8

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

8.1 Banco de España Circulars and Guidelines

8.1.1 Circular 1/2019

Banco de España Circular 1/2019 of 30 January 2019 amending Circular 8/2015 of 18 December 2015 to institutions and branches belonging to the Deposit Guarantee Scheme for Credit Institutions (DGSCI), on information for determining the basis of calculation of contributions to the DGSCI.

In accordance with Article 12 of Royal Decree-Law 16/2011 of 14 October 2011 establishing the DGSCI, the Banco de España must subject it to stress tests.

In 2017 during the first cycle of tests, the Banco de España stress-tested the files with data per depositor for a sample of institutions belonging to the DGSCI. The content of these files is described in detail in Annex 2 of Circular 8/2015. As a result of this testing it was deemed necessary to amend Annex 2, to add new fields with depositors' contact details, specify the definition of some of the fields whose content was not sufficiently clear and permit the use of certain special characters needed to correctly process some of the depositors' contact details. The aim is to ensure better data quality in the files and enable identification of depositors in the event of reimbursement by the DGSCI.

8.1.2 Circular 2/2019

Banco de España Circular 2/2019 of 29 March 2019 on the requisites of the Fee Information Document and Statement of Fees and on comparison websites for payment accounts, amending Circular 5/2012 of 27 June 2012 to credit institutions and payment service providers on the transparency of banking services and responsible lending.

Circular 2/2019 was published on 4 April 2019 in the Official State Gazette. It establishes: i) the list of the most representative services associated with payment accounts; ii) the additional requisites for completion of the Fee Information Document and Statement of Fees; iii) the information that payment service providers have to submit to the Banco de España for publication on the comparison website; iv) the content of the declaration of responsibility that comparison website operators other than the Banco de España have to provide before they commence their activity, and any other information that these operators have to make available

to the Banco de España; and v) periodic reporting on payment accounts with basic features and switching of payment accounts.

Circular 2/2019 also revises some provisions of Circular 5/2012 to bring them into line with the new transparency requirements set out in Royal Decree-Law 19/2017 and eliminate overlaps.

8.1.3 Circular 3/2019

Banco de España Circular 3/2019 of 22 October 2019 exercising the power conferred by Regulation (EU) 575/2013 for defining the materiality threshold for credit obligations past due.

Circular 3/2019 exercising the power conferred in Article 178(2)(d) of the CRR for defining the materiality threshold for credit obligations past due was published in the Official State Gazette on 1 November 2019.

When establishing this threshold, the competent authorities must comply with the conditions specified by the European Commission in Commission Delegated Regulation (EU) No 2018/171 of 19 October 2017 supplementing the CRR with regard to regulatory technical standards for the materiality threshold for credit obligations past due.

The Banco de España, as the competent authority for LSIs, exercised this power through Circular 3/2019 and established the same rules as specified by the ECB for SIs in its Regulation (EU) 2018/1845.

Accordingly, the materiality of credit obligations past due shall be assessed against a threshold comprising two components: an absolute limit, in terms of the sum of all amounts past due, of €100 for retail exposures and €500 for all other exposures, and a relative limit, equal to 1% of the total amount of the obligor's exposures. A default shall be deemed to have occurred when both components of the threshold are exceeded for 90 consecutive days.

8.1.4 Circular 4/2019

Banco de España Circular 4/2019 of 26 November 2019 to specialised lending institutions on public and confidential financial reporting standards and formats.

Circular 4/2019 aims to lay down a complete and specific financial reporting regime for specialised lending institutions (SLIs). The Banco de España thus exercises its new accounting powers over SLIs stemming from Ministerial Order ECE/228/2019 of 28 February 2019.

With effect as of 1 January 2014, Royal Decree-Law 14/2013 of 29 November 2013 stripped specialised lending institutions of their credit institution status. Since then, SLIs had temporarily retained their previous accounting regime (Circular 4/2004 on public and confidential financial reporting standards and formats for credit institutions, as amended as at December 2013).

