

Supervision Report: digest

Supervisory functions of the Banco de España

- The Banco de España has supervisory powers over credit institutions and over other financial institutions and undertakings related to the financial system operating in Spain. Specifically, it has powers over payment institutions, account information service providers, specialised lending institutions (SLIs), electronic money institutions, mutual guarantee societies, reguarantee companies, currency-exchange bureaux, appraisal companies, certain banking foundations and Sareb (the asset management company for assets arising from bank restructuring).
- Microprudential supervision of credit institutions aims to ensure their solvency and liquidity, as well as compliance with prudential regulations. It is carried out within the framework of the Single Supervisory Mechanism (SSM), led by the European Central Bank (ECB) and with the participation of the national competent authorities of each country, including the Banco de España. The Directorate General Banking Supervision (DGBS) is responsible for the tasks relating to this function.
- Macroprudential policy is aimed at safeguarding the stability of the financial system as a whole. The Banco de España's Directorate General Financial Stability, Regulation and Resolution is responsible for making the necessary proposals and analyses for decision-making in this area. To this end, it has macroprudential tools provided for in the European regulatory framework and in Spanish legislation. At the Spanish level, the Banco de España participates in the Spanish macroprudential authority (AMCESFI), together with the other two sectoral supervisory authorities: the National Securities Market Commission (CNMV) and the Directorate General Insurance and Pension Funds, as well as with the Ministry of Economic Affairs and Digital Transformation. At the European level, it coordinates with the ECB and the European Systemic Risk Board (ESRB).
- The Banco de España is also entrusted with supervising the conduct, transparency and consumer protection of the institutions in its Official Registers. The General Secretariat is responsible for carrying out the tasks necessary for the exercise of this function.
- The Banco de España is responsible for the supervision of payment service provision. Three directorates general are involved in the exercise of this function: the DGBS, the General Secretariat and the Directorate General Operations, Markets and Payment Systems. Also, the latter is responsible for overseeing payment systems and instruments and it shares with the CNMV the oversight of the financial market securities infrastructures.
- The Banco de España collaborates with the Commission for the Prevention of Money Laundering and Monetary Offences (CPMLMO) and its Executive Service in the area of anti-money laundering and counter-terrorist financing (AML/CTF).

Supervisory and oversight staff

- At 31 December 2021, the Banco de España had 844 employees performing supervisory and oversight functions, as compared with 847 employees at 2020 year-end. 49% of supervisory and oversight staff are men and 51% are women.

The Spanish banking sector

- The recovery of the financial situation of Spanish banks in 2021 can be seen in many indicators, which are close to or even exceed the levels prior to the outbreak of the health crisis. The total volume of loans extended by Spanish institutions at consolidated level increased again in 2021.
- The NPL ratio has remained stable at around 3% since the beginning of 2020. However, it is necessary to remain prudent, given the possibility of further deterioration in loan quality in the near future due to the deferred materialisation in institutions' balance sheets of part of the impact of the COVID-19 crisis.
- Profitability recovered significantly in 2021 with respect to the anomalous previous year, when extraordinary write-downs pushed this ratio into negative values. However, the challenge remains to adapt the institutions' structure to the low net interest income and growing competitive pressure in the sector.
- The solvency of Spanish banks has maintained its upward trend, and there has been a slight improvement since the second quarter of 2021 due to the positive contribution of earnings and lower risk-weighted assets. The system's average solvency ratios remain, however, below their European peers.
- The liquidity coverage ratio of Spanish banks has been on an upward trend since the outbreak of COVID-19, mainly as a result of the monetary policy measures adopted by the ECB due to the pandemic.

