

2 EXERCISE OF SUPERVISORY FUNCTIONS

2 Exercise of supervisory functions

The sections of this chapter are as follows. First, an account is given of the supervisory action taken, indicating the supervised institutions, the on-site inspections made and the requirements and recommendations letters sent to institutions as a result of such action. The second section explains what was involved in the exercise of sanctioning powers in 2008 and states the number of proceedings initiated and resolved for each type of infringement. Third, reference is made to the Banco de España's other responsibilities complementing its supervisory functions (e.g. those relating to regulations governing the transparency of banking transactions or to the keeping of official registers). The fourth and last section of this chapter explains succinctly the Banco de España's system of continuous supervision.

2.1 Supervisory activity

At 31 December 2008, the Banco de España had under its supervision a total of 505 institutions of a diverse nature, of which 361 were credit institutions.

The Banco de España's supervision consists of continuous monitoring and analysis of their situation, supported by a programme of information checks conducted via on-site inspections (see Section 2.4). In 2008 it made 166 inspection visits, of which 48 were under way at 31 December 2008, 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 more 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 accounts, etc.).

The decline in the figures in Table 2.1 reflects the changes the Banco de España is making in how it conducts the continuous supervision of institutions, with a view to achieving more intense and efficient supervision. Traditional on-site inspection, the only activity reflected in the statistics of the above table, is being increasingly complemented by very intense and close continuous monitoring. This has been favoured by the off-site availability of regular information and of increasingly extensive and better quality management, as well as closer interaction with supervised institutions. These developments have enabled analysis and monitoring activities to be broadened to obtain a better and more continuous and up-to-date knowledge of institutions' risk profiles. Also, the review type known as "on-site continuous monitoring", which entails the permanent presence at institutions of inspection staff combining analysis and verification tasks and was put into practice by the Banco de España to meet supervision needs at the two large banking groups, has recently been extended to other institutions whose size and complexity call for such monitoring. Continuous monitoring, whether on-site or off-site, now accounts for a significant proportion of the available supervisory resources, although it is not reflected in statistics on inspection visits.

In regard to 2008 in particular, most supervisory activity was influenced by the crisis which began in summer 2007. Hence inspection visits have looked more carefully at the matters that are most crucial in properly assessing the position of institutions in the current economic context. This has led to a comprehensive review of loan and mortgage foreclosure portfolios, with the related impact on the duration of inspections. Particular attention was also paid to analys-

Number

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

SOURCE: Banco de España.

ing and assessing the liquidity risk of credit institutions, their risk measurement and control systems, their capacity to generate earnings and their solvency.

The validation of internal models designed to calculate regulatory capital for credit risk was completed, and eight groups of Spanish credit institutions were authorised to use, for regulatory purposes, internal ratings based (IRB) approaches once Circular 3/2008 on the determination and control of minimum own funds was published. The validation process included systematic review of methodologies and documentation, databases, quantitative and qualitative procedures and the technological environment, as well as assessment of the degree of implementation and effective use of advanced management systems and of the existence of an appropriate control environment (including the role of the validation and internal audit functions) in order to ensure the appropriate functioning and maintenance of the models in the future. Additionally, three exercises were conducted to analyse the quantitative impact of IRB approaches on solvency levels and, in regard to operational risk, guidelines were published on the application of the standardised approach to determine regulatory capital for this risk.

To carry out its monitoring and analysis activities and on-site inspections, the Banco de España's Directorate General Banking Supervision had a staff of 431 as at end-2008, as detailed in Table A.1.4. An increasingly significant and growing part of this staff (around 20% on overall estimates) do not work directly on the continuous supervision of institutions, but rather engage in internal advisory tasks, supervisory policy design, definition of methodology and procedures, and participation in international fora, etc.

As a result of the knowledge acquired by it in the continuous 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 disciplinary proceedings against institutions and their boards of directors and management; and iv) interven-

SUPERVISORY ACTIVITY

TABLE 2.2

Number

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

SOURCE: Banco de España.

tion or director-replacement measures. In 2008 it was not necessary to take any precautionary intervention or director-replacement 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 2008, the Banco de España sent 77 recommendation and requirement letters to credit and other institutions supervised by it, either as final addressees or as the heads of consolidated groups. The distribution of these letters is given in Table 2.2.

The 77 letters to supervised institutions contained a total of 357 remarks or observations on the matters set out in Table 2.3.

As usual, the main matter addressed in recommendations was the accounting for and control of credit risk with around 50% of the total. In 2008, the Banco de España continued to require adequate provisioning for the less solvent obligors and improvements in the quality of controls over the origination and monitoring of loans.

The second most common matter, with 59 recommendations, was the internal control of institutions, which broadly encompasses the need for institutions appropriately to manage all their risks and improve their internal control procedures. Finally, the strict monitoring of compliance with solvency rules gave rise to 23 requirements and recommendations, and this issue thus ranked third by number of requirements, in a year in which, as mentioned above, the new solvency regulations (Basel II) came into force.

