

THE BANCO DE ESPAÑA AND THE BANKING SUPERVISION ARCHITECTURE IN THE 20TH CENTURY THROUGH ITS KEY MILESTONES: 1921, 1962 AND 1977

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Abstract

Banking supervision in Spain during the 20th century can be understood through three pivotal moments: 1921, 1962, and 1977. The Banking Law of 1921 introduced basic prudential regulations and for the first time entrusted the Banco de España – then a private institution – with the inspection function, although it was hardly exercised before the Civil War. After a period without any effective supervision during the Franco regime (1939-1955), inspections were resumed under the oversight of the Ministry of Finance, focusing on compliance with interbank interest rate agreements. After the nationalisation of the Banco de España, the 1962 Framework Law reinstated its supervisory responsibility, which was resumed gradually. Over the following years the Inspection Service and the Central Credit Register were created and an in-house inspectorate was set up. The decisive transformation towards modern supervision came with the 1977 banking crisis. Institutions such as the Deposit Guarantee Scheme and the Banking Corporation were established and the Inspectorate was strengthened with more resources and specialised training. At the same time, the process of European integration and Spain's accession to international organisations contributed to the convergence of Spanish regulations on solvency and banking risk.

Keywords: banking supervision, Banco de España, inspection, solvency

1 Introduction and objectives

The banking crises of the 1980s led to the adoption of the international Basel accord, which introduced recommendations on banking regulation and supervision to strengthen banks' financial soundness globally, with a focus on credit risk control and capital adequacy. Following the 2007-2008 financial crisis, banking supervision became a central pillar of international economic policy, which today faces challenges requiring ongoing adaptation beyond the original Basel framework. In Spain the supervisory framework was redesigned after the Great Recession of 2007-2008, with the main European supervisory mechanisms implemented between 2009 and 2013. This entailed a change in the historical supervisory functions of the Banco de España, which now directly supervises the Spanish financial system's less significant institutions and collaborates with the European Central Bank (ECB) in on-site inspections and oversight of significant institutions.¹ In addition, the Banco de España's supervision has gradually expanded beyond microprudential supervision to include conduct, reporting transparency and credit institutions' relationship with their customers, as well as monitoring

¹ In addition to supervising banks, from 1971 the Banco de España was also tasked with supervising savings banks and credit cooperatives. In 1988 its remit was expanded to include specialised credit institutions, followed by other types of credit institutions not limited to banks, including mutual guarantee societies and currency-exchange bureaux.

payment systems and instruments, providing payment services and supervising system operators and payment processors (Banco de España, 2024).

Before the current regulations were in place, the Banco de España's role in supervision shifted throughout the 20th century under the various regulatory frameworks and economic and institutional contexts. This paper provides a brief historical overview of banking supervision in Spain during the 20th century, highlighting three key milestones when its supervisory scope was expanded:² 1921, 1962 and 1977. In the 19th century, Spain had early banking supervision mechanisms linked to the emergence of its domestic banking system. The banking laws of 1856, along with earlier rules enacted in 1829, 1849 and 1851, regulated the publication of balance sheets and created the role of royal commissioner at the Banco de San Fernando (predecessor of the Banco de España) and local issuing banks, and of inspector at credit corporations. This legal framework reflected the State's interest in controlling banking activity, particularly monetary issuance and circulation. However, this first attempt at banking supervision, led by the Ministry of Finance and not by the Banco de España, was short-lived and largely ineffective. First, the financial crisis of 1864-1866 and the subsequent shift in economic policy triggered by the Glorious Revolution of 1868 meant that the regulations were in force only during the 1870s, after which a half-century of banking laissez-faire ensued. Second, supervision merely certified the information provided by banks on their balance sheets and failed to prevent the crisis that destroyed much of the financial system. Weak enforcement and "regulatory capture" undermined effective supervision. The importance of supervision was not brought back into focus until the Banking Law of 1921. An overview of the history of Spanish banking supervision is provided in Table 1.

This paper is organised into four parts, starting with this introduction. The second part provides a brief overview of the international literature on the history of supervision. The third part focuses on the Banco de España's role in supervision during the 20th century. Lastly, the paper puts forth a short conclusion.

2 The history of banking supervision. Origins, factors and key players

Historical studies about supervision, particularly over the long term, are scarce.³ However, Hotori, Wendschlag and Giddey (2022) recently analysed this issue in the United States, Japan, Sweden, Germany, Switzerland, Belgium, France and Great Britain during the 19th and

2 This work summarises the research carried out on the history of supervision in Spain, financed by the Banco de España through its Economic History programme, and published in the *Estudios de Historia Económica* series (Cuevas and Pons, 2025a). The research and documentary sources, which are mainly from the Historical Archive of the Banco de España (HABE), are detailed therein. The study focuses exclusively on the supervision of the banking sector and not on the supervision of other financial institutions.

3 For the United States, extensive research exists focusing on specific periods (Mitchener, 2005; White, 2009), along with some long-term analyses (Mitchener and Jaremski, 2015; Conti-Brown and Vanatta, 2025). For Great Britain, Hall (1999) analysed how supervision had changed since 1945 and James (2020) addressed supervisory aspects in his study on the Bank of England between 1979 and 2003. For Germany, see Bähre (1984), and for France, Mastin and Touchelay (2023) explores various aspects of bank control during the 20th century.

