

2

MICROPRUDENTIAL SUPERVISION

MICROPRUDENTIAL SUPERVISION



SUPERVISION OF SPANISH CREDIT INSTITUTIONS

In the SSM, the ECB directly supervises the 10 groups of Spanish SIs, with the participation of the Banco de España, while the Banco de España directly supervises the 57 less significant Spanish groups or institutions



ONGOING OFF-SITE SUPERVISION

The SREP is a core element of the supervisory activity, as it maintains an up-to-date opinion on the situation and risk profile of credit institutions



ONSITE ACTIONS

36 onsite actions were carried out, of which 6 corresponded to LSIs and the rest to SIs

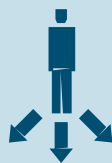
Inspections
22

Model investigations
14



ANTI-MONEY LAUNDERING

3 inspections were completed and another 3 were started



DECISIONS OF THE ECB SUPERVISORY BOARD

528 decisions affecting Spanish credit institutions, the details being as follows:

SIs
282

LSIs
10

General
236



LETTERS AND REQUIREMENTS

108 letters addressed to LSIs and the ICO, containing 373 requirements, recommendations and expectations. 4 letters addressed to institutions other than credit institutions, containing 40 requirements and recommendations

2.1 The Spanish banking sector and supervisory priorities

2.1.1 The Spanish banking sector

At 30 September 2021, the consolidated assets of the credit institutions making up the Spanish banking sector totalled €3,877 billion, of which 89% corresponds to Spanish SIs, 6% to Spanish LSIs and the ICO, and the remaining 5% to subsidiaries and branches in Spain of foreign credit institutions. The banking consolidation process intensified in 2021, with the agreements to integrate Bankia into Caixabank and Liberbank into Unicaja.

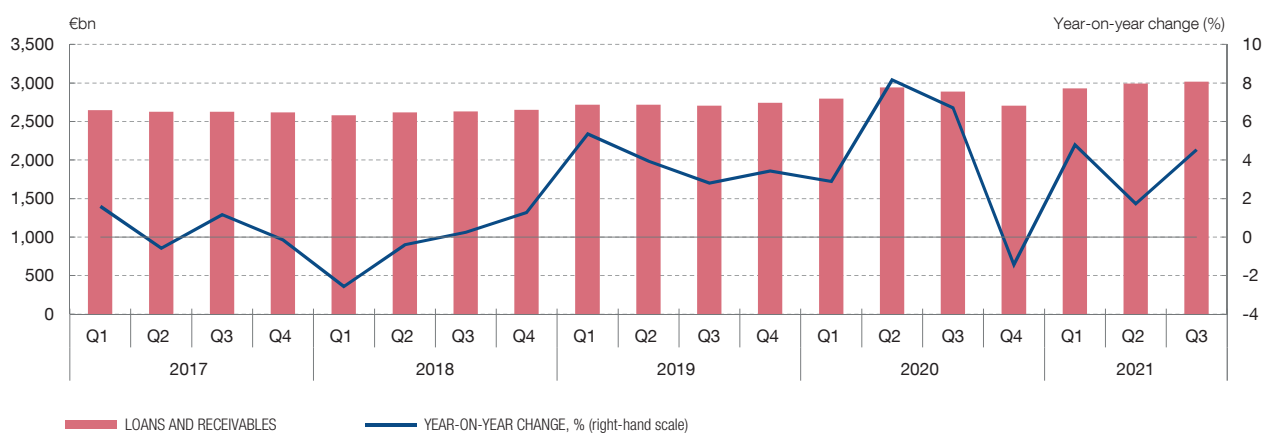
The recovery of the financial situation of Spanish banks in 2021 can be seen in many indicators, which are close to or even better than the levels prior to the outbreak of the health crisis.

The total volume of loans extended by Spanish institutions at consolidated level increased again in 2021 (Chart 2.1). The total loan figure includes loans to central banks, which account for this growth, since loans to non-financial companies and to households scarcely changed (Chart 2.7).

Chart 2.1

LOANS AND CREDIT. DEVELOPMENTS

The volume of loans is growing due to exposures with central banks.



