

2 Exercise of supervisory functions in 2007

The Spanish banking system again showed in 2007 the sound solvency, profitability and efficiency that have characterised it in recent years, as can be appreciated from the information provided in Annex 2.

In 2007 the Banco de España and the institutions continued to prepare themselves for the regulatory changes introduced by the new Capital Accord, commonly known as Basel II. This preparation requires substantial human and technical resources to be devoted to the validation of advanced internal models for measuring Pillar 1 risks and to the drafting of the Banco de España circular which completes the legal process of transposition of the Directive and will replace Circular 5/1993 on the determination and control of minimum own funds.

During the process of internal model validation, the specialised supervision teams have noted progress, although they continue to observe some weaknesses regarding a lack of effective integration of models in institutions' commercial operations, underdeveloped internal validation, methodological difficulties, problems in the adaptation and quality of data, insufficiency of systems and paucity of documentation. These same teams have completed two parallel calculation exercises to determine the current own funds requirements and those that will result from the new solvency circular. The results still showed excessive dispersion, due to the application of some insufficiently satisfactory methods and estimates and to certain problems of reliability of the information provided.

In addition to the work on the drafting of the new solvency circular, in 2007 the Banco de España published two documents on criteria for validating these models and submitted to public consultation the ICAAP (Internal Capital Adequacy Assessment Process) Guidelines for credit institutions. Section 2.4 discusses these documents in depth.

2007 was characterised by the financial market instability initiated in August as a result of the so-called sub-prime mortgage crisis in the USA. The Banco de España has published analyses of the financial turbulence and its impact on Spanish banks in the Financial Stability Reports, which are available to the public on its website.

In the area of international supervisory co-operation, work commenced in 2007 on the implementation of the new supervisory co-operation schemes envisaged in Directive 2006/48/EC, which represent a step forward in information exchange and in the co-ordination of the various authorities' supervisory oversight of the banking groups with a presence in various European countries. In particular, pursuant to the sixth final provision of Law 36/2007, the Banco de España has co-operated with host country supervisory authorities in the case of international groups with a Spanish parent, and with home country authorities in the case of Spanish subsidiaries of European banking groups, in the processes of analysis and validation of advanced models for the calculation of own funds.

Among the actions carried out as home country supervisor, mention may be made of the work done in Europe with the British host-country supervisor (the United Kingdom Financial Services Authority), which enabled a joint opinion to be reached on an application to use advanced credit risk models, and of the commencement of practical co-ordination with the Portuguese supervisor (*Banco de Portugal*). Noteworthy in Latin America were the validation work co-ordinated with the Mexican supervisor (*Comisión Nacional Bancaria y de Valores*) under the

co-operation agreement entered into in 2006, and the signature of a co-operation agreement (similar to that signed in 2006 with the Mexican supervisor) with the Peruvian supervisor (*Superintendencia de Banca, Seguros y Administradoras Privadas de Fondos de Pensiones*). Lastly, as host-country supervisor, the Banco de España has agreed on opinions, set progressive implementation timetables and provided technical co-operation to the supervisors of various European countries.

In 2007 Q4 the Banco de España organised the first meeting of the college of supervisors (understood as a permanent, albeit flexible, forum for co-operation and co-ordination between the authorities responsible for supervising the components of international banking groups) of a Spanish banking group, in which representatives of the German, Italian, Norwegian, Portuguese and UK authorities, as well as managers of the banking group in question, participated. The main aim of the meeting was to comment on and discuss practical implementation of the new solvency framework in the group. Conversely, when the Banco de España is host-country supervisor of foreign banks, Spanish supervisory staff have attended the college meetings organised by other European countries.

A new co-operation agreement was signed on 29 February 2008 between the Banco de España and the Commission for the Prevention of Money Laundering and Monetary Offences to work together in their respective supervision and control functions. This agreement replaces that in force since 15 June 2005 and incorporates the improvements derived from past experience with a view to strengthening supervisory co-operation in this area.

The following sections of this chapter describe, first, the supervisory action taken, indicating the supervised institutions, the on-site inspections made and the staff members of the Directorate General Banking Supervision, along with an enumeration of the requirements and recommendations letters sent to institutions as a result of such action. Second, an account is given of what was involved in the exercise of sanctioning powers in 2007 and the number of proceedings initiated and of proceedings resolved is indicated for each type of infringement. Third, reference is made to the Banco de España's other supervisory functions (e.g. those relating to regulations governing the transparency of banking transactions, the protection of bank customers and the keeping of official registers). The fourth and last section of this chapter, which addresses supervisory policies, looks at the internal capital adequacy assessment process in credit institutions and the validation of Basel II advanced approaches.

2.1 Supervisory activity

At 31 December 2007, the Banco de España had under its supervision a total of 499 institutions of a diverse nature, of which 358 were credit institutions. Additionally, in the case of 122 foreign subsidiaries of Spanish credit institutions, the Bank has responsibilities commensurate with its capacity as consolidated supervisor of groups headed by a Spanish credit institution.

The Banco de España's supervision consists of ongoing monitoring and analysis of their situation, supported by a programme of information checks conducted via on-site inspections. In 2007 it made 202 inspection visits, including those commenced before the beginning of the year, of which 55 were under way at 31 December 2007, as detailed in Table 2.1.