SUBJECT MATTER OF LETTERS SENT TO SUPERVISED INSTITUTIONS

TABLE 2.3

Number

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

SOURCE: Banco de España.

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 other financial supervision authorities in Spain and to the supervisory authorities of the foreign parents of Spanish credit institutions, within the framework of current legislation and of the Banco de España's cooperation agreements.

In the field of supervisory cooperation, 2008 saw continued fluid cooperation with European, Latin American and North American supervisors. Noteworthy in Europe was the work carried out with the UK host supervisor (United Kingdom Financial Services Authority) and the Portuguese supervisor (Banco de Portugal), while in Latin America mention should be made of the validation work in coordination with the Mexican supervisor (Comisión Nacional Bancaria y de Valores). Also, within the framework of European cooperation, the Banco de España participated in a CEBS project in which international teams of supervisors reviewed the economic capital models of a number of international banks, including a Spanish banking group.

In regard to "colleges of supervisors", understood as permanent, albeit flexible, fora for cooperation and coordination between the authorities responsible for supervising the members of international banking groups, in the last quarter of 2008 the Banco de España organised the respective meetings relating to two Spanish banking groups. These meetings were attended by representatives of the supervisory authorities of Germany, Argentina, Brazil, Chile, United States, Italy, Mexico, Norway, Panama, Paraguay, Peru, Poland, Portugal, United Kingdom, Switzerland, Uruguay and Venezuela, and by managers of these banking groups. The basic aim of these meetings was to exchange information on the risk profile of these banking groups, share the supervisory approach adopted in each country and become apprised of the supervision plans envisaged for these banking groups in 2009. Additionally, these meetings also seek to strengthen the ongoing multilateral and bilateral communication and cooperation between the various supervisors. Fur-

thermore, as the host supervisor of foreign banks, in 2008 the Banco de España attended various meetings of “colleges” in countries such as Germany, United States and France, and participated in an internal college of US supervisors on subsidiaries of a Spanish banking group and in another college in Holland relating to the acquisition of a banking group in that country.

Lastly, the Banco de España entered into four new cooperation agreements: with SEPBLAC (to replace the agreement of June 2005), with the financial supervisory authorities, central banks and finance ministries of the EU, with the Commissioner of Financial Institutions of Puerto Rico and with four supervisory authorities of the United States (Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Office of Thrift Supervision).

2.2 Exercise of the sanctioning power

The sanctioning power exercised over the financial institutions and markets 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 pointed out 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 stipulated conditions of access, whether it be through the exercise of activities legally restricted to duly registered institutions or through the use of generic names restricted to credit institutions or of any 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 2008

In 2008, in view of the matters disclosed during on-site inspections by the Banco de España and of other circumstances, it was decided to initiate 14 disciplinary proceedings.

Classified by type of supervised institution, the proceedings initiated in 2008 by the Banco de España were as follows: three were brought against licensed appraisal companies and 10 against their directors and managers; six were brought against currency-exchange and mon-

Number

INSTITUTIONS	2005	2006	2007	2008
Banks	1	1	1(a)	—
Branch of EU foreign credit institutions	—	1	—	—
Savings banks	1	—	—	—
Owner of significant holdings in credit institutions	—	—	—	1
Non-compliance with ECB minimum reserve requirements	3	5	2	2
Use of names or pursuit of activities reserved for credit institutions	—	—	—	1
SCIs	—	1	—	—
Appraisal companies	5	2	2	3
Appraisal company revocation	1	—	—	—
Currency-exchange bureaux and money transfer agencies	5	5	6	6
Unauthorised currency-exchange bureaux	—	2	—	1
Currency-exchange bureaux revocations	163	1	1	3
Total	179	18	12	17

SOURCE: Banco de España.

a. Agreement on lifting suspension.

ey-transfer bureaux and 23 against their senior officers; one was brought against a natural person and a legal person for the presumed acquisition of significant holdings in the capital of a specialised credit institution without having previously informed the Banco de España; one against a company and its sole director for engaging in activities restricted to credit institutions; and one against an entity which was engaging in the activity of cross-border money transfers without the required authorisation.

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. Two of the proceedings initiated in 2008 were of this nature.

Lastly, mention must be made of the three proceedings initiated to withdraw authorisation of the respective currency-exchange bureaux due to them having relinquished such authorisation, since they had requested deregistration from the register of owners of currency-exchange and/or money-transfer bureaux. 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 and market oversight powers, since these proceedings provide a form of control over supervised institutions insofar as these can be prevented from forming part of the system if they give cause for revocation of their authorisation under existing regulations.

The foregoing figures are not particularly different from those of previous years in regard to the number of proceedings and the types of supervised institutions sanctioned by the Banco de España, although notably the institutions against which proceedings were brought in 2008 include some which had already been sanctioned in the past for failing to comply with organisational and disciplinary regulations. Repeat infringements are considered particularly undesirable in a regulated sector such as the financial market, where con-

fidence in the lawfulness of the relationships established in that market is vital for it to function properly.

