER INSTITUTIONS

TABLE 2.9

	2012	2013	2014	2015	2016 (a)
Specialised lending institutions	1	2	—	3	—
Appraisal companies	—	—	—	—	—
Mutual guarantee companies	1	—	—	2	1
Payment institutions	3	3	5	3	1
Currency-exchange bureaux	—	—	—	—	2
Electronic money institutions	1	—	—	1	—
Sareb	—	—	1	1	1
TOTAL	6	5	6	10	5

SOURCE: Banco de España.

a Of these inspections, 1 was in progress as at year-end.

2.3.2 AUTHORISATIONS AND OTHER PROCEDURES

Granting and withdrawal of licences

The Banco de España participates in the granting and withdrawal of licences to open those institutions and to perform other procedures relating to the exercise of their activities. However, the scope of its involvement is not the same for all types of institutions. The Banco de España is the competent authority for granting and withdrawing licences for currency exchange bureaux and officially recognises appraisal companies. However, it only has to issue a mandatory report on the authorisation of the following types of institutions, which is granted by the Ministry of Economy and Competitiveness:

- Specialised lending institutions
- Electronic money institutions or branches in Spain of non-EU electronic money institutions.
- Payment institutions or branches in Spain of non-EU payment institutions.
- Mutual guarantee companies.

In 2016, a total of 14 requests to open institutions and 10 deletions in the register were processed, according to the breakdown in Table 2.10.

REGISTRATIONS AND DEREGISTRATIONS OF OTHER INSTITUTIONS

TABLE 2.10

Number of registrations/deregistrations in 2016

	Registered on 31/12/2016	2016 registrations	2016 deregistrations	Variation 2015-2016
Specialised lending institutions	35	1	5	-4
Specialised lending institutions - hybrid payment institutions	8	3	0	3
Mutual guarantee and reguarantee companies	22	0	0	0
Appraisal companies	37	1	0	1
Currency-exchange bureaux	12	1	2	-1
Payment institutions	41	2	4	-2
Hybrid payment institutions	3	1	0	1
Electronic money institutions	4	1	0	1
Branches of EU payment institutions	15	4	-1	3
Branches of EU electronic money institutions	2	0	0	0
TOTAL	179	14	10	2

SOURCE: Banco de España.

Other procedures

As indicated earlier, the Banco de España holds various supervisory powers over those institutions. In 2016, a total of 404 procedures relating to those powers were performed, as detailed in Table 2.11. Additionally, two procedures were handled relating to consultations with other supervisors in the sphere of cross-border activity.

OTHER PROCEDURES PERFORMED BY THE BANCO DE ESPAÑA RELATING TO OTHER INSTITUTIONS

TABLE 2.11

Number of procedures in 2016

	Payment institutions	Electronic money institutions	Specialised lending institutions	Mutual guarantee companies	Appraisal companies	Currency-exchange bureaux	Sareb	Banking foundations	Total other institutions
Acquisition of qualifying holdings	1		4		6				11
Cross-border activity of Spanish credit institutions	59								59
Branches in the EU	4								4
Branches in third countries									0
Freedom to provide services	55								55
Suitability	64	5	54	129	34	3	0	0	289
Other procedures relating to own funds			2						2
Structural changes			2						2
Amendments of articles of association	11	4	7	10					32
Authorisation of management and financial protocols								16	16
Other procedures	2	0	3	2	0	0	1	0	8
TOTAL									419

SOURCE: Banco de España.

Letters

Following the supervisory actions, 9 letters were sent to those institutions containing 27 requirements and recommendations. The most significant subject matters related to organisation, general internal control and management policies (25.9%); accounting shortcomings and reporting to the Banco de España (22.2%) , and liquidity and meeting debt commitments and obligations (18.5%).

LETTERS ADDRESSED TO OTHER INSTITUTIONS

TABLE 2.12

Number

	2013	2014	2015	2016
Specialised lending institutions	1	1	3	—
Appraisal companies	—	—	—	1
Mutual guarantee companies	—	2	2	2
Payment institutions	5	5	5	2
Currency-exchange bureaux	—	—	—	2
Electronic money institutions	1	—	—	—
Sareb	—	2	—	2
TOTAL	7	10	10	9

SOURCE: Banco de España.

2.3.3 COMPLIANCE WITH VETTED ACCESS TO ACTIVITY

Spanish legislation establishes that several financial activities are subject to vetted access to activity, i.e. they can only be carried out by the institutions legally authorised to do so. The Banco de España's functions include overseeing compliance with this legislation, taking action on persons seeking to break into the financial market without meeting the

conditions of access, whether it be through the exercise of activities legally restricted to credit institutions, payment service providers or other types of supervised institutions, or through the use of generic names restricted to those institutions or any other name that may cause confusion with them.

2016 saw the initiation of supervisory actions relating to 19 natural or legal persons who might be carrying out restricted activities without authorisation, the outcome of which might lead to the adoption of penalties.