

## 2 EXERCISE OF SUPERVISORY FUNCTIONS



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This chapter is structured as follows. The first section describes the supervisory activity during 2010, indicating the supervised institutions, the main supervisory actions in the year, the details of the requirements and recommendations letters sent to institutions as a result of such actions and the staff of the Directorate General Banking Supervision. The second section summarises the consequences of the exercise of sanctioning powers and states the number of proceedings initiated and resolved for each type of infringement. The third section refers 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 last section of this chapter briefly discusses the recommendations made on the drafting of internal capital adequacy assessment reports and the strengthening of transparency in the relation to the assets of CIs.

### 2.1 Supervisory activity

At 31 December 2010, a total of 482 institutions of various kinds were supervised by the Banco de España, of which 339 were CIs.<sup>1</sup> As explained in the document entitled "The Banco de España Supervisory Model",<sup>2</sup> the Banco de España exercises a process of on-going supervision of these institutions.

The essential aim of the Banco de España supervisory process is to determine and keep updated each institution's supervisory risk profile, taking the appropriate measures 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, the Directorate General Banking Supervision has 22 operational inspection divisions and seven cross-sectional or support divisions formed by bank examiners, senior analysts, IT auditors, junior analysts and administrative staff (see Table A.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 consisting of 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.

The number of supervisory actions in 2010 totalled 179, of which 39 were in progress at 31 December. These actions basically consisted of traditional on-site visits and actions conducted as part of on-site continuous monitoring.

During the year, such on-site continuous monitoring, which involves a permanent presence at the institution, extended to 15 groups of CIs as against 10 in 2009. This system is especially intense in the two main banking groups, to which more than 50 persons were assigned solely to perform this function.

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<sup>1</sup> This figure refers to the number of institutions in the official registers of institutions at 31.12.10. However, in the case of savings banks, as a consequence of the integration processes, this figure has been reduced in practice to 18 institutions or groups, plus the Spanish Confederation of Savings Banks (CECA). See Section 1.1 for more information on types of institutions and changes in their numbers.

<sup>2</sup> Available at [http://www.bde.es/webbde/en/supervision/funciones/Banco\\_de\\_Espana\\_supervisory\\_model\\_clean.pdf](http://www.bde.es/webbde/en/supervision/funciones/Banco_de_Espana_supervisory_model_clean.pdf).

Number

	On-site supervisory actions							
	Completed				Under way			
	2007	2008	2009	2010	2007	2008	2009	2010
Credit Institutions	125	98	114	136	44	37	21	39
Banks	63	52	82	79	12	20	7	28
Savings banks	17	19	16	51	18	10	10	5
Credit cooperatives	18	8	1	2	4	0	1	6
Foreign branches	6	7	4	2	1	1	1	0
EU credit institutions	6	2	2	1	1	1	1	0
Specialised credit institutions	21	12	11	2	9	6	2	0
Other institutions	22	20	15	4	11	11	3	0
Appraisal companies	8	8	8	1	7	8	1	0
Mutual guarantee companies	5	1	0	0	1	0	0	0
Currency-exchange bureaux and money transfer agencies	9	11	7	3	3	3	2	0
TOTAL	147	118	129	140	55	48	24	39

SOURCE: Banco de España.

Another 329 jobs were also performed in relation to CIs, including:

- Specific monitoring actions, apart from those mentioned above, such as, for example, studies of claims arising from troubled assets.
- Examination of internal capital adequacy assessment reports prepared by institutions and the supervisory process arising from such examination.
- The most important actions arising from relations with national and international supervisors and bodies in the case of groups of CIs with a presence in Spain and other countries.
- The EU stress tests.

In addition, the Banco de España conducted the various administrative procedures subject to prior authorisation relating to supervised institutions: loans to senior officers, the taking of qualifying holdings in Spanish institutions, acquisitions of qualifying holdings or of control abroad, etc.

Against this background, letters were sent to supervised institutions containing 192 requirements relating to matters such as: credit risk (loan approval criteria and credit risk classification and provisioning), management and internal control, own funds and solvency, and other matters (transparency vis-à-vis customers, deficiencies in reporting to the Banco de España's Central Credit Register, etc.). As usual, credit risk was the main area of recommendations, with 108 requirements, or 56 % of the total.

On 22 May 2010 the Banco de España resolved to replace the directors of CajaSur and to appoint the Fund for the Orderly Restructuring of the Banking Sector (FROB) as the institution's provisional administrator, as a consequence of its viability problems. This action was

Number	Letters sent to institutions			
	2007	2008	2009	2010
Credit institutions	97	63	47	38
Banks	31	21	23	16
Savings banks	17	19	9	14
Credit cooperatives	22	8	0	4
Foreign branches	11	2	3	2
EU credit institutions	7	1	1	1
Non-EU credit institutions	4	1	2	1
Specialised credit institutions	16	13	12	2
Other institutions	18	14	11	4
Appraisal companies	7	5	0	1
Mutual guarantee companies	4	1	7	0
Currency-exchange bureaux and money transfer agencies	7	8	4	3
TOTAL	115	77	58	42

SOURCE: Banco de España.

conducted within the new framework established by Royal Decree-Law 9/2009 and was resolved in just 55 days with its adjudication through a competitive process to Bilbao Bizkaia Kutxa (BBK). This was the only precautionary “intervention” measure that needed to be adopted during 2010. The process of resolution of the crisis of Caja Castilla-La Mancha (CCM), that commenced in 2009, was also concluded in 2010, with its assets and liabilities being integrated into Cajastur. Unlike the action in relation to CajaSur, the approach to the handling of the crisis of this institution was traditional and involved the participation of the Savings Bank Deposit Guarantee Fund.

Two of the subjects that have been most relevant externally have been the savings bank integration processes and the stress tests to which the banking system has been submitted.

The savings bank integration processes have been of two kinds: firstly, traditional mergers and, secondly, agreements to create institutional protection schemes (IPSs), a formula that is fully equivalent, in its essential effects, to a traditional merger.

In 2010 the Banco de España participated in the stress tests<sup>3</sup> conducted under the mandate from the EU’s ECOFIN Council and coordinated by the Committee of European Banking Supervisors (CEBS) in cooperation with the European Central Bank (ECB). However, the Banco de España decided to increase the transparency of the exercise beyond the minimum level required under its European commitments (50 % of the banking sector), including in the sample all savings banks and all listed banks (27 institutions in all), which represented practically 100 % of the total assets of Spanish banks and savings banks. Further, the Banco de España supplied additional detailed information on the situation of the sector, in particular in relation to real-estate lending. The exercise confirmed that the Spanish banking system is solid: in the stressed benchmark scenario no institution failed to meet the target set in the exercise (6 % Tier 1 ratio) while, in the adverse stressed sce-

<sup>3</sup> A stress test assesses the extent to which institutions are capable of withstanding an extraordinarily adverse macroeconomic scenario during a specific time period.

