

2 Exercise of supervisory functions in 2009

This chapter is structured as follows. The first section describes the supervisory activity during 2009, indicating the supervised institutions, the main supervisory actions in the year, the staff of the Directorate General Banking Supervision and the requirements and recommendations sent to institutions as a result of such action. The second section explains what was involved in the exercise of sanctioning powers in 2009 and states the number of proceedings initiated and resolved for each type of infringement. Third, reference is made to the Banco de España's other responsibilities complementing its supervisory functions (e.g. those relating to regulations governing the transparency of banking transactions or to the keeping of official registers). The fourth and last section of this chapter explains briefly the supervisory policies adopted in respect of compensation and credit institution resolution plans.

2.1 Supervisory activity

To raise public awareness of its supervisory activity, in 2009 Banco de España published the document entitled "*Modelo de Supervisión del BE* (Banco de España supervisory model)",¹ summarising the processes traditionally carried out in compliance with its obligations under Article 7 of Law 13/1994 of Autonomy of the Banco de España, which have been updated as a result of the new Capital Accord (better known as Basel II). As reflected in that document, the Banco de España exercises a process of continuous supervision of the 353 CIs in the financial system, to which must be added 141 institutions of other types (see Tables 1.1 and 2.6).

The essential aim of the Banco de España supervisory process is to determine and keep updated each institution's supervisory risk profile, taking the measures needed to correct it when necessary. This process is based on the attainment of an up-to-date and in-depth knowledge of each supervised institution, including its business outlook and future viability.

To this end, at 31 December 2009 the Directorate General Banking Supervision had 21 operational inspection divisions and eight cross-sectional or support divisions formed by bank examiners, senior analysts, IT auditors, junior analysts and administrative staff (see Annex 1.4), each under the leadership of the head of division. Every operational division has assigned to it certain CIs which are subject to an intensive programme of supervisory actions including on-site inspection, off-site analysis and, where so required because of the size and complexity of the banking group supervised, on-site continuous monitoring.

In 2009, as in the year before it, supervisory activity was influenced by the crisis which broke out in summer 2007. Against this background, a total of 372 supervisory actions were conducted, of which 153 were on-site actions (129 completed in 2009 and 24 in progress at 31 December 2009), as indicated in Table 2.1, and the remainder were other special monitoring projects.

The supervisory actions were designed to enable close supervision of lending, particularly real estate exposures, and of the liquidity of Spanish institutions and their ability to act under stress. In the specific case of special monitoring, this encompassed, inter alia, checks and analyses of restructuring and merger operations, review of liquidity, review of loan portfolios by individual analysis and by segmentation of their quality and features, internal control proce-

1. Available in Spanish at www.bde.es/webbde/es/: Inicio > Supervisión > El modelo de supervisión > Modelo de supervisión del BE.

Number

	ON-SITE SUPERVISORY ACTIONS							
	COMPLETED				UNDER WAY			
	2006	2007	2008	2009	2006	2007	2008	2009
Credit institutions	69	125	98	114	80	44	37	21
Banks	36	63	52	82	37	12	20	7
Savings banks	11	17	19	16	21	18	10	10
Credit cooperatives	10	18	8	1	12	4	0	1
Foreign branches	1	6	7	4	2	1	1	1
<i>EU credit institutions</i>	<i>1</i>	<i>6</i>	<i>2</i>	<i>2</i>	<i>2</i>	<i>1</i>	<i>1</i>	<i>1</i>
Specialised credit institutions	11	21	12	11	8	9	6	2
Other institutions	12	22	20	15	16	11	11	3
Appraisal companies	2	8	8	8	6	7	8	1
Mutual guarantee companies	3	5	1	0	5	1	0	0
Currency exchange bureaux and money transfer agencies	7	9	11	7	5	3	3	2
TOTAL	81	147	118	129	96	55	48	24

SOURCE: Banco de España.

dures, technological risk, business plans, foreclosed assets, valuation of investees and fixed income securities, and other matters relating to own funds and yields.

The number of supervisory actions stated above does not include monitoring in the two main banking groups, the scale of which is evidenced by the fact that they are conducted through the permanent presence of more than 50 people in them, since for the purposes of the above statistic this monitoring cannot be expressed as a number of supervisory actions because of its continuous and recurring nature.

On-site continuous monitoring entails the permanent location of inspection teams at the supervised institution. In the case of the largest and most complex groups of credit institutions, it aims to allow information to be obtained earlier and thus permit supervisory measures to be taken more promptly. It is, in short, a way of organising continuous supervision which enables a supervisor to keep in closer touch with the supervised institutions and to obtain up-to-date, in-depth knowledge of their situation and of how it is changing, and to do all this more efficiently and flexibly than by on-site inspection visits, which it therefore replaces.

This system, which the Banco de España has for some years been applying to the two largest Spanish banking groups because of their size and complexity, is now also more recently being applied at eight other Spanish groups of CIs.

By means of on-site inspection, special monitoring and on-site continuous supervision, the Banco de España has in recent years exercised increasingly intensive supervision tailored at all times (regarding supervisory techniques, priority attention areas and types of institutions) to the requirements derived from the situation of and developments in the banking system and to the risk profile of each institution.

Number

	LETTERS SENT TO INSTITUTIONS			
	2006	2007	2008	2009
Credit institutions	80	97	63	47
Banks	24	31	21	23
Savings banks	14	17	19	9
Credit cooperatives	20	22	8	0
Foreign branches	9	11	2	3
<i>EU credit institutions</i>	4	7	1	1
<i>Non-EU credit institutions</i>	5	4	1	2
Specialised credit institutions	13	16	13	12
Other institutions	17	18	14	11
Appraisal companies	5	7	5	0
Mutual guarantee companies	4	4	1	7
Currency exchange bureaux and money transfer agencies	8	7	8	4
TOTAL	97	115	77	58

SOURCE: Banco de España.

In 2009 the Banco de España sent 58 recommendation and requirement letters to credit and other institutions supervised by it, either as final addressees or as the heads of consolidated groups. The distribution of these letters is given in Table 2.2.