With this new Circular, which brings the above-mentioned temporary accounting regime to an end, the Banco de España continues with its strategy of adapting the accounting standards of supervised institutions to the most advanced principles in the European accounting framework, that is, the International Financial Reporting Standards adopted by the European Union (IFRS-EU). For this purpose, taking as reference the accounting regulations for credit institutions, i.e. Circular 4/2017 which is compatible with IFRS-EU, either similar standards are set or direct reference is made to those contained in the Circular. In consequence, with this new circular, SLIs now estimate loan impairment using the expected loss approach.

The reporting formats provided for refer to the formats used by credit institutions. But the reporting regime for SLIs is simpler, on account of the differences in terms of the nature, scale and complexity of their activities compared with credit institutions. In other words, SLIs will have to submit a subset of credit institution reporting statements (in some cases, with less frequent reporting dates and longer reporting deadlines).

Circular 4/2019 entered into force on 1 January 2020, with the exception of the new confidential returns which will be first submitted with reference date 30 June 2020.

8.1.5 Circular 1/2020

Banco de España Circular 1/2020 of 28 January 2020 amending Banco de España Circular 1/2013 of 24 May 2013 on the Central Credit Register.

The chief aim of Circular 1/2020, published in the Official State Gazette on 5 February 2020, is to adapt the Central Credit Register (CCR) to the changes made, by Law 5/2019 of 15 March 2019 regulating real estate credit agreements, to Law 44/2002 of 22 November 2002 on financial system reform measures, to ensure that all real estate credit lenders have access to the Banco de España's CCR.

8.1.6 *Supervisory guidelines for the use of automated valuation models (AVMs) by appraisal companies*

Annex 9 of Circular 4/2017 of 27 November 2017 on public and confidential financial reporting standards and formats envisages that, in certain circumstances, AVMs may be used to determine the reference value of properties in Spain that serve as

collateral for operations (paragraph 78 of Annex 9) and of foreclosed real estate assets (paragraph 166).

In April 2019 the Banco de España published these supervisory guidelines for the use of AVMs, to convey to appraisal services and companies responsible for these valuations the principles and best practice that the Banco de España considers appropriate for valuations commissioned by credit institutions to be used in real estate valuations for accounting purposes, in accordance with the provisions of Annex 9 of Circular 4/2017.

The guidelines lay down eight principles that the Banco de España expects to be followed for valuations using AVMs:

1 Only AVMs that follow generally accepted valuation practices for properties with a certain degree of homogeneity should be used.

2 The valuations should include information both on the market value and the mortgage value.

3 The methodology used should be sound, regular and appropriately tested and should ensure that the property valuations made using AVMs are traceable.

4 The AVMs used should be specified and documented.

5 The AVMs used should be calibrated and the process documented.

6 The sufficiency and quality of the information available should be checked to ensure that a commission for a mass AVM appraisal can be performed.

7 A sufficient sample of complete individual appraisals should be taken from the properties included in a mass appraisal in order to back-test the results obtained using AVMs.

8 All the information relating to property valuations made using AVMs should be made available to the Banco de España.

8.2 Other draft circulars in progress

Amendments to Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial reporting standards and formats are at an advanced stage. The public information and consultation process concluded in September. The main changes contained in the draft circular are as follows:

a) The necessary changes are made to the financial statements to adapt them to the changes to be made to Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 and to ECB Regulation (EU) 534/2015. The changes to these regulations amplify the information on NPEs and the income statement and include some changes stemming from the first-time adoption of IFRS-16 Leases.

b) The necessary changes are made to the financial statements to comply with the ESRB recommendation on closing real estate data gaps (ESRB/2016/14).

c) The latest developments in IFRS-EU are included in the accounting criteria and data submission rules. The main change in the accounting criteria is in the definition of "business", to facilitate and simplify its application.

The new circular that will amend Circular 8/2015 of 18 December 2015 to institutions and branches belonging to the DGSCI on information for determining the basis of calculation of contributions to the DGSCI has also now completed its public information and consultation process.