Number	2007	2008	2009	2010
Credit risk	231	177	127	108
Accounting for credit risk, borrower weakness and higher coverage requirements	164	130	95	79
Quality of credit risk controls (origination, monitoring and other procedures)	67	47	32	29
Management and internal control	147	79	52	36
Management and internal control in general	120	59	44	25
Capital market activities	27	20	8	11
Capital and solvency	41	23	15	8
Solvency ratio	41	23	15	8
Other regulations	162	78	84	40
Failure to comply with rules on transparency and customer relations	35	19	16	3
Deficiencies in information reported to the CCR	30	13	12	7
Requirements for authorisation of non-credit institutions	14	15	11	4
Other	83	31	45	26
TOTAL	581	357	278	192

SOURCE: Banco de España.

nario (with a very low probability of occurrence) only four groups of savings banks failed to meet the target.

The increase in the number of institutions subjected to the stress tests was not the only transparency measure taken by the Banco de España. Against a background of concern regarding the solvency of our system and following the international recommendations included in the CEBS's "Principles for disclosures in times of stress",<sup>4</sup> the Banco de España has required CIs to make greater efforts in transparency towards the market by providing more information on the financing of construction and property development, lending for house purchase and assets acquired in payment of debts, as well as their funding needs and strategies (see Section 2.4.2).

In relation to the internal models of the eight Spanish groups of CIs authorised to use internal ratings based (IRB) methods to calculate regulatory capital for credit risk, the processes for authorising new portfolios have continued in accordance with the successive application plan presented to the Banco de España by these groups, which includes the approval of exposures at subsidiaries abroad in close coordination with local supervisors. In addition, the monitoring of the models already approved has been strengthened, especially with regard to the modifications that the institutions are introducing. A key element in the monitoring of the models is the review of the internal control framework that institutions have to ensure that the approved models are maintained and used appropriately. With regard to the processes to validate internal models to calculate the regulatory capital for operational risk, in 2010 the conditions for approval and the results of the operational risk model approved for a Spanish group of CIs were monitored.

The Banco de España continued to work actively in the area of international supervisory cooperation, through, inter alia, "colleges of supervisors". The Banco de España hosted

<sup>4</sup> See Principles for disclosures in times of stress (Lessons learnt from the financial crisis), April 2010.

the meetings of the colleges of the two Spanish international banking groups and participated, in its capacity as host country supervisor, in six meetings of colleges of banking groups with foreign parents.

In 2010 five cooperation agreements of the kind provided for in Article 131 of Directive 2006/48/EC, relating to the supervision of European groups of credit institutions with subsidiaries in Spain, and a bilateral cooperation agreement with an EU country (Rumania) were signed. In addition, the cooperation agreement between EU financial supervisors, central banks and ministries of economic affairs and finance for cross-border financial stability signed in 2008 was extended to the European Economic Area. Finally, at the beginning of 2011, a cooperation agreement was signed with the supervisory agency of Andorra.

## 2.2 Exercise of the sanctioning power

The sanctioning power exercised over the financial institutions whose control and inspection are the responsibility of the Banco de España is the final step in its supervisory function. It is intended to act as a means of ensuring compliance with the organisational and disciplinary regulations applicable to institutions operating in the financial sector. And indeed, as established in the preamble to the Law on Discipline and Intervention of Credit Institutions, the effectiveness of these regulations depends on whether the supervisory authorities of financial institutions have sufficient coercive powers.

The exercise of this sanctioning power is directed at all institutions and markets subject to supervision by the Banco de España, which includes not only credit institutions and any other financial institutions subject to its control and inspection, but also their directors and managers, who can be sanctioned for very serious or serious infringements when these are attributable to wilful misconduct or negligence. Also, sanctions can be imposed on the owners of significant holdings in credit institutions and on Spanish nationals that control a credit institution of another EC Member State.

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 enter the financial market without meeting the conditions of access, whether it be through the exercise of activities legally restricted to duly registered credit institutions or currency-exchange and money-transfer bureaux or through the use of generic names restricted to credit institutions or of any other that may be confused with them.

In this regard, the Banco de España has competence to bring and conduct disciplinary proceedings against the aforementioned parties, the imposition of sanctions being governed by the rules set forth in Article 18 of the Law on Discipline and Intervention of Credit Institutions. Under this law, the Banco de España has competence 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 intruders in the financial sector, competence for the imposition of sanctions, whatever their seriousness, lies with the Banco de España.

### 2.2.1 PROCEEDINGS INITIATED IN 2010

In 2010, in view of the matters disclosed during on-site inspections by the Banco de España and of other circumstances, the governing bodies of the Banco de España decided to initiate disciplinary proceedings against seven supervised institutions and 50 of their directors and managers.

Number	Institutions	2007	2008	2009	2010
Banks		1 (a)	—	—	—
Savings banks		—	—	1	1
SCIs		—	—	1	—
Branches of EU foreign credit institutions		—	—	—	—
Owners of significant holdings in credit institutions		—	1	—	1
Appraisal companies		2	3	2	—
Currency-exchange bureaux and money transfer agencies		6	6	3	1
Use of names or pursuit of activities reserved for credit institutions		—	1	2	1
Unauthorised currency-exchange bureaux		—	1	—	3
Appraisal company revocations		—	—	—	—
Currency-exchange bureaux revocations		1	3	1	2
Non-compliance with ECB minimum reserve requirements		2	2	—	1
<b>TOTAL</b>		<b>12</b>	<b>17</b>	<b>10</b>	<b>10</b>

SOURCE: Banco de España.

a Agreement on lifting suspension.

More specifically, the Executive Commission decided to initiate proceedings against a credit institution (a savings bank), a currency-exchange and money-transfer bureau and other companies that were engaging without the correct authorisation either in activities restricted to credit institutions (in one case), or in the purchase and sale of foreign currency and the arrangement of cross-border money transfers (in another three cases). Finally, a disciplinary proceeding was initiated against a foreign foundation for breach of the rules on qualifying holdings, and a proceeding initiated in 2009 was extended to the director of a currency-exchange bureau.

In addition, although they are not strictly sanctioning proceedings, mention may be made, as shown in Table 2-C04, of the initiation and execution of proceedings against two companies to revoke the authorisation to carry on the professional activity of purchase and sale of foreign currency.

To the foregoing that it should be added that, pursuant to Article 19 of the Statute of the European System of Central Banks, the Governing Council of the European Central Bank is empowered to impose a certain level of minimum reserves on credit institutions. Failure to meet this obligation is punishable within the framework of a proceeding conducted by the Banco de España. One of the proceedings initiated in 2010 was of this nature

Having described the proceedings initiated in 2010, it should be pointed out that, with respect to previous years, the number of proceedings initiated has not changed significantly, either in the case of those against supervised institutions or those against directors or managers (in the latter case, seven more were initiated than in 2009).