In supervisory planning, inspection visits can be either full-scope or limited to certain matters. Full-scope inspections are intended to obtain up-to-date information on the institution in question. Partial inspections have a limited scope and seek to obtain sufficient knowledge of one or more areas of the institution or group (e.g. loan portfolio or the treasury or custody activity) or to monitor specific matters (e.g. the degree of compliance with requirements previously formulated by the Banco de España, the relevant circumstances for the year-end closing of ac-

Number

	INSPECTION VISITS			
	COMPLETED		UNDER WAY	
	2006	2007	2006	2007
Credit Institutions	69	125	80	44
Banks	36	63	37	12
Savings banks	11	17	21	18
Credit co-operatives	10	18	12	4
Foreign branches	1	6	2	1
<i>EU credit institutions</i>	1	6	2	1
Specialised credit institutions	11	21	8	9
Other Institutions	12	22	16	11
Appraisal companies	2	8	6	7
Mutual guarantee companies	3	5	5	1
Currency exchange bureaux and money transfer agencies	7	9	5	3
TOTAL	81	147	96	55

SOURCE: Banco de España.

counts, etc.). Part of the supervisory activity in the second half of 2007 and in the opening months of 2008 was aimed at assessing the situation of Spanish banks in the face of the international financial market turbulence initiated in August.

To carry out the actions described above, the Banco de España's Directorate General Banking Supervision had a staff of 424 as at 31.12.2007, as detailed in Annex 1.4. According to overall estimates, they spent 53% of their time on ongoing analyses of institutions, 32% on on-site inspections and 15% on other functions such as internal advice, participating in the design of supervisory policy, attending international fora and carrying out other additional support tasks.

As a result of the knowledge acquired by it in the ongoing supervision of institutions, the Banco de España is qualified to take various types of measures provided for by law, such as: i) recommendations and requirements; ii) approval of restructuring plans; iii) initiation of proceedings to sanction institutions and their board of directors and management; and iv) intervention or director-replacement measures. In 2007 it was not necessary to take any precautionary measures in respect of supervised institutions.

The requirements and recommendations that the Banco de España notifies to the supervised institutions are intended to remedy observed deficiencies or non-compliances with prudential regulations and resolve internal control and management shortcomings, with the ultimate purpose of improving the risk profile of credit institutions and thus contributing to the stability of the financial system.

In 2007 the Banco de España sent a total of 115 recommendation and requirement letters to institutions considered either in an individual capacity or as the heads of consolidated groups. In the latter case, the recommendations may refer to more than one institution in the group and to the consolidated group as a whole. The letters are listed in Table 2.2 by type of supervised institution.

SUPERVISORY ACTIVITY

TABLE 2.2

Number

	LETTERS SENT TO INSTITUTIONS	
	2006	2007
Credit Institutions	80	97
Banks	24	31
Savings banks	14	17
Credit co-operatives	20	22
Foreign branches	9	11
<i>EU credit institutions</i>	4	7
<i>Non-EU credit institutions</i>	5	4
Specialised credit institutions	13	16
Other institutions	17	18
Appraisal companies	5	7
Mutual guarantee companies	4	4
Currency exchange bureaux and money transfer agencies	8	7
TOTAL	97	115

SOURCE: Banco de España.

SUBJECT MATTER OF LETTERS SENT TO SUPERVISED INSTITUTIONS

TABLE 2.3

Number

	2006	2007
Credit risk	145	231
Accounting for credit risk, borrower weakness and higher coverage requirements	96	164
Quality of credit risk controls (origination, monitoring and other procedures)	49	67
Management and internal control	102	147
Management and internal control in general	84	120
Capital market activities	18	27
Capital and solvency	30	41
Solvency ratio	30	41
Other regulations	146	162
Failure to comply with rules on transparency and customer relations	31	35
Deficiencies in information reported to the CCR	22	30
Requirements for authorisation of non-credit institutions	13	14
Other	80	83
TOTAL	423	581

SOURCE: Banco de España.

These 115 letters contained a total of 581 recommendations and requirements, which can be classified into four broad categories relating to credit risk, management and internal control, own funds and solvency, and deficiencies or non-compliance with other banking disciplinary rules. Table 2.3 breaks down all the requirements and recommendations into these categories and lists the matters addressed.

In terms of amount, matters relating to credit risk continued to be the most significant category. They accounted for 40% of the total and related basically to the proper management, classification and provisioning of credit risk. These letters were also used to inform institutions of the Banco de España's criteria on mortgage portfolio and other risks.

Lastly, it should be mentioned that, depending on the nature of the deficiencies detected, some of these non-compliances gave rise to the appropriate communications to the Spanish National Securities Market Commission (CNMV), to the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences (SEPBLAC) and the foreign supervisory authorities of the parents of Spanish credit institutions, within the framework of current legislation and of the Banco de España's co-operation agreements.

2.2 Exercise of the sanctioning power

One of the ways in which the supervisory function assigned to the Banco de España is exercised is through the sanctioning activity. This activity is one of the instruments granted by the Spanish legal system to the administrative authority, namely the Banco de España, to strengthen the effectiveness of the supervision of financial institutions.

In this sense, the immediate purpose of the Banco de España's sanctioning activity is to punish infringements. But in addition to that, the sanctioning activity is clearly preventive in nature insofar as it is a further stimulus for the supervised institutions to act at all times in accordance with regulatory provisions. Finally, it cannot be overlooked that the exercise of the sanctioning activity should ensure reinstatement of the legal order, to the extent that the latter may have been disrupted as a consequence of the infringements that have occurred of banking regulations and disciplinary rules.

