

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



Imperial mantel clock. 19th century. Banco de España collection.

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The Banco de España places strategic importance on its participation in international banking regulation and supervision fora. This is a growing priority, in light of the need to address the challenges posed by globalisation and the importance of increasing the capacity to influence new global and European policies affecting the banking industry. Figure 6.1 shows the international regulatory and supervisory bodies and committees in which the Banco de España plays a part.

The Banco de España has, therefore, focused on strategic issues and on coordinating positions that foster coherent and efficient participation in these fora. See the *2016 Report on Banking Supervision in Spain* for more details on the positions upheld by the Banco de España.

6.1 Global fora

6.1.1 FINANCIAL STABILITY BOARD

In November 2008 the G20 asked the Financial Stability Board (FSB) to lead and coordinate regulatory reform in response to the international financial crisis. With the main elements of the reform now complete, the FSB is currently finishing the final work pending. It is also focusing on evaluating the effects and reviewing the implementation of the reform, to ensure consistency, and on identifying and monitoring new risks for financial stability.

Latest regulatory reform work

The FSB made progress in several areas in 2017. The results of an analysis of interdependencies between CCPs and their members (especially banks) were published, highlighting the concentration of exposures among a small number of CCPs and of member institutions. The FSB continued to work on the plan established to prevent and mitigate misconduct, specifically to strengthen the role played by governance and compensation

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

FIGURE 6.1

GLOBAL FORA	Financial Stability Board (FSB)	<ul style="list-style-type: none"> – Coordinating national authorities and international regulatory bodies. – Identifying vulnerabilities of the financial system. – Defining and implementing regulatory and supervisory policies.
	Basel Committee on Banking Supervision (BCBS)	<ul style="list-style-type: none"> – Establishing international standards, guidelines and best practices for the prudential regulation of the banking sector. – Uniform implementation of standards and promotion of a level playing field for banks which operate internationally.
EUROPEAN UNION	European Banking Authority (EBA)	<ul style="list-style-type: none"> – Convergence of supervisory practices. – Single Rulebook. – Resolution. – Consumer protection and financial innovation. – Payments.
	European Systemic Risk Board (ESRB)	<ul style="list-style-type: none"> – Macroprudential oversight of the EU financial system to prevent and mitigate systemic risk. – Issuing recommendations, opinions and warnings on macroprudential matters.

SOURCE: Banco de España.

NB: This is not an exhaustive list. The Banco de España also actively participates in other international regulatory and supervisory bodies, especially the International Financial Consumer Protection Organisation (FinCoNet) and the Association of Supervisors of Banks of the Americas (ASBA) which is of strategic importance to the Banco de España.

frameworks. It is also studying ways to increase individual accountability and to prevent staff with a history of misconduct from moving from one firm to another. In addition, it published a progress report on reforming interest rate benchmarks.

Evaluating effects of reforms

In 2017 the FSB developed a framework for evaluating the effects of the G20 regulatory reforms, to analyse whether they are achieving their intended outcomes and to help identify material unintended consequences that may have to be addressed, without compromising on the objectives or the implementation of the reforms. The first two projects to be analysed in 2018 and in which the Banco de España will be involved are the effect on incentives to clear OTC derivatives at CCPs and the effects on financial intermediation (initially focusing on financing for infrastructure investment, before extending the analysis to other areas).

New technology challenges

In view of the development of new technologies applied to the financial sector (Fintech), the FSB has been working to identify the risks and opportunities posed. In June 2017 it published a report identifying the potential benefits of innovation (e.g. greater efficiency) and the potential risks for financial stability (e.g. greater interdependency). Although the report concludes that, for the time being and in general, the main risks are covered within existing regulatory frameworks, it also highlights a number of areas that require special attention (e.g. risks from third-party service providers).