#### 2.2.2 PROCEEDINGS RESOLVED IN 2010

Together with the data on the number of proceedings initiated in 2010, reference should also be made to those resolved in that period. In this respect, the competent bodies resolved in 2010 disciplinary proceedings against supervised institutions and 25 members of their boards of directors and management, 22 of whom were sanctioned. In these reso-

PROCEEDINGS RESOLVED, BY TYPE OF INFRINGEMENT

TABLE 2.5

Number

Number of proceedings	Sanctioning procedures							Non-sanctioning proceedings		
	Against supervised institutions				Proceeding dismissed	Intruders		ECB	Revocation	
	Infringement			Name/ activity reserved for credit institutions		Unauthorised curr. exch. bureaux	Minimum reserve requirements	Appraisal companies	Curr. exch. bureaux	
	Very serious	Serious	Minor							
Against institutions										
2007	14	12	24	7	—	—	2	1	—	1
2008	16	12	26	6	1	1	—	3	—	3
2009	13	9	24	18	1	—	1	—	—	1
2010	9	4	6	2	—	3	1	1	—	1
Against particular directors of institutions or owners of qualifying holdings										
2007	46	27	91	—	3	—	—	—	—	—
2008	43	26	87	—	8	1	—	—	—	—
2009	45	25	85	—	1	—	—	—	—	—
2010	25	38	28	—	11	—	—	—	—	—

SOURCE: Banco de España.

lutions, (i) four sanctions were imposed on institutions and 38 on their directors or managers for the commission of very serious infringements; (ii) for the commission of serious infringements, six sanctions were imposed on institutions and 28 on directors and finally, (iii) for the commission of minor infringements, two sanctions were imposed, on institutions only, since Spanish law does not provide for the imposition of sanctions on directors for the commission of minor infringements. Also, one sanction was imposed on a legal entity for engaging in the activity of arranging cross-border money transfers without the necessary authorisation and three were imposed on three companies for engaging in activities legally restricted to credit institutions, without having obtained the necessary authorisation or being duly registered.

Finally, the Banco de España conducted a proceeding for non-compliance with the minimum reserve ratio established by the European Central Bank.

Along with the information on sanctioning activity in the strict sense, we also report here the resolution in 2010 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 bureau itself for deregistration from the official register.

2.2.3 INFRINGEMENTS BY TYPE OF OFFENDING INSTITUTION

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.

a. Credit institutions

Notable among the proceedings resolved is one against a savings bank and 20 members of its board of directors and management, in which this credit institution was found to have committed three infringements, two of which were classified as very serious and the third as serious. As regards the very serious infringements, (i) deficiencies were found in its organisational structure, in its internal control mechanisms and in its administrative and accounting procedures, and such deficiencies were found to have jeopardised the viability

and solvency of the institution, for which reason sanctions were imposed on the savings bank and on 17 of the members of its board of directors and management subject to the proceedings, since they were considered responsible for this situation; also (ii) the institution was found to have failed for at least six months to meet 80 % of the capital requirements made, so that the relevant sanction was imposed on the institution, and 16 of the 20 directors and managers subject to the proceedings were considered responsible for this infringement. Finally, the savings bank was considered to have committed a serious infringement by failing to comply with the rules in force regarding the limits on exposures, as a result of which a sanction was imposed on the institution. Of its directors and managers, 16 were considered responsible for this conduct and the relevant sanction was imposed on them.

b. Appraisal companies

In 2010, sanctions were imposed on an appraisal company and its three directors, for the commission of various infringements. Specifically, four sanctions were imposed for very serious infringements (one on the company and the other three on each of its directors), since the company's appraisal certificates and reports were found to lack veracity and to fail to match the data and evidence arising from the valuation activity performed. Also, four sanctions were imposed for serious infringements (one on the company and the other three on each of its directors) arising from organisational deficiencies of an administrative and technical kind and relating to personnel in the internal control procedures that guarantee the correct performance of appraisals. And finally, one sanction was imposed for the commission of one minor infringement, owing to non-compliance with the applicable rules on civil liability insurance.

c. Currency-exchange  
and money-transfer bureaux

Against currency-exchange and money-transfer bureaux, one proceeding was conducted and resolved in 2010 against a bureau and its two directors and managers. In this proceeding the bureau was found to have committed a very serious infringement, consisting of fundamental irregularities in its accounting records that prevented the entity's net worth and financial position from being known, for which sanctions were imposed on the bureau and on the two directors subject to the proceeding. Also, the bureau was found to have committed three serious infringements arising from its failure to perform various obligations, these being the obligations to have a minimum level of capital, to duly provide information to the supervisory authority and, finally, to perform only those operations it is authorised to perform, for which three sanctions were imposed. The directors of the bureau were considered likewise responsible for these infringements and a total of three sanctions were imposed on each. Finally, a sanction was imposed on the bureau for a minor infringement consisting of a breach of the rules regulating the recording of its transactions.

d. Unauthorised currency-  
exchange bureaux

In 2010 a proceeding was initiated and resolved against a company, which was sanctioned for performing the activity of cross-border money transfers professionally with the public without having obtained the necessary authorisation from the Banco de España or having been duly registered.

e. Pursuit of activities  
restricted to supervised  
institutions

Finally, the Banco de España's sanctioning activity also covers those individuals or legal entities which, without having obtained the required authorisation or having been duly registered, pursue activities restricted to supervised institutions. Three such proceedings were resolved in 2010, against three companies for carrying out cross-border money transfers without having obtained the required authorisation, with the imposition of fines. The companies were also sent a requirements letter instructing them to cease the unauthorised activity and noting that, if they failed to do so, they could be sanctioned again.

2.2.4 SANCTIONS  
AND CONCLUSION

Within the range of sanctions available under the sectoral regulations, those imposed in 2009 consisted mainly of fines, of which 13 were imposed on entities and 66 on directors or managers. However, in certain cases, in view of the conduct of the offending entity or officer, the sanction imposed was a public reprimand (with publication in the Spanish Official State Gazette). Such sanctions on entities were generally accompanied by fines and, on occasions, the disqualification of directors or managers.

As a conclusion to the foregoing, it can be said that in 2010 the Banco de España continued to exercise its sanctioning power broadly within the parameters and trends of previous years, as regards the persons against whom the proceedings were conducted and resolved and their subject-matter. Also, as in previous years, 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.

2.3 Other supervisory  
activities of the  
Banco de España

The Banco de España is also entrusted with overseeing other aspects of the activity of CIs. The following is a brief review of those functions along with comments on the most notable aspects of their performance in 2010.

2.3.1 TRANSPARENCY  
AND INFORMATION  
FOR BANK CUSTOMERS

The Banco de España, in accordance with the provisions of the Order of 12 December 1989 on interest rates and fees, rules of behaviour, information to customers and advertising of credit institutions, 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. By law, such verification activity consists in checking that the brochure expresses, clearly and in an orderly fashion, maximum prices and the terms of their application. Such checking does not include securities transactions since these are the competence of the CNMV.

However, on 8 July 2010, Order EHA/1608/2010 of 14 June 2010 on transparency of conditions and information requirements applicable to payment services came into force. This Order completes the transposition into Spanish law of the Payment Services Directive, initiated with Law 16/2009 of 13 November 2009 on payment services. Among other changes, it establishes that the transparency of such services will be regulated by the provisions of this Order and not by those established in the Order of 12 December 1989.

As a result, institutions are no longer required to include payment service fees in their charges brochures, although the Banco de España has offered them the possibility of continuing to publish them on their websites, provided that it is explained that they are not verified by the Banco de España. Most institutions have accepted the Banco de España's offer and have started to carry out the necessary processes to adapt their charges brochures to the new situation.