Within this framework, in 2007, in view of the matters disclosed during on-site inspections at certain supervised institutions and of other circumstances, the governing bodies of the Banco de España decided to initiate 2 proceedings against appraisal companies and 9 of their directors, and 6 proceedings against currency-exchange and transfer bureaux and 18 of their directors.

Also, in 2007 the decision was taken to lift the suspension of a proceeding against a bank and 16 of its directors, and thus the process was resumed. This suspension arose from the fact that the Banco de España's proceeding coincided with a criminal proceeding on the same facts.

As indicated above, the proceedings referred to were brought both against the offending institutions and also against the allegedly responsible individuals, members of their boards of directors and management, to clarify the liability which the latter might have incurred due to their failure to meet their respective obligations. Such obligations arise in turn from the position, duties and responsibilities of each of them.

The proceedings initiated in 2007 include 2 brought against credit institutions for non-compliance with the minimum reserve ratio, one of which was resolved that very year. These proceedings stem from the provision in Article 19 of the Statute of the European System of Central Banks, which establishes that 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 which is conducted by the Banco de España.

Lastly, as regards proceedings commenced in 2007, mention must be made of the proceeding brought to withdraw the authorisation of a currency-exchange bureau due to it having re-

Number

INSTITUTIONS	2004	2005	2006	2007
Banks	—	1	1	1(a)
Branch of EU foreign credit institutions	—	—	1	—
Savings banks	—	1	—	—
Owner of significant holdings in credit institutions	—	—	—	—
Non-compliance with ECB minimum reserve requirements	4	3	5	2
Use of names or pursuit of activities reserved for credit institutions	2	—	—	—
SCIs	—	—	1	—
Appraisal companies	1	5	2	2
Appraisal company revocation	—	1	—	—
Currency-exchange bureaux	4	5	5	6
Unauthorised currency-exchange bureaux	2	—	2	—
Currency-exchange bureaux revocations	183	163	1	1
Total	196	179	18	12

SOURCE: Banco de España.

a. Agreement on lifting suspension.

linquished such authorisation. Strictly speaking, proceedings of this type do not involve the exercise of the Banco de España's sanctioning power, but they do form part of its supervisory power. These proceedings provide a form of control over supervised institutions insofar as entities which, for regulatorily established reasons, have ceased operations or given cause for the relevant authorisation to be revoked, are prevented from forming part of the system.

Together with the data on the volume of proceedings commenced during 2007, reference should also be made to the proceedings which were resolved in that period. In this respect, the competent bodies (whose competence is legally determined depending on the type of infringement, sanction and institution) resolved a total of 14 proceedings against supervised institutions and 46 proceedings against members of their boards of directors and management. In these resolutions, 12 sanctions were imposed on institutions and 27 on directors for the commission of very serious infringements. 24 sanctions were imposed on institutions and 91 on their directors for serious infringements. 7 sanctions were imposed for minor infringements, in this case only on institutions, since Spanish law does not envisage imposing sanctions on directors for the commission of minor infringements.

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. Thus, it is worth mentioning in the first place the proceedings conducted against 1 bank and 12 directors. In this case there was a very serious infringement regarding the refusal of, or resistance to, inspection activities carried out by the Banco de España and 2 serious infringements regarding the failure to comply with the duty of accuracy when reporting to shareholders, depositors, lenders and the public in general plus the existence of shortfalls in administrative and accounting organisation or in internal control procedures, once the period granted for remedying these shortfalls had elapsed.

PROCEEDINGS RESOLVED, BY TYPE OF INFRINGEMENT

TABLE 2.5

Number

NUMBER OF PROCEEDINGS	SANCTIONING PROCEDURES				OTHER PROCEEDINGS				
	INFRINGEMENT			PROCEEDING DISMISSED	NON-COMPLIANCE WITH ECB MINIMUM RESERVE REQUIREMENTS	RESERVED NAME/ACTIVITY (ARTS. 28-29 LD)	APPRAISAL COMPANY REVOCATIONS (RD 775/97)	UNAUTHORISED CURR. EXCH. BUREAUX	CURR. EXCH. BUREAUX REVOCATIONS
	VERY SERIOUS	SERIOUS	MINOR						
Against institutions									
2004	75	16	73	14	4	2			53
2005	232	5	16	2	3	1	1	1	220
2006	18	13	33	13	5				1
2007	14	12	24	7	1			2	1
Against particular directors of institutions									
2004	70	61	199			1		1	10
2005	87	14	47	2					63
2006	56	39	132	2					
2007	46	27	91	3					

SOURCE: Banco de España.

Similarly, a proceeding was resolved against a branch of an EU credit institution and sanctions were imposed on the branch itself and its general manager for a serious infringement relating to actions or operations breaching the rules issued pursuant to Art. 48.2 of Law 26/1988 on transparency and customer protection. The branch was also sanctioned for 2 minor infringements consisting of less important non-compliances with the regulations governing the Central Credit Register and with accounting rules, respectively.

In the area of specialised credit institutions, which are also classed as credit institutions, one institution and 8 directors were sanctioned for an infringement consisting of acts or operations which breached the rules issued pursuant to Art. 48.2 of Law 26/1988 on transparency and customer protection.