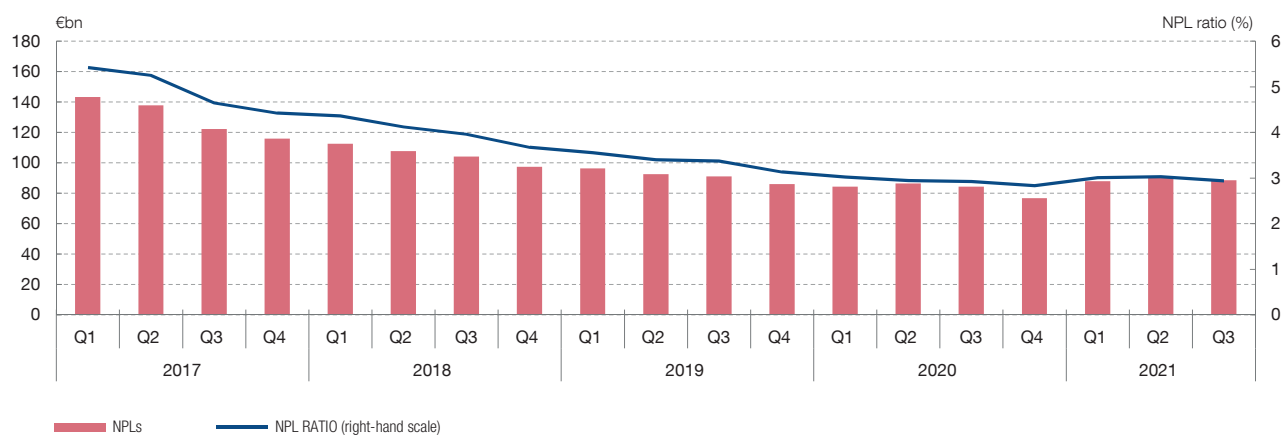
SOURCE: Banco de España (supervisory statistics on credit institutions).

Chart 2.2

NPLs AND NPL RATIO

Slight upturn in NPLs. The ratio appears to have come to a halt, albeit with slight growth excluding central banks.

NON-PERFORMING LOANS AND CREDIT



SOURCE: Banco de España (supervisory statistics on credit institutions).

During the pandemic crisis, the NPL ratio has remained stable at around 3% (Chart 2.2), although it is necessary to remain prudent, given the possibility of further deterioration of these levels in the near future due to deferred materialisation in institutions' balance sheets of part of the impact of the COVID-19 crisis. In any case, the provisions accumulated during the pandemic should mitigate possible loan loss provisions arising from these potential impairments.

Also, profitability recovered significantly in 2021 with respect to the anomalous previous year, when extraordinary write-downs pushed this ratio into negative values (Chart 2.3). However, the challenge remains to adapt the institutions' structure to the low net interest income and growing competitive pressure in the sector.

The efficiency ratio has been quite stable in recent years, including in 2020 (see Chart 2.4). During this period, institutions have managed to offset the progressive decline in net interest income, and the resulting decrease in gross income, by reducing their overhead costs. In 2021, overhead costs rose significantly as a result of the sector's restructuring plans, most notably in the institutions merged in the last year.