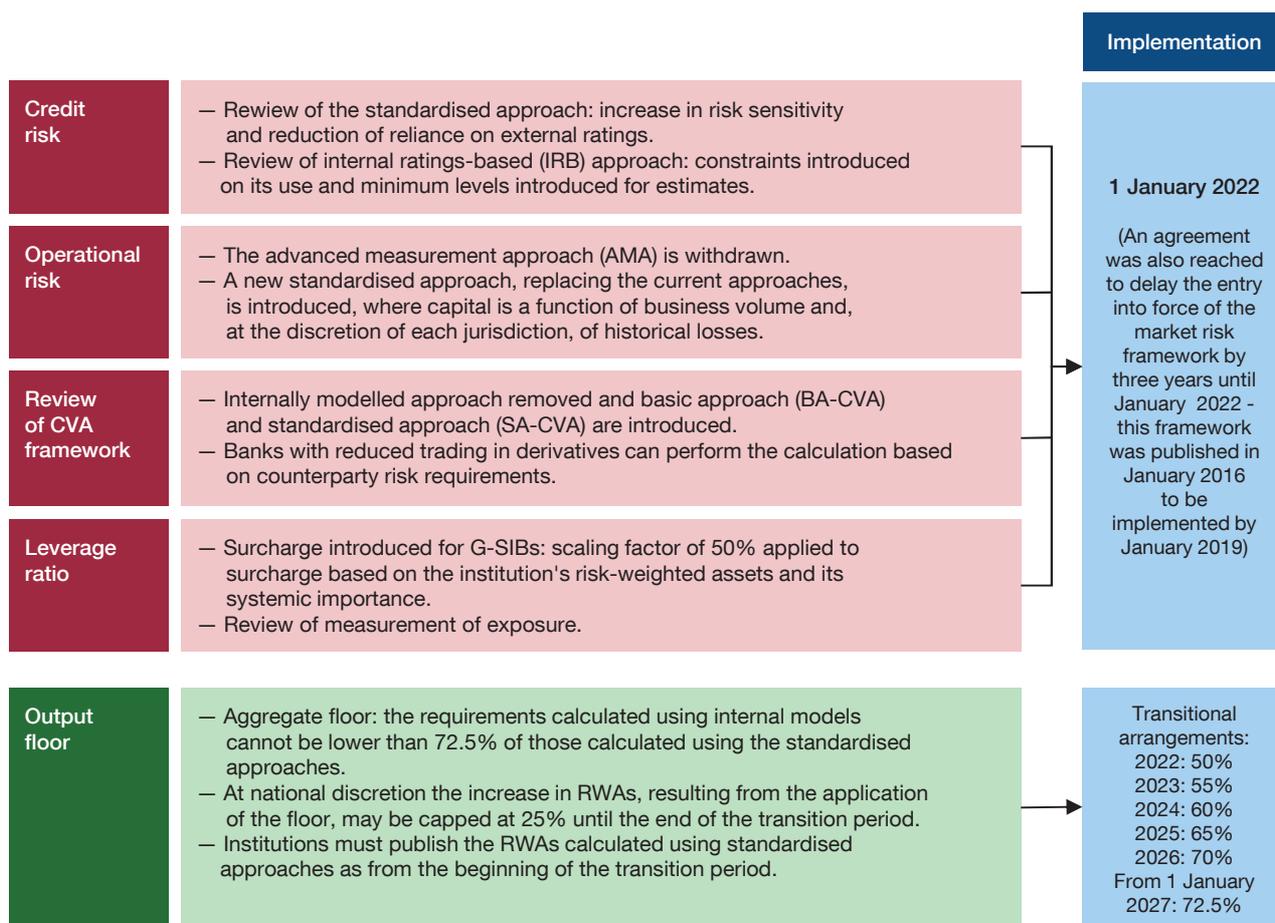
In addition, growing digitalisation in the financial sector has made cyber risk a key priority. In this connection, in October 2017 the FSB published a report on national cybersecurity regulatory and supervisory practices, aimed at promoting a set of effective practices among G20 members.

6.1.2 BASEL COMMITTEE ON BANKING SUPERVISION

On 7 December 2017 the Basel Committee's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), endorsed the Basel III reforms outstanding. This package, which completes the post-crisis reform of the regulatory framework, seeks to reduce undue variability in risk-weighted assets (RWAs), improving the comparability and transparency of capital ratios. The essential changes relate to the capital ratio denominator and the leverage ratio (see Figure 6.2). The Banco de España played an active part in the preparation of these reforms.



Audit Sub Group (ASG) meeting. Sala Europa, Banco de España.



SOURCE: Banco de España.