Table 1

Timeline of banking supervision in Spain, 1851-1986

Years	Supervisory authority	Main characteristics
1851 - 1868/69	Ministry of Finance	<ul style="list-style-type: none"> • Publication of balance sheets • Royal commissioner at the Banco de San Fernando (from 1856 onwards, the Banco de España) and issuing banks • Inspectors at credit corporations
1868/69 - 1920	—	<ul style="list-style-type: none"> • No supervision
1921 - 1936	Banco de España	<ul style="list-style-type: none"> • Controlled access to the sector • Creation of the Spanish Banking Supervisory Authority and the Banking Commission • Prudential measures: minimum capital and solvency ratio • Publication of accounting information in a standardised format
1939 - 1962	Ministry of Finance	<ul style="list-style-type: none"> • Monitoring with little banking supervision • Inspections to monitor interest rates on deposits
1963 - 1986	Banco de España	<ul style="list-style-type: none"> • Publication of accounting information in a standardised format • Submission of credit information to the Central Credit Register • Creation of the Private Banking Inspection Service • Creation of the Inspectorate • Creation of the Deposit Guarantee Scheme and the Banking Corporation

SOURCE: Prepared by the authors based on Cuevas and Pons (2025a).

20th centuries. For more recent periods, Penikas (2015) provides an overview of international banking supervision between 1974 and 2014.

The goals of bank regulation and supervision have changed depending on the historical and institutional context and the characteristics of each country's financial system. Although “modern supervision” is relatively recent – with just four decades of existence (Masciandaro and Quintyn, 2013) – in countries such as the United States and Spain its origins date back to the 19th century. The first supervisory initiatives were based on two instruments: (i) controlling access to the sector through registration or authorisation subject to certain requirements, and (ii) the collection of statistical information to mitigate information asymmetry and to make it easier for shareholders and depositors to assess banks' financial situation and risks. Banks also had the obligation to publish balance sheets and other accounting information, such as the composition of their portfolio, profit and loss accounts and annual reports. However, these requirements were not always complied with and they didn't follow a standardised format.

Financial crises have been a driver of supervisory change, even if it is not possible to establish a consistent pattern (Hotori, Wendschlag and Giddey, 2022). In the United States bank failures throughout the 19th century triggered the emergence of supervision.⁴ In Spain too financial instability in the 19th century led to an inspection system for credit corporations. Following the 1907-08 crisis Germany chose – with the support of the then central bank (the Reichsbank) – to implement self-regulation through “gentlemen's agreements”. The First World War and the

⁴ The 1873, 1884 and 1890 crises in the United States bolstered banking supervision and the 1907 bank run led to the establishment of the Federal Reserve System in 1913 (Conti-Brown and Vanatta, 2025).

subsequent restructuring of the financial system also influenced regulation and supervision. This was the case in Spain, with the Banking Law of 1921, and Italy, with the 1926 reform following the 1921-23 banking crisis (Molteni and Pellegrino, 2022).⁵ This link between crises and supervision became even more evident after the Great Depression of the 1930s. In the United States, the 1929 crisis led to a stricter supervisory arrangement, with the creation of dedicated market control institutions (the Securities and Exchange Commission) and, for the first time, a deposit guarantee scheme (the Federal Deposit Insurance Corporation) (White, 2009). In Germany, a 1934 law made it mandatory for banks to submit monthly reports and report new loans, and created a supervisory authority, although its effectiveness was limited during the Nazi regime and was not strengthened until after the Second World War (Bähre, 1984).

However, “modern supervision” only emerged in the 1970s and 1980s, again driven by banking crises and runs.⁶ In the United Kingdom, the “secondary banking crisis” (1973-75) forced the Bank of England to assume supervisory responsibilities, although a formal supervisory system was not introduced until 1979 (Capie, 2010). In the United States, supervision was strengthened following the crisis of the late 1970s and the 1980s, coupled with problems in international banking and deregulation (Schenk, 2014). Between 1980 and 1994, nearly 1,600 banks failed or received assistance and nearly 1,300 savings institutions collapsed, prompting a strengthening of the supervisory framework and the adoption of a risk assessment system (White, 2009). All these crises led the Basel Committee on Banking Supervision (BCBS), which had been established in 1974 after the bankruptcy of the Herstatt Bank, to define in 1988 what was then known as the Basel framework (now, Basel I) on international minimum bank capital standards (Drach, 2019). Instability in the banking sector also affected the Bank for International Settlements (BIS), which for the first time set up an early warning system to detect liquidity and credit problems in a timely manner and prevent contagion (Wood, 2005).

Another crucial aspect of supervision concerns the assignment of responsibility: should supervision rest with central banks, a ministry of the Government or an independent agency (Grossman, 2010)? There is no one-size-fits-all solution: the characteristics and structure of the banking sector, the degree of central bank independence from the government, its monetary policy and reputation, and the level of integration into global financial markets all shape the architecture of the supervisory system and determine who should exercise oversight (Goodhart and Schoenmaker, 1992). For De Krivoy (2000), the systemic crises of the 1990s were partly attributable to supervision which depended on political power. In countries with weak institutions and limited human capital which face challenges in coordinating and running State agencies, an independent agency may prove more effective. Conversely, in developed countries central banks have the prestige, human capital and resources to perform supervisory functions.

5 Other examples from that period are the reforms in Austria (1924-25), Czechoslovakia (1919-20 and 1924), Norway (1924-25), Portugal (1925), Canada (1924) and Japan (1927).

6 The 1970s crisis, the collapse of the Bretton-Woods monetary system, increased financial liberalisation and technological changes heightened financial instability, leading to numerous banking crises around the world: Great Britain (1973-75), Germany (1973-74), Italy (1973-83) and the United States (1973-75 and 1980-84).