Focal points in 2021 and supervisory priorities for 2022

- The supervisory focal points for the SSM as a whole in 2021 were grouped into four broad areas: credit risk management, the objective of which was the early identification of asset impairment and appropriate credit risk management; the soundness of institutions' capital position, monitoring institutions' capital plans and dividend policies (also, stress tests were conducted at European level); the sustainability of the business model, focusing on the analysis of institutions' strategic plans; and, lastly, governance, with a focus on institutions' crisis management procedures, the prudential impact of money laundering and terrorist financing (ML/FT) risk and the assessment of technological and cyber risk.
- The priorities for the SSM as a whole in 2022 are to address the impacts of the pandemic and promote the banking sector's resilience in the context of exiting the crisis, paying particular attention to the potential deterioration of asset quality; to tackle institutions' structural vulnerabilities through digital transformation and improved governance; and to assess the response to emerging risks, including climate and environmental risk, technology risk and cyber risk.
- Law 7/2020, for the digital transformation of the financial system, created a controlled testing environment in Spain, known internationally as Sandbox. The law provides for two annual cohorts for submitting access requests. In the first cohort, of the applications that were initially assigned to the Banco de España, alone or together with other supervisory authorities, six have finally passed to testing. In the second cohort, of those initially assigned to the Banco de España, only one obtained a favourable prior assessment and is in the negotiation phase of the corresponding protocol.
- The Banco de España and the CNMV, together with the ECB, have worked this year to encourage institutions to make an orderly transition to new benchmark rates, following the disappearance of EONIA (Euro Overnight Index Average) and LIBOR (London Interbank Offered Rates).
- As part of its commitment to improve the financial sector's cybersecurity, the Banco de España has adopted the advanced cybersecurity testing framework TIBER-ES, which is the local adoption of TIBER-EU, published by the ECB. Testing under the TIBER-ES framework enables financial institutions to enhance their cybersecurity capabilities.

Supervision of credit institutions

- Ongoing supervision of significant institutions (SIs) is performed by joint supervisory teams (JSTs) comprising ECB and Banco de España staff. The Banco de España directly supervises less significant institutions (LSIs) according to a common policy laid down by the ECB.
- The most effort-intensive task in the ongoing monitoring of SIs is the supervisory review and evaluation process (SREP), whose findings are used to adopt Pillar 2 decisions (capital and liquidity decisions), as well as to assess the adequacy of their governance and risk controls. While in 2020 the ECB decided, in view of the COVID-19 crisis, to follow a simplified approach in the SREP, the return to relative normality allowed the JSTs to apply the full SREP methodology in 2021.
- The SREP is complemented by other supervisory tasks, such as institution-specific in-depth reviews (deep dives), cross-institutional reviews—which are conducted uniformly for all or several SSM institutions—which in 2021 dealt, inter alia, with the monitoring of coverage for non-performing exposures and with institutions' exposure to sectors vulnerable to the COVID-19 crisis.
- Stress tests originally planned for 2020, but which had to be postponed due to the COVID-19 crisis, were carried out in 2021.
- In 2021, 861 ongoing off-site supervision actions were conducted on Spanish LSIs, the Official Credit Institute, branches of LSIs from other SSM participating countries and other EU Member States, and branches of non-EU credit institutions. The SREP is one of the core tasks of the ongoing off-site supervision of the LSIs, and in 2021 a Pillar 2 capital guidance (P2G) was set for each institution for the first time.
- Ongoing off-site supervision is supplemented with on-site actions, which can take two forms: inspections and model investigations. In 2021, on-site actions continued to be carried out on a remote and online basis, following the model adopted in the previous year due to the pandemic. In the last quarter of the year, occasional visits to institutions were resumed in some actions. In 2021, 15 inspections and 13 internal model investigations were carried out at Spanish SIs and, additionally, 2 cross-border missions were carried out at non-Spanish SIs. As regards LSIs, the Banco de España carried out 6 inspections.
- Both the ECB and the Banco de España decided against extending their previous recommendation on profit distribution—which called on institutions not to distribute dividends or buy back shares, and to be extremely prudent with variable remuneration payments—so that it ceased to be in force from 30 September 2021. However, despite not setting limits, they recommend that banks remain prudent in these decisions.

<p>Supervision of credit institutions</p>	<ul style="list-style-type: none"> • In 2021, the Banco de España participated in 233 suitability procedures for institutions' senior officers. In addition, the ECB launched the so-called "IMAS Portal" to facilitate various procedures (senior officer suitability assessments, passporting notifications, acquisition of qualifying holdings and non-material model changes). In addition, the ECB has published the Guide to fit and proper assessments, with supervisory policies on the requirements for senior officers, and the new questionnaire for suitability assessment, which the Banco de España will adapt to Spanish specificities in the course of 2022. • As a result of its supervisory tasks, the Supervisory Board of the ECB –of which the Banco de España is a member– adopted 528 decisions and actions affecting Spanish institutions. Furthermore, the Banco de España sent 108 letters to institutions containing 373 requirements and recommendations. • During 2021, three AML/CTF compliance review inspections were completed and three more were initiated. In March 2021, a new agreement was signed between the CPMLMO and the Banco de España for the coordination of their respective actions in the supervision and inspection of AML/CTF obligations, which clarifies the Banco de España's role and deepens supervisory cooperation and coordination.
<p>Supervision of other institutions, compliance with vetted access to activity and supervision of payment service providers</p>	<ul style="list-style-type: none"> • The Banco de España has exclusive microprudential supervisory powers over institutions other than credit institutions, on which 399 ongoing off-site supervisory actions were carried out in 2021 under various modalities as well as 3 inspections. • The Banco de España, as the body responsible for overseeing compliance with vetted access to activity, acted in 2021 in 37 possible cases of operations being performed without meeting the conditions of access, including 21 cases of possible non-compliance with vetted access to activity of payment service providers. • In addition to the tasks inherent in the ongoing monitoring of payment service provision, oversight tasks in 2021 were mainly divided between the assessment of authorisation and registration applications —suggestive of a trend towards a payment service provision ecosystem that has ever more participants and is, therefore, ever more heterogeneous— and the verification of compliance with strong customer authentication (SCA) regulations and common and secure open standards of communication.