The above-mentioned Order also removes the obligation to include transaction valuation conditions in the brochure, since they are regulated directly by Law 16/2009 on payment services.

The number of proposals processed during the year was 833, against 964 in the previous year, so that the downward trend of recent years continued. A significant proportion of the proposals corresponded to the adaptation of charges brochures to the legislation mentioned above.

On 29 June 2010, Order EHA/1718/2010 of 11 June 2010 on regulation and control of the advertising of banking services and products was published in the Official State Gazette. This Order came into force a day later.

The enactment of this Order involves a significant modification of the rules regulating the advertising of banking products and services in Spain, since it removes the need for the prior authorisation from the Banco de España envisaged in Chapter III of the Order of 12 December 1989 on interest rates and fees, rules of behaviour, information to customers and advertising of credit institutions, without prejudice to the same powers that regional (autonomous) governments may retain over certain credit institutions.

The singularity of this prior authorisation regime within the EU, its incompleteness insofar as it only affected banking transactions, but not securities market investment transactions or insurance transactions, and the fact that it significantly slows down the supply of products and services demanded by the financial sector and of securities, made it advisable to change this regime.

However, the removal of prior administrative control is accompanied by several measures aiming to ensure that the advertising of credit institutions (and of payment institutions, to whom it also applies) is not misleading.

Thus, the Order (whose content is, at the same time, consistent with Order EHA/1717/2010 of 11 June 2010 on the regulation and control of the advertising of investment services and products, which the Ministry for Economic Affairs and Finance has processed in parallel) replaces the prior authorisation regime with a system to control advertising based upon two elements:

- a preventive one, based on the creation of specific criteria for financial advertising to guide its clarity and honesty, and requiring certain internal procedures and controls that are conducive to such aims;
- and another one that enables any inappropriate conduct to be corrected, for which purpose the Banco de España may require cessation or rectification of advertising that fails to comply with the provisions of the Order or with those established by the Banco de España to implement the Order.

These aspects are addressed in the above-mentioned Order 1718/2010 and in the Circular of the Banco de España 6/2010 of 28 September 2010.

First, a number of general principles and specific criteria are established that must be respected by the advertising of credit and payment institutions, to ensure that such advertising is clear, sufficient, objective and not misleading.

The second question addressed relates to the internal procedures and controls and the commercial communication policy of credit institutions, with a view to achieving the above mentioned objectives

Thus, among the internal procedures and controls that may be required in accordance with Article 30 bis of Law 26/1988 of 29 July 1988 on the discipline and intervention of credit institutions, institutions must include those necessary to protect the legitimate interests of their customers and to manage the risks to which they are or may be exposed as a result of their advertising.

For this purpose, institutions must have a commercial communication policy that includes appropriate criteria and procedures to ensure that the institution complies with the rules, principles and general criteria established in the legislation applicable to them.

Taking this into account, and with the aim, *inter alia*, of encouraging institutions to join some duly approved advertising self-regulation body, credit institutions not associated with any approved advertising self-regulation system, or whose advertising is not subject to prior authorisation by a regional (autonomous) government (like savings banks and many credit cooperatives), must submit to the Banco de España their commercial communication policy and the alternative internal controls they have to minimise the risks relating to inappropriate advertising.

And in relation to the correction of any inappropriate conduct, the Banco de España is understood to have powers to require the cessation or rectification of any advertising that does not comply with the legislation regulating banking products and services or that is in breach of the provisions of the Order or the Circular, and may require any warnings it considers necessary in relation to the advertised product or service to be included in the advertising.

Without prejudice to these powers to require the rectification or cessation of advertising, institutions, along with their directors and managers, that infringe the obligations envisaged in this legislation will be liable to administrative sanctions pursuant to the provisions of Title I of Law 26/1988 of 29 July 1988.

Another competence relates to the control of the advertising of credit institutions, whose form of exercise has been transformed during 2010 (see box). Thus, in the first half of 2010 when the regime of prior authorisation of advertising campaigns by the Banco de España was still in force, 3,696 authorisation applications were processed.

Also related to transparency is the function of verifying the customer protection rules regulating the activity of the customer service departments and ombudsmen of CIs,<sup>5</sup> except for those of savings banks and local or regional credit cooperatives, in which case the verification is carried out by the competent body of the autonomous region in which the institution's registered office is located. In any case, the Banco de España must be

<sup>5</sup> The requirements of which were laid down by Order ECO/734/2004 of 11 March 2004.

notified of the appointment of the head of the department and, where applicable, of the ombudsman.

As mentioned in last year's report, the task of initial verification of these rules was practically completed in 2006. Hence, as in 2007, 2008 and 2009, the work in 2010 consisted in checking the rules of institutions newly registered in that year and the changes proposed by the institutions to existing rules.

Finally, with the aim of providing information and guidance to non-business customers of credit institutions, the Banco de España created a new portal on its website in 2005, called "Portal del Cliente Bancario".

In 2010, the number of viewings of the portal was 2,329,523, 12.9 % fewer than in 2009. However, the number of visitors increased by 1.6 % with respect to 2009, to 510,679.

The most visited sections were those relating to simulators, banking products, interest rates, the glossary, the Central Credit Register and frequently asked questions.

The number of queries received through the portal's "contact us" facility was 2,471, somewhat fewer than in 2009 (2,838). Telephone inquiries also decreased in comparison with 2009, from 2,664 to 2,570.

### 2.3.2 OFFICIAL REGISTERS AND INSTITUTIONAL INFORMATION

The Banco de España is responsible, under Spanish law, for keeping various public registers with different purposes. Not only must CIs and other financial intermediaries and auxiliaries subject to supervision be recorded in these registers, but also certain elements of their corporate governance and organisational structure. 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.<sup>6</sup>

Table 2.6 gives the number of institutions registered in this register,<sup>7</sup> both Spanish and foreign, including those that operate in Spain under the freedom to provide services.

In relation to this register, the decline in 2010 in the number of registered savings banks, from 46 to 36, as a consequence of the integration and restructuring taking place in the sector, is especially noteworthy. In parallel with this process there has been an increase in the number of banks which, in net terms, have increased by seven units to 71. Five of these banks are the central institutions of five Institutional Protection Schemes (IPs), in which a total of up to 22 savings banks have been integrated. Another of the new banks has been set up to enable the transfer of the financial business of a savings bank, such transfer in another case taking place through an existing bank.

<sup>6</sup> 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 using different criteria.

<sup>7</sup> 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.

## Year-end data (a)

Number	2007	2008	2009	2010
Institutions with an establishment	558	561	550	538
Credit institutions (b)	358	361	353	339
Representative offices	57	55	55	54
Mutual guarantee companies	24	24	23	24
Reguarantee companies	1	1	1	1
Currency-exchange bureaux and money transfer agencies (c)	59	62	63	61
Payment institutions	—	—	—	2
Agent networks of EU payment institutions	—	—	—	1
Appraisal companies	57	56	54	55
Controlling companies of credit institutions	2	2	1	1
Credit institutions operating without establishment	433	480	517	556
Of which: EU CIs operating without an establishment	428	475	492	506
Of which: financial subsidiaries of EU CIs	2	2	2	2
Of which: payment institutions (d)	—	—	20	45

SOURCE: Banco de España.