The letters to supervised institutions contained a total of 278 observations on the matters set out in Table 2.3.

As usual the main area of recommendations, warranting 127 requirements, equivalent to 46% of the total, was credit risk, including basically the related accounting, the need to increase provisions due to borrower weaknesses and the advisable improvements in loan approval and monitoring processes. Other significant matters addressed in recommendation and requirement letters were management and internal control (including activities on capital markets), own funds and solvency, and other issues such as transparency towards customers, deficiencies in reporting to the Banco de España's Central Credit Register, etc.

A noteworthy new development in 2009 was the receipt and review of the first internal capital adequacy assessment reports, which serve to enhance the Banco de España's supervisory analyses since they include significant information on such aspects as risk profiles, governance systems, risk management and control, capital targets, own funds planning, business strategies, future action programs, etc.

With regard to the validation of internal models for the calculation of regulatory capital for credit risk, the Banco de España monitored the conditions of approval and results of the models of the eight Spanish groups of CIs authorised since 2008 to use internal ratings based (IRB) methods for regulatory purposes. Also, the appropriate authorisations were issued so that these groups could use IRB models for additional portfolios, as envisaged in the successive application plan submitted to the Banco de España. For the first time, some of these models have been approved for subsidiaries outside Europe, specifically in Latin America, as a result of close bilateral coordination between the Banco de España and the Mexican banking super-

SUBJECT MATTER OF LETTERS SENT TO SUPERVISED INSTITUTIONS

TABLE 2.3

Number

	2006	2007	2008	2009
Credit risk	145	231	177	127
Accounting for credit risk, borrower weakness and higher coverage requirements	96	164	130	95
Quality of credit risk controls (origination, monitoring and other procedures)	49	67	47	32
Management and internal control	102	147	79	52
Management and internal control in general	84	120	59	44
Capital market activities	18	27	20	8
Capital and solvency	30	41	23	15
Solvency ratio	30	41	23	15
Other regulations	146	162	78	84
Failure to comply with rules on transparency and customer relations	31	35	19	16
Deficiencies in information reported to the CCR	22	30	13	12
Requirements for authorisation of non-credit institutions	13	14	15	11
Other	80	83	31	45
TOTAL	423	581	357	278

SOURCE: Banco de España.

vision authority (*Comisión Nacional Bancaria y de Valores*), which has also authorised their regulatory use at local level.

In its capacity as consolidating supervisor of the two large Spanish banking groups, the Banco de España organised for the first time the so-called “crisis management meetings” relating to each of these groups, attended by the supervisors and central banks of the main host countries. This was an initiative of the G-20 and the Financial Stability Board (FSB) derived from the recent international financial crisis and it aims to develop appropriate preventive measures to reduce the likelihood and impact of a possible crisis at a major financial institution.

The Banco de España also continued working actively in the area of international supervisory cooperation. It maintained and strengthened the smooth liaison with European, Latin American and North American supervisors, conducted mainly but not exclusively through “colleges of supervisors”. Specifically, the Banco de España hosted meetings of the colleges of the two Spanish international banking groups and participated, in its capacity as host country supervisor, in four meetings of colleges of banking groups with foreign parents.

During the year six cooperation agreements were concluded in compliance with Article 131 of Directive EC/48/2006, whereby the competent authorities responsible for consolidated supervision of a credit institution are required to have written cooperation and coordination agreements for effective supervision. One agreement was entered into as home country supervisor and five as host country supervisor. At the national level, a new cooperation agreement was entered into with the CNMV.

On 29 March 2009 the Banco de España took a precautionary measure to replace the directors of Caja Castilla-La Mancha (CCM). This was the only special precautionary measure taken regarding supervised institutions during the year.

Number

INSTITUTIONS	2006	2007	2008	2009
Banks	1	1 (a)	—	—
Branch of EU foreign credit institutions	1	—	—	—
Savings banks	—	—	—	1
Owner of qualifying holdings in credit institutions	—	—	1	—
Non-compliance with ECB minimum reserve requirements	5	2	2	—
Use of names or pursuit of activities reserved for credit institutions	—	—	1	2
SCIs	1	—	—	1
Appraisal companies	2	2	3	2
Appraisal company revocation	—	—	—	—
Currency-exchange bureaux and money transfer agencies	5	6	6	3
Unauthorised currency-exchange bureaux	2	—	1	—
Currency-exchange bureaux revocations	1	1	3	1
Total	18	12	17	10

SOURCE: Banco de España.

a. Agreement on lifting suspension.

2.2 Exercise of the sanctioning power

Under Spanish law the Banco de España has the competence to exercise sanctioning power over certain institutions and is endowed with sufficient coercive powers within the framework of its supervisory function to ensure that it can act with maximum effectiveness in achieving compliance with the disciplinary regulations applicable to the institutions supervised by it.

The parties subject to this sanctioning power are the institutions supervised by the Banco de España, basically credit institutions and other entities operating in the financial sector, such as licensed appraisal companies and currency-exchange bureaux. Furthermore, in view of the importance of the proper diligent management of these institutions by their directors and executives, this specific sanctioning power also applies to the senior officers of these institutions in the event of very serious or serious infringements attributable to wilful misconduct or negligence.

Additionally, the Banco de España controls and, if appropriate, sanctions the owners of qualifying holdings in credit institutions and those Spanish nationals that control a credit institution of another EU Member State, whenever they infringe the legal provisions applicable to them. The Banco de España's sanctioning power also extends to natural and legal persons that acquire or dispose of qualifying holdings in credit institutions without having obtained the required authorisation.

Finally, the Banco de España's sanctioning powers extend also to the individuals and entities not included among the aforementioned supervised parties that seek to operate on the financial market without having obtained the required authorisation (i.e. compliance with the stipulated conditions of market access is not adequately controlled), whether it be through the exercise of activities legally restricted to duly registered institutions or through the use of generic names restricted to credit institutions or of any others that may be confused with them.