In 2007 the proceedings brought against 2 appraisal companies and their directors were resolved. In both cases the companies and their directors were sanctioned for 2 serious infringements relating, respectively, to the issuance of appraisal certificates and reports which lacked concordance with the data and evidence obtained in the companies' appraisal activity or which departed, without saying so expressly, from the procedures, checks and instructions envisaged in the applicable legislation, and to the failure to report data to the Banco de España. Both appraisal companies were also sanctioned for minor infringements consisting of the breach of regulations governing insurance coverage against liability and shortfalls in internal control mechanisms.

5 proceedings conducted against currency-exchange and cross-border money-transfer bureaux and their directors were resolved. The infringements which were considered very serious refer, in 3 cases, to the keeping of accounting records with fundamental irregularities preventing the establishment's net worth and financial position from being known. In another 5 cases the infringements were considered to be very serious since a serious infringement had been committed and in the previous 5 years a firm sanction had been imposed for the same type of infringement (failure to comply with: minimum capital requirements; regulations on agents;

rules governing the recording of transactions; rules on the transparency of transactions and accounting regulations). In one case a very serious infringement was considered to exist due to the omission of information which must be reported to the Banco de España and whose absence made it difficult to appreciate the bureau's net worth and financial position.

Serious infringements resulted from the failure to comply with: regulations on minimum capital requirements of currency-exchange bureaux (2 cases); the compulsory insurance coverage of liability which might arise from money transfers (4 cases); transaction recording and money transfer obligations (3 cases); regulatory provisions on transparency and the protection of customers (3 cases); and regulations on agents and the exclusivity of accounts for channelling money transfers (one case for each). They also arose due to the performance, other than on an isolated basis, of activities outside the scope of the exclusive corporate purpose (2 cases) and the existence of omissions or inaccuracies in the information which must be reported to the Banco de España (2 cases). Lastly, there was a minor infringement relating to less important breaches of the regulations on agents.

The Banco de España's sanctioning activity also covers those individuals or legal entities which, without having obtained the required authorisation and having been registered in the corresponding registers, pursue activities reserved to credit or other types of institutions which by law require some type of authorisation. Two proceedings of this type were resolved in 2007 against companies which engaged in foreign currency purchase operations without the compulsory authorisation. Both proceedings terminated with the imposition of the respective fines, and requirements letters were sent instructing such companies to cease the unauthorised activity and noting that, if they failed to do so, they could be sanctioned again.

Lastly, the sanctions imposed, which fall within the range available under the disciplinary regulations, mainly include fines. However, sometimes the decision was taken to impose another type of sanction since it was considered more in keeping with the ultimate aim of the exercise of the disciplinary power which, as noted, is not so much the punishment of illicit conduct but rather the protection of the system and the reinstatement of the legal order. Thus, in certain cases it was advisable to opt for sanctions of public reprimand, disqualification from serving as a director and even, on three occasions, it was considered necessary to revoke the authorisation given to three foreign-currency bureaux since it was thought that the seriousness and persistence of the infringements committed made the offenders unsuitable for remaining in the system.

To conclude, during 2007 the Banco de España continued to exercise its sanctioning power within the parameters and trends of previous years, as regards the number of proceedings conducted and resolved in the year and the types of sanctioned institutions. In all cases in which institutions were sanctioned, the individuals in charge of them, i.e. the members of their boards of directors and management, were also sanctioned.

There were no significant changes in the infringements that were found in comparison with previous years. Traditionally, infringements in this specific area of activity are usually grouped into four categories: infringements of rules which protect the solvency of institutions, infringements of rules governing institution-supervisor relations, infringements of rules which protect and encourage suitable internal control and organisational procedures, and infringements which violate the adequate transparency of transactions, customer relations, etc.

As indicated above, there are no significant differences in comparison with the data for previous years or an increase in the seriousness or frequency of any of the infringements.

2.3 Other supervisory activities of the Banco de España

In addition to its powers and activities concerned primarily with the prudential supervision of CIs, the Banco de España is also entrusted with overseeing other aspects of the activity of these institutions. Following is a brief review of those functions along with comments on the most notable matters arising in 2007.

2.3.1 TRANSPARENCY AND INFORMATION FOR BANK CUSTOMERS

a. Fees and commissions

Freedom – practically without exceptions – in setting the prices of bank services entails the obligation to draw up a brochure of fee and commission charges, valuation conditions and chargeable expenses, detailing the maximum amounts applicable, the item to which they relate and terms of their application in the transactions and services which CIs habitually provide. This brochure is to be available at all times to customers and, since 2001, can also be consulted on the Banco de España website.

The Banco de España is responsible for checking and registering the brochure that includes these charges and for checking any changes thereto. These responsibilities are restricted by law to checking that the brochure reflects maximum prices and the conditions governing their application in an orderly, clear and comprehensible fashion. Such checking does not, however, include securities transactions (since they are the competence of the CNMV) unless they relate to the Public Debt Book-Entry Market.

In connection with this process of verification in 2007, the largest number of changes to brochures of fee and commission charges was due to revision of the rates for domestic transfers as a result of the changes made to the National Electronic Clearing System (known by its Spanish acronym "SNCE") in order to bring the Spanish transfers system into line with international banking practices and ensure its readiness for the creation of a single euro payments area (SEPA).¹

Regarding other changes to brochures, as has been the case in recent years, the absence of regulatory changes requiring these brochures of charges to be adjusted by all institutions had the result that they generally relate to increases in the price of services or to the provision of new services. This explains why the number of cases examined decreased for the fifth consecutive year to stand at 1,104.