The GHOS also reaffirmed that it expected full, timely and consistent implementation of all the changes proposed. Looking ahead, the Committee will focus on continuing to ensure that the Basel standards are implemented and on evaluating the post-crisis reforms.

Also in December 2017 a discussion paper was published on the regulatory treatment of sovereign exposures. The paper indicated that there will be no changes in the short term, so the Committee decided not to consult on the ideas presented, although it admitted that the views received will be useful in informing the Committee's longer-term thinking on this issue.

Other regulatory framework reviews

The Committee published other significant changes in the year. First, ahead of the entry into force in January 2018 of IFRS 9, it published a document proposing a transitional arrangement for the prudential treatment of accounting provisions (see Box 7.4). Second, as part of the G20's shadow banking initiatives, it issued Guidelines on identification and management of step-in risk.¹ Lastly, relating to liquidity risk and in order to facilitate the entry into force, in January 2018, of the net stable funding ratio (NSFR), the Committee agreed to allow national discretion for the treatment of financial derivative liabilities.

¹ Step-in risk is the risk that a bank decides to provide financial support to an entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support.

The Banco de España is a member of and chairs the Basel Committee's Accounting Experts Group. In 2017 the Group's work focused on monitoring the implementation of IFRS 9. In addition, the Group contributed to the project for reform of audit standard-setting bodies, with a view to increasing their independence.

The Group also prepared responses to documents subject to consultation of the international accounting (IASB) and audit (IAASB) standard-setting bodies and collaborated with other Basel groups on analysis of the interaction between accounting standards and prudential requirements. As a result of this collaboration, the following were published:

- In March 2017, a document on the transitional arrangement for provisions made as a consequence of implementation of IFRS 9, referred to above.
- In April 2017, FAQs on the new International Financial Reporting Standard – Leases (IFRS 16), establishing that assets arising as a consequence of the new standard should not be deducted from regulatory capital, that they should be risk-weighted at 100% provided that the underlying asset is a tangible asset, and that they should be included in the capital and leverage ratios.

6.2 European fora

6.2.1 EUROPEAN BANKING AUTHORITY

In 2017 the EBA continued to contribute to the Single Rulebook, approving various regulatory products. It also continued work to further strengthen convergence of supervisory practices throughout the European Union.

Particularly noteworthy, on account of its importance, was the work on the methodology to be applied to the stress testing of European credit institutions in 2018 to assess their solvency in an adverse economic scenario. This methodology was published at the end of 2017 and will be similar to that used in the 2016 exercise, although with one notable difference, namely the need to consider the new accounting framework with the entry into force of IFRS 9. In this respect, the calendar for the stress test exercise will be slightly different from that of previous years and will extend throughout most of 2018, in anticipation of possible difficulties, relating to the availability of the information that these tests require, associated with the first-time application of the new accounting standard. For this reason, the EBA does not expect to publish the results of the exercise before November.

Below we highlight – for the different areas of the EBA's activity – other important work carried out and in which the Banco de España played an active part. Box 6.1 contains a description of the work performed by the EBA on technological risk.

Convergence in the application of supervisory reviews, evaluations and supervisory measures

In 2017 the EBA published for consultation the revised version of its **Guidelines on the Supervisory Review and Evaluation Process (SREP)**. The main change was the inclusion of the capital recommendation (Pillar 2 Capital Guidance, P2G) which, in the stacking order of capital requirements, sits above the combined buffer requirement (see Figure 6.3). P2G can only be met with CET1 instruments and will not be taken into account to calculate the maximum distributable amount (MDA). Figure 6.3 depicts the capital requirements structure.

Other relevant changes to guidelines concern: i) integration into one single document of the various requirements relating to the stress testing exercises addressed to supervisors; ii) clarification of certain aspects of the scoring framework contained in the guidelines; and iii) review of coherence with other standards and guidelines that entered into force after the publication of the original SREP guidelines in December 2014.

Information and communication technology (ICT) is a key resource in developing and supporting banking services. Not only is it a key enabler of business strategies, but it also forms the backbone of almost all banking processes and their distribution channels. Aside from supporting the business, technological innovation also plays a crucial role from a strategic standpoint, as it is a fundamental tool to compete in the financial markets by offering new products and services and by restructuring and optimising the value chain.