- a** The number of institutions also includes those that are non-operational and in the process of deregistering.  
**b** Including electronic money entities 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.

Contrasting with these changes is the stability in the register of credit cooperatives, in which there was just one deregistration in 2010, due to a merger. The reason for this stability has been that the integration between credit cooperatives is taking place through two institutional protection schemes, in which the central institution is one of the participating cooperatives.

Also noteworthy is the decline in the number of registered SCIs, by ten units, from 69 to 59. In half of these cases this was a consequence of the restructuring of international financial groups.

As regards the types of registered institutions, in 2010, following completion of the transposition into Spanish law of EU law on payment services, the first two Spanish payment institutions (PIs) were registered, as well as the first EU PI agent network. These agent networks are treated in a similar way to branches insofar as they are one way of exercising the right of establishment.

EU institutions operating without an establishment registered in this register continued their customary growth, both on the side of CIs, which increased by 14 to 506, and PIs, whose numbers doubled to 45.

**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 requirements that

have 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.

As at end-2010, the number of senior officers in this register<sup>8</sup> was 4,755, a slight reduction of 3 %, in line with the smaller number of registered institutions and a certain simplification of their boards of directors. Thus, the largest declines in proportional terms occurred in the number of senior officers registered for savings banks and SCIs, which contracted by 12 % and 9 % to 1,069 and 327, respectively. Although the number of registered women declined for the first time (by somewhat more than 1 %), the percentage decline was larger among male senior officers (almost 4 %). Thus, the number of female senior officers as at end-2010, 538, was a higher proportion (13 %) relative to male senior officers (3,640). For their part, legal person senior officers accounted for slightly more than 9 % of the total.

With the entry into force of the Circular of the Banco de España 1/2009 of 18 December 2009, there were various changes in this register in 2010. The obligation and extent of the registration of the senior officers of savings banks, the branches of foreign EU CIs and the subsidiary financial institutions of the branches of foreign EU CIs, which until then were only regulated indirectly and are now expressly required for the sole purposes of permitting the performance of the supervisory functions entrusted to the Banco de España, have been clarified. Also, the forms used to notify senior officers have been unified and those persons considered similar to general managers have been specified, for the purposes of their registration in this register. In addition, a process of complete verification and updating was carried out during 2010.

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<sup>9</sup>. This information is vital for the basic supervisory 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 2010, 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. Thus, the number of registered shareholders of banks fell by barely 2 % to stand at 532, while that of SCIs fell by almost 12 %, to 157.

Nonetheless, it should be pointed out that, in the case of the registered members of credit cooperatives, Table A.4.2 in Annex 4 of the digital edition published on the Banco de España's website shows a notable increase from 364 to 518. This increase is merely due to a change in the computer program used to obtain this information. Until 2010, all holdings of less than 0.25 % in the share capital of cooperatives were aggregated, in order to eliminate information that, from the prudential point of view, is not relevant. However, with the publication of the Circular of the Banco de España 1/2009 of 18 December 2009, re-

<sup>8</sup> 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.

<sup>9</sup> 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.

ferred to above, and taking into account that most of those holdings corresponded to cross holdings between credit cooperatives, this aggregation was discontinued.

d. Reporting of agents

CIs operating in Spain and, since the beginning of 2002, also 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.<sup>10</sup> In addition, they must report to the Banco de España the list of foreign CIs with which they have entered into agency agreements or agreements to provide financial services to customers.

In 2010, the changes in this register returned to the patterns seen in the years prior to 2009, which saw a sharp decrease in the number of agents registered as a consequence of the restructuring of the Spanish banking business of the subsidiary of a foreign bank.<sup>11</sup> Thus, the total number of agents of CIs increased moderately in 2010, by 2.5 %, to stand at 5,289, the most notable change being the shift in agents from savings banks to commercial banks, owing to the transfer of business from the dissolved savings bank Caja de Ahorros de Castilla-La Mancha to the new commercial bank Banco de Castilla La-Mancha, since the agents of this savings bank amounted to 23 % of the total number of agents of savings banks. This further increased the preponderance among agents of CIs of agents of banks who, numbering 4,830, account for more than 91 % of the total.

For their part, the number of agents reported by currency-exchange bureaux authorised to make cross-border money transfers continued the upward trend of previous years, with an increase of almost 11 %, which has raised their number to 18,734.

The most important change in this register from a qualitative viewpoint has been the registration of the first agents of Spanish PIs who, like those of the branches of foreign PIs and those belonging to the agent networks of EU PIs, must also be included in it. As at end-2010, 83 agents of Spanish PIs had been registered.<sup>12</sup>

e. Special Register of Articles of Association

The Banco de España also keeps an up-to-date register of the 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, following a report from the Banco de España.

In 2010 the number of applications analysed and reported on by the Banco de España doubled to 50, basically as a consequence of the integration processes mentioned above. At the same time, the number of amendments registered increased by somewhat more than 18 %, to 168.

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10 From 2011, as a result of the entry into force of Banco de España Circular 4/2010 of 30 July 2010, CIs must also report those natural or legal persons whom they have appointed to perform regularly, on a professional basis and in the name of and on behalf of the institution, activities to promote and market transactions or services typical of the activity of a credit institution, including the investment and ancillary services referred to by Article 63 of the Securities Market Law.

11 See Section 2.3.2 (d) of the 2009 Report on Banking Supervision in Spain.

12 The Banco de España Circular 4/2010 of 30 July 2010 extended the reporting obligations of CIs to those natural or legal persons who they would have appointed to promote and market, in their name and on their behalf, on a professional basis and regularly, operations or services that constitute the typical activity of a CI. However, this reporting must be carried out twice a year, the first time with respect to the situation as at December 2010, so that it remains outside the time period covered by this report.

2.3.3 OTHER AUTHORISED  
ELIGIBLE CAPITAL FOR  
SOLVENCY PURPOSES

In order to ensure that CIs comply with the solvency requirements to which they are subject, the Banco de España verifies the eligibility as own funds of certain financial instruments issued by CIs, by their special purpose vehicles or by other subsidiaries, in accordance with applicable law.<sup>13</sup>

The items eligible as own funds include subordinated debt and preference shares, which have features of equity instruments, in that they will remain on the institution's balance sheet for an indefinite period of time and the returns on them depend on the issuer's solvency and on the existence of sufficient profits.

The issues verified by the Banco de España for eligibility as own funds declined significantly in 2010, to a total amount of €6.5 billion. This figure is around 75 % lower than that for 2009, but almost double the figure for 2008, when the international financial crisis broke.

There are two reasons that may explain this decline: first, Spanish CIs carried out less debt substitution in 2010 than in 2009, when they capitalised heavily on the particularly low prices of the securities issued by them to make profits that were set aside as provisions or reserves;<sup>14</sup> second, the issuance activity of operating subsidiaries of Spanish CIs subject to specific own fund requirements in the country in which they are authorised to operate was lower in 2010, with only one issue, with an equivalent value of barely €750 million (45 % less than in 2009), being recognised as eligible own funds.