The number of rejections of CIs' proposals or requests for additional clarification was 519 (acceptances amounted to 368), a figure very similar to the previous year, although the number of recommendations made grew to 1,893.

In 2007 there were 73,168 consultations of brochures of charges on the Banco de España website.

b. Advertising

The function assigned to the Banco de España in this area is the authorisation, prior to publication, of CIs' advertising projects that refer to the cost or return to the public of the services or products offered.

This authorisation, which is unique among our peer countries (where self-regulation usually plays a greater role), is intended to ensure that advertising reflects clearly, accurately and in a manner respectful of competition, the basic features of financial offers, and that the cost or the return offered has been calculated in keeping with the rules regulating the annual percentage rate (APR). This measure seeks to harmonise that calculation so as to ensure that different offers can be compared.

1. For more details, see the 2006 Report on Banking Supervision in Spain.

As has been happening for several years, the number of advertising projects subject to authorisation continued to increase. The growth in 2007 with respect to 2006 was 6.4%² and practically all of it came from campaigns to attract deposits, as compared with the unchanged number of lending campaigns.

The number of rejections was minimal (2), although this figure requires comment, since it should be taken into account that the number of withdrawals amounts to 208. These are projects dropped by the credit institution itself before reaching fruition because of the changes requested by the Banco de España.

As regards the media, there was a further fall in advertising in the print media (to 1,181 projects, practically the same as in 2004) and a reversal of the growth trend in television advertising³, which also fell back to figures similar to those of 2004. This decline was offset by the considerable increase in Internet projects⁴ (included under the "Other" heading), which now account for 15% of the total projects authorised.

c. Reporting of interest rates on lending transactions

Spanish commercial banks, savings banks and credit co-operatives and the branches of foreign CIs are obliged to disclose a number of interest rates on their lending transactions. These are their prime rate, the respective rates on current-account and credit-account overdrafts, the latter two applicable at the maximum rate unless lower rates are contractually envisaged, and the indicative reference rates relating to other financial facilities deemed most habitual or representative. In turn, institutions should report such rates, and changes therein, to the Banco de España, indicating the dates from which they will be applicable. The Banco de España publishes these rates on its website so that they may be freely consulted by analysts and customers.

There were 292 reportings in 2007 (against 174 in 2006). This increase was mainly due to changes in the legal rate of interest for 2007 (it went from 4% in 2005 and 2006 to 5%), which obliged institutions to change the interest rates reported by them, since the maximum APR applicable to consumers' overdrafts is 2.5 times the legal rate of interest.

In 2007 there were 21,847 visits to the Banco de España web pages where these rates are published.

d. The bank customer's portal

The bank customer's portal was created in February 2005 by the Banco de España on its Internet website to provide information and financial guidance to non-business customers of credit institutions.

In the second half of April 2007, a new version of the bank customer's portal was made available to the public. It contained significant improvements, including most notably:

- graphic design and architecture
- a new visual language

2. In the version of this Report published on the Banco de España website, Table A 5.1 of Annex 5 gives statistical information relating to transparency and information for bank customers. 3. Only advertising referring to yield or cost is subject to prior authorisation by the Banco de España; in the absence of such references, this requirement does not apply. 4. Not all the information that appears on institutions' websites concerning the specific characteristics of their products or services should be classified as advertising (and, where applicable, subject to prior authorisation by the Banco de España), either because access to it will necessarily have to be at the initiative of customers, and consequently making such information available to them cannot be considered an act of advertising, or because of its strictly informative nature.

- specific messages created for each section seek to draw the attention of customers
- the portal contents have been revamped to make them more accessible to citizens in respect of their order and the language used
- the portal contents have been broadened by the incorporation of examples and new simulators

Portal page viewings numbered practically two million in 2007, with a daily average of 5,400. The number of visitors was 278,000, each making an average of 1.9 visits. The average number of pages viewed per visit was 3.75.

The most frequently visited sections in 2007, which were very similar to those visited in 2006, were: banking products (23.95% of total visits), interest rates (10.84%), simulators (10.20%) and glossary (5.96%).

Also noteworthy is the number of queries received through the Portal's "Contact Us" facility, which in 2007 amounted to 1,379 questions addressed specifically to the portal, practically all answered in the same day. The number of telephone inquires was 1,887.

e. Customer service department

Spanish credit institutions and the branches of foreign institutions are obliged to have a Customer Service Department and, where applicable, also an ombudsman (requirements established by Ministerial Order ECO/734/2004, of 11 March 2004). The Banco de España is responsible for verifying the customer protection rules regulating the activity of the Customer Service Department and ombudsman, except in the case of savings banks and local and regional credit co-operatives, the verification of which is carried out by the competent body of the Regional (Autonomous) Community in which their registered office is located. In any event, the Banco de España must be informed of the designation of the head of this service or department and, where applicable, of the ombudsman.

The task of initial verification of these rules was practically completed in 2006. Hence the work in 2007 consisted of checking the rules of institutions newly registered in that year and the changes proposed to existing rules.

2.3.2 OFFICIAL REGISTERS AND INSTITUTIONAL INFORMATION

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

a. Register of Institutions

The purpose of this register, in which certain institutions must be recorded before they commence activities, is twofold: first, it seeks to implement the "vetted access" principle governing the presence of various institutions operating on Spain's financial markets; and second, it aims to publicise the fact that those institutions are subject to supervision by the Banco de España.⁵

Table 2.6, which this year includes for the first time a new type of institution, namely the controlling companies of CIs, lists the number of institutions subject to supervision by the

⁵ 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, where they are located in the section on banking supervision. The register of institutions is available not only as it currently stands, but as it stood at past dates, and selective searches can be made on the basis of different criteria.