The growing importance and complexity of ICT within the banking industry has brought associated risks which may have a highly significant prudential impact and may even threaten the viability of an institution. Notable in this connection is, among others, the increase in cyber threats, the growing reliance of banks on outsourcing of services and the risks associated with the FinTech phenomenon (understood as financial innovations arising from the intensive use of technology).

In this connection, the EBA has developed certain guidelines to assess the risks associated with ICT within the framework of the supervisory review and evaluation process (SREP). These guidelines, which were published in May 2017 and came into force on 1 January 2018, aim to guide supervisors in assessing technological risks at banks. They will provide a common supervisory framework for technology-related risks for the first time in Europe, a highly necessary step given the growing importance

of ICT and a determining factor for enabling supervisory convergence to increase.

Another area requiring the EBA's attention is the use of cloud computing services, a rising trend in the banking industry owing to the significant advantages they provide to banks in terms of cost savings, scalability and flexibility. Alongside the advantages, cloud computing also involves an increase in certain risks, including those relating to data location and protection, security and concentration in a small number of providers which may become single points of failure. Although the outsourcing guidelines of the Committee of European Banking Supervisors (CEBS) are still in force, it has been considered necessary to work on specific guidelines relating to cloud outsourcing. Thus, in 2017 the EBA drew up a recommendation on cloud computing which will enter into force on 1 July 2018 and will subsequently be included in certain EBA guidelines on outsourcing which constitute a revision of the CEBS guidelines.

Finally, as regards FinTech, the EBA published in August 2017 a discussion paper on its approach to financial technology and its proposals for future work on the areas identified as most affected. Additionally, in 2017 a working group was set up which is analysing the prudential risks and opportunities which the use of certain technologies, such as biometrics, artificial intelligence, big data and distributed ledger technology (Blockchain), entail for banks.

Prudential regulations

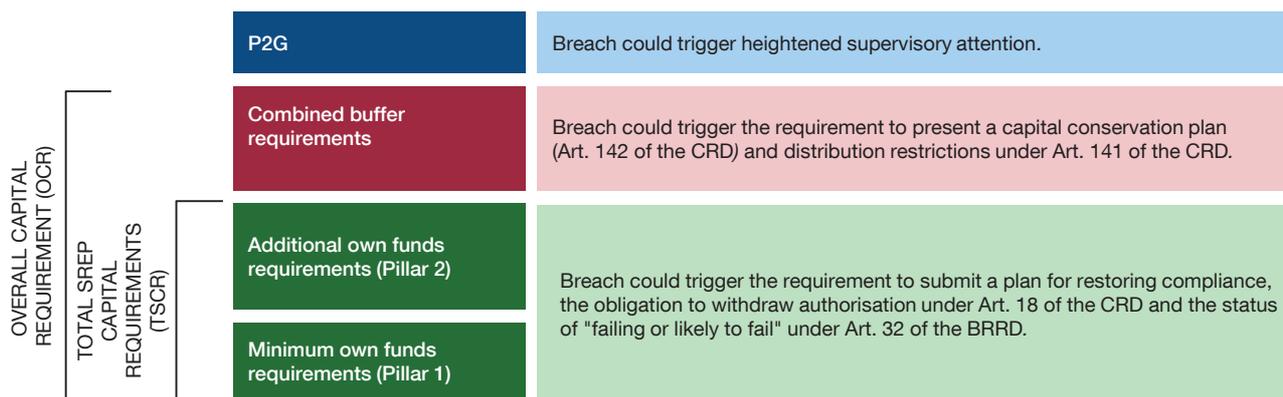
One of the EBA's key projects in the field of prudential regulation has been the preparation of the Guidelines on PD and LGD estimation and the treatment of defaulted exposures. Regulatory Technical Standards (RTS), still in preparation, on the nature, severity and duration of economic downturn will be issued to complete these Guidelines.

These two products are the culmination of a regulatory process set in motion by the EBA in 2015, whose chief aim was to increase the reliability of the internal models used to calculate capital requirements, and to reduce the variability observed in the results of those calculations. Specifically, the Guidelines on PD and LGD estimation seek to clarify the main concepts and definitions underlying the calibration of the different regulatory parameters used as inputs in the calculation of capital requirements.

The Banco de España has contributed to this work from the outset, insisting on the importance of consistency with the work of the Basel Committee in this area.