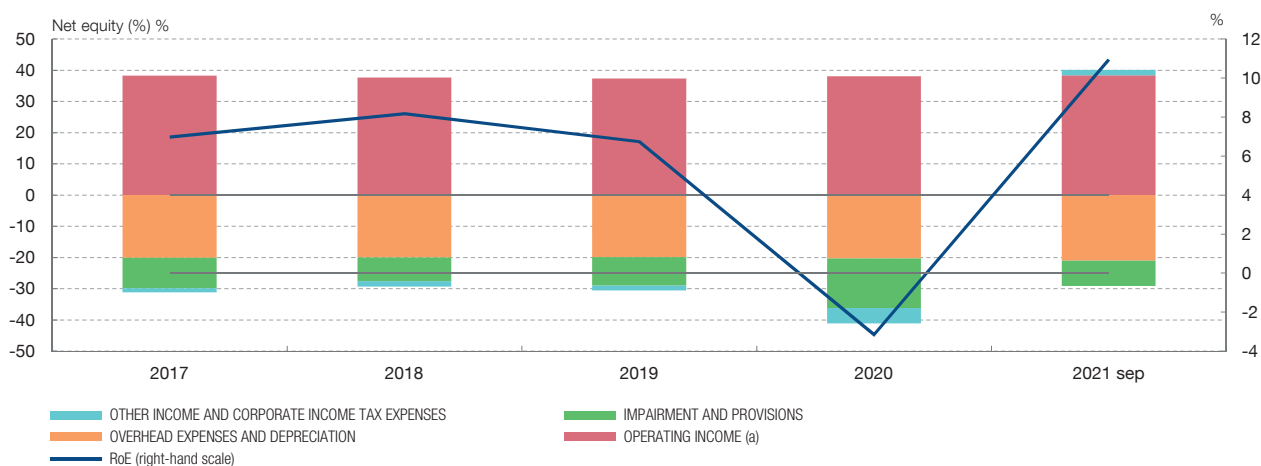
The solvency of Spanish institutions has maintained its upward trend, with a slight improvement since the second quarter of 2021 due to the positive contribution of earnings and lower risk-weighted assets (RWA), partly shaped by corporate operations (see Chart 2.5). The system's average solvency ratios remain, however, below their European peers.

Chart 2.3

RoE BY COMPONENTS. ANNUAL CHANGE

Significant recovery in profitability in 2021, underpinned mainly by the return to pre-pandemic write-downs and to extraordinary income deriving from the mergers of institutions.

RoE - BREAKDOWN BY COMPONENTS



SOURCE: Banco de España (supervisory statistics on credit institutions).

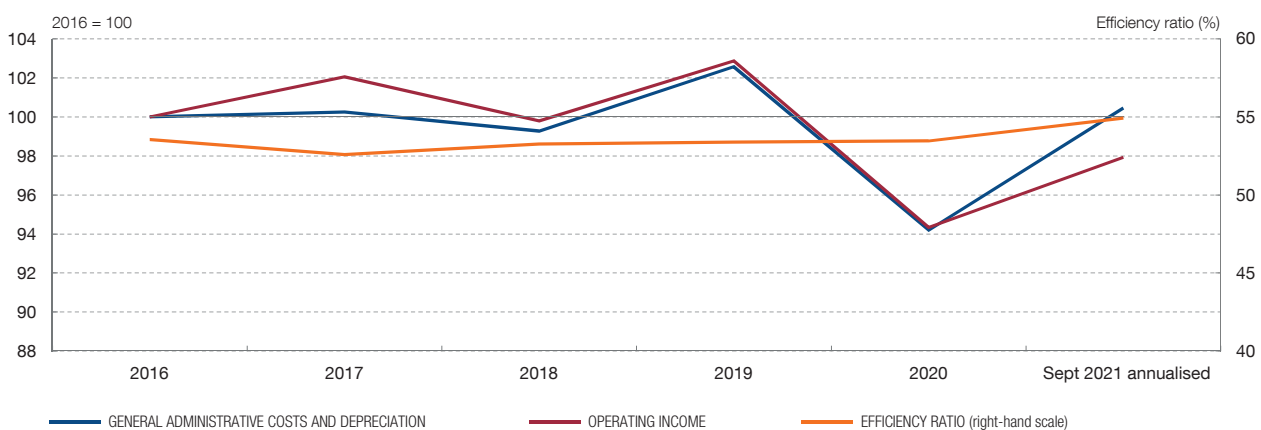
a Operating income is the sum of net interest income, net fee and commission income, net income from financial operations, net exchange differences and other net operating income.

Chart 2.4

ANNUAL EFFICIENCY RATIO

There was an upturn in overhead costs in 2021, causing the efficiency to fall slightly as a result of the sector's restructuring plans, especially at the merged institutions.

EFFICIENCY RATIO AND DEVELOPMENTS IN ITS COMPONENTS



SOURCE: Banco de España (supervisory statistics on credit institutions).