Number. Year-end data (a)

	2004	2005	2006	2007
Institutions with an establishment	547	542	550	558
Credit institutions	348	350	355	358
Representative offices	56	53	54	57
Mutual guarantee companies	23	23	24	24
Reguarantee companies	1	1	1	1
Currency-exchange bureaux and money transfer agencies (b)	58	57	59	59
Appraisal companies	61	58	56	57
Controlling companies of credit institutions	—	—	1	2
Credit institutions operating without establishment	355	383	404	433
Of which: EU CIs operating without an establishment	350	378	398	428
Of which: financial subsidiaries of EU CIs	3	3	3	2

SOURCE: Banco de España. Data available at 31 December 2007.

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

b. Does not include foreign currency purchasing establishments.

Banco de España and entered in the corresponding registers,⁶ as well as the number of institutions from other EU countries that operate in Spain under the freedom to provide services.

The total additions registered in 2007 numbered 28, as against 20 deletions. Within the additions, the branches of EU institutions and representative offices, which make up 50% and 29% of the total, are those showing the greatest changes. In regard to deletions, SCIs, with 35% of the total, accounted for the largest number of entries, followed by deposit institutions and representative offices, with 24% each.

There were two main reasons for these entries: first, for additions, the transnational movements typical of the single market; and second, for deletions, a series of corporate movements mostly aimed at business restructuring, mainly, although not only, effected in the EU.

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 data 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 accrediting the commercial and professional experience and standing required of the senior officers of financial institutions; and, secondly, acting as a specific instrument for checking the restrictions and incompatibilities applicable to senior officers of banks and credit co-operatives which the Banco de España has to supervise in regard to the holding of similar posts in other companies.

6. 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.

The steadiness shown by the total number of senior officers entered in the related registers⁷ reflects the minimal alterations in the number of institutions. The only noteworthy development is the slow but constant increase in the percentage of women recorded in the registers of senior officers with respect to the total individuals registered, which nevertheless at end-2007 scarcely amounted to 11%.

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 co-operatives,⁸ for the dual purpose of supporting the basic supervisory tasks of the Banco de España, in which it is essential for the latter to know the share ownership structure of the institutions under its supervision, and of checking compliance with the legal provisions which bring under control of the Banco de España any equity holdings in these institutions exceeding certain thresholds.

The fall of 4% in the number of shareholders reported by banks was similar to that of previous years. This fall, which was sharper in individual shareholders, follows the usual pattern in shareholders of this type of institution. More significant was the increase in the number of credit co-operative members, which grew by 15% mainly as a result of the respective capital increases at two credit co-operatives. Meanwhile, the number of reported shareholders of SCIs, many of which form part of larger credit groups, remained steady.

d. Reporting of agents

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

In 2007 the number of registered agents of owners of currency-exchange bureaux licensed to make transfers kept up the notable pace of growth shown in previous years (around 30%), related above all to the growth of immigration. However, it should be taken into account that 43% of agents work for only three bureaux.

The increase in agents of CIs in 2007 was 6%. Of the total CI agents, 96% worked for banks. The concentration in the case of CIs is, if anything, greater than for currency-exchange bureaux, since four banks retain 83% of all agents.

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

The Banco de España also keeps a register of articles of association of supervised institutions in which the successive amendments are recorded to ensure continuity in the exercise of prudential control over supervised institutions.

On occasions, these amendments are subject to administrative authorisation by the Ministry of Economy and Finance, or the corresponding body of the regional (autonomous) government, in which case a prior report from the Banco de España is mandatory. In 2007 there were

7. All the statistical information in this section other than that relating to the number of registered institutions is included in Table A 5.2 of Annex 5 of the version published on the Banco de España website. 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. 8. 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 greater than or equal to 0.25% in the case of commercial banks, 1% in credit co-operatives and 2.5% in SCIs.

37 applications to amend articles of association, the primary cause of which was the adaptation to changes in the regulations. The notable decrease in the number of amendments processed in 2007 reflects the end of the adaptation of articles of association of Spain-wide credit co-operatives to the changes in their regulations, particularly in those on equity contributions.

2.3.3 OTHER AUTHORISED
ELIGIBLE CAPITAL FOR SOLVENCY
PURPOSES

The capital instruments eligible as own funds include, along with the subordinated debt recognised as own funds in 1985, other elements known as hybrids which simultaneously have the characteristics of debt and capital. These characteristics are basically that they can be set off against losses without the need to liquidate the institution, that they will remain on the institution's balance sheet for an indefinite period of time and that the returns on them depend on the existence of sufficient profits and on the issuer's solvency. These instruments include perpetual subordinated debt and preference shares, in many cases issued by special-purpose entities that are subsidiaries of CIs.

There are no restrictions on the issuance of such instruments, which is subject to the securities market regulations and, in the case of preference shares, to the provisions of Law 13/1985, as reworded under Law 19/2003 of 4 July. Also, as a prerequisite for their eligibility as own funds of the issuing institution or of its consolidated group⁹, the Banco de España must verify that these instruments meet the conditions established by bank solvency law.