2.2.2 PROCEEDINGS RESOLVED IN 2008

Together with the data on the number of proceedings initiated in 2008, reference should also be made to those resolved in that period. In this respect, the competent bodies resolved in 2008 disciplinary proceedings against nine supervised institutions and 42 members of their boards of directors and management. In these resolutions, 12 sanctions were imposed on institutions and 26 on directors or managers for the commission of very serious infringements. Twenty-six sanctions were imposed on institutions and 87 on their senior officers for serious infringements. Six sanctions were imposed for minor infringements, in this case only on institutions, since Spanish law does not envisage imposing sanctions on directors or managers for the commission of minor infringements.

Also resolved in 2008 were three proceedings against the respective credit institutions for non-compliance with the minimum reserve ratio. As mentioned above, proceedings of this type are brought and resolved by the European Central Bank, and are heard by the Banco de España.

Lastly, one proceeding for the pursuit of activities restricted to credit institutions, brought against a company and its sole director, was resolved in 2008, with only the latter being sanctioned.

Along with the information on sanctioning activity in the strict sense, we also report here the resolution in 2008 of three proceedings to withdraw authorisation to carry on the professional activity of foreign currency exchange in establishments open to the public, as a consequence of the application by the bureaux themselves for deregistration from the official register.

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.

Credit institutions

First, mention should be made of the proceeding conducted against 1 bank and 16 individuals formerly holding directorships or management positions in the institution. In this proceeding a serious infringement was found to have been committed relating to non-compliance with rules on accounting and on preparation of balance sheets and income and other financial statements that have to be reported to the competent administrative authority.

Three infringements consisting of non-compliance with the obligation of credit institutions to maintain a certain level of minimum reserves established by the Governing Council of the European Central Bank in accordance with Article 19 of the Statute of the European System of Central Banks and of the European Central Bank, were found to have been committed in the appropriate proceedings brought and resolved by the European Central Bank, which were heard by the Banco de España.

Appraisal companies

In regard to disciplinary proceedings against institutions supervised by the Banco de España other than credit institutions, the proceeding conducted against one appraisal company and its five directors was resolved in 2008. A sanction was issued for a very serious infringement due to non-compliance with the authorisation requirement of having the organisational and internal control resources necessary to carry on the activity of appraisal. In the same proceeding sanctions were also imposed for serious infringements relating, respectively, to the issuance of appraisal certificates and reports which lacked concordance with the data and evidence obtained in the company's appraisal activity or which departed, without saying so

PROCEEDINGS RESOLVED, BY TYPE OF INFRINGEMENT

TABLE 2.5

Number

NUMBER OF PROCEEDINGS	SANCTIONING PROCEDURES				OTHER PROCEEDINGS					
	INFRINGEMENT			PROCEEDING DISMISSED	NON-COMPLIANCE WITH ECB MINIMUM RESERVE REQUIREMENTS	RESERVED NAME/ACTIVITY (ARTS. 28-29 LDI)	APPRAISAL COMPANY REVOCATIONS (RD 775/97)	UNAUTHORISED CURR. EXCH. BUREAUX	CURR. EXCH. BUREAUX REVOCATIONS	
	VERY SERIOUS	SERIOUS	MINOR							
Against institutions										
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
2008	16	12	26	6	1	3	1	—	—	3
Against particular directors of institutions										
2005	87	14	47	—	2	—	—	—	—	63
2006	56	39	132	—	2	—	—	—	—	—
2007	46	27	91	—	3	—	—	—	—	—
2008	43	26	87	—	8	—	1	—	—	—

SOURCE: Banco de España.

expressly, from the procedures, checks and instructions envisaged in the applicable legislation, and to the failure to report data to the Banco de España. A third infringement consisted of non-compliance with the requirement to have liability insurance meeting certain conditions to which institutions of this type are subject under the applicable sectoral regulations. This conduct (which, in isolation, could be considered to constitute a minor infraction) was, however, regarded as serious because it was a repeat offence, since the institution had been sanctioned for the same type of infringement in the preceding five years.

Currency-exchange and money-transfer bureaux

Proceedings against seven currency-exchange and cross-border money-transfer bureaux and their directors and managers (21 in total) were resolved in 2008. The infringements which were considered very serious refer, in two cases, to the keeping of accounting records with fundamental irregularities preventing the establishment's net worth and financial position from being known. In another eight cases the infringements were considered to be very serious since a serious infringement had been committed and in the previous five years a firm sanction had been imposed for the same type of infringement (failure to comply with: current rules on accounting and on preparation of financial statements that have to be reported to the competent administrative authority; the requirement of exclusivity in the use of bank accounts through which money transfers are made; the rules regulating insurance against liability; regulations on agents; and rules on the transparency of transactions and the recording of transactions). 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 (six cases); rules on accounting and on preparation of balance sheets and income and other financial statements that have to be reported to the competent administrative authority (one case); the compulsory insurance coverage of liability which might arise from money transfers (4 cases); transaction recording and money

transfer obligations (four cases); regulatory provisions on transparency and the protection of customers (three cases); the existence of omissions or inaccuracies in the information which must be reported to the Banco de España (three cases); and the requirement of exclusivity in the use of bank accounts through which money transfers are made (two cases). Also considered a serious infraction was the isolated non-compliance with regulatory provisions on transparency and the protection of customers, since the institution had been sanctioned for the same infraction in the preceding two years.