CHAPTER 3. MACROPRUDENTIAL POLICY

<p>The Banco de España's macroprudential policy actions</p>	<ul style="list-style-type: none"> • In accordance with the prevailing legislation, the Banco de España regularly sets two macroprudential capital buffers to address the build-up of cyclical and structural risks. • In 2021, the Banco de España maintained the countercyclical capital buffer at 0% for credit exposures in Spain. It is not expected to be increased at least until the main economic and financial effects of the pandemic have dissipated. • In 2021, four other systemically important institutions were identified —one less than the previous year as a result of the integration of Bankia, SA into CaixaBank, SA— and their associated capital buffers were set for 2022. • The Banco de España published in 2021 a circular on new macroprudential tools applicable to credit institutions. • The prospective exercise conducted in 2021 by the Banco de España to measure credit institutions' resilience to adverse scenarios shows a high loss-absorbing capacity, albeit with significant differences between institutions.
<p>Macroprudential coordination at national level</p>	<ul style="list-style-type: none"> • As a member of AMCESFI, the Banco de España actively contributed to its activities in 2021, which included the publication of its second annual report, an occasional paper on public support measures in response to COVID-19 and an opinion on the Banco de España's macroprudential measure relating to other systemically important institutions.
<p>ECB macroprudential tasks</p>	<ul style="list-style-type: none"> • The Banco de España participates in the ECB's Financial Stability Committee and Macroprudential Forum. As an SSM authority, in 2021 the Banco de España notified the ECB of its proposed macroprudential measures prior to their adoption and reporting.

CHAPTER 4. SUPERVISION OF INSTITUTIONS' CONDUCT

Conduct-related supervisory activity	<ul style="list-style-type: none">• Supervision of effective compliance with the conduct regulation and discipline legislation establishing bank customer protection measures is essential to preserve public confidence in the banking system and to promote the stability of the financial system.• In 2021, the conduct-related supervisory activity was adapted to new circumstances following the onset of the pandemic and efforts were redirected to ensure appropriate conduct by institutions, in particular in the way they digitally engage with their customers.• Other noteworthy areas of activity in 2021 were consumer credit (with a focus on car financing, overdrafts, responsible lending and marketing of revolving cards), real estate lending, remote marketing of current and savings accounts, transfer of payment accounts (noteworthy in relation to these accounts is a supervisory action to verify the marketing of payment accounts in bank branches), advertising and customer service in bank branches.• In recent years, conduct-related supervisory activity has become more complex and requires new tools and specific information for the supervisor. To this end, in 2021 the Banco de España published the first conduct-related supervisory guide, on customer service departments (CSDs), and a circular on confidential conduct-related information and on the complaints register.
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CHAPTER 5. OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Oversight of payment systems and instruments	<ul style="list-style-type: none">• The analysis of incidents experienced in 2020 in TARGET2 services was one of the key activities in 2021 in the oversight coordinated by the ECB. On the basis of the recommendations arising from this oversight, together with the recommendations issued by internal audit and those arising from an independent review, a global action plan was prepared.• In Spain, as in the rest of the euro area, the context of the pandemic has contributed to the acceleration of digitalisation in retail payments. In 2021, remote payments made strong progress and contactless payments have become widespread in the face-to-face environment.• Noteworthy in card scheme oversight in Spain is the reduction of the fraud rate in card transactions, which was 0.023% in the first half of 2021 in terms of number of transactions (compared to 0.032% in 2020). The deployment of SCA in remote card transactions may have contributed to this decline.• The new Eurosystem oversight framework for electronic payment instruments, schemes and arrangements (known as the "PISA framework") was approved in November 2021.
Supervision of Iberpay (National Electronic Clearing System manager)	<ul style="list-style-type: none">• A new regulation of the National Electronic Clearing System (SNCE) was approved at the beginning of 2022, notably updating the settlement procedure for immediate transfers. This procedure has been adapted to the ECB Governing Council's decision of July 2020 to achieve pan-European accessibility of instant payments through the TARGET Instant Payment Settlement service, known as "TIPS".
Oversight of securities infrastructures	<ul style="list-style-type: none">• In 2021, monitoring continued on the implementation of the recommendations arising from the TARGET2-Securities assessment of compliance with the principles for financial market infrastructures of the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, and those arising from the assessment of the penalties mechanism set out in the Central Securities Depositories Regulation.