To correctly analyse eligible debt issued in 2007, the issuance of securities by Banco Santander in the acquisition (together with the Belgian-Dutch Fortis Group and the British Royal Bank of Scotland) of the Dutch bank ABN Amro, NV should be considered in particular. This issue, which amounted to €7,000 million and was distributed among retail investors, has special characteristics, which, for equity classification purposes, exceeded those required for it to be classed as preference shares.

If this issue is disregarded (it has been excluded from subsequent comments), the resulting figures are more in line with those of previous years. Thus, in overall terms, the total issued in 2007 was €14,592 million, just under 9% less than the previous year. This decline was more pronounced in fixed-maturity subordinated debt where it reached 18%, which, given its higher relative share in nominal terms, could not be offset by the 23% rise in undefined-maturity and preference share issues.

However, the fall in the total number of issues, solely attributable to the fixed-maturity subordinated debt of savings banks, was even higher at 25% and, as a result, the average amount of all types of issues increased by about 20% (55% in undefined-maturity subordinated debt, although the low number of this type of issues diminishes the analytical value of this figure).

The higher average amount of issues could be explained by the growing international importance of the special-purpose entities of Spanish CIs. 84% of the amount was issued exclusively abroad and only 7% was placed solely in Spain. Furthermore, nearly all of the issues (96% in terms of the amount issued) were targeted exclusively at institutional or qualified investors. In this way the trend which began last year of avoiding the distribution of these complex instruments among retail customers was consolidated.

9. See Rule 8 of Banco de España Circular CBE 5/1993 of 23 March 1993 on the determination and monitoring of minimum own funds.

€m. Yearly data

	NUMBER				AMOUNT			
	2004	2005	2006	2007	2004	2005	2006	2007
TOTAL	70	63	79	60	13,230	8,471	16,078	21,592
Subordinated debt	49	51	65	45	6,654	5,587	13,942	11,962
<i>Fixed-term</i>	46	48	60	41	5,104	5,222	12,728	10,458
Banks	16	11	24	29	3,795	1,865	8,853	9,189
Savings banks	19	28	25	9	1,235	2,870	3,724	1,224
Credit co-operatives	2	3	3	3	24	403	23	45
SCIs	9	6	8	—	50	85	128	—
<i>Of which:</i>								
<i>Loans</i>	15	9	12	4	704	202	297	420
Undated	3	3	5	4	1,550	365	1,214	1,504
Banks	2	1	2	1	1,050	15	64	1,019
Savings banks	1	2	3	3	500	350	1,150	485
Preference shares	21	12	14	15	6,576	2,884	2,136	9,630
Banks	14	3	6	7	5,063	1,800	1,602	9,239
Savings banks	7	8	8	7	1,513	995	534	389

SOURCE: Banco de España.

A noteworthy feature, yet not a new one, which was particularly significant in 2007, was the classification as own funds of several issues by foreign institutions which are the operating subsidiaries of Spanish CIs. These issues, which accounted for 8% of the total issued¹⁰, are subject to specific own funds requirements in their country of origin and are eligible as capital of the consolidated group provided that they do not give rise to significant excesses in the issuer's solvency ratio.

In 2007 the standard issue was a euro-denominated fixed-maturity subordinated debt issue with variable-rate interest, mainly tied to the 3-month euribor, with a spread of less than 50 basis points in the first part of the year and clearly more than 100 basis points at the end of the year¹¹; a maturity of around ten years with an early redemption option from year 5, following authorisation from the supervisor; and an interest rate step-up of 50 basis points in anticipation of non-exercise of the option.

Preference share issues were more varied, even though the currency they were issued in was predominantly the dollar and they were mainly tied to the euribor, with spreads which, like subordinated debt, increased by more than 50% at year-end. Although they did not have a specific maturity, all the issues envisaged the possibility of early redemption, following authorisation from the supervisor, mainly from year 10, together with an interest rate step-up of 100 basis points in anticipation of non-exercise of the option. Noteworthy among these issues was the first issue by a specialised credit institution, although it was for a small amount.

¹⁰. In 2007 more issues by operating subsidiaries were eligible as capital but such issues are not shown in Table 2.7 because they were placed in previous years. ¹¹. As a result of capital market turbulence in the second half of the year.

Finally, as in previous years, in 2007 there were no issues of non-voting equity units (*cuotas participativas*) of savings banks.

2.4 Supervisory policies

2.4.1 THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT CREDIT INSTITUTIONS

Article 6.4 of Law 13/1985 on investment ratios, own funds and reporting requirements of financial intermediaries, as reworded under Law 36/2007 enacted to transpose Directive 2006/48/EC of the European Parliament and Council into Spanish law, requires credit institutions to have sound, effective and exhaustive strategies and procedures to evaluate and maintain on a permanent basis the amounts, types and distribution of capital which they or their consolidated groups deem necessary. These strategies and procedures require the consideration not only of quantitative aspects of risk management, such as risk measurement and estimating capital requirements, but also qualitative aspects such as internal governance procedures.

The new Article 10.bis.1 of the above-mentioned Law authorises the Banco de España, as the authority responsible for the supervision of credit institutions and their consolidated groups, to publish guides indicating criteria, practices or procedures for adequate risk assessment.

For this purpose, the Banco de España has prepared a Guide on the Internal Capital Adequacy Assessment Process (ICAAP) of credit institutions and their groups which implements the above-mentioned Article 6.4 of Law 13/1985 and Article 30.bis.1 of Law 26/1988 on Discipline and Intervention of Credit Institutions, which refers to internal corporate governance. The Guide is based on the principles and the criteria developed by the Committee of European Banking Supervisors (CEBS) in its document "Guidelines on the Application of the Supervisory Review Process under Pillar 2" and other guides on Pillar 2 prepared by the CEBS and the Basel Committee.