3 The Banco de España and banking supervision during the 20th century

3.1 The Banking Law of 1921 and the Banco de España

In the early 20th century, the Spanish financial system grew significantly as banks expanded through share issues and major domestic banks emerged (Martín-Aceña, 2011).⁷ This boom was driven by the repatriation of funds from Spain's former colonies and by Spain's non-belligerent stance during the First World War (1914-18). Spain's neutrality caused the banking sector to initially suffer, but later demand for financial services increased, and they became more prominent in industry and services (Roldán, García Delgado and Muñoz, 1973; Tortella and Palafox, 1984). The number of banks rose from 52 in 1915 to 91 in 1920, and assets, paid-up capital and branches – which reached almost one thousand in 1923 – increased (Martín-Aceña, 2005). The end of the Great War led to the collapse of some banks, as renewed international competition rendered many businesses created during the conflict non-viable. Fraudulent behaviour by bank managers, currency speculation and the absence of effective legislation also played an important role (Sudrià, 2014).

Financial instability, the post-war banking crisis and, particularly, the difficulties faced by Catalan banks led to the introduction of the 1921 Banking Law, known as the Cambó Law (Pons, 2022). The Law had two goals: renewing the Banco de España's monopoly over banknote issuance, which was due to expire that year, transforming it into a “true central bank” (although it was still a private institution), and adapting the regulation in order to “organise and strengthen Spanish private banking”. Savings banks were left outside its scope, even though in 1914 they managed nearly 20% of the Spanish financial system's deposits and competition with banks for retail savings was increasing (Martínez Soto and Hoyo, 2019). The 1921 Law preserved unrestricted access to banking activity, but was more interventionist than previous legislation, as Cambó considered that liberalisation had led to too much competition and “*exaggerated, almost anarchic individualism*” in banking (draft Banking Law, Part Three, Title I, p. 7). The Law defined what a bank was and created a voluntary register of banks and bankers, providing incentives to those who registered. It also established the Banking Commission (with a royal commissioner who reported to the Ministry of Finance) and the Spanish Banking Supervisory Authority (CSB), which acted as an official link between private banking and the authorities. Lastly, and most importantly, the responsibility for banking inspection was finally entrusted to the Banco de España.

The 1921 Banking Law can be considered to have laid the foundation for current supervisory activity. For the first time, the Banco de España was given supervisory powers (Article 2, Section IV). As Cambó stated in Congress: “For the Banco de España there can be no mysteries or reservations in private banking; no bank should consider its dignity offended or its }professional secrecy violated for making the details of its operations available to the Banco

⁷ The main banks established during this period were Banco Guipuzcoano (1899), Banco Hispano Americano (1900), Banco Vizcaya (1901), Banco Español de Crédito (1902), Banco Urquijo (1918), Banco Central (1919) and Banco Exterior de España (1929).

de España...”.⁸ However, supervision was considered a one-off, non-permanent activity, and its initial effectiveness was limited. The 1922 CSB Regulation laid the foundations for the inspection and sanctioning activities of the CSB and the Banco de España.⁹ Article 16 set out the penalties applicable, ranging from warnings to expulsion from the banking community (a precedent of the sanctioning model later adopted by the Franco regime). Article 39 (Section X) provided that the inspections would be carried out by the Banco de España at the request of the CBS. In 1925 an attempt was made to strengthen banking inspection¹⁰ through a specific draft regulation, approved by a CSB committee, but it was not ratified by the Government.

The 1921 Banking Law also introduced prudential rules and measures to improve bank transparency. It established minimum capital requirements and a “minimum ratio between minimum capital plus reserve funds and the amount in each bank or banker’s creditor current accounts”. According to Olano (2022), this amounted to introducing a solvency ratio, by requiring not only a minimum amount of capital but also sufficient capital to cover the risks arising from the deposits collected. The regulation also incorporated a nascent liquidity ratio by setting a mandatory ratio between realisable assets and enforceable obligations (Olano, 2022). With regard to transparency, the Law mandated the CSB to compile banking statistics, standardise the format of balance sheets and publish them.

These measures, however, did not prevent further banking crises: between 1924 and 1926 more than 12 banks failed and were wound up, including Banco de Castilla (1924), Crédito de la Unión Minera (1925) and Banco Comercial de Tarragona (1926) (Martín-Aceña, 2013). The 1921 Banking Law was amended in 1927 and 1929 to prohibit the use of the terms “bank” and “banker” without authorisation from the Ministry of Finance, subject to a favourable report from the CSB, and to encourage enrolling in the registry. The Banking Law of 25 November 1931 strengthened the interventionist nature of the 1921 law, especially with regard to the central bank, and introduced stricter oversight, security mechanisms and restrictions on foreign banks. The reform was not prompted by the banking crisis, which – despite the disappearance of seven banks (three in 1930 and four between 1934 and 1935) – was less serious in Spain than in other countries thanks to the intervention of the Banco de España and the possibility for banks to obtain liquidity (Martín-Aceña, 2013). Rather, it reflected legislative changes made abroad in response to the new international setting. It did not substantially alter banking regulation or supervision, which remained under the Banco de España’s remit,¹¹ but it did increase Government control over the institution by adding three State representatives to its Board. The scope of government intervention in monetary policy was expanded to include setting the discount rate, intervening in the foreign exchange markets and exercising the right to access the gold reserves through advances to the Treasury (Olariaga, 1933).

8 Cambó (1921).

9 Regulation for compliance with Article 2 of the Banking Law of 28 December 1921, which governs the Spanish Banking Supervisory Authority. *Madrid Official Gazette*, 16 June 1922.

10 The CSB supervised non-compliance with the rules on maximum interest rates and fees and imposed penalties. HABE, *Actas del CSB*, 13 August 1926 and 15 December 1926.

11 The 1931 Banking Law mirrored the 1921 law. Its Article 2(4) indicated that “any inspection of a registered bank or banker that needs to be carried out to verify non-compliance with the established regulations shall be entrusted to the Banco de España”. The sanctioning regime also replicated that in the 1921 Law.