PROCEEDINGS RESOLVED, BY TYPE OF INFRINGEMENT

TABLE 2.5

Number

	NUMBER OF PROCEEDINGS	SANCTIONING PROCEDURES				OTHER PROCEEDINGS				
		INFRINGEMENT			PROCEEDING DISMISSED	NON-COMPLIANCE WITH ECB MINIMUM RESERVE REQUIREMENTS	RESERVED NAME/ACTIVITY (ARTS. 28-29 LDI)	APPRAISAL COMPANY REVOCATIONS (RD 775/97)	UNAUTHORISED CURR. EXCH. BUREAUX	CURR. EXCH. BUREAUX REVOCATIONS
		VERY SERIOUS	SERIOUS	MINOR						
Against institutions										
2006	18	13	33	13	—	5	—	—	—	1
2007	14	12	24	7	—	1	—	—	2	1
2008	16	12	26	6	1	3	1	—	—	3
2009	13	9	24	18	1	—	—	—	1	1
Against particular directors of institutions										
2006	56	39	132	—	2	—	—	—	—	—
2007	46	27	91	—	3	—	—	—	—	—
2008	43	26	87	—	8	—	1	—	—	—
2009	45	25	85	—	1	—	—	—	—	—

SOURCE: Banco de España.

From a procedural standpoint, the Banco de España is responsible for deciding when to bring disciplinary proceedings against supervised parties and also for conducting the related investigations with a view to specifying and gathering evidence on the acts of which the defendant is to be accused, to defining the illegal conduct committed and the legal liability for the offence, and to imposing or, where appropriate, proposing the related sanctions. Once the investigation stage has been completed, the party which is competent to impose the final sanction depends on the nature of the offender and on the seriousness of the infringement. Thus, as a general rule, the Banco de España has to impose sanctions for serious and minor offences, and the Minister for Economic Affairs and Finance, upon the proposal of the Banco de España, has competence to impose sanctions for very serious offences, except for that of withdrawal of authorisation to operate as a credit institution, in respect of which competence lies with the Council of Ministers. Exceptionally, in the cases of currency-exchange and money-transfer bureaux and of unauthorised parties engaging in activities reserved to supervised institutions, competence for the imposition of sanctions, whatever their seriousness, lies with the Banco de España.

2.2.1 PROCEEDINGS INITIATED IN 2009

In 2009, in view of the matters disclosed during on-site inspections by the Banco de España and of other circumstances, it was decided to initiate disciplinary proceedings against nine institutions and 43 of their directors and managers.

More specifically, the Executive Commission decided to bring proceedings against a savings bank, a specialised credit institution, two appraisal companies and three currency-exchange and money-transfer bureaux. Proceedings were also brought against two companies for engaging in activities reserved to credit institutions without having obtained the required authorisation.

In addition, although they are not strictly sanctioning proceedings, mention may be made, as shown in Table 2.4, of the initiation and execution of a proceeding to revoke the authorisation to carry on the professional activity of purchase and sale of foreign currency. The significance

of this type of proceedings is that, through them, entities which, for regulatorily established reasons, have ceased operations or given cause for the relevant authorisation or licence to be revoked are prevented from forming part of the system.

Compared with previous years, the number of proceedings against directors or managers of supervised institutions did not vary significantly, with 10 more being brought against senior officers than in 2008. Furthermore, the parties against which proceedings were brought in 2009 included a company (a specialised credit institution) which had already been sanctioned in the past for non-compliance with the sectoral regulations applicable to it. This repeat conduct is viewed more seriously than a first-time offence and warrants the exercise of sanctioning power against this type of practice in a regulated market such as that for financial services.

2.2.2 PROCEEDINGS RESOLVED IN 2009

A description of the sanctioning activity of the Banco de España would not be complete without a reference to the proceedings resolved in 2009. In this respect, the competent bodies resolved in 2009 disciplinary proceedings against 12 institutions and 43 members of their boards of directors and management. To this should be added another proceeding against two owners of qualifying holdings in a supervised institution. In these resolutions sanctions were imposed (i) for very serious infringements: nine sanctions against institutions and 25 against directors, managers or owners of qualifying holdings in a supervised institution; (ii) for serious infringements: 24 sanctions against institutions and 85 against directors and, finally, (iii) for minor infringements: 18 sanctions imposed only against institutions, since the law does not envisage the imposition of sanctions against directors for minor infringements. Finally, a sanction was imposed against a legal person for engaging in cross-border money transfers without having obtained the required authorisation.

2.2.3 PROCEEDINGS TO WITHDRAW AUTHORISATION OF CERTAIN PARTIES

Along with the information on sanctioning activity in the strict sense, it is appropriate to report here the resolution in 2009 of a proceeding to withdraw authorisation to carry on the professional activity of foreign currency exchange in establishments open to the public, as a consequence of the application by the bureaux themselves for deregistration from the official register.

2.2.4 INFRINGEMENTS BY TYPE OF OFFENDING INSTITUTION a. Appraisal companies

The analysis, by type of institution, of the nature of the various infringements warranting the imposition of sanctions during the year is of particular interest.

Sanctions were levied against five appraisal companies for two very serious, three serious and nine minor infringements.

As for the conduct of these companies, the infringements appreciated in the proceedings resolved can be classified in two groups:

First, it is of prime importance that the appraisal activity of these companies, consisting of the issuance of appraisal reports and certificates for use in the mortgage market, be controlled from a technical standpoint to prevent the overvaluation or undervaluation of the assets being appraised. Accordingly, in the five proceedings against appraisal companies, sanctions were imposed for infringements of this type deemed to be very serious (in the case of two of them), since it was considered that the certificates or reports contained manifest appraisal inaccuracies and, in particular, a lack of concordance with the data and evidence obtained in the valuation activity performed. In the other three cases a serious infringement was considered to have been committed since the offenders issued reports or certificates which departed, with-

out saying so expressly, from the procedures, checks and instructions envisaged in the applicable legislation.