Article 30 quater of Royal Decree 217/2008 provides for coverage by the DGSCI, in the event of insolvency of a credit institution, of balances held by investment firms in instrumental and cash suspense accounts open in their name on behalf of their clients at the institution against which an insolvency order has been made. In this respect, Article 43(3) of this Royal Decree adds that when an investment firm deposits cash on behalf of clients at a credit institution, the balances should be on a client-by-client basis and it should periodically inform the credit institution of the client-by-client balances.

The changes made to Royal Decree 217/2008 make it advisable to amend Circular 8/2015, to clarify how the new information should be reported in the returns entitled "Information for determining the basis of calculation of contributions to the DGSCI" and "Breakdown of deposits received" envisaged, respectively, in Annex 1 and 2 of Circular 8/2015.

In addition, now that the public information and consultation process has concluded, the process for approval of the **draft circular on advertising of banking products and services,** which will repeal Circular 6/2010 of 28 September 2010, continues. The new circular aims to adapt the existing circular to the latest developments in the advertising sector, as a consequence of the impact of digital technology and to reinforce the internal control requirements that credit institutions must satisfy, all with the aim of permitting more efficient supervision of compliance and to ensure that customers have sufficient and accurate information on which to base their decisions.

Also in progress is a **future circular on the macroprudential instruments provided for in Articles 45(1), 69 bis and 69 ter of Law 10/2014 and in Article 15 of Royal Decree 102/2019** of 1 March 2019 whereby AMCESFI, Spain's new macroprudential authority, was created, its legal regime was established and certain aspects of the macroprudential instruments were detailed. The future circular, which has now completed the public consultation process, will include provisions on:

a) The CCyB requirements applicable to exposures of credit institutions or of a group to a specific sector.

b) Limits on the concentration of exposures of credit institutions or of a subset thereof to a specific economic sector.

c) Conditions on lending and purchase of debt securities and derivatives by credit institutions, for operations with the private sector in Spain.

Lastly, regarding the **future circular to payment service providers on operational and security risk management relating to payment services, reporting of serious operational and security incidents and communication of data on fraud relating to means of payment,** the public consultation process has concluded. This circular will elaborate the obligations of payment service providers deriving from Articles 66 and 67 of Royal Decree-Law 19/2018 of 23 November 2018 on payment services and other urgent financial measures, i.e.:

a) The requirement to establish a framework with sufficient palliative measures and control mechanisms to manage operational and security risks relating to payment services provided by payment service providers.

b) The requirement to provide, at least once a year, a complete and up-to-date assessment of the operational and security risks associated with the services provided by payment service providers and of the sufficiency of the palliative measures and control mechanisms applied in response to these risks.

c) The requirement to immediately report to the Banco de España any serious operational and security incidents.

d) The requirement to submit to the Banco de España, at least once a year, statistical data on fraud related to means of payment.

8.3 Other new regulatory developments

Lastly, and although these are not regulations issued by the Banco de España, of particular importance in 2019 was the publication of **Regulation (EU) 2019/876**

and Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending the regulations on capital requirements of credit institutions and investment firms. See Box 8.1 for a description of the main changes to prudential regulations as a result of these legislative changes, which incorporate part of the Basel III framework into European law.

The legislative package for transposition of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property was also approved in 2019. In Spain, the transposition was made through Law 5/2019 of 15 March 2019 regulating real estate credit agreements, Royal Decree 309/2019 of 26 April 2019 partially implementing Law 5/2019, and Ministerial Order ECE/482/2019 of 26 April 2019 amending Ministerial Order EHA/1718/2010 of 11 June 2010 on the regulation and control of advertising of banking products and services and Ministerial Order EHA/2899/2011 of 28 October 2011 on transparency and protection of customers in banking services.

This set of measures establishes important standards of conduct and transparency, aimed at responsible lending in the case of certain credit types. It also regulates real estate credit lenders and intermediaries and their designated representatives, endowing the Banco de España with the power to register, supervise and sanction those entering into operations with resident borrowers throughout Spain or in more than one region of Spain.