The aim pursued by the Banco de España with the ICAAP Guide was to set out a series of guidelines on aspects to be considered by institutions when assessing their capital adequacy, always bearing in mind the need to simplify the task for smaller institutions. This is why the Guide establishes simple calculation and estimation methods.

The ICAAP will be based on analysis of the risks that institutions use in their management, although at the same time it must be a useful instrument for the general evaluation of their solvency which also takes into account how capital is affected by the economic cycle and external conjunctural factors. The ICAAP is the responsibility of the institutions themselves and, consequently, they must determine its content and scope and the depth of analysis, focusing on the risks relevant to them and on organisational and control-related matters, all in proportion with the level of sophistication of their assessment, their risk profile and the suitability of their risk assessment, management and control systems. The result of the ICAAP must be compared with the legal minimum capital requirements, although it will not necessarily result in increased capital requirements, but rather in internal governance improvements, the strengthening of risk management systems or tighter internal controls.

The Banco de España requires the ICAAP to take the form of an annual report called the Internal Capital Adequacy Assessment Report (ICAAR), which is approved by the institution's directors and sent to the Banco de España together with the own funds return at year-end. This report will include the following sections:

- 1 Summary and conclusions: scope of application, individuals responsible for or in charge of preparing the report (who will act as interlocutors with the Banco de España), date of approval by the Board of Directors or equivalent body; conclu-

sions on the institution's risk profile, systems of governance and risk management and control; and economic capital targets, detailing the level, breakdown and distribution between legally independent institutions in the group and the level of compliance with projections and corrective measures.

- 2 Internal governance, risk management and internal risk audit: general principles of risk management at the institution; indication of the policies established for each risk, organisation of the risk function and the measurement, communication, control and valuation tools; and risk-review related tasks of the internal audit.
- 3 Risk measurement and quantification of capital required to cover risks: summary of the methodologies chosen for the different risks (credit risk, concentration risk, market risk, operational risk, on-balance-sheet interest-rate risk and liquidity risk, among others); references to internal documents substantiating them; details of the risk mitigation techniques used; explanation of relevant factors not considered under Pillar 1; etc.
- 4 Aggregation of the capital requirements of the various risks and reconciliation adjustments: approach used (bottom-up or top-down), benefits of diversification, reconciliation adjustments of management and solvency approaches, etc.
- 5 Capital planning: analysis of divergences in the year with respect to the previous year's planning, (projected) sources and future allocation of capital and summary of the stress scenarios determined and of alternative sources of capital (with the due references to internal supporting documents).
- 6 Future action programme: principal deficiencies and shortfalls detected, action plan (if appropriate) and changes envisaged in risk management strategy.
- 7 Other matters.

The Banco de España will review and evaluate the ICAAP and the internal governance environment under the "risk-based approach" to banking supervision (SABER) which it employs in its supervision of groups and banking institutions. Within the supervisory transparency framework established in the new Article 10.bis.1.d of Law 13/1985, in the near future the Banco de España will publish a guide on the Capital Review Process (CRP), in which it will point out the methods which it will follow in reviewing and evaluating the ICAAP.

2.4.2 VALIDATION CRITERIA AND DOCUMENTS OF BASEL II ADVANCED APPROACHES

As a means of developing the transparency framework for reviewing risk management models, which the Banco de España initiated in June 2006 with the publication of the document entitled "Implementation and validation of Basel II advanced approaches in Spain", and in accordance with the guidelines established by the CEBS, it was considered necessary to start issuing specific documents to clarify and harmonise certain minimum criteria which relate to the salient issues of the advanced models and whose dissemination among institutions and quantitative and qualitative impact are of special significance.

For this purpose, the Banco de España website (*Supervision* section, *Supervisory functions and policy – Implementation and validation of advanced models* subsection) has begun to publish a set of Validation Documents which gather together in a consistent and ordered fashion certain validation criteria focused on specific issues. These documents take into account

technical and practical matters arising from the validation work and the institutions' opinions and suggestions.

These documents are organised as follows. A first section describes the situation analysed, the main reasons for the observed problems and the implications for validation. A second section focuses on the specific purpose of the validation criteria issued and their scope. Finally, the main part of the document is basically devoted to stating and explaining validation criteria in a sufficiently detailed manner to achieve the clarification and harmonisation objectives of the document. Examples and descriptions of institutions' practices are included to help understand certain of the criteria proposed.

The first of these documents is on downturn loss given default (DLGD) estimates in mortgage loan portfolios in Spain and also covers related issues. The purpose of the criteria specified in this document is to achieve a certain degree of harmonisation in the approaches used by the various institutions, to provide references and default options which that can be used in internal estimation processes, in those cases in which institutions cannot directly obtain reliable internal estimates of the required parameters.

The second document looks at institutions' internal validation of advanced risk-management models. It aims to define the internal validation function, its purpose and the scope of the tasks to be carried out. It points out that it is advisable for a specific unit, which meets certain requirements as to competence, independence and reporting level, to be responsible for performance of the internal validation function. Lastly, it defines what schemes are acceptable in the design and implementation of internal validation tests, as well as distinguishing between the internal validation and the internal audit functions.