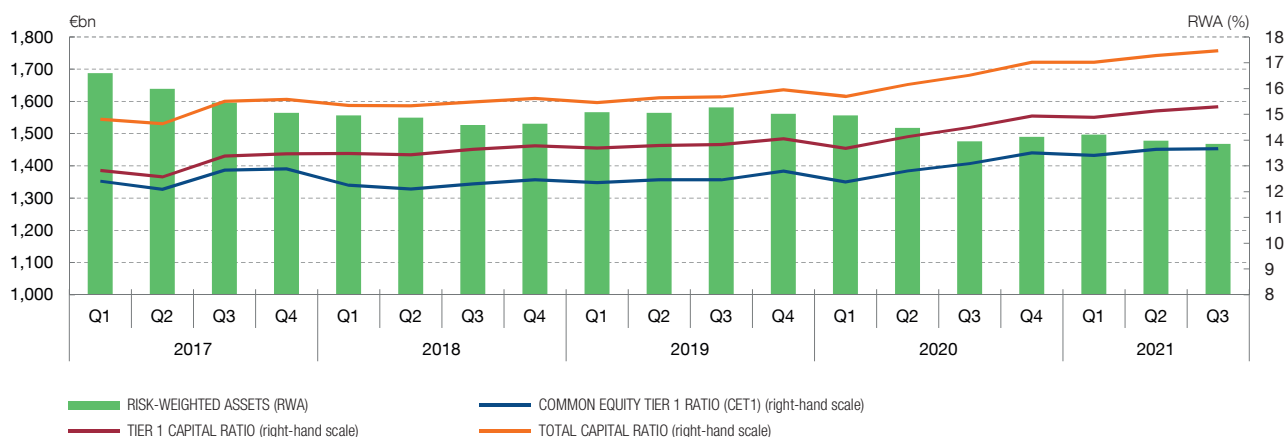
The leverage ratio had a relatively stable performance, with slight downside fluctuations (see Chart 2.6). However, performance since the outbreak of the pandemic in 2020 has been driven by institutions' strong reliance on ECB funding, partially offset, since the third quarter of 2020, by the regulatory changes introduced to mitigate the effects of the pandemic.

Chart 2.5

CAPITAL RATIOS (PHASED-IN)

Slight improvement in solvency in 2021 due to net dividend income and lower RWA, owing in part to the contribution of extraordinary corporate transactions.

CAPITAL RATIOS (TRANSITIONAL DEFINITION)



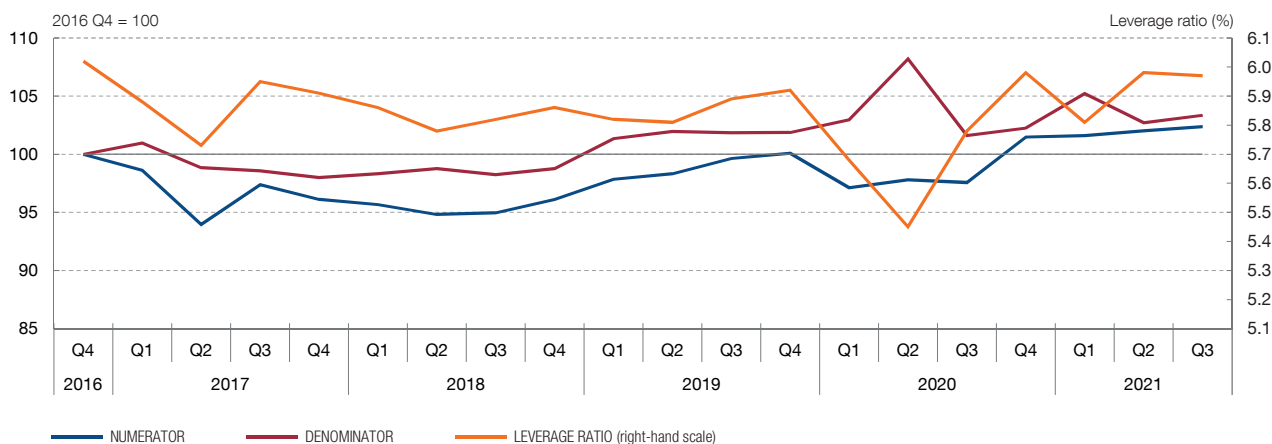
SOURCE: Banco de España (supervisory statistics on credit institutions).