Second, nine sanctions were imposed for minor infringements due to non-compliance by the offending institution with its specific obligations under applicable law, such as having a means of internal control to ensure: proper formulation of appraisals and independence of the appraisal company and of its professionals (in four cases), sufficient insurance coverage of the third-party liability derived from appraisal activities (in two cases), due remittance of data to the supervisory authority (in two cases) and the exclusive pursuit of the corporate purpose (in one case).

b. Currency-exchange and money-transfer bureaux

Proceedings against six currency-exchange and money-transfer bureaux and against their directors and managers (21 in total) were executed and resolved in 2009. The infringements which were considered very serious refer, in two cases, to the keeping of accounting records with fundamental irregularities preventing the establishment's net worth and financial position from being known. In another three cases the infringements were considered to be very serious since a serious infringement had been committed and in the previous five years a firm sanction had been imposed for the same type of infringement (failure to comply with current rules on accounting or the infringement of regulations on agents or of those on transparency of transactions). In one case the currency-exchange bureaux was considered to have committed a very serious infringement because for two consecutive years it failed to have the obligatory external audit performed. Lastly, in another case the offending institution was considered to have committed a very serious infraction because it failed to comply with its duty of accuracy when informing the public in general, this non-compliance being considered especially significant because of the number of people affected and the importance of the information involved.

Serious infringements resulted from the failure to comply with: (i) regulations on minimum capital requirements of currency-exchange bureaux (four cases); (ii) the duty of exclusivity in the use of bank accounts through which cross-border money transfers are made (four cases); (iii) the regulations applying to these bureaux in respect of agents (three cases); (iv) the rules on accounting and on preparation of balance sheets and income and other financial statements that have to be reported to the competent administrative authority (two cases); (v) transaction recording and money transfer obligations (two cases); (vi) obligation of remittance to the Banco de España (two cases); (vii) the compulsory insurance coverage of liability which might arise from money transfers (one case); (viii) the duty of accuracy when informing the public in general (one case); and (ix) regulatory provisions on transparency and the protection of customers (one case).

Finally, there were 10 minor infringements for non-compliance with various obligations under applicable law which, however, because of their isolated nature or other circumstances, were considered less serious than those described above. Thus, in four cases the bureau did not have complete insurance cover of the liability which might arise from its activity and in three cases the obligation to report to the Banco de España was not complied with. Lastly, there were three minor infractions for non-compliance with transaction recording and money transfer obligations, with regulatory provisions on customer transparency and protection and with obligations concerning agents, respectively.

c. Owners of qualifying holdings

As stated above, the owners of qualifying holdings in credit institutions are liable to sanctions if those qualifying holdings are directly or indirectly acquired or increased in violation of the applicable law, which requires them to notify the Banco de España of the pertinent transac-

tion and to refrain from carrying out that transaction within the three-month period allowed to the Banco de España to assess it or, obviously, when the Banco de España has expressly opposed the transaction. Taking into account this regulatory framework, it was considered that one natural person and one legal person had committed a very serious infringement by failing to notify an indirect purchase of qualifying holdings in a specialised credit institution, the Banco de España, moreover, having previously expressly opposed a similar transaction notified to it.

d. Pursuit of activities reserved to supervised institutions

As mentioned above, the Banco de España's sanctioning activity also covers those individuals or legal entities which, without having obtained the required authorisation and having been registered in the corresponding registers, pursue activities reserved to supervised institutions. In this respect, one such proceeding was resolved in 2009. It was brought against an entity for engaging in cross-border money transfers without having obtained the required authorisation and it resulted in a fine. The entity was also sent a requirements letter instructing it to cease the unauthorised activity and noting that, if it failed to do so, it could be sanctioned again.

2.2.5 SANCTIONS AND CONCLUSION

Within the range of sanctions under the sectoral regulations, those imposed in 2009 consisted mainly of fines, made up as follows: 45 on entities, 104 on directors or managers and two on owners of qualifying holdings. However, in certain cases, in view of the conduct of the offending entity or officer, the sanction imposed was a reprimand, either public (with publication in the Spanish Official State Gazette) or private. Also, on two occasions, given the seriousness of the offence, it was considered necessary to revoke the authorisations granted to the respective foreign-currency bureaux and, in another instance, the authorisation of an appraisal company was revoked. Such maximum sanctions on an entity have generally been accompanied by disqualification of its directors or managers.

As a conclusion to the foregoing, it can be said that in 2009 the Banco de España continued to exercise its sanctioning power broadly within the parameters and trends of previous years, as regards the number of proceedings conducted and resolved. As regards the types of sanctioned institutions, it should be mentioned that there was an increase in proceedings brought against appraisal companies compared with the previous year, and that, in the cases in which very serious or serious infringements were found to have been committed, not only the institutions were sanctioned, but also the directors and managers whenever their guilt or negligence in the commission of those infringements was proven.

There were no significant changes in the infringements ultimately proven and sanctions imposed in comparison with previous years and there was no noteworthy increase in seriousness or frequency in any of the types of infringements.

2.3 Other supervisory activities of the Banco de España

2.3.1 TRANSPARENCY AND INFORMATION FOR BANK CUSTOMERS

The Banco de España is also entrusted with overseeing other aspects of the activity of CIs. Following is a brief review of those functions along with comments on the most notable matters arising in 2009.

The Banco de España is responsible for checking and registering the brochure to be drawn up by institutions setting out their fee and commission charges (prices of bank services), chargeable expenses and valuation conditions, as well as the maximum charges applicable, the item to which they relate and the terms of their application. These verification tasks are restricted by law to checking that the brochure reflects maximum prices and the conditions governing their application in a clear and orderly fashion. Such checking does not include securities transactions since these are the competence of the CNMV.

The changes in 2009 mainly concerned price rises in bank services and the inclusion of new services.

Although the new Law 16/2009 of 13 November 2009 on payment services entered into force in the reporting year, the date on which it did so (4 December) and the fact that some of its regulatory implementation has yet to be completed meant that it had no impact on institutions' proposals.

The proposals processed in 2009 numbered 964, compared with 1,205 in the previous year. This followed the downward trend of recent years (which had been broken temporarily in 2008) in which there had not been any regulatory changes requiring adjustments to the brochure of fee and commission charges.

Another function entrusted to the Banco de España regarding transparency is the authorisation, prior to publication, of CIs' advertising projects that refer to cost or return to the public.