Although the 1921 Banking Law was a step forward compared with previous regulation, as it entrusted the Banco de España with supervisory and investigatory powers, interventions were sporadic. The scant evidence available, for example for the Crédito de la Unión Minera and Banco Central cases, suggests that the Banco de España neither exercised supervision nor detected the problems in advance. In the case of Crédito de la Unión Minera, the Banco de España's Bilbao branch provided very poor supervision and failed to prevent the winding up of the Basque bank. Events unfolded differently with Banco Central, whose links to Crédito de la Unión Minera ultimately dragged it down in the 1920s (Tortella and García Ruiz, 1999). After initiating insolvency proceedings in February 1925, the Count of Gaitanes, who was a director at both banks, requested the CBS to carry out an inspection to assess their solvency, believing that the report would be favourable (Tortella and García Ruiz, 1999). The advisory opinion declared the bank solvent, in what appears to be the first inspection carried out by the Banco de España, although there is no documentation on it. The inspection must have been very perfunctory, as it did not detect the problems that surfaced shortly afterwards.¹² In 1924 an inspection of Banco López Quesada was requested, but the CSB deemed it unnecessary.¹³ There is also evidence that in 1925 Crédito Navarro and La Vasconia were inspected by a committee including representatives of the local and provincial government and the Banco de España.¹⁴

Following the amendments to the 1921 Banking Law in 1931 and up until the Civil War, official inspections became widespread (García-Agulló, 1941), making Spain a pioneer in bank oversight in Europe, with the Banco de España playing an increasingly larger role – similarly to what happened in Italy with the Banca d'Italia. In 1932 inspections targeted foreign banks, likely in connection with foreign currency control, which elicited complaints of discrimination. In 1931 problems at Banco Central resurfaced, worsened by divisions within its board of directors (Tortella, 2001). Inspections were requested in March and July 1936 and, finally, the Minister of Finance ordered an inspection¹⁵ on 9 July 1936, which was never completed due to the outbreak of the Civil War. Only a few handwritten notes from the inspectors survive in the HABE.¹⁶ Paradoxically, the disruption caused by the Civil War may have saved Banco Central.

3.2 From autarky to the 1962 Framework Law: the Banco de España regains its supervisory role

After the Civil War and during the period of autarky, the Franco regime deprived the Banco de España of its supervisory functions, which had been entrusted to it through the Law of 1921. The interventionist regulation enacted during the early years of the Franco regime, mainly

¹² The request for this inspection can be found at the HABE, but without further documentation. The advisory opinion declared the bank solvent, overlooking the fact that three directors had loans backed by shares in Crédito de la Unión Minera (Tortella and García Ruiz, 1999).

¹³ HABE, Banca Privada, C. 64.

¹⁴ No documentation on them has been found, only references in the book *Acuerdos con síntesis y por orden alfabético del CSB (1922-1936)*. HABE, Banca Privada, C. 64.

¹⁵ HABE, Banca Privada, C. 69.

¹⁶ HABE, Dirección de Sucursales, C. 901154.

reflected in the 1946 Banking Law, altered the players involved in banking oversight (see Table 1), which was returned to the Ministry of Finance. Even before the end of the Civil War, regulations already granted the Ministry of Finance the power to order ad hoc inspections of banks and bankers. The shift in banking policy, towards prioritising stability and restricting competition during the 1940s and 1950s, was initiated by the Government and backed by the banking sector (Cuevas and Pons, 2025c).

During the first 15 years of the Franco regime, heavy intervention and restriction of competition limited banking inspection, which focused on verifying compliance with interest rate rules and certain ratios. Oversight was based on the submission of accounting information to the CSB, and the Directorate General for Banking and Exchange (DGBE) of the Ministry of Finance was put in charge of “conducting at its own discretion occasional inspections of a bank or banker, using its own staff or that of the Banco de España”. Although the 1946 Law envisaged penalties, they were seldom imposed, as the regime resorted to warnings and reprimands that the CSB would often soften. The Government’s priorities – low-cost financing for the public sector – and the interests of the banking sector, enunciated through the CSB, relegated the Banco de España to a secondary role, subject to government control despite not having been nationalised. The CSB became the Ministry of Finance’s advisory body and took on new tasks, some already set out in the 1921 Law, such as compiling banking statistics to promote transparency, interpreting and monitoring compliance with the rules on banking service fees, and reporting breaches to the DGBE. It also acted as a link between the Ministry and the banks.

The 1950s marked a shift away from the previous lack of competition and supervision. Growing demand for financial services spurred competition among banks, which adopted practices outside the regulatory framework, such as offering above-market interest rates and opening unauthorised branches. In the second half of the decade the CSB pushed for reigning in these practices. Although inspectors were concerned about risk concentration, particularly due to insider lending, their primary focus remained monitoring compliance with anti-competition rules. Supervision largely targeted local and regional banks and, as there was no dedicated inspection unit, the inspections, which were very rudimentary, were carried out by commercial teachers from the Ministry of Finance. The HBE records five inspections in 1955, nine in 1956 and eleven in 1957, which decreased to four in 1958 and two in 1959.¹⁷ Inspection visits were also planned in 1956 and 1957 for which no documentary evidence has been found. In 1957, the year with the most activity, 12% of banks were inspected (14 out of 113 banks) (Cuevas and Pons, 2025a).

The shift towards a more modern banking supervision came with the 1962 Framework Law, as part of the economic modernisation triggered by the 1959 Stabilisation Plan. Notable changes introduced by this law include the nationalisation of the Banco de España and the definitive reassignment of supervisory powers over private banking to the issuing bank. However, these functions were effectively regained only gradually. First, an intermediation office was set up between the Banco de España and the Ministry of Finance, which was ultimately dissolved in

17 HBE, Banca Privada. C. 931 and C. 958.

1970. In addition, the Private Banking Inspection Service was created within the Banco de España under the leadership of José Luis Núñez de la Peña, and it gradually expanded its human and material resources and increased the frequency and complexity of inspections – both regular and extraordinary.