Chart 2.6

LEVERAGE RATIO AND DEVELOPMENTS IN ITS COMPONENTS

Stable leverage ratio. It fell sharply in 2020 owing to the institutions' considerable recourse to the ECB, which was corrected by the introduction of regulatory amendments.

LEVERAGE RATIO AND DEVELOPMENTS IN ITS COMPONENTS



SOURCE: Banco de España (supervisory statistics on credit institutions).

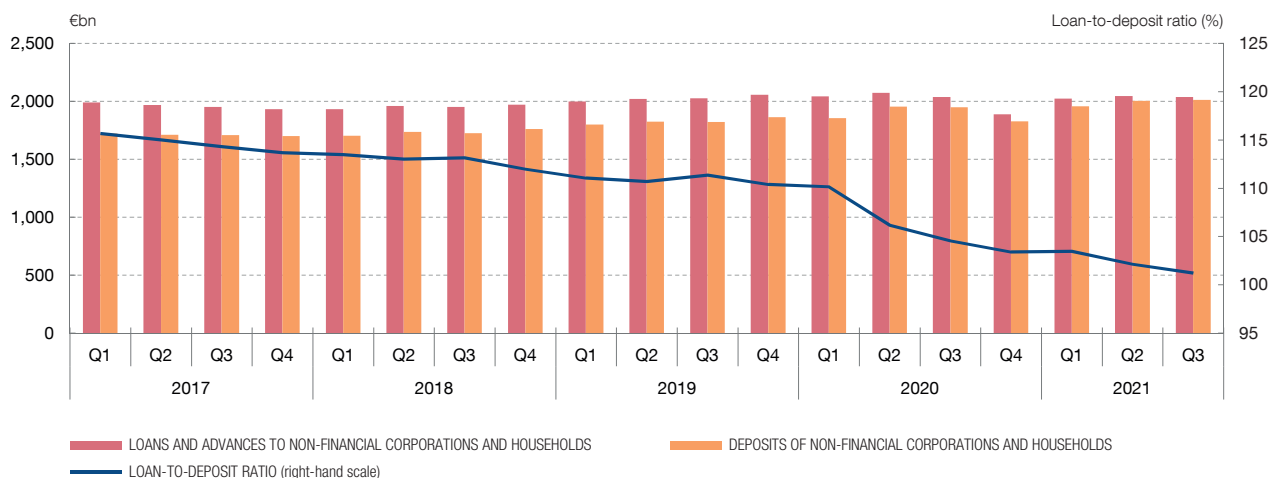
The loan-to-deposit ratio of non-financial corporations and households has been on a steady downward trajectory since 2015, as a result of deposits growing faster than loans. This trend accelerated in 2020 and continued smoothly in 2021 (Chart 2.7).

Chart 2.7

NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS. DEVELOPMENTS IN LOANS AND ADVANCES RELATIVE TO DEPOSITS

The loan-to-deposit (LTD) ratio improved slightly owing to stronger growth in deposits than in loans in the non-financial corporations and households segment.

LOANS AND DEPOSITS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS



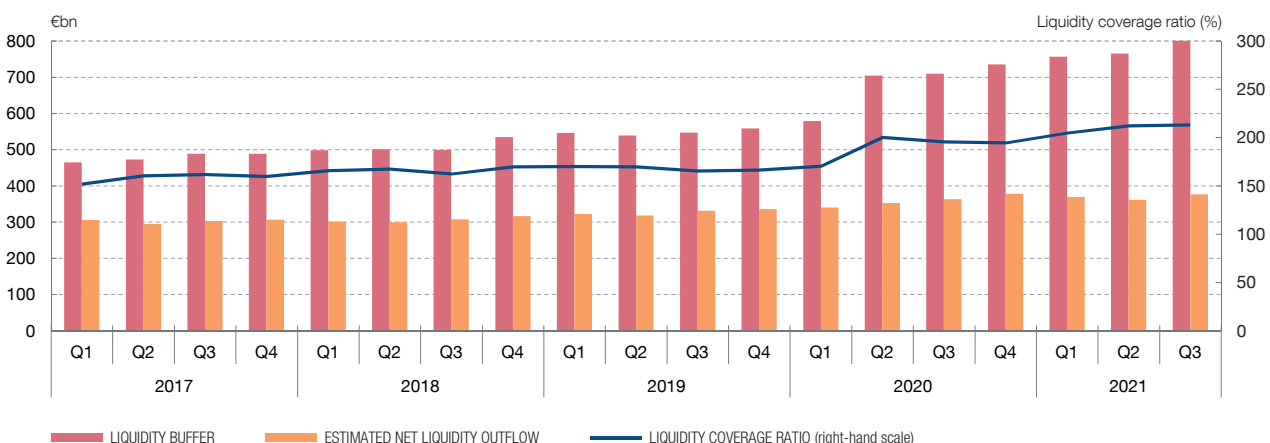
SOURCE: Banco de España (supervisory statistics on credit institutions).