This authorisation is intended to ensure only that advertising reflects clearly, accurately and in a manner respectful of competition, the features of financial offers, and that the cost or the return offered has been calculated in keeping with the rules regulating the annual percentage rate (APR). This measure seeks to harmonise that calculation so that different offers can be compared.

In 2009 the number of applications for authorisation of advertising projects was practically unchanged from the previous year (6,376 applications, against 6,525 in 2008). Although this represents only a slight decrease with respect to the previous year, it bears out the change of trend with respect to the past decade, in which the number of applications processed had been increasing significantly. In any event, the 2009 figures show a notable decrease in the number of new projects (5,182, against 5,707 in 2008), and, simultaneously, an increase in changes or updates (of interest rate or offer validity period) of previously authorised projects.

The number of applications processed containing offers of loans (52.16% of new projects) exceeded those with offers of deposits (42.36% of new projects). These percentages were very similar to those of the previous year (in 2008 loans accounted for 51.34% of new projects and deposits for 44.80%).

With regard to the media used, the presence of advertising by CIs in the print media, which fell sharply in 2007 and 2008, increased to 17.32% of total new applications.

Another function relating to transparency is that of verifying the customer protection rules regulating the activity of the Customer Service Department and ombudsman, except in the case of savings banks and local and regional credit cooperatives, the verification of which is carried out by the competent body of the regional (autonomous) community in which their registered office is located. In any event, the Banco de España must be informed of the designation of the head of this service or department and, where applicable, of the ombudsman.

As stated in the 2008 report on banking supervision, the task of initial verification of these rules was practically completed in 2006. Hence, as in 2007 and 2008, the work in 2009 consisted of checking the rules of institutions newly registered in that year and the changes proposed to existing rules.

The Bank Customer's Portal

The bank customer's portal is a specific section of the Banco de España website intended to provide information and guidance to non-business customers of credit institutions.

OFFICIAL REGISTERS OF INSTITUTIONS

TABLE 2.6

Number. Year-end data (a)

	2006	2007	2008	2009
Institutions with an establishment	550	558	561	550
Credit institutions (b)	355	358	361	353
Representative offices	54	57	55	55
Mutual guarantee companies	24	24	24	23
Reguarantee companies	1	1	1	1
Currency-exchange bureaux and money transfer agencies (c)	59	59	62	63
Appraisal companies	56	57	56	54
Controlling companies of credit institutions	1	2	2	1
Credit institutions operating without establishment	404	433	480	517
Of which: EU CIs operating without an establishment	398	428	475	492
Of which: financial subsidiaries of EU CIs	3	2	2	2
Payment institutions (d)	—	—	—	20

SOURCE: Banco de España. Data available at 31 December 2009.

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

b. Including electronic money entities (one in 2009) and ICO.

c. Not including foreign currency purchasing establishments.

d. In application of Directive 2007/64/EC and of Law 16/2009 on payment services.

In 2009 portal page viewings numbered 2,673,764, an increase of only 5% with respect to 2008 and well below the increase achieved in 2008 (25%).

The most visited sections were the simulators, banking products, glossary, interest rates and frequently asked questions.

The 2,838 queries received through the portal's "contact us" facility was very similar to the number in 2008 (2,776), in which year the queries doubled those of 2007. Telephone inquiries decreased from the 3,578 received in 2008 to 2,664 in 2009.

2.3.2 OFFICIAL REGISTERS AND INSTITUTIONAL INFORMATION

Under Spanish law the Banco de España is responsible for various public registers in which not only CIs and other financial intermediaries and auxiliaries, but also certain elements of their corporate governance and organisational structure, have to be registered. These registers are as follows:

a. Register of Institutions

Diverse institutions operating on Spain's financial markets must be recorded in the register of institutions before they commence activities. The purpose of this register is twofold: first, it seeks to implement the "vetted access" principle governing the presence of those institutions in the market; and second, it aims to publicise adequately the fact that those institutions are subject to supervision by the Banco de España or by the competent authority in their respective home countries.²

² This register and the register of agents described below are available to the public and can be consulted by either traditional means or on the Banco de España's website (banking supervision section). The register of institutions is available not only as it currently stands, but as it stood at past dates, and selective searches can be made on the basis of different criteria.

Table 2.6 gives the number of institutions entered in the register,³ including those supervised directly by the Banco de España and those from other EU countries that operate in Spain under the freedom to provide services.

The most significant event in 2009 in this register was the inclusion for the first time of a new category of supervised institutions, namely payment institutions.⁴ Thus in the last quarter of that year, in application of Directive 2007/64/EC and of Law 16/2009 on payment services (at that time lacking the related implementing regulations), 20 EU payment institutions, mainly Irish and British, which had expressed their wish to operate in Spain under the freedom to provide services, were registered. At end-2009, due to the aforementioned lack of regulations implementing Law 16/2009, no Spanish payment institution had yet been registered.

Apart from this, the changes in the register of institutions in 2009 were minimal and mainly due to restructurings in some consolidated groups of CIs which often ended in the closure of specialised subsidiaries, mainly SCIs. Thus the number of registered SCIs decreased by 8% to 69 at the end of the year. The only other notable development in this regard was the increase in the number of CIs operating without an establishment, which, in line with the growing reality of the European single market, increased by 3.5%.

b. Register of Senior Officers

The reason for this register, in which information is entered on the directors and senior managers of the institutions supervised by the Banco de España, is to manage and supply up-to-date personal and professional information on the main officers responsible for the activity of such institutions. This is done with the dual purpose of, firstly, acting as an ancillary tool for the Banco de España and other agencies in checking the commercial and professional experience and standing which has to be accredited by the senior officers of financial institutions; and, secondly, providing a means of monitoring the restrictions and incompatibilities applicable to such officers in banks and credit cooperatives, which have to be verified by the Banco de España.

In 2009 the number of senior officers recorded in this register⁵ continued the slow decline resulting from the smaller number of institutions and a certain simplification of the boards of directors of supervised institutions. This decrease was only among male senior officers, since the number of women registered continued to increase slowly to stand at a still modest 13% of the total.