The increase in inspectors made it possible to expand supervision to include large banks, which until then had no specific oversight. In addition to stepping up inspections, the Banco de España launched two key initiatives: issuing circulars on accounting and prudential standards,¹⁸ and creating the Central Credit Register (CCR) to centralise statistical information.¹⁹ The transfer of responsibilities from the Ministry of Finance to the Banco de España also entailed a shift in approach: the focus moved away from managing competition to prioritising financial stability through risk control. This change was driven by increased competition and risk, stemming from the emergence of Spanish industrial banking following the entry into force of the 1962 regulations. As regards prudential regulation, a guarantee ratio was established, based on the relationship between own and external funds as a means of protecting depositors.

The Decree-Law which reassigned supervision to the Banco de España provided that control and inspection of private banks, together with the centralisation of monetary and credit statistics, were essential to its function as a central bank. It introduced four new regulatory, prudential and sanctioning developments: (i) for the first time, alongside extraordinary inspections, periodic inspections of private banks were to be conducted to verify compliance with balance sheet, account, interest, fee and credit policy rules; (ii) the Banco de España was empowered to issue warnings to boards of directors and directors themselves on inappropriate dividend policies; (iii) the Banco de España could issue recommendations about credit policy; and (iv) the Banco de España could make sanctioning proposals to the Ministry of Finance. With the exception of inspection, all other powers were reserved as non-delegable powers of the Governor.

Assuming these new functions required a new body to be created at the Banco de España: the Credit Institution Inspectorate. Its implementation was initially slow due to the difficulty in recruiting staff with sufficient technical expertise. However, during that decade, Spain saw a surge in economically trained professionals, who began taking on influential decision-making roles at institutions ranging from government ministries to the Banco de España (Cuevas and Pons, 2025b). The first ten inspectors joined the Bank in September 1964 and a further eight were recruited in March 1967. Since then, the number of inspectors stabilised²⁰ at around 15

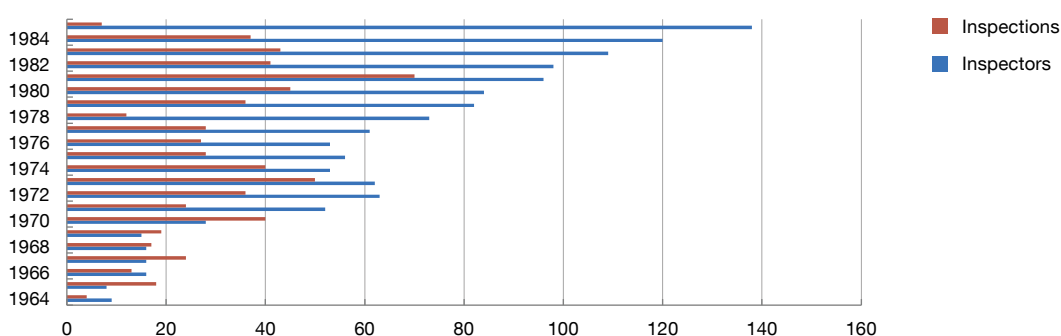
18 The first circular for banks was published in 1965 and the first circular for savings banks and credit cooperatives was published in 1971. Circulars were used extensively during the 1980s crisis. At first they regulated the opening of branches and aspects such as cash ratios, liquidity, compulsory investment, fees and dividend policy. Subsequently, the confidential accounting models for mandatory reporting were standardised. In the late 1970s, standardised monthly balance sheet and profit and loss account models were introduced, which had to be submitted to the Banco de España (Prado, 2002).

19 The 1962 Decree created the CCR, which was implemented in 1963 by Ministerial Order. From then on, the CCR prepared the general credit statistics and identified exceptional risks exceeding prudential limits in each bank's lending policy, with the aim of making risk analysis easier for financial institutions and acting as the Banco de España's key tool for supervision and the compilation of credit statistics.

20 HABE, Libros. Escalafones del Personal, 1966 and Supervisión, C. 6507.

Chart 1

Number of inspections and credit institution inspectors



SOURCE: Historical Archive of the Banco de España.

or 16. As Deputy Governor Gonzalo Lacalle pointed out at the 1966 Banco de España General Council, following the nationalisation and reorganisation of the Banco de España in 1962: “the Banco de España had to hastily organise a body of inspectors, not to inspect its own services (which it already did), but to inspect private banks, by identifying among its senior staff those with university or similar studies who could join this important service...”.²¹ The result was an increase in inspections in the second half of the 1960s, covering up to 14% of banks (18 out of 125 banks in 1965),²² conducted by its own inspectors (see Chart 1). As in the previous decade, inspections focused on small banks, but in 1967 a comprehensive inspection of a large bank (Banco Hispano Americano) was carried out for the first time. Its importance led the Banco de España to prepare a report with detailed guidelines for periodic inspections of larger banks.

The inspection reports reveal credit concentration issues and loans granted to banks’ chairs, managers and investees and to persons linked to the banks. These shortcomings, which endured from the previous decade, remained a structural feature of the banking system. In response, in 1968 the Banco de España proposed to the Ministry of Finance to apply stringent risk concentration measures (in loans to companies, subsidiary groups and related natural or legal persons), as well as to limit the loans granted to directors, managers and investee companies, which was a widespread practice especially at newly created banks.²³ As early as 1966, the Banco de España had warned about the regulatory limitations that restricted its inspection capacity in these areas:

However, it is necessary to stress the Banco de España’s legal constraints in successfully conducting its inspection functions... The Banco de España still lacks the power to inspect banks’ subsidiaries, and it is through these subsidiaries that unauthorised transactions

²¹ HABE, *Acta del Consejo General de 25 de noviembre de 1966*, libro 26555.