Chart 2.8

LIQUIDITY COVERAGE RATIO

The institutions' liquidity increased owing to the ECB measures in view of the pandemic and to growth in customer deposits.

LIQUIDITY COVERAGE RATIO AND COMPONENTS



SOURCE: Banco de España (supervisory statistics on credit institutions).

The upward trend in Spanish institutions' liquidity coverage ratio since the outbreak of COVID-19 is mainly due to the monetary policy measures adopted by the ECB in view of the pandemic. The most substantial increases in the ratio are associated with the funding windows of the TLTRO-III (Targeted Longer-Term

Refinancing Operations-III) opened in the second quarter of 2020 and the first quarter of 2021. Another element contributing to the increase in the liquidity buffer is the growth in customer deposits, which has outpaced growth in lending since the outbreak of the pandemic (Chart 2.8).

2.1.2 Supervisory focal points in 2021

The ECB, in cooperation with the NCAs, conducts an annual analysis of the sources of risk and vulnerabilities in the banking sector, which form the basis for setting the supervisory priorities for the SSM as a whole. On the basis of the risk and vulnerability analysis¹, the focal points were grouped into four areas:

- 1 Credit risk management. The objective in this area was the early identification of asset impairment and its appropriate management. Banking supervision was focused on reviewing institutions' credit risk management procedures. The monitoring of this risk has been the focus of the main supervisory efforts this year (see Box 2.1 for more details).
- 2 Soundness of institutions' capital position. Given the uncertainty generated by the pandemic and the resulting increase in credit risk, it was considered essential to ensure that institutions had a sufficiently sound capital position and to identify specific vulnerabilities on a bank-by-bank basis in order to adopt early corrective measures where necessary. To this end, work was focused on the adequate monitoring of institutions' capital plans and their dividend policies. In addition, in 2021 stress tests were conducted at the European Union (EU) level, coordinated by the European Banking Authority (EBA).
- 3 Business model sustainability. The low levels of profitability that institutions have been showing in recent years in an environment of low interest rates, low cost efficiency and high competition have been further hampered by the COVID-19 crisis. Thus, supervisory efforts have been focused on reviewing institutions' strategic plans and the measures they have taken to remedy the situation. In addition, given the key role of the development of digitalisation plans, an assessment was carried out on the progress of institutions' digital transformation and its impact on their business models.

Also worthy of note in view of the challenge posed by the digitalisation of the financial sector is the work carried out in the year by the Banco de

¹ For further details, see Banco de España (2021), "Supervisory priorities in 2021", Section 2.1.2, 2020 Supervision Report.

CREDIT RISK: A SUPERVISORY PRIORITY

Both the Single Supervisory Mechanism (SSM) and the European Banking Authority decided to include credit risk management as the top supervisory priority area for 2021, in view of the possible further deterioration in loan quality resulting from the COVID-19 crisis and the consequent worsening of the macroeconomic environment.

In November 2020, the SSM designed a coordinated strategy geared towards ensuring that institutions have sound management practices in place to identify, measure and mitigate the impact of credit risk, as well as the operational capacity needed to manage the expected increase in non-performing loans.