It should also be noted that Table 2.7 does not include six issues of preference shares convertible into shares or non-voting equity units which, for a total amount of €8.4 billion and within the framework of the same number of savings bank restructuring processes, were subscribed for by the FROB last year.

As regards the financial characteristics of the issues made, it is not possible to find a predominant type of issue in 2010.

In terms of the nature of the issuer, although commercial banks carried out the largest number of issues, the total amount issued by savings banks was higher, accounting for almost 60 % of total issuance. From the standpoint of investors, those issues aimed at retail investors predominated among issues that were not intended to be exchanged for or converted into other existing securities, but represented barely 60 % of the total amount.

Meanwhile, fixed and variable interest rates occurred as often as each other and frequently existed simultaneously in the same issues, with the variable rates applying after a certain number of years (in most cases five). Variable interest rates stood at around 4 % and were based on EURIBOR, with spreads of more than one percentage point. Fixed rates ranged from 6 % to 8 %.

Only in relation to original maturities was there some uniformity, which mostly stood at ten years, and in the nature of the securities issued, with subordinated debt accounting for 85 % of both the total number of issues and the total amount issued. In fact, the two issues of shares or preference shares shown in Table 2.7 correspond to issues of bonds that are mandatorily convertible into shares of the issuer, which means that, for the purposes of own funds, they can be treated in a similar way to preference shares.

<sup>13</sup> Law 13/1985 of 25 May 1985 on investment ratios, own funds and reporting requirements of financial intermediaries, and implementing legislation.

<sup>14</sup> See Section 2.3.3 of the 2009 Report on Banking Supervision in Spain.

## Yearly data

€m

	Number				Amount			
	2007	2008	2009	2010	2007	2008	2009	2010
TOTAL	60	36	75	14	21,592	3,747	26,314	6,465
Subordinated debt	45	32	42	12	11,962	2,597	7,938	5,497
Fixed-term	41	27	39	11	10,458	2,497	7,865	5,477
Banks	29	14	15	6	9,189	1,259	2,541	1,492
Savings banks	9	9	18	4	1,224	1,233	5,092	3,983
Credit cooperatives	3	1	1	1	45	2	3	2
SCIs	—	3	5	—	—	3	229	—
Of which: loans	4	7	11	1	420	678	409	1
No agreed maturity	—	3	—	—	—	19	—	—
Credit cooperatives	—	1	—	—	—	3	—	—
SCIs	—	2	—	—	—	16	—	—
Of which: loans	—	2	—	—	—	16	—	—
Undated	4	2	3	1	1,504	81	73	20
Banks	1	—	3	—	1,019	—	73	—
Savings banks	3	—	—	—	485	—	—	—
SCIs	—	2	—	1	—	81	—	20
Preference shares	15	4	33	2	9,630	1,150	18,376	968
Banks	7	1	15	2	9,239	1,000	9,426	968
Savings banks	7	3	18	—	389	150	8,950	—

SOURCE: Banco de España.

## 2.4 Supervisory policies

### 2.4.1 RECOMMENDATIONS FOR THE PREPARATION OF INTERNAL CAPITAL ADEQUACY ASSESSMENT REPORTS

#### a. Introduction

In March 2010 the Banco de España received for the second time the internal capital adequacy assessment report (“capital report”) which, since the implementation of Basel II, credit institutions have to prepare every year. To prepare this report, CIs have as a reference the Guidelines on the Internal Capital Adequacy Assessment Process (ICAAP),<sup>15</sup> published initially in June 2008 and subsequently revised on two occasions, in March 2009 and in January 2011. These revisions seek to keep the Guidelines up-to-date and consistent with the European regulatory framework (including the guidelines issued by the CEBS-EBA<sup>16</sup>), and also to make improvements by including and rectifying matters as needed, in accordance with the experience acquired over the years.

The objective of the ICAAP is that institutions ensure there is a balance between their risk profile and the capital available to them. For this purpose, in the capital report institutions explain their internal assessment of the risk inherent in their activity, set out their corporate and internal governance and describe how they manage, measure and control their risks. Finally, they establish their own funds target, which must be compatible with their risk profile, and set out the capital planning, including stress testing, which will enable them to meet that target.

<sup>15</sup> Available at: [http://www.bde.es/webbde/en/supervision/regulacion/solvencia/ICAAP\\_guidelines\\_26\\_01\\_11.pdf](http://www.bde.es/webbde/en/supervision/regulacion/solvencia/ICAAP_guidelines_26_01_11.pdf). See also the 2007 Report on Banking Supervision in Spain.

<sup>16</sup> The European Banking Authority (EBA), created by Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010, took over as from 01.01.2011 all existing and ongoing tasks of the CEBS.

The Banco de España's detailed knowledge of this process helps it to assess the solvency of institutions, and, therefore, the review and assessment of the ICAAP is an essential part of the supervisory process. This is explained in "The Banco de España Supervisory Model"<sup>17</sup> and, more specifically, in the "Guidelines on the Capital Review Process (CRP)", published in February 2010.<sup>18</sup>

The above-mentioned three documents set the framework of the Banco de España supervisory process, the objective of which is not only to ensure that CIs have the necessary capital to cover the risks derived from their business, but also to encourage them to develop and adopt more suitable risk management and control mechanisms.

b. Guidelines on the Capital Review Process

The objective of the capital review process (CRP) or, as it is more commonly known, the supervisory review and evaluation process (SREP) is to allow the Banco de España to confirm that there is an adequate relationship between the risk profile of each credit institution and the own funds effectively held by it. The main source of information used by the CRP for this purpose is the yearly internal capital adequacy assessment report ("capital report"), i.e. the report in which each institution gives an account of its internal capital adequacy assessment process (ICAAP). This information is supplemented by the own funds return of each institution and other relevant information available to the Banco de España, including that derived from its supervisory actions.

Although the review of the ICAAP is ongoing and forms part of the general supervisory process, it has two separate milestones: a) the yearly off-site reviews to check that the capital report is complete and reasonable and is consistent with the institution's own funds return and other relevant information available to the Banco de España, and b) specific reviews in greater depth and with a broader scope, carried out in on-site inspections. The objective in this case is to confirm that the information contained in the capital report is adequate and accurate, to review and evaluate the methodological aspects of the ICAAP and to identify possible deficiencies and weaknesses.

Further, to increase consistency between the reviews carried out by the various operational inspection groups, certain areas of the capital report are cross-reviewed by groups at the same level, so as to ensure that the analysis of significant aspects of it, such as for example the own funds target, the evaluation of internal governance, the evaluation of certain risks, etc. is carried out as uniformly as possible.

In the case of institutions subject to on-site continuous monitoring, every year an action plan is prepared for the coordinated review of the various sections of the ICAAP.

The yearly review of the capital report focuses particularly on the following sections: a) own funds target; b) capital planning, including the degree of fulfilment of prior years' projections (which is an indicator of the reliability of those projections), stress scenarios and contingency plans; c) consistency between the institution's internal assessment in its capital report and the scores assigned in the Banco de España risk matrix; and d) action plan for the future and, where applicable, degree of fulfilment of past action plans.