Meriting special mention in 2009 was the entry in this register of the people designated by institutions as authorised for the purposes of electronic signature of reporting statements, which accounts for the increase in the number of entries. Also noteworthy was the increase in total inquiries as a result of those by the CNMV regarding the formation of new financial advice firms, a relatively recent type of company still under development.

c. Information on shareholders

The Banco de España also receives confidential information on the shareholders of banks and SCIs and on the members of credit cooperatives.⁶ This information is vital for the basic super-

3. For more details of the institutions that have to be entered in this register, see Section 2.3.6. of the 2006 Report on Banking Supervision in Spain. 4. See Section 3.2.3.2 below in Chapter 3 of this Report. 5. All the statistical information in this section other than that relating to the number of registered institutions is included in Annex 4.2. In that annex, the information relating to the Register of Senior Officers is based on identity without regard to the number of posts that each may hold, i.e. the stated figure is the total number of senior officers registered and not the total number of senior posts in the institutions supervised by the Banco de España. 6. These institutions are required to report data quarterly on all their shareholders or holders of contributions that are deemed to be financial institutions, and on those who, while not deemed to be such, hold shares or contributions representing a percentage of the share capital of the institutions equal to or more than 0.25% in the case of commercial banks, 1% in credit cooperatives and 2.5% in SCIs.

visory tasks of the Banco de España, in which it is essential to know the shareholder structure of the institutions under its supervision, and for checking compliance with the law on qualifying holdings, a task entrusted to the Banco de España.

There were no significant changes in this register in 2009, apart from those relating to the aforementioned decrease in the number of supervised institutions entered in the register of institutions kept by the Banco de España.

d. Reporting of agents

CIs operating in Spain and, since the beginning of 2002, also the currency-exchange bureaux licensed to make cross-border money transfers, are obliged to report to the Banco de España those agents whom they have authorised to operate habitually with their customers, in the name of and on behalf of the principal, in negotiating or entering into transactions typical of their activity. In addition, Spanish CIs must report to the Banco de España the list of foreign CIs with which they have entered into agency agreements or, where applicable, agreements to provide financial services to customers.

Noteworthy in 2009 was the sharp decrease in the number of agents reported, down by 17%. This fall was attributable almost exclusively to banks, the number of whose agents dropped to practically half as a result of the closure of this business channel by the company most active in it (a subsidiary of a foreign bank). Disregarding this closure, the decrease in the number of agents reported by banks was 15% and the total number of agents reported only fell by somewhat more than 1%.

The reason for this is that the number of agents reported by currency-exchange bureaux authorised to make cross-border money transfers continued the upward trend of previous years, although the growth rate of 25% in the past moderated to 8% in 2009.

e. Special register of articles of association (Registro Especial de Estatutos)

The Banco de España also keeps an up-to-date register of articles of association of supervised institutions to ensure continuity in the exercise of prudential supervision of them and to monitor the changes in those articles of association, which are sometimes subject to administrative authorisation by the Ministry for Economic Affairs and Finance or the corresponding body of the regional (autonomous) government, in which case a prior report from the Banco de España is mandatory.

In 2009 the Banco de España analysed and reported on 25 applications to amend articles of association, practically the same as in 2008 and far fewer than in previous years, when the articles of association of institutions were being adapted to the changes in the principles of corporate governance.

The decrease of more than 20% in the number of amendments registered reveals that the applications processed now contain changes of a more specific nature and thus affect a smaller number of provisions in the articles of association.

2.3.3 OTHER AUTHORISED
ELIGIBLE CAPITAL FOR SOLVENCY
PURPOSES

For purposes of compliance with certain prudential regulations, certain financial instruments issued by CIs, by their special purpose vehicles or by other subsidiaries are assessed by the Banco de España for inclusion in the own funds of the CIs or of their consolidated groups in accordance with applicable law.⁷

The items eligible as own funds include fixed-term and perpetual subordinated debt and preference shares. These financial instruments, known as hybrids, have features of debt instru-

7. Royal Decree 216/2008 of 15 February 2008 on the own funds of financial institutions.

€m. Yearly data

	NUMBER				AMOUNT			
	2006	2007	2008	2009	2006	2007	2008	2009
TOTAL	79	60	36	75	16,078	21,592	3,747	26,314
Subordinated debt	65	45	32	42	13,942	11,962	2,597	7,938
Fixed-term	60	41	27	39	12,728	10,458	2,497	7,865
Banks	24	29	14	15	8,853	9,189	1,259	2,541
Savings banks	25	9	9	18	3,724	1,224	1,233	5,092
Credit cooperatives	3	3	1	1	23	45	2	3
SCIs	8	—	3	5	128	—	3	229
<i>Of which:</i>								
Loans	12	4	7	11	297	420	678	409
No agreed maturity	—	—	3	—	—	—	19	—
Credit cooperatives	—	—	1	—	—	—	3	—
SCIs	—	—	2	—	—	—	16	—
<i>Of which:</i>								
Loans	—	—	2	—	—	—	16	—
Undated	5	4	2	3	1,214	1,504	81	73
Banks	2	1	—	3	64	1,019	—	73
Savings banks	3	3	—	—	1,150	485	—	—
SCIs	—	—	2	—	—	—	81	—
Preference shares	14	15	4	33	2,136	9,630	1,150	18,376
Banks	6	7	1	15	1,602	9,239	1,000	9,426
Savings banks	8	7	3	18	534	389	150	8,950

SOURCE: Banco de España.

ments and, in addition, those of equity instruments, in that they can be set off against losses without the need to wind up the institution, they will remain on the institution's balance sheet for an indefinite period of time and the returns on them depend on the existence of sufficient profits and on the issuer's solvency.

The total amount subscribed in 2009 in the issues verified by the Banco de España for eligibility as own funds amounted to €26,314 million, somewhat more than seven times the amount in the preceding year (in which issuances of this type fell sharply) and nearly 22% more than in 2007.