Finally, there were four minor infringements relating, respectively, to isolated non-compliance with regulations on agents; to transparency and the protection of customers; to the performance, on an isolated basis, of activities outside the scope of the exclusive corporate purpose; and to the failure to comply with the required timely remittance of certain documentation to the Banco de España.

Pursuit of activities reserved to supervised institutions

As noted above, the Banco de España's sanctioning activity also covers those individuals or legal entities which, without having obtained the required authorisation and having been registered in the corresponding registers, pursue activities reserved to credit institutions. One proceeding of this type was resolved in 2008. It was brought against a company and its sole director for the taking of repayable funds from the public in the form of loans and resulted in the sole director being fined. He was also sent a requirements letter instructing him to cease the unauthorised activity and noting that, if he failed to do so, he could be sanctioned again. This practice is considered particularly culpable because it directly affects not only the public's trust in the financial system, the proper functioning of which is altered by the unauthorised activity of the offender, but also the interests of the owners of the funds contributed, who assume the risk of loss in the event of insolvency of the recipients of the funds.

2.2.3 SANCTIONS AND CONCLUSION

Lastly, the sanctions imposed in 2008, which fall within the range available under the disciplinary regulations, consisted mainly of 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 unauthorised conduct but rather the protection of the system, the prevention of future non-compliance and the reinstatement of the legal order. Thus, in certain cases it was deemed advisable to opt for sanctions of public reprimand, disqualification from serving as a senior officer 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.

As a conclusion to what has been said above, it can be said that in 2008 the Banco de España continued to exercise its sanctioning power broadly within the parameters and trends of previous years, as regards the number of proceedings conducted and resolved and the types of sanctioned institutions. In this respect, it should be noted that in all disciplinary proceedings 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 responsibility in the commission of these infringements was proven.

There were no significant changes in the infringements found and sanctions imposed in comparison with previous years, nor were significant changes noted with respect to previous years. The only noticeable difference was the higher frequency of repeat infringements, which are deemed to be more serious than first-time offences.

2.3 Other supervisory activities of the Banco de España

2.3.1 TRANSPARENCY AND INFORMATION FOR BANK CUSTOMERS

The Banco de España is also entrusted with overseeing other aspects of the activity of CIs. Following is a brief review of those functions along with comments on the most notable matters arising in 2008.

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

In 2008 the largest number of changes to brochures of fee and commission charges was aimed at incorporating in them the provisions of Law 41/2007, amending Law 2/1981 of 25 March 1981, on mortgage market regulation and other mortgage and financial system regulations. Among other things, Law 41/2007 amended the regime applicable to early repayment of mortgage loans taken out since its entry into force, when the borrower is an individual and the mortgage is on a house. This regime also applies to transactions of this nature in which the borrower is a legal entity taxed under the small-companies regime.

The other changes to brochures relate, as usual, to alterations in the prices of bank services and to the inclusion of new services.

The proposals processed in 2008 numbered 1,205, compared with 1,104 in the previous year. This broke the downward trend of recent years in which there had not been any regulatory changes requiring adjustments to the brochure of fee and commission charges.

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

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

In 2008 the number of applications for authorisation of advertising projects was practically unchanged from the previous year (6,525 applications, against 6,528 in 2007). This represents a change of trend, since over the past decade the number of applications processed had been increasing significantly and systematically.

Although the number of applications processed containing offers of loans again exceeded the offers of deposits, the former decreased, losing ground to the offers of deposit products. In regard to the media used, the presence of advertising by CIs in the print media decreased by around 30%.

Another function relating to transparency is that of verifying the customer protection rules regulating the activity of the Customer Service Department and ombudsman,¹ except in the

1. The requirements in this respect were laid down by Ministerial Order ECO/734/2004 of 11 March 2004.

case of savings banks and local and regional credit cooperatives, the verification of which is carried out by the competent body of the regional (autonomous) community in which their registered office is located. In any event, the Banco de España must be informed of the designation of the head of this service or department and, where applicable, of the ombudsman.

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

The Bank Customer's Portal

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

In 2008 portal page viewings numbered 2,529,171, an increase of 25% with respect to 2007. October was the month with the highest number of viewings, at 388,398. The most visited sections were the simulators, banking products, glossary, interest rates and frequently asked questions.

The 2,776 queries received through the portal's "contact us" facility numbered practically twice those in 2007 (1,379). Much the same happened with telephone inquires, which amounted to 3,585, compared with 1,887 in 2007.