17 Available at: <http://www.bde.es/webbde/en/supervision/funciones/funciones.html> . See also the 2008 Report on Banking Supervision in Spain.

18 Available at: <http://www.bde.es/webbde/en/supervision/regulacion/prc.pdf>.

In light of the conclusions drawn from this review and if considered necessary, the weaknesses found are explained to and discussed with the institutions in question, so they can be remedied as soon as possible.

c. Changes in the 2011 ICAAP guidelines

The experience gained from the review of the 2008 and 2009 capital reports showed that it was advisable to make further changes to the ICAAP guidelines to clarify and improve certain aspects of it and to reinforce various criteria communicated to institutions. These changes reflect the main areas of supervisory attention in the recent past and formalise some of the recommendations made by the Banco de España in response to inquiries from institutions or their associations:

a) Risk profile of institutions

It was clarified that, when they value their risks, institutions must refer to the inherent, and not the residual, risk. As explained in the “The Banco de España Supervisory Model”, inherent risk is the risk intrinsic to the institution’s various activities and business areas, without considering the control systems.

It was also clarified that, to value their risks, institutions have to use the definitions and scale of scores used by the Banco de España in its supervisory review process, in order to foster a common language and facilitate analysis of whether the institution’s perception of risk coincides with that of the Banco de España. That is to say, institutions have to use the definitions and scale of scores (high, medium-high, medium-low and low) of the risk matrix explained in the “The Banco de España Supervisory Model”.

b) Own-funds target

The ICAAP guidelines define the own-funds target as that which the institution “considers necessary to maintain both at present and in the future period (...) in keeping with the risks inherent in the institution’s activity, the economic environment in which it operates, the governance and risk management and control systems, the strategic business plan, the quality of the capital available (...) and the actual possibilities of obtaining more capital if needed.”<sup>19</sup>

The current crisis has made it apparent that only core capital is useful in practice for withstanding losses on a going concern basis and, for this reason, the future rules (Basel III) put all their emphasis on it. In view of this, the Banco de España began, for the purposes of Pillar 2, to focus on core capital and finally included in the ICAAP guidelines the requirement that institutions express their capital target in terms of core capital.

The modified ICAAP guidelines specify that the definition of core capital to be used is that of “common equity tier 1” established by the Basel Committee,<sup>20</sup> including the related implementation criteria set out in EU and Spanish legislation. However, given that the concept of “common equity tier 1” (CET1) will only become compulsory gradually from January 2013, until then the defini-

<sup>19</sup> Some institutions indicate in their capital report ratios that they act as a threshold for the application of corrective measures (“trigger ratios”) instead of true targets to be met and maintained in the long term (“target ratios”).

<sup>20</sup> See the Basel Committee document entitled “Basel III: A global regulatory framework for more resilient banks and banking systems”.

tion of core capital used will be that given in Article 2 of Royal Decree-Law 2/2011 of 18 February for reinforcing the Spanish financial system, which is very similar to the definition of CET1 applicable in 2013.

c) Assessment of capital needs for credit concentration and structural interest rate risk

The Banco de España included in the ICAAP guidelines the respective simplified options for assessing the capital needs for credit concentration risk and for on-balance-sheet structural interest rate risk in order to help less complex institutions analyse these risks and, at the same time, to establish objective criteria for comparing the level of inherent risk faced by institutions in relation to these two risks.

The simplified option for calculating capital needs for individual concentration risk was recalibrated in order to fine-tune the multipliers (the simplified methodology for estimating capital needs for sectoral concentration risk is also being revised).

The simplified option for calculating the capital needs for on-balance-sheet structural interest rate has also been modified: rules have been set on the maximum duration and percentage of volatility of non-interest-earning sight deposits in order to harmonise the criteria of the different institutions.

d) Capital planning and stress tests

The objective here is to establish a more structured and detailed capital planning framework in both normal conditions (ordinary planning) and stressed conditions (stress scenarios) so as to make these tests more uniform from one institution to another, thereby simplifying the Banco de España's task of reviewing them.

For this purpose, as a result of numerous working meetings with institutions and their associations,<sup>21</sup> the simplified option for stress tests was eliminated, institutions are requested to provide more details on their capital planning and on the stress tests conducted in the ICAAP, and some matters have been modified or clarified. The main changes are as follows:

- Institutions will include each year in their capital report what are known as the “baseline planning scenario” and the “macro stress scenario”. In both scenarios, and for the different tests comprised in the planning, they will provide information on the macroeconomic variables used. Based on these variables, institutions will show the changes in their core capital ratio and, in addition, the envisaged amount of the main balance sheet items (including loans to the public and private sectors, private sector deposits, doubtful loans and receivables and loan loss provisions), a representative breakdown of risk-weighted assets, net interest income, gross income, net operating income and profit before tax.

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<sup>21</sup> And also to make the recommendations of the ICAAP guidelines in this section compatible with the recent changes to the CEBS “Guidelines on Stress Testing”.

- The “macro stress scenario” will consider a significant fall in economic activity and assume simultaneous adverse changes in at least GDP, interest rates, employment and house prices. For this purpose, the recommendations and predictions of the EBA, and, where applicable, the ECB, will be followed, except where the institution considers, and provides evidence, that they are not appropriate.
- The stress test results will be set out in the ICAAP summary return (return ICAAP 01) disregarding alternative capital items and active management strategies to mitigate their effects, i.e. they will be stated gross of mitigation. Where applicable, the effects of the mitigation produced by alternative capital items or any other means will be stated separately in the ICAAP, so their effect can be evaluated.

With these changes the Banco de España trusts that institutions will continue to improve their internal capital assessment procedures and devote efforts to a process which is key to the Banco de España’s supervisory review.

#### 2.4.2 TRANSPARENCY OF CREDIT INSTITUTIONS

The financial crisis which broke out in mid-2007 showed that a key factor in market confidence is the disclosure by credit institutions of appropriate high-quality information which meets the needs of financial information users. And this greater need for transparency has been evident in numerous areas of activity and even in the governance of institutions.

Thus, quite early in the piece, the Financial Stability Forum (all the functions of which were taken over by the Financial Stability Board in 2009) issued a report on 7 April 2008 entitled *Enhancing Market and Institutional Resilience* which identified several areas where market transparency had to be improved, including that of disclosure of information on risks and on structured products and securitisation processes and markets, and that of the valuation models and procedures used by institutions.

As the financial crisis deepened and gave way to an economic crisis in numerous countries it became still more evident that it was necessary to reinforce the transparency of institutions in all areas related to their activity in order to maintain market confidence. Although there are numerous documents and reports of international fora in this respect, special mention should be made of the document published in April 2010 by the Committee of European Banking Supervisors (CEBS) addressed to all EU credit institutions, entitled *Principles for disclosures in times of stress (Lessons learnt from the financial crisis)*.

This document<sup>22</sup> contains sixteen principles on information disclosure which reflect the lessons to be learnt from the financial crisis and help institutions to improve the quality of the information they publish. These principles address general matters, although they also touch on specific aspects of the content and presentation of information, as can be seen from the summary included in Box 2.2.