Box 8.1

NEW CAPITAL REQUIREMENTS FRAMEWORK: CHANGES TO THE CRR AND TO CRD-IV

After lengthy and intense negotiations between the European Council (EU) and the European Parliament on the package of legislative proposals submitted by the Commission in November 2016 — the risk reduction measures — the Regulation[1] and the Directive[2] amending the CRR and CRD-IV, respectively, were published in the OJ L on 7 June 2019. The key changes are as follows:

- Regarding the scope of application, the term "institution" is extended to include (mixed) financial holding companies for the purposes of capital requirements on a consolidated basis. Also, supervisory powers may be exercised directly over these companies. In addition, in the case of third-country groups with a significant volume of activity in the European Union, the requirement that an intermediate parent undertaking (IPU) be established in the EU is introduced.
- The proportional application of the regulations is dealt with in detail. Thus, institutions that may be considered "small and non-complex" in accordance with certain quantitative and qualitative criteria may apply some requirements proportionally. For example, the requirements relating to interest rate risk, to the new net stable funding ratio (NSFR)[3] and to supervisory reporting, disclosure and remuneration.
- With respect to the changes made to own funds requirements, one essential objective has been to include the FSB's TLAC Term Sheet into EU law. Changes have also been made relating to the eligibility of instruments and minority interests of third-country subsidiaries and to deductions (for example, software) and the administrative procedures relating to own funds instruments have been simplified.
- A new market risk framework has been introduced following the FRTB carried out by the BCBS, aiming to correct the limitations, in terms of risk sensitivity, detected during the financial crisis. In the European Union, reporting requirements according to the new framework will first be introduced, subsequently followed by capital requirements.
- Although the credit risk framework has not been revised,[4] a number of measures have been introduced, such as the supporting factor for infrastructure projects or the LGD adjustment for massive disposals of defaulted exposures. In addition, the SME supporting factor has been revised to broaden its scope.
- A minimum Tier-1 leverage ratio requirement of 3% has been set, compared with the previous system that required only disclosure and supervisory reporting. Also, for the G-SIIs, an additional leverage ratio buffer requirement has been set of 50% of the applicable G-SII risk-based buffer rate.
- The Basel changes to limits on large exposures (Tier-1 is the new capital base to be used for calculation of large exposure limits and a lower limit has been set for exposures between G-SIIs), counterparty risk, interest rate risk in the banking book (IRRBB) and capital requirements for exposures to central counterparties and investment fund shares have also been included, among others.
- Regarding liquidity risk, to incentivise institutions to establish long-term funding arrangements, the NSFR has been introduced, complementing the liquidity coverage ratio (LCR).[5]
- Pillar 2 has been redesigned, with a Pillar 2 requirement (P2R) and Pillar 2 supervisory guidance (P2G) that should be limited to covering microprudential risks. Moreover, relating to the inclusion of the leverage ratio in Pillar 1, P2R and P2G leverage requirements have been incorporated.
- In the macroprudential sphere, various changes have been made to the capital buffers. Among the most notable ones are the possibility of applying the systemic risk buffer only to certain exposures

1 Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013.
2 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU.
3 The NSFR is a liquidity ratio for a longer timeframe. It is the amount of available stable funding relative to the amount of required stable funding.
4 The EBA and the European Commission are working to transpose the Basel III reforms of December 2017 into national legislation across Europe.
5 The LCR is the requirement whereby banks must hold liquid assets sufficient to cover net cash outflows over a 30-day stress scenario.