2.3.2 OFFICIAL REGISTERS AND INSTITUTIONAL INFORMATION

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

Register of Institutions

Institutions 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 the diverse 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.²

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

The changes in the register of institutions in 2008 were minimal. Perhaps most noteworthy was the restructuring of the Banco Popular group mentioned in Chapter 1.1 and, in particular, the registration as a CI of the first Spanish electronic money institution: Yunique Money, EDE, SA.

Apart from this, the only other development calling for comment is the increase in the number of branches of EU institutions, which rose by 12.5% to stand at a total of 81 branches, reflecting the typical cross-border movements of the European single market.

2. This register and the register of agents described below are available to the public and can be consulted by either traditional means or on the Banco de España's website. 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. 3. For more details of the institutions that have to be entered in this register, see Section 2.3.6. of the 2006 Report on Banking Supervision in Spain.

Year-end data (number) (a)

	2005	2006	2007	2008
Institutions with an establishment (b)	542	550	558	561
Credit institutions	350	355	358	361
Representative offices	53	54	57	55
Mutual guarantee companies	23	24	24	24
Reguarantee companies	1	1	1	1
Currency-exchange bureaux and money transfer agencies (c)	57	59	59	62
Appraisal companies	58	56	57	56
Controlling companies of credit institutions	—	1	2	2
Credit institutions operating without establishment	383	404	433	480
Of which: EU CIs operating without an establishment	378	398	428	475
Of which: financial subsidiaries of EU CIs	3	3	2	2

SOURCE: Banco de España. Data available at 31 December 2008.

- a. The number of institutions also includes those that are non-operational and in the process of deregistering.
b. Including electronic money institutions (one in 2008) and ICO.
c. Not including foreign currency purchasing establishments.

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 cooperatives which the Banco de España has to supervise in regard to the holding of similar posts in other companies.

The steadiness shown by the total number of senior officers entered in the related registers,⁴ and in the number of registrations and deregistrations, accurately reflects the minimal alterations in the number of institutions. Within that total, the percentage of women recorded in the registers of senior officers with respect to the total individuals registered stood at 13% at the end of 2008.

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,⁵ for the dual purpose of supporting the basic

4. All the statistical information in this section other than that relating to the number of registered institutions is included in Annex 4.2 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. 5. 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 cooperatives and 2.5% in SCIs.

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.

Two changes in this register in 2007 call for comment. First, the increase in the number of bank registered shareholders who are natural persons, which was due to the conversion of a credit cooperative (Caja Caminos) into a bank (Banco Caminos). This event had the opposite effect on the register of credit cooperative shareholders. Second, the increase in the number of SCI registered shareholders. This increase took place among resident credit institutions as a result of the creation of a new SCI by 25 savings banks which are registered as its shareholders.

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 2008 the number of registered agents of currency-exchange bureaux licensed to make transfers kept up the notable pace of growth shown in previous years (above 25%), related above all to immigration. However, the degree of concentration continues to be high, since 58% of agents work for only five bureaux.

By contrast, the number of agents of CIs decreased by 9% to stand at the levels of 2006. Banks, which continued to account for 95% of the agents of CIs, proceeded to reduce them in a very general manner.

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 2008 there were 24 applications to amend articles of association. This was 35% fewer than in 2007, mainly as a result of the virtual completion of the process of adaptation of articles of association of institutions to the changes in the principles of corporate governance and to the regional regulatory framework for Valencian credit cooperatives. Accordingly, the number of changes to articles of association decreased by 17% to 184.

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, along with the typical features of debt financial instruments, have features characteristic of equity instruments: they can be set off against losses without the need to liquidate the institution, they will remain on the institution's balance sheet for an indefinite period of time and the returns on them depend on the existence of sufficient profits and on the issuer's solvency. These instruments include perpetual subordinated debt and preference shares, in many cases issued by special-purpose entities that are subsidiaries of CIs.

Yearly data (€m)

	NUMBER				AMOUNT			
	2005	2006	2007	2008	2005	2006	2007	2008
TOTAL	63	79	60	36	8,471	16,078	21,592	3,747
Subordinated debt	51	65	45	32	5,587	13,942	11,962	2,597
Fixed-term	48	60	41	27	5,222	12,728	10,458	2,497
Banks	11	24	29	14	1,865	8,853	9,189	1,259
Savings banks	28	25	9	9	2,870	3,724	1,224	1,233
Credit cooperatives	3	3	3	1	403	23	45	2
SCIs	6	8	—	3	85	128	—	3
<i>Of which:</i>								
<i>Loans</i>	9	12	4	7	202	297	420	678
No agreed maturity	—	—	—	3	—	—	—	19
<i>Credit cooperatives</i>	—	—	—	1	—	—	—	3
<i>SCIs</i>	—	—	—	2	—	—	—	16
<i>Of which:</i>								
<i>Loans</i>	—	—	—	2	—	—	—	16
Undated	3	5	4	2	365	1,214	1,504	81
Banks	1	2	1	—	15	64	1,019	—
Savings banks	2	3	3	—	350	1,150	485	—
SCIs	—	—	—	2	—	—	—	81
Preference shares	12	14	15	4	2,884	2,136	9,630	1,150
Banks	3	6	7	1	1,800	1,602	9,239	1,000
Savings banks	8	8	7	3	995	534	389	150

SOURCE: Banco de España.