²² There is little information in the HABE for the first half of the decade, probably because of the transfer of functions from the Ministry of Finance to the Banco de España.

²³ *Informe del Banco de España, 30 de octubre de 1968* and Law 31/1968 of 27 July 1968 laying down the rules on incompatibilities and limitations for private bank chairs, directors and senior executives.

are carried out. It lacks the power to impose sanctions for credit abuses and, whenever there is an incident or loss of confidence involving a bank, the underlying cause is often found to be the misuse of credit by directors for their own benefit or for the benefit of companies in which they hold an interest.²⁴

Still, the inspection reports point to a growing emphasis on risk concentration and the review of the documentation sent to the CCR, reflecting two developments: a change in supervisory approach relative to the early Franco years (autarky period) – when the emphasis was on anti-competition regulations – and the operational transformation of the banking sector in the 1970s. The growing demand for financing and the 1962 liberalisation promoted competition and the creation of new industrial and commercial banks, but also increased credit risk-taking.

Although the Framework Law entailed progress, inspections continued to be beset by problems. Because of legal constraints, inspections focused on individual institutions, without supervising banking groups, as was subsequently laid bare by the Rumasa case. In addition, they focused on small banks, and the 1967 manual on inspections of large institutions had little impact. Sanctions regulations were ineffective and permissive: recommendations and sanctions were issued but without effective mechanisms against administrators other than suspension (Álvarez Rendueles, 1984). The available case files show that, despite the greater attention paid to the concentration of credit risks, neither asset quality nor management was thoroughly assessed. Lastly, although the Private Banking Inspection Office and CCR were strengthened, the lack of personnel was a chronic issue.

In sum, the Framework Law of 1962 represented an institutional leap forward in that it consolidated and reorganised banking supervision under the Banco de España's responsibility. Nevertheless, the difficulties referred to above limited the effectiveness of bank inspections and facilitated the accumulation of imbalances, risks and bank failures that would erupt even more loudly in the next decade.

3.3 The 1977 banking crisis and the growth of bank supervision

A third chapter in the history of bank supervision in Spain in the 20th century unfolded amid the severe banking crisis from 1977 to 1985. Internationally, the 1970s witnessed profound transformations: the end of the exchange rate regime established at Bretton Woods after the Second World War, the surge in international capital flows and the internationalisation of banking complicated domestic supervision just as new bank risks emerged, as shown by the 1974 failure of the German bank Herstatt (Schenk, 2014). This situation led to the creation of the BCBS as the first attempt at global bank supervision. Nevertheless, Spain was not involved in these supranational initiatives (the Banco de España joined the BCBS in 2001), and its supervision was conditioned by the banking crisis that broke out in 1977 and was aggravated by the industrial and stock market crisis after oil prices rose.

²⁴ HABE, *Acta del Consejo General de 25 de noviembre de 1966*, libro 26555.

Numerous institutions, especially the recently created banks that had emerged as a result of the distinction introduced by the 1962 Framework Law between commercial and business banks, ran into difficulties because of a combination of management problems and shortcomings in risk control (Sudrià, 2014). The conjunction of an industrial crisis with rising competition caused overhead costs to soar, by triggering the opening of more branches as a competitive strategy. Risk exposure was aggravated by the large amount of own shares and the close ties between banks and business groups. The first bank to be taken over was Banco de Navarra in 1978, followed by many small institutions. A second wave, in 1982, claimed larger banks such as Bankuni3n, Banca Catalana, the Rumasa Group and Banco Urquijo. Between 1978 and 1985, 63 of the 110 banks – accounting for nearly 30% of bank assets and 18% of deposits – that existed in 1977 faced difficulties (Cuervo, 1988). A total of 29 banks were taken over, and in 1983, 20 belonging to Rumasa were expropriated. The entities involved accounted for nearly 30% of the equity and liabilities in the private banking sector and 27% of the workforce (Tortella and Mart3n-Aceña, 1991). The crisis ended between 1984 and 1985, when the number of distressed institutions declined significantly.

The most salient aspect of the crisis from a banking supervision standpoint was that it unfolded in a context of inadequate and insufficient regulations, which had been ushered in during the preceding decade and which were ineffectual in dealing with it. Rules on inspections were weak in key respects such as requirements on bank ownership/management and on risk control. Supervisors, focused on administrative control more than on solvency, were overwhelmed. There was a need for rules on asset prices, NPL management and provisions (De Juan, 2021), as well as sanctioning capacity, prosecution of financial crimes and enhanced procedures for bankruptcies and bankruptcy protection. There were no specific legal mechanisms for managing crises, and inspections lacked effective tools for sanctioning fraudulent practices and countering the obstruction of the work of inspectors of the institutions in question. From this perspective, the crisis served as a turning point in supervision, causing changes in how the Banco de Espa3a was viewed as well as structured. Inspections were reoriented toward early detection of solvency problems arising from credit risk through, first, circulars and, later, specific prudential regulations, which led to more intense inspection work. In addition, starting in 1977-78 institutional arrangements and bank-bailout programmes were designed to deal with the bank crisis comprehensively.