A significant portion of this amount was intended to replace previous issues, on which exchange or general repurchase transactions of a total or partial nature were conducted. Many of the repurchase transactions were authorised by the Banco de España to enable institutions to take advantage of the low prices of securities to realise gains to be used to record provisions or reserves and, at the same time, strengthen their market position. Replacement is normally with issues of similar quality.

Continuing the trend initiated in 2008, 70% of the issue amount was placed, at least partially, with retail investors (18% solely with them). The amount of the issues targeted only at institutional investors stood at 30% of the total.

In 2009 the predominant type of issue was preference shares, accounting for 70% of the total.

Perpetual subordinated debt related in full to loans between institutions of the same consolidated group aimed at strengthening the solvency of the borrower.

The issues of operating subsidiaries of Spanish CIs subject to specific own fund requirements in their country of origin which were recognised by the Banco de España as eligible capital of the consolidated group had an equivalent value of €1,343.4 million in 2009. This represented 5% of the total, a slightly lower percentage than in the preceding year.

Apart from that mentioned above, subordinated debt related practically in full to savings banks. Most of these issues had a maturity of 10 years with interest tied to Euribor (three-monthly, six-monthly or yearly) plus a spread ranging between 200 and 650 basis points, although some issues had tranches earning fixed interest between 4% and 8.5%. In most cases, there was an early repayment option at five years with a step-up of between 25 and 75 basis points.

However, the archetypal issue in 2009 was euro-denominated preference shares allowing early redemption by the issuer from year five upon authorisation by the supervisor, targeted at retail investors and quoted on the AIAF market. The interest rate structure consisted of a tranche of approximately two years at a fixed rate of nearly 7% and a variable rate for the rest of the issue term tied to three-month Euribor, with a spread of around 6% and a minimum remuneration threshold of slightly less than 7%.

2.4 Supervisory policies

2.4.1 COMPENSATION POLICY OF CREDIT INSTITUTIONS

As the crisis deepened in 2008, the international community became increasingly aware that an inadequate compensation policy had been one of the contributing factors. The compensation policy, not only at the level of directors and executives, contributed to excessive risk-taking which left institutions with scant resources for absorbing losses. The setting of short-term objectives allowed the distribution of bonuses without taking into account the risk imposed on institutions over a longer time horizon. Also, institutions viewed their compensation policy as having little to do with risk management and corporate governance. As a result of all this, different international initiatives were set in train with the same objective: to correct the inadequate incentives created by compensation systems in the financial industry.

Thus, at global level, in November 2008 the leaders of the G-20 asked their ministers of finance to prepare recommendations for revising compensation practices in the financial sector and avoiding systems which rewarded risk-taking or excessive short-term profit-seeking. The response came from the Financial Stability Board (FSB, although at that time it was still known as the Financial Stability Forum) with the publication in April 2009 of its *Principles for Sound Compensation Practices* intended for significant financial institutions. The principles fall into three broad areas: corporate governance, alignment of compensation policy with risk, and transparency and supervisory oversight.

In the first area, the FSB sets the key objective of ensuring effective governance of compensation and underlines the need for the firm's board of directors to actively oversee the design and operation of the whole compensation system. Additionally, the staff engaged in financial and risk control must be independent from the units they control and have appropriate authority.

The second group of FSB principles stresses the need for effective alignment of compensation with prudent risk-taking. Variable compensation must be adjusted for all types of risk and in-

clude the cost of capital. Compensation schemes must be symmetric with risk outcomes, which means that variable pay should decrease considerably if the firm or unit in question performs poorly. Further, compensation pay-out schedules must be sensitive to the time horizon of risks, which implies an appropriate policy of pay deferral and possible claw-back of amounts already paid. Finally, the mix of cash, equity and other forms of compensation must be consistent with risk alignment.

The FSB's last two principles emphasise that supervisory review of firms' compensation practices must be rigorous and sustained, and deficiencies must be addressed promptly through supervisory action. For their part, firms must disclose clear, comprehensive and timely information about their compensation practices to facilitate constructive engagement by all stakeholders (shareholders, creditors, employees, supervisor, etc).

At the same time as the FSB published its principles in April 2009, there was also a response from the EU with the publication by the Committee of European Banking Supervisors (CEBS) of its *High-Level Principles for Remuneration Policies*. Its principles, although less detailed, are fully consistent with those of the FSB and, once again, address the areas of corporate governance, alignment with risk (via recommendations on the measurement of performance as the basis for remuneration and on the form of remuneration), and the necessary disclosure of the compensation policy. The CEBS also stresses that a financial institution's remuneration policy should be in line with its business strategy and risk tolerance and should not encourage excessive risk-taking. It should, however, be noted that the CEBS principles are applicable to all credit institutions and investment firms, while the FSB principles are for "significant financial institutions" (mainly those with international activity). In Europe, the supervisory thrust in compensation matters was completed by the European Commission's issuance of two Recommendations in April 2009.⁸

Some months later, in order to ensure that the reforms were implemented resolutely and consistently at international level, the G-20 requested the FSB to prepare a more detailed proposal on compensation. Thus in September 2009 the *Implementation Standards* were published. The standards are an extension of the principles, and establish important guidelines and quantitative thresholds for certain areas, compliance with which is compulsory and immediate. Notable in the area of corporate governance is the requirement for important institutions to have a remuneration committee to evaluate the compensation policy and ensure compliance with FSB principles and standards, working together with the risk committee. There should also be an independent annual review.

The pay structure and its alignment with risk is the area where the standards made the most significant, and most controversial, proposals. The document establishes a series of minimum recommended thresholds, such as the need for between 40% and 60% of variable compensation to be deferred for various (minimum of three) years and for at least 50% of such compensation to be in shares or similar instruments. These percentages should increase with the level of seniority or responsibility of the employee. Another significant clause, which represents a balance between those in favour of and those against limiting compensation levels, is that

8. Recommendation 2009/385/EC on the regime for the remuneration of directors of listed companies and Recommendation 2009/384/EC on remuneration policies in the financial services sector. The first complements earlier recommendations from 2004 and 2005 and sets exhaustive requirements for managers of listed firms, increasing the disclosures required in the annual remuneration report already obligatory for listed firms. The second recommendation is less exhaustive and stringent than the first, although it covers all the CEBS principles and is addressed to all employees of financial institutions.

national supervisors may limit variable compensation as a percentage of total net revenues when it is inconsistent with the maintenance of a sound capital base.