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 group,⁶ the Banco de España must verify that these instruments meet the conditions established by bank solvency law.

To correctly analyse the eligible debt issued in 2008, any comparison with that of previous years must take into account the exceptional nature of the securities obligatorily convertible into shares issued in 2007 by Banco Santander (€7,000 million) in the acquisition (together with the Belgian-Dutch group Fortis and the UK bank Royal Bank of Scotland) of the Dutch bank ABN AMRO, NV. In order to avoid the distortions which this exceptional issue would cause in a study of the time series of eligible debt instruments, it is disregarded in the following analysis.

In overall terms, the total amount subscribed in 2008 in the issues verified by the Banco de España was €3,747 million, which represents a decrease of more than 74% with respect to 2007. This decline was more pronounced in subordinated debt (78%) than in preference

6. Such eligibility is for the purpose of compliance with certain prudential requirements such as the solvency ratio or the limits on large exposures.

shares (56%). The decline was particularly significant in perpetual subordinated debt, which, although starting from relatively low levels, decreased practically to zero.

It should also be noted that the bulk of the issues was subscribed in the second half of 2008, since, overall, in the first half only €465 million (a little more than 12% of the total) were placed.

The decrease of 29% in the number of subordinated debt issues was less sharp than the decrease in their amount, indicating that there was not only a fall in the total volume issued, but also in the average amount of each issue. Regarding preference share issues, although their small number does not allow definitive conclusions to be drawn (particularly in view of the large amount of one of them), it can be said that the average amount of the issues by savings banks was in line with that of previous years.

All these developments reflect the complex situation prevailing in 2008 in the international financial markets, which even ceased to function for a good part of the year. That is why, unlike in previous years, most of the issuances took place, either totally (74%) or partially (89%) in Spain. In 2007 only 7% of issues were wholly in Spain.

The target public was also different, since while in 2007 96% of the issue amount was directed exclusively at institutional investors, in 2008 52% was placed, at least partially, among retail investors and 39% wholly with them. 32% of the total issued was placed wholly with Spanish individuals.

The issues launched by operating subsidiaries of Spanish CIs subject to specific own funds requirements in their country of origin amounted to €265 million in 2008. This represented 7% of the total, similar to the percentage of the previous year.

In 2008 the predominant type of issue was euro-denominated 10-year subordinated debt with optional early repayment from year 5 subject to prior authorisation of the supervisor and interest tied to 3-month EURIBOR with a spread which was around 3% in October and above 4% in the last part of the year, and a step-up of 75 percentage points if the early repayment option was not exercised. This issue was typically quoted in the AIAF market. The main difference from the previous year was the wider spread on EURIBOR, since in 2007 it was normally less than 1% (with a step-up of only 50 bp).

Lastly, although it is not an instrument the Banco de España is responsible for verifying, we mention here that the first issue of non-voting equity units (*cuotas participativas*) was made in 2008 by Caja de Ahorros del Mediterráneo, for an amount of €100 million.⁷

2.4 Supervisory policies: The Spanish system of continuous supervision

2.4.1 INTRODUCTION

In the 2001, 2002 and 2003 reports on banking supervision in Spain, the Banco de España explained the development, extensive application and further building-up of its methodology for risk-based supervision. Since then, there have been notable regulatory changes, including the release of Circular 4/2004 of 22 December 2004 to credit institutions on public and confidential financial reporting rules and formats and, more recently, Circular 3/2008 of 22 May 2008 to credit institutions on the determination and control of minimum own funds.

Circular 3/2008, in addition to replacing the old system of determining own funds by a more complex one that is more sensitive to banking risks, introduces new features relating to the

7. This issue is not reflected in Table 2.7.

function of supervisors. Their risk control responsibility is broadened in accordance with the requirements of so-called Pillar 2, which stipulates that institutions must have a procedure for assessing capital adequacy on the basis of their risk profile, which shall be examined and assessed by the supervisor.

In this connection, the Banco de España published its Guidelines on the Internal Capital Adequacy Assessment Process (ICAAP) of credit institutions in June 2008, conducted a general pilot trial to assess the suitability of these processes and commenced work to up-date its supervisory model, which, although constantly under revision as a result of the ongoing interaction between supervisor and supervised institutions, must now incorporate the most recent regulatory changes, such as the ICAAP and the Supervisory Review and Evaluation Process (SREP).

Hence, although the Banco de España's present-day supervisory system maintains the essential ideas expressed in the aforementioned banking supervision reports, it is now a good time to explain this system again and look at the new features included in it.