At the outset of the crisis, the Governor of the Banco de Espa3a was Jos3 M. L3pez de Letona. He was replaced in March 1978 by the then-State Secretary for Economic Affairs (1977-78), Jos3 Ram3n 3lvarez Rendueles. 3lvarez Rendueles entrusted Luis 3ngel Rojo, then-Director General of Economics, Statistics and Research at the Banco de Espa3a, with monetary policy, while the Deputy Governor, Mariano Rubio, was put in charge of bank reforms. In 1978, Rubio submitted a report titled *La funci3n supervisora del Banco de Espa3a sobre la banca y las cajas de ahorro* (The Banco de Espa3a's supervisory function with regard to the banking sector and savings banks), which was circulated internally and became a reference document on anti-crisis policy (Tortella, 2015). Nevertheless, as noted, in 1977 there were no legal mechanisms for bank restructuring, or suitable prudential regulations, or experience in detecting losses. When liquidity problems arose, enquiries were not commonly

carried out on the possible insolvency; the parties involved would resort to rediscounting at the Banco de España, backed by credits considered healthy and, at times, supplemented with funds from the interbank market (Poveda, 2011; De Juan, 2021).

An attempt was made to resolve the problems of the first distressed banks with the available instruments – recommendations and sanctions – and also with ad hoc solutions intended to bail out viable institutions. Failing this, steps were taken ensure that the bankruptcy was less costly, though specific legal and mechanisms, most notably the creation of the DGS²⁵ and the BC. The two institutions were implemented progressively and experimentally, in a process that might be described as learning by doing, in which there was close collaboration between the Banco de España, the government and the banking sector.

From an organic standpoint, the crisis spurred changes in bank control. Although in the 1970s, the inspection service was strengthened, it was the Law on Governing Bodies of 1980 that consolidated Banco de España's role as a financial system regulator and supervisor. This law formally created a new institutional arrangement placing banking oversight and discipline under the authority of the Executive Board and the Governor. Inspections were placed under the responsibility of a Director General and a Deputy Director General. In addition, the Executive Board acquired sanctioning powers, and raised to the General Council the most serious sanctions, which were forwarded to the competent ministry. This regulatory framework remained in effect for the entire decade, until the enactment of the 1988 Law on Discipline and Intervention of Credit Institutions.

The Bank doubled down on its efforts to expand its inspection capacity, which required strengthening the Inspectorate. Between 1977 and 1985, the number of inspectors doubled, from 61 to 138, as a result of the greater complexity of supervision and the needs relating to the banking crisis. Nevertheless, the first expansion of the Inspection Service had already taken place by the early 1970s, when the Bank assumed responsibility for inspecting savings banks and, subsequently, credit cooperatives, incorporating inspectors from the Instituto de Crédito de las Cajas de Ahorro.²⁶ Nonetheless, given the magnitude of the problems and the need for more intensive supervision, this expansion proved insufficient. A 1981 internal report reflects these deficiencies:

It is clear that the Inspection Office lacks not only inspectors, but also infrastructure – a need regarding which the inspectors have voiced complaints many times. There is a lack not only of technical resources, but also of human resources, in many cases making it necessary for the inspectors to prepare simple statements themselves, and even to make numeric calculations, and also to go personally to other units to pick up the documentation they need and make to photocopies. They also consider the number of typists insufficient, at times causing delays in preparing and submitting work.²⁷

25 Since 1980, it has been customary for most financial systems to establish bank guarantee funds: in 1995, a total of 40 countries had implemented such funds, and by 2003 the number had risen to 87. The various types and tiers of protection systems are currently governed by EU law. The Spanish Deposit Guarantee Scheme (FGD) continues to be a cornerstone of the current institutional framework.

26 Decree 1473/1971 of 9 July 1971, and Law 52/1974 of 19 December 1974.

27 HABE, Supervisión, C. 6506, 3 December 1981.

In addition to the increase in staff size and the provision of employee training, between 1970 and 1982 instructions were issued that unified the criteria and hence the inspection actions. Inspectors had to give the institution one month's notice, requesting key documentation: detailed shareholding structure, early withdrawals of term deposits, deposits bearing interest at above the permitted rate, possible impairment of assets, and the most recent external audit, if applicable. The advance notification contained a warning of penalties in the event information was withheld.

The Banco de España tried to establish guidelines on risk and solvency through circulars, which it used as a tool for conveying prudential and banking oversight regulations. Circular 157 of December 1978, known as the Pastoral Letter,²⁸ discussed bank solvency and introduced criteria to assess the different line items of the balance sheet, prepare income statements, distribute earnings, deal with insolvencies and establish provisions and reserves. Nevertheless, the power to enforce the circular was limited. Subsequent circulars implemented aspects included in Circular 157, especially Circular 172, “The Heroic”, which attempted to thwart illegal practices such as cross credits and to establish penalties for falsehoods in the information sent by the banks to the CCR.²⁹ According to Cuervo (1988), the circulars were intended to enhance the information provided and strengthen the inspections carried out by the Banco de España. However, as these were non-binding recommendations their effectiveness was limited and they gave rise to continuous tension between the supervisor and the targets of the supervision (De Juan, 2021). It was not until 1982 that these recommendations became mandatory accounting circulars. Lastly, the country would have to wait until 1985 for a solvency ratio that was more in line with asset risk levels and that exceeded the guarantee ratio of the 1962 Law.³⁰

Until 1977, the number of inspections continued the upward trend begun in the previous decade, despite the limited human and organisational resources. In 1974, more than 33% of the country's 107 banks were inspected – a higher percentage than in the 1960s – and inspections continued to focus on small and medium-sized banks, although large institutions were also examined, including Banco Central (1971, 1972) and Banco Español de Crédito (1971). Starting in 1975-76, routine inspections detected problems arising from the rapid growth in the banking industry, with patterns similar to those observed at the beginning of the decade, although more severe.³¹ Starting in 1979, and in particular in 1981, the number of

28 *Economic Bulletin - Banco de España*, February 1979. *Circular 157: Cuenta de pérdidas y ganancias*

29 *Economic Bulletin - Banco de España*, July-August 1979. *Circular 172: Políticas de crédito*.