In particular, the supervisory focus has been on the early detection of asset impairment and an adequate provisioning policy, paying special attention to the economic sectors most vulnerable to the impact of the pandemic, without forgetting the measures already in place to reduce and remove existing NPLs from banks' balance sheets.

To this end, various analysis tasks have been carried out. Letters were sent to significant institutions (SIs) to obtain precise information on their operational capabilities to manage debtors in difficulty and their credit risk identification and measurement practices. With regard to vulnerable sectors, reviews were focused on the hospitality and food service sectors and commercial real estate.

In the framework of the Supervisory Review and Evaluation Process (SREP), the assessment of credit risk has been given priority over other risks, and the corresponding methodological adjustments have been made to better capture the effects of the pandemic.

Lastly, 2021 was the first year in which the SREP has included a demand for higher capital due to the shortfall in relation to supervisory expectations of additional coverage of older non-performing exposures (for more details, see the European Central Bank's "Communication on supervisory coverage expectations for NPEs" of 22 August 2019).

Despite initial fears of an increase in credit risk in the system with the pandemic crisis, the NPL ratio of SIs under SSM supervision continued to fall in 2021, to an average of 2.32% in June 2021, as compared to 2.94% in June 2020. In the case of Spain, the ratio rose slightly to 3.13%¹ in June 2021 (it was 3.02% in June 2020).

Looking forward, credit risk is also among the strategic objectives and priorities set by the SSM for 2022-2024, in which work will again focus on analysing shortcomings in management frameworks, exposures to sectors vulnerable to the pandemic (including commercial real estate) and, as a new development, exposures to leveraged finance and counterparty credit risk.²

¹ Data obtained from *Supervisory Banking Statistics-Second quarter 2021* for the 11 Spanish SIs.

² Access the website from this link (<https://www.bankingsupervision.europa.eu/banking/priorities>).

España and other supervisory authorities in the implementation of the so-called Sandbox (for more details, see Box 2.10 at the end of this chapter).

- 4 Governance. Supervision in this area was focused mainly on monitoring institutions' crisis management procedures and their ability to adapt and to implement these procedures adequately in this situation. Also, the risk management systems' capacity to provide relevant information and data was analysed. In addition, analysis continued on the prudential impact of money laundering and terrorist financing (ML/TF) risk and its relationship with institutions' internal control framework. Lastly, an assessment of

TIBER-ES: A FRAMEWORK FOR STRENGTHENING FINANCIAL SECTOR CYBERSECURITY

In a context in which the provision of financial services is fundamentally digital, it is crucial that financial institutions have an adequate level of cybersecurity. In recent years, as the digitalisation of the sector has progressed, cyber attacks have intensified significantly in terms of volume and sophistication. It should not be forgotten that the financial sector is particularly attractive to various types of attackers, from those seeking illicit economic gain to those seeking to destabilise society.

Therefore, institutions need to be constantly prepared to deal with cyber threats. This means improving not only their protection and detection capabilities, but also the capabilities that enable them to respond effectively to a cyber incident. It should be noted that while technical measures are essential, it is no less important to protect the human factor, which is often successfully exploited by cyber attackers. To this end, institutions must provide training and raise awareness among all their employees on the subject of cybersecurity, including senior management. Lastly, institutions need to establish organisational processes that allow for an agile and coordinated response and ensure the necessary communication.

As part of its commitment to improving the financial sector's cybersecurity, the Banco de España has

adopted the advanced cybersecurity testing framework, TIBER-ES. This framework constitutes the local adoption of TIBER-EU, published by the European Central Bank, and will allow any financial institution or financial market infrastructure operating in Spain to voluntarily undergo a TIBER-ES test. The National Securities Market Commission and the Directorate General of Insurance and Pension Funds are collaborating in the adoption, and the role of the three authorities is to validate that the tests are carried out in line with the framework's requirements.

Testing under the TIBER-ES framework enables financial institutions to enhance their cybersecurity capabilities. These tests, which are conducted by an external provider without the institution's defensive teams being informed, simulate a sophisticated cyber attack on production systems. The objective is for the institution to detect possible weaknesses in the three above-mentioned factors: technical, human and organisational, which could be exploited by a real attacker. While the sophistication of these tests makes them recommendable only for institutions with the highest level of cybersecurity maturity, TIBER-ES aims to be a catalyst to encourage all institutions to improve their capabilities, until they become candidates to undergo this type of test.

technological and cyber risk was carried out (Box 2.2), with a particular focus on risks arising from the outsourcing of services.