2.4.2 SUPERVISION OF CIs AND THEIR CGs: RISK PROFILE AND CONTINUOUS SUPERVISION

The basic delimitation of the Banco de España's competence in the supervision of CIs and their CGs continues to be based on Article 43.bis of Law 26/1988 of 29 July 1988 on the discipline and intervention of credit institutions and on Article 7.6 of Law 13/1994 of 1 June 1994 on the Autonomy of the Banco de España.

In exercise of the legal mandate received, the Banco de España, like the other supervisory authorities of developed systems, focused its attention on the solvency and conduct of CIs and CGs considered separately, in the knowledge that the aim of financial system stability set out in Article 7.3.b) of Law 13/1994 requires the implementation of due protection against the risk of contagion and that no public supervision system can completely eliminate the possibility of a CI failing as a result of poor management.

Given a dynamic banking system such as that in Spain, the traditional supervisory model based on a knowledge of the present accounting and financial situation and on the administrative control of regulatory compliance is not sufficient and must be supplemented by a risk-based approach to incorporate time dynamics, improve the assessment of institutions' future viability and strengthen the preventive measures that may be adopted. The Banco de España's supervisory system shares this risk-based approach with those of the supervisors of countries with highly developed banking systems, but it also has distinctive features derived, *inter alia*, from the importance of inspection visits in the supervisory process, from the retention of accounting regulatory competence, and from an organisation designed for frequent contact with institutions through teams charged with off-site analysis and monitoring functions, as well as inspection visits. That is to say, it is a supervision system which is in close touch with the institutions' business reality and, additionally, is supported by a system of periodic and highly detailed reporting by supervised institutions which makes it possible to hold an expert and up-to-date opinion at all times on the situation and performance of institutions.

2.4.3 STRUCTURE AND ORGANISATION OF SUPERVISION AT THE BANCO DE ESPAÑA

In recent years the Banco de España's supervision has been strengthened through the incorporation of specialists in widely diverse fields. Lawyers, economists and information technologists have been joined by others with statistics and mathematics training in order to smooth the adaptation to the new solvency framework. All of them form part of the Directorate General Banking Supervision, in the following areas (see also Table A.1.2):

- a) The three inspection departments, entrusted with the analysis, monitoring and inspection of institutions and composed of a variable number of divisions, each

under its respective head. These divisions consist of inspectors with general training (which enables a comprehensive view and knowledge of the institutions examined by them), support technical staff and IT auditors. Each of these divisions has assigned to it specific credit institutions at which it conducts off-site analyses and the related inspection visits and engages in dialogue and direct contact with management. In this way supervisory tasks are unified in a single group of people and the process of continuous supervision, i.e. up-to-date knowledge of each institution and banking group, is strengthened.

- b) The Associate Directorate General Banking Supervision, with its cross-sectional and specialised support divisions, which assist in activities ranging from analysis and monitoring in specialised matters to direct participation in inspection work on those matters. These divisions, which also carry out other functions, such as the coordination of supervisory policy and of the Banco de España's international activities in the area of supervision, are: Technical Secretariat and Institutional Relations, International Coordination and Advice, Latin America and United States, Off-Site Analysis, Credit and Operational Risk Management Models, and Market and Liquidity Risk Management Models and Custody.
- c) Supervision Planning, which consists of the Innovation and Technology Division and the Methodology and Quality Division.

2.4.4 SUPERVISORY ACTIONS AND ACTIVITIES

The Banco de España pursues three lines of action within its continuous supervision:

- Off-site monitoring and analysis based on confidential returns and other information received periodically at the Banco de España, supplemented, as appropriate, by additional information requested from the institutions, by information gathered in contacts with institutions and by any other available information considered useful.
- Full or partial inspection visits, which enable direct verification of information provided to the Banco de España and of the level of compliance with the various rules, a deeper knowledge of risk management and asset valuation practices and direct assessment of qualitative matters (policies, organisation, management, controls) impinging on the situation of credit institutions.
- On-site continuous monitoring, which, in the case of the larger, more complex groups of credit institutions, enables the Banco de España to obtain information promptly and hence take supervisory measures earlier.

Within the framework of these supervisory lines of action, the Banco de España carries out the following activities:

- Accounting review: this is a basic activity in supervision, since the other supervisory activities mentioned below require the assurance that the institutions' accounting records are accurate. Accordingly, the Banco de España devotes substantial resources to checking compliance with accounting rules, particularly the valuation of assets, liabilities and off-balance-sheet items, and, in addition, draws on information gathered in the institutions' own review work (internal audit) and that of external auditors (audit report and supplementary audit report).