30 In this process, in addition to the crisis, the Banco de España's gradual inclusion in international organisations such as the BIS (1983) and Spain's accession to the European Economic Community (1985), were key. Between 1986 and 1992, the implementation of European Directives ensured that Spanish regulations were aligned with those of other European countries in terms of solvency and banking risk.

31 The paradigmatic case of rapid growth linked to investees and mismanagement was the Rumasa Group, which was expropriated in 1983. A report by the Inspectorate of the Banco de España (HABE, Consejo Ejecutivo del Banco de España, 11 April 1978) underscored the problems of its nearly 20 banks: diversion of funds to the benefit of the group, lack of awareness of its financial situation and poor banking performance. Regulations made it difficult to curb purchases of new institutions or risk concentration, given that each subsidiary had its own legal personality. Banks' solvency depended on that of the group's companies, of which little was known. Credit files were incomplete, income statements were unreliable and the group's banks systematically thwarted inspections and ignored the relevant recommendations (*Informe sobre la crisis bancaria en España*, HABE, Inspección, Correspondencia General, C. 2643).

inspections rose (Chart 1). Although there is limited documentary evidence for the 1982-85 period, the inspection plans show a high number of actions, which coincide with the implementation of resolution schemes (FGD and BC). In 1982, 41 inspections were documented, although Álvarez Rendueles (1984) states that the number rose from 38 in 1979 to 89 in 1982. In 1981, 54 inspections were carried out, and in 1985, 47. The sum of the inspections conducted plus those envisaged in the plans indicates that the percentage of institutions supervised was higher than in any preceding period.

The Inspection Service was also charged with supervising foreign banks, which operated in Spain through branches authorised since 1978, albeit with certain limitations.³² Regulations required these institutions to be inspected at least once a year during their first five years. The Banco de España was better positioned to pressure foreign banks than domestic banks: in the event of a bank or branch exposed to clear risks or incurring in non-compliance, it could ask the Ministry of the Economy to take it over, or even withdraw its authorisation. The final pillar of supervisory policy was the gradual inclusion of external audits, which were largely conducted by US and British firms.³³ In 1978, the Banco de España recommended that financial statements be audited annually, not only as a guarantee for shareholders but also to support inspections.³⁴ Within a few years, most banks and savings banks had adopted that practice.

In sum, the 1977-85 banking crisis and its resolution marked the end of an era and gave the Banco de España a central role in supervision. In addition, this encouraged the abandonment of the regulatory isolation that characterised previous decades and paved the way for regulatory and supervisory convergence with international guidelines. Since the 1990s, banking oversight began to be aligned with the international standards set out in the successive Basel Accords. Spain's entry into the European Economic Community – which would become the European Union – in 1986 and into the European Monetary System in 1989 made it necessary for the country to transpose EC regulations, adapting the sector and its supervision to banking coordination directives on solvency (since 1985), banking transactions and the prevention of money laundering (1993).

Conclusions

Current banking supervision in Spain is consistent with global banking regulation, following Spain's inclusion in supranational institutions in the 1980s and 1990s. However, Spain had early examples – at the international level – of supervisory and prudential regulations, in the

32 Royal Decree 1388/1978 of 23 June 1978 regulated foreign banks in Spain. Authorisations were limited to opening representative offices, creating subsidiary banks and opening branches (not more than three agencies, including the head office).

33 Although the Spanish Companies Law of 1951 referenced auditing activity, only after the country's inclusion in the European Economic Community in 1986 did it adjust to European regulations (Law 19/1988 on Audits). The bank sector spearheaded the progressive implementation of the law (REA Auditores, 2021).

34 A note signed by Mariano Rubio in July 1984 highlighted the importance of external audits as a complement to Banco de España's inspection work and urged institutions to standardise the information provided in these audits (HABE, Inspección, Correspondencia General, C. 2643).

19th and 20th centuries: first under the direction of the Ministry of Finance, with little headway made, and later, in the 20th century, when the Banco de España gradually assumed supervisory functions at three pivotal moments. The 1921 Banking Law was the first attempt at implementing formal supervision by the Banco de España, which was still a private entity. This law introduced prudential regulations, measures to enhance transparency and occasional bank inspections. Inspections were interrupted by the Civil War and the closed economy of the early Franco years, when supervision was once again entrusted to the Ministry of Finance within a context of strong government intervention in the banking sector. For its part, the lack of competition among institutions encouraged supervision based on compliance with anti-competition regulations and the publication of accounting information. This situation changed starting in the late 1950s and, especially, in the wake of the related financial deregulation linked to the second pivotal moment: the 1962 Framework Law. This law nationalised the Banco de España and restored its supervisory competencies, by establishing the Private Banking Inspection Service and the Inspectorate. Inspections were carried out more frequently and they increasingly sought to detect credit risks, although the dearth of human and organisational resources and the uneven growth of the banking sector gave rise to vulnerabilities which would erupt a decade later.

The Banco de España was a protagonist of the third key moment, between 1977 and 1985. Two fundamental changes stood out: first, the strengthening of the Banco de España as a banking supervisory authority – with greater control, inspection and sanction powers – and second, the transformations of prudential regulations on solvency and risk. At the same time, the Bank designed institutional arrangements to face the crisis. This was a turning point in the history of banking supervision in Spain, marking a leap in the design and intensity of banking inspection, as well as in Banco de España's decisive action to deal with the sector's problems. The next major milestone for banking supervision in Spain came well into the 21st century with the creation of the Single Supervisory Mechanism in connection with the European Central Bank (2013).

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