Other standards mentioned the government's ability to restructure the compensation system in the event of intervention to stabilise or rescue an institution, as well as the requirement for institutions to immediately adopt the measures needed to apply the FSB standards, including a review of payments in the event of termination of all employment contracts. Also included is the obligation to publish a yearly compensation report with qualitative information (compensation system design) and detailed quantitative information (aggregate amounts for senior executives and other employees).

Even though the review of compensation policies already formed part of the Banco de España's supervisory work (included both in Basel Pillar 2 guidelines and in SABER methodology), all these international initiatives met with an immediate response in Spain. The Banco de España twice directed itself to the associations of institutions under its supervision to call their attention to their compensation practices and the need for them to comply with the principles and standards recently issued by the FSB and the CEBS. They were also asked to engage in an exercise of self-assessment of their compensation policies and were informed that maximum convergence with the new international standards was expected by 31 December 2009.

Since the end of 2009, resources are being assigned to verify the compensation policies of Spain's largest institutions and the changes in them. Full convergence is expected to be achieved in 2010, before the current proposal to amend the Capital Requirements Directive (Directive 2006/48/EC or CRD III) comes into force. Moreover, the yearly Supervisory Action Plan for 2010 already includes specific new actions to review institutions' compensation practices in greater depth. The Banco de España's position, as evidenced by the action taken in recent months, is to encourage the immediate implementation of the FSB compensation principles and standards. However, owing to the business model prevailing in Spain (traditional commercial banking), bonuses do not represent a high percentage of profits and in no case compromise the solvency of institutions.

The Banco de España does not plan to issue specific rules on compensation in 2010 because the CRD III already includes the FSB and CEBS principles and standards, and their transposition at the end of the year will incorporate them into Spanish law. Additionally, the draft Sustainable Economy Bill expressly refers to the reform of Law 13/1985 on investment ratios, own funds and reporting requirements of financial intermediaries and provides that "the Banco de España may require credit institutions to have compensation policies consistent with prudent and effective risk management". It also provides that financial institutions shall publish information on their compensation policies.

To finish up, it should be mentioned that in January this year the BCBS published an *Assessment Methodology* or supervisory guides prepared at the express request of the FSB. The document provides useful additional clarifications and guidelines on interpreting the FSB principles and standards, and gives a list of available supervisory actions, with a view to promoting consistent international application of the FSB principles and standards. The guidelines emphasise the importance of proportionality (to the size and complexity of institutions; the CRD III also particularly stresses this) and are highly flexible and adaptable, allowing each supervisor to choose according to its national particularities and acknowledging the different approaches in the industry when it comes to setting compensation policy.

The FSB is currently conducting a *Peer Review* exercise on compensation to gather information on the actions taken by national authorities to implement these principles or standards.

Following the decision taken by the G-20 at its Pittsburgh meeting, the FSB, among other international agencies, is considering how to mitigate the various aspects of the moral hazard problem associated with systemic institutions, which has been exacerbated by the large quantity of funds deployed by the various countries to support their large international banks. The problem basically admits two complementary approaches: the first centres on strengthening the individual resilience of each institution, for which possible requirements on group solvency, liquidity and management, or restrictions on size or activity, are proposed; the second focuses on improving overall financial system infrastructure to reduce the likelihood of a systemic institution going bankrupt and make the consequences less traumatic. This issue is a current topic of debate in the various international fora.

Most notable among the measures to strengthen overall financial system infrastructure is the appropriate preparation of both the institution itself and the supervisory authorities to cope with a crisis at a systemic institution. To this end, the Banco de España traditionally places great importance on prudent management with adequate risk control and on meticulous prudential supervision.

The 2001 Banking Supervision Report defined a framework of good practice for the design and management of Spanish banking groups with an international presence which includes the following principles: group culture and management information, with effective control over the whole group by the parent; prudent accounting policies, adapting the financial statements of the foreign subsidiaries to the minimum Spanish standards; group solvency and solvency on an individual basis; clear and publicly-available chart setting out control relationships in the group; financial autonomy of each institution within the banking group; and control of liquidity with appropriate contingency plans for the group's consolidated position in the currencies in which it operates. This general framework continues to be applicable in the current circumstances, since it has proven its robustness in adverse circumstances, without prejudice to it being applied with differing scopes in each specific situation.

Nevertheless, the recent crisis has made it clear that each Spanish international banking group should have individual contingency plans prepared according to the Banco de España's guidelines and approved in coordination by the Spanish and foreign authorities. These authorities, gathered together in crisis management groups, will arrange any crisis that affects systemic banks. It is envisaged that they will meet at least once a year, or more frequently when necessary, to review new developments affecting the organisation and operations of the banking group in question and the regulatory environment relating to crisis management. The existence of contingency plans, which must be kept up-to-date, has a usefulness above and beyond specific crisis management measures, since they will serve as a key tool for authorities to exercise ordinary supervision and also for managers to administer the group.

To encourage appropriate preparation for crisis, the Banco de España requested the large international Spanish financial groups to draw up recovery and resolution plans, also known as *living wills*, which will be analysed by the aforementioned crisis management groups. These groups, which are led by the Banco de España, are a particularly flexible means of bringing together the main supervisory, monetary and fiscal authorities of the countries where the international Spanish groups have a significant presence.

The process of drawing up living wills as recommended by the FSB has already begun for the large international Spanish groups. Broadly, living wills have two parts: one addresses the last-resort measures which the group in distress would take to preserve its essential business and avoid collapse; the other sets out the measures the authorities would take to wind up the institution without causing market turbulence. Additionally, a living will also includes essential information for the recovery or winding-up of the institution.

The Banco de España will continue promoting the preparation and updating of contingency plans and will maintain ongoing communication and coordination with other supervisory authorities in order to ensure a high degree of preparation at all times in the event of crisis.