- Economic and financial analysis: the strength of a credit institution is based on an appropriate lending and deposit structure, sufficient net interest margins, closely controlled costs and realistic write-downs enabling the generation of high recurring income and adequate capitalisation. This makes it important to undertake this analysis in the framework of supervisory action.
- Review and assessment of risks and solvency: the aforementioned reviews are completed by this supervisory activity which, like the economic and financial analysis, has a clear prospective component. The assessment of an institution's corporate governance and of its management and control of risks and of own funds provides a knowledge of its true solvency situation, which, being linked to the risks assumed, gives an idea of the future risks that institutions may have to face.

Additionally, the Banco de España performs reviews of general regulatory compliance within its area of competence.

These supervisory lines of action and activities make for a supervisory system in close touch with institutions which enables knowledge, information and opinions in respect of each supervised institution to be kept up-to-date. It thus enables the supervisor to determine institutions' strengths and weaknesses, anticipate as far as possible any potential problems, assess corporate governance and management and risk control policies, assess solvency and detect areas requiring stronger supervisory action.

To help it carry out these actions and activities, the Banco de España has developed a large body of analysis and management tools which, inter alia, allow: the consultation and processing of financial information received by the Banco de España from CIs and their CGs; the handling of risk information received via the Central Credit Register; documentary management of inspections; monitoring of institutions and administrative procedures relating to them, etc.

2.4.5 RISK MATRIX

As noted above, the objective of the Banco de España's supervisory model is to obtain comprehensive up-to-date knowledge of the situation of supervised institutions and of how that situation is changing. This knowledge is used to build a supervisory risk profile of each institution which summarises, in a single variable, the probability with which the Banco de España considers that a credit institution will have solvency problems in the future. Based on this profile and on the systematic importance of each institution, priorities and a supervisory strategy are established for institutions and are reflected in the supervisory framework, which is used to prepare the tentative annual plan action.

To ensure that the supervisory risk profile is constructed on a consistent and reasoned basis, the Banco de España has developed an institution assessment methodology known as a SABER (the Spanish acronym for a risk-based approach to banking supervision). This methodology provides a uniform and structured framework for assessing institutions which is summarised in the form of scores assigned in the risk matrix. These scores are determined by drawing on all the information and knowledge obtained in all supervisory actions and activities and reflect the opinion held on the institutions at the time. Once these scores have been determined, the risk matrix acts, in addition, as the common language which, in the annual planning phase of supervisory tasks, enables institutions to be compared and priorities to be established in an objective manner.

The new solvency regulation and the implementation of Basel Pillar 2 have posed the question of whether it is appropriate to include in SABER methodology the conclusions drawn from the ICAAP and SREP and from the risk matrix review.

	TYPE OF RISK	INHERENT RISK	CONTROL	RESIDUAL RISK
Credit				
Market				
Business				
Liquidity				
Interest rate				
Foreign exchange				
Operational				
Institution's risk profile				
Cross-sectional assessment of corporate governance				
Solvency assessment				
Supervisory risk profile				

SOURCE: Banco de España.

The 2002 Report on Banking Supervision (Box II.3, page 95) explained the methodology for preparing the following risk matrix:

The new features the Banco de España intends to include shortly in this risk matrix are:

- A revised risk list conforming to the risk categories used by Basel 2 and reflected in the IPAAC Guidelines. Accordingly, legal risks are included in operational risk and provision is made for the assessment of other risks not included in the main list (strategic, reputational, etc.).
- A vertical assessment of the institution's internal governance, i.e. of the manner in which the Board of Directors or equivalent body takes responsibility for the nature, level and management and control of the risks assumed. This assessment is additional to the cross-sectional assessment of corporate government regarding the relationship of the institution's governing bodies with third parties (shareholders, investors, depositors customers, etc.).
- An assessment of the systemic nature of the institution.

Lastly, the possible assessments of the various facets (inherent risk, internal governance, management and control, residual risk, corporate governance, solvency and supervisory risk) were reduced from five categories to four.

Despite these new features, the structure and rationale of the existing risk matrix are unchanged. Accordingly, the process started by successively assessing for each risk the following: the risk inherent in or intrinsic to the institution's activity, internal governance, and risk management and control, i.e. policies and systems of risk measurement, origination, communication, control and monitoring. The result of these analyses is a judgement based on the residual risk level of each type of risk, working on the principle that the controls mitigate but do not eliminate the inherent risk, which is consequently the component with most weight in the residual risk.

The weighted aggregate of the various residual risks determines, along with external corporate governance, the institution's risk profile, which is a key factor for the Banco de España, since, in the near future, it will determine the level of capital the Banco de España considers the institution has to have in application of Article 10 bis, Section 1.c of Law 13/1985 on investment ratios, own funds and reporting requirements for financial intermediaries.

Lastly, the adjustment of the institution's level of own funds to the risks assumed, the quality of those own funds and the reasonableness of the capital target and planning are assessed. All this information and the assessment of the institution's risk profile are used to obtain the supervisory risk profile, which, as mentioned above, summarises in a single variable the probability that, in the Banco de España's judgement, a credit institution will have solvency problems in the future. The assignment of a value to this variable concludes the Banco de España's assessment of institutions by the SABER methodology.