It is precisely in the area of the information to be disclosed in times of stress where the Banco de España decided to impose greater market transparency requirements on institutions at the end of 2010 in regard to construction and real estate development loans, house purchase loans, assets acquired in satisfaction of debt and funding needs and strategies.

<sup>22</sup> In March 2011 the Banco de España reminded institutions in writing of the importance and timeliness of this CEBS document.

**I GENERAL PRINCIPLES**

- 1 Financial institutions should provide timely and up to date information.
- 2 Financial institutions should provide disclosures on areas of uncertainty.
- 3 Financial institutions should provide comprehensive and meaningful information that fully describes their financial situation.
- 4 Disclosures should allow comparisons over time and between institutions.
- 5 Financial institutions should seek to early adopt new disclosure regulations.
- 6 Financial institutions should specify whether and to what extent information has been reviewed or verified by external auditors.

**II CONTENT**

- 7 Financial institutions should provide sufficient information on the business model underlying the activities under stress and their significance. Disclosures should cover:
  - background information on the business model underlying the activities under stress (to put the disclosures into context) with a description of the degree of involvement of an institution in such activities;
  - an explanation of how activities contribute to an institution's value creation process;
  - a discussion of the impact a stressed situation has had on the institution's strategy and objectives, including changes in business orientation or policies.
- 8 Financial institutions should provide clear and accurate information regarding the impacts the activities under stress have on results and on risk exposures. Disclosures should cover:
  - the level of exposures related to the activities under stress and the precise nature of the risks involved;
  - detailed information on losses;
  - the nature of the protection implemented or acquired to cover the risk and the quantitative impact of risk mitigation;

- some narrative comments on possible developments in the situation.

- 9 Financial institutions should provide information regarding impacts on the institution's financial position. Disclosures should cover:

- the impact of the activities in question on the level of capital and on the resulting solvency ratio; and
- the impact on the institution's liquidity position.

- 10 Financial institutions should provide information on the management of the risks involved in activities under stress. Disclosures should cover:

- a description of relevant risk management practices, including associated governance arrangements where necessary; and
- a description of any measures taken to enhance risk management processes.

- 11 Financial institutions should provide detailed information with regard to critical accounting issues. Disclosures should cover:

- an adequate description of the accounting policies that are of particular relevance for the activities in question;
- details of relevant changes, if any; and
- detailed information where significant judgement has been applied.

**III PRESENTATIONAL ISSUES**

- 12 Financial institutions should ensure that disclosures regarding activities under stress can be easily located.
- 13 Financial institutions should provide information at an appropriate level of granularity.
- 14 Financial institutions should strike an appropriate balance between quantitative information and narrative information.
- 15 Financial institutions should continue to develop an educational approach.
- 16 Financial institutions should clearly specify when not exposed to particular activities under stress where this information is likely to be decision-useful for users.

These requirements, insofar as construction and real estate development loans are concerned, focus on the reporting of detailed quantitative information on these loans, along with an indication of what part is doubtful or sub-standard, by what amount the loan exceeds the collateral received and what specific provisions have been set aside for these loans. Also, it is requested that the policies and strategies established by institutions to cater for troubled loans in this sector, both in the short term and in the medium and long term, be made public.

Furthermore, institutions are requested to publish information on total loans to households for house purchase, specifying what part is secured by mortgage collateral and what is not and indicating the amount considered to be doubtful. Also, for this total and for the part thereof that is doubtful, institutions are required to publish a breakdown by interval of the LTV ratio, i.e. the proportion of the outstanding debt to the value of the collateral.

As regards assets acquired in satisfaction of debt, the information to be published includes a breakdown of the real estate assets on institutions' balance sheets (or of the ownership interests in or loans to unconsolidated firms holding such assets) arising from loans to construction and real estate development firms or from mortgage loans to households for house purchase, indicating in both cases the coverage by specific provisions.

Lastly, institutions have to include an assessment of their funding needs on the markets, as well as the short-, medium- and long-term strategies pursued in this respect.

All this information making up the new transparency requirements has to be disclosed by consolidated groups of credit institutions and by individual credit institutions not forming part of any group, and included, along with the appropriate explications, under a specific heading in the 2010 financial statements. However, certain institutions involved in merger or integration processes have been asked to disclose this information earlier.

Finally, and also somewhat related to these disclosure requirements, mention should also be made of the recurring disclosures in credit institutions' financial statements introduced by Banco de España Circular 7/2010 of 30 November 2010 developing certain aspects of the mortgage market. In effect, the various areas in which higher-level regulations<sup>23</sup> empower the Banco de España to issue implementing provisions include certain transparency-related matters which go directly to the heart of some of the concerns awakened by the nature and origin of the financial crisis referred to above.

The realisation that these concerns originated in US mortgage loans led numerous international fora to question whether, at a more general and broader level, mortgage lending standards were relaxed during the expansionary phase of the economic cycle and to what extent this may have affected the quality of institutions' mortgage portfolios and the quality of the mortgage markets themselves. In this respect, the various international studies and reports calling for greater transparency also in this area include most notably the recommendation by the Joint Forum in its report of January 2010 entitled *Review of the Differentiated Nature and Scope of Financial Regulation - Key Issues and Recommendations* that countries should have disclosure systems to disseminate information on the health of their mortgage market, including mortgage loan origination practices, encompassing all mortgage market participants.

The culmination of the Spanish mortgage market reform by means of Royal Decree 716/2009 and the development of various aspects of that reform via the aforementioned Circular 7/2010 draw on these sources when it comes to establishing further disclosure requirements regarding mortgage market transactions. Thus the Circular includes detailed rules on the essential data to be included in the special accounting register which, pursuant to Article 21 of the aforementioned Royal Decree, have to be included in the financial statements of institutions issuing mortgage covered or other bonds, thus providing the

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23 Royal Decree 716/2009 of 24 April 2009 developing certain aspects of Law 2/1981 of 25 May 1981 on mortgage market regulation and other mortgage and financial system rules.

users of financial information with breakdowns and comparative figures of asset and liability transactions relating to the mortgage market.

Also, this Circular specifies the minimum content of the financial statement disclosure setting out the express representation of the Board of Directors or equivalent body of the credit institution with regard to the existence of express policies and procedures concerning their activities on the mortgage market. This note must indicate whether these policies and procedures include criteria on matters such as the ratio of the loan amount to the appraisal value of the mortgaged real estate asset (the aforementioned LTV ratio), the influence exerted by other collateral or guarantees supplementary to the mortgage collateral, the selection of appraisal companies, the relationship between the borrower's debt and revenue, or the verification of the information furnished by the borrower and of the borrower's solvency.

Note that some of these areas in which greater transparency is required of credit institutions are closely related to certain matters regarding credit risk management policies and methodology introduced by Banco de España Circular 3/2010 of 20 June 2010 amending Annex IX of Circular 4/2004 of 22 December 2004 on public and confidential financial reporting rules and formats. These matters, which supplement the good practices contained in the aforementioned Annex IX which the Banco de España considers essential for credit risk management to be deemed prudent and robust, include most notably criteria relating to the proper evaluation of cash flows generated by the borrower and the role to be played by collateral in the analysis of loan origination and management.