Consumer protection and financial innovation

In the area of supervision of institutions' market conduct and financial consumer protection, the EBA has played an active part in achieving greater convergence in the application of standards. Work has been done, in particular, to define a harmonised interpretation of the guidelines on retail banking product oversight and governance processes, to ensure their uniform implementation and supervision.



SOURCE: EBA Pillar 2 Roadmap.

Also noteworthy are the Guidelines on procedures for complaints of alleged infringements of PSD2.² These set out the requirements to be applied by competent authorities in connection with the complaints procedure to ensure and monitor effective compliance with the Directive. This procedure is, therefore, an important supervisory tool in the area of payment services.

Payments

In the payments area, development of the Regulatory Technical Standards on Strong Customer Authentication and Common and Secure Communication Standards under PSD2 merits special mention. The EBA has drawn up these standards, seeking to establish a correct balance between security and innovation and to address the different positions of the parties concerned: consumers, retailers, third-party payment service providers (TPPs) and account servicing payment service providers (ASPSPs), among others.

These technical standards, which lay down the technical requirements of the strong customer authentication process and regulate the cycle of personalised security credentials, include two measures that are particularly noteworthy. First, they provide for exemptions to the authentication process based on transaction risk analysis, conditional upon the payment service providers having exceptionally low fraud levels. Second, they include fall-back solutions as a contingency measure for when ASPSPs grant TPPs access to customers' payment accounts through specific interfaces (APIs). They also provide that, after consulting with the EBA, national competent authorities may exempt ASPSPs from implementing this measure when the corresponding APIs have been satisfactorily tested by the TPPs.

6.2.2 EUROPEAN SYSTEMIC RISK BOARD

In 2017 the ESRB continued to analyse the European Union's macroprudential and financial situation and the possible systemic risks and vulnerabilities in the area.

In addition to this regular task, in July 2017 it published a report on solutions for non-performing loans in Europe.³ The report concludes that the volume of non-performing loans in Europe is significant, given that it generates a series of negative effects that have an adverse impact on economic growth. It highlights the pressing need to reduce these exposures and includes a series of recommendations to that end. For banks with very high NPL levels, the report recommends a return to sustainable profitability by means of restructurings, mergers or even resolution or liquidation processes.

² Directive (EU) 2015/2366 of 25 November 2015 on payment services.

³ ESRB, *Resolving non-performing loans in Europe*, 11 July 2017.

Also noteworthy is the work arising from compliance with the ESRB's Recommendation on recognising and setting countercyclical buffer rates for exposures to third countries. The Recommendation seeks to ensure that macroprudential authorities monitor jurisdictions to which their domestic banking sector has what are considered material exposures, and where appropriate that a specific countercyclical buffer rate be set if that set by the local authorities is considered inadequate. In 2017 the Banco de España identified six material third countries for the Spanish banking sector (United States, Brazil, Mexico, Chile, Turkey and Peru), although it did not consider it necessary to activate the countercyclical capital buffer for any of them.⁴

6.3 Other fora

FinCoNet

In the area of market conduct and financial consumer protection, the Banco de España is a member of the Governing Council of the International Financial Consumer Protection Organisation (FinCoNet). Since its launch in 2013, this international forum for financial market conduct supervision has continued to gain new members. Its work programme for the period 2017-18 will concentrate on the impact on consumers of the digitalisation of financial products and services, focusing in particular on work relating to the analysis of supervisory tools in a digitalised world and other lines of work relating to digitalisation of payments and fast credit.

ASBA

In 2017 the work programme of the Association of Supervisors of Banks of the Americas (ASBA) focused on strengthening the exchange and cooperation relations and the technical and leadership capabilities of its member institutions, and on further implementing best practice and regulatory and supervisory policies. The Association also addressed its efforts to areas such as technological innovation, deposit insurance schemes and bank resolution frameworks, and the process whereby financial institutions abandon or significantly pare down certain business lines to avoid regulatory and compliance risk.

As in previous years, the Banco de España played an active part in ASBA's activities in 2017 and gave its continued support to its Continental Training Plan, through seminars in the region and in Spain.

⁴ For more details, see Box 3.2 ("Material third countries for the purposes of the countercyclical capital buffer") in the Banco de España's *Financial Stability Report* of November 2017.