CHAPTER 6. EXERCISE OF SANCTIONING POWERS

Sanctions	<ul style="list-style-type: none">• Sanctioning powers, as a corollary of supervisory powers, continued to be exercised in 2021 in the following areas: i) transparency and customer protection, which, as in previous years, accounts for the largest number of sanctioning proceedings initiated, and ii) prudential matters, which include most notably proceedings initiated against appraisal companies.
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CHAPTER 7.

THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

Global fora	<ul style="list-style-type: none">• In 2021, the Financial Stability Board continued to promote international cooperation and the coordination of responses to the pandemic, the identification, monitoring and assessment of financial system vulnerabilities, as well as the implementation and assessment of reforms agreed on in the aftermath of the 2008 global financial crisis.• The work of the Basel Committee on Banking Supervision, chaired by the Governor of the Banco de España, has focused on new strategic priorities, including climate change and the impact of digitalisation, as well as the assessment of the functioning of the Basel III framework and the monitoring of its implementation.
European fora	<ul style="list-style-type: none">• The work of the European Banking Authority (EBA), which continues to be influenced by the consequences of the pandemic, includes most notably the following: i) that stemming from the CRD/IFD/CRR/IFR capital requirement directives and regulations for credit institutions and investment firms, and from the directive on the restructuring and resolution of both types of institution, BRRD, especially with regard to internal governance and remuneration; and also, from a prudential perspective, the work on securitisations; ii) improvements in the area of reporting and transparency, which will turn the EBA into an integrated EU datahub; iii) preparatory work on the new regulatory framework for crypto-assets (MiCA regulation) and on information and communication technology risk and security risk management (known as "DORA"); and iv) enhanced disclosure of environmental, social and governance risks.• In 2021, the work of the ESRB —the Advisory Technical Committee of which is chaired by the Governor of the Banco de España— focused on the following areas: i) vulnerabilities in the residential real estate sector; ii) regulatory reform of money market funds; iii) mitigation of systemic cyber risk; iv) macroprudential aspects of the low interest rate environment and climate risks; v) post-Brexit equivalence of UK central counterparties; and vi) financial stability implications of fiscal measures introduced to tackle the economic effects of the pandemic.

CHAPTER 8.

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

Banco de España's new regulatory developments	<ul style="list-style-type: none">• In 2021, the Banco de España published six circulars on the following subjects: i) functioning of the Central Credit Register (Circular 1/2021); ii) official reference interest rates (Circulars 1/2021 and 3/2021); iii) information for determining contributions to the Deposit Guarantee Fund (Circular 2/2021); iv) information for conduct-related supervision purposes (Circular 4/2021); v) new macroprudential tools (Circular 5/2021); and vi) accounting regime for credit institutions and SLIs (Circular 6/2021). It also published supervisory guidance on institutions' CSDs. In addition, Circular 1/2022 on liquidity requirements for SLIs was published in early 2022.• Three circulars are currently in the pipeline, which will cover the following subjects: (i) prudential regime for credit institutions; (ii) reporting obligations applicable to revolving credit; (iii) operational and security risk management and incident reporting related to payment services; and (iv) payment statistics.
Other new regulatory developments	<ul style="list-style-type: none">• In 2021 there were several notable new developments in the field of prudential regulation. Firstly, the Spanish legislation was adopted transposing the latest amendment to the Capital Requirements Directive (known as "CRD-V") and exercising the options provided for in the amendment to the Capital Requirements Regulation (known as "CRR-II"). In addition, a new directive on credit managers and credit purchasers was adopted. Lastly, the EU adoption of the most recent amendments to the Basel Capital Accord was begun and the proposal for the MiCA regulation was published.