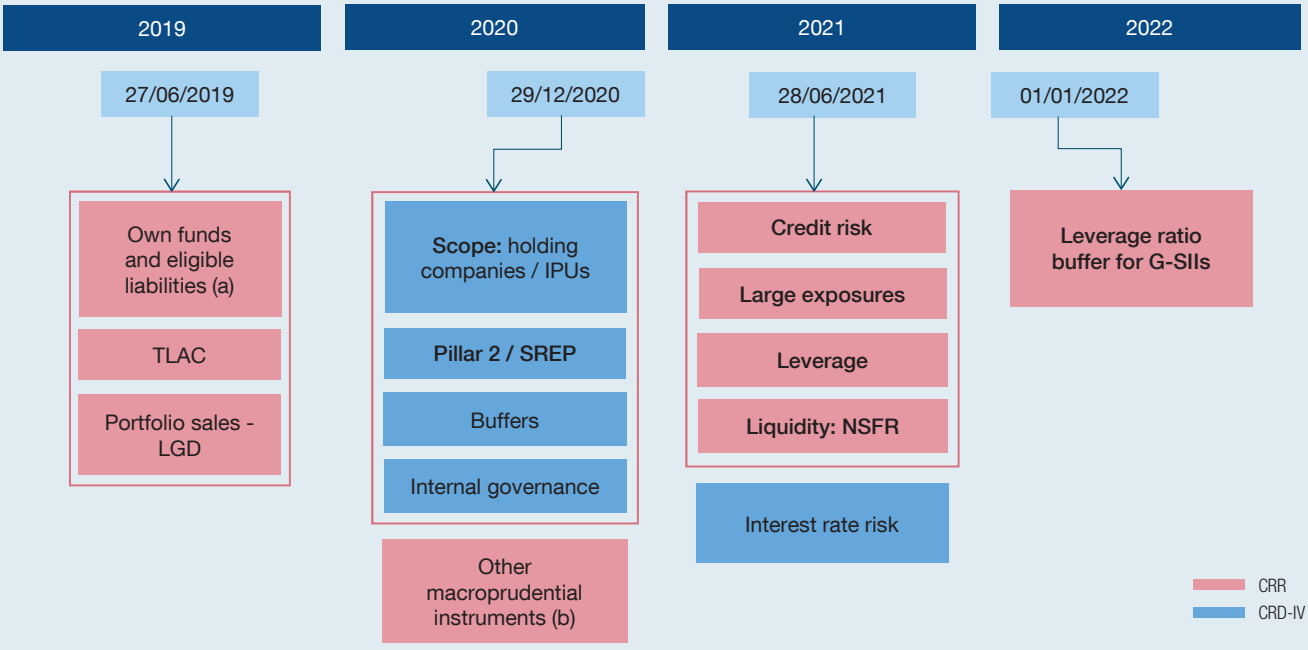
and the introduction of an alternative methodology for identifying G-SIIs which excludes from the cross-border activity indicator operations performed within the banking union. In addition, the elimination of the macroprudential use of Pillar 2 has been offset by granting more flexibility to other macroprudential tools. See Box 3.1 for more details.

— New PBC/FT requirements have been introduced in various aspects of CRD-IV; for example, in the assessments by competent authorities of the adequacy of institutions' corporate governance arrangements and of the suitability of board members.

Both the Regulation and the Directive entered into force on 27 June 2019, but the dates of application of the different measures envisaged vary (see Figure 1). The general date of application of the changes to the CRR is two years after the date of entry into force, although some aspects, essentially those relating to own funds, are directly applicable. In the case of the changes to the CRD, the general date of application is 18 months after the date of entry into force, following the period granted for transposition into national law, but there are also exceptions, such as interest rate risk, which will be applicable at the same time as the changes to the Pillar 1 risks envisaged in the CRR.

In addition to transposition into national law of the changes to CRD-IV, the national discretions and options contained in both the Regulation and the Directive must be reviewed, both at the Member State and the competent authority level. Also, the EBA has been asked to draw up numerous technical standards and guidelines.

Figure 1
MAIN CHANGES IN THE CRR AND CRD-IV, AND DATE OF APPLICATION



SOURCE: Banco de España.

a Except for the exemption of the deduction of software assets, which will be applicable 12 months after the entry into force of the RTS drafted by the EBA.
b Applicable from 28 December 2020 onwards.