Following a similar process, the Banco de España identified the key risks affecting Spanish LSIs and, for these institutions, it focused its work in 2021 on the following issues: i) credit risk management and, in particular, the analysis of the impact of the COVID-19 crisis; ii) the sustainability of business models in an environment of low interest rates, high levels of public debt and high efficiency ratios; iii) as regards governance, the assessment and monitoring of the composition and functioning of management bodies and other committees; iv) the analysis of institutions' capital position and their dividend payment policy; and v) technology risk, cybersecurity and operational resilience.

Lastly, it should be noted that the Banco de España and the CNMV, together with the ECB, continued to work in 2021 to encourage institutions to undergo an orderly transition to new benchmark rates following the elimination of EONIA (Euro Overnight Index Average) and LIBOR (London Interbank Offered Rates). For more details, see Box 2.3.

ELIMINATION OF THE LIBOR/EONIA INTEREST RATE BENCHMARKS

Since the beginning of the year, two of the most globally significant interest rate benchmarks have ceased to be published. These are the EONIA (Euro Overnight Index Average) and the LIBOR (London Interbank Offered Rates) for various currencies (euro, Japanese yen, pound sterling and Swiss franc). The US dollar LIBOR (USD LIBOR) was eliminated for some maturities, while others will continue to be published until 30 June 2023.¹

Interest rate benchmarks reflect the cost of interbank funding and, therefore, they are used in a wide variety of financial contracts and transactions and they are a key component in the functioning of the economy and the financial system. They are used for multiple purposes, such as the pricing and valuation of financial instruments, and institutions' risk management.

The interest rate benchmark reform was promoted by the G20 and the Financial Stability Board, and it was triggered by manipulation attempts and the decline in liquidity in money markets following the 2008 financial crisis.

The new European benchmark regulation (Regulation (EU) 2016/2011 —BMR—), in force since 1 January 2018, establishes the EONIA and Euribor as critical indices. Both have been reformed, albeit with different approaches. In the case of EONIA, it has been replaced by the Euro Short Term Rate² (€STR). The €STR and the recalibrated EONIA (€STR + 8.5 bp) coexisted until 3 January 2022, when the publication of the EONIA ceased. In the case of the Euribor, the methodology has only been improved to adapt it to the BMR, so it will continue to be published.

In addition, in order to ensure legal certainty in contracts, Regulation (EU) 2021/168, which amends the BMR, has introduced a mechanism allowing the European Commission to designate a statutory replacement rate applicable to contracts and financial instruments that do not contain a replacement benchmark and are subject to the law of a European Union Member State.

With regard to banks, the European Central Bank and, in Spain, the National Securities Market Commission and the Banco de España, have been issuing recommendations for banks to carry out an orderly transition, which includes the review of existing contracts, the formalisation of new contracts with the new benchmarks and the consideration of operational, systems, accounting and risk assessment matters and informing customers. In addition, in the second half of 2019, the Single Supervisory Mechanism (SSM) conducted a horizontal analysis of the eurozone banks' degree of preparation to identify good practices³ and intensify the monitoring of the banks lagging furthest behind. In the last quarter of 2021 it conducted a new survey of the institutions with most exposure to USD LIBOR in the SSM. The Banco de España Institutions' Conduct Department performed a supervisory action on multi-currency mortgage contracts indexed to LIBOR.

In Spain, the main benchmark is the Euribor, which is not being eliminated; however, there are still significant challenges relating to the renegotiation of contracts in other benchmarks maturing after 31 December 2021, and potential legal and conduct risks in the renegotiation of retail contracts.

1 The 1-week and 2-month USD LIBOR is eliminated. The overnight USD LIBOR and the 1-month, 3-month, 6-month and 12-month USD LIBOR will continue to be published.

2 The €STR reflects overnight unsecured deposit transactions and it was first published on 2 October 2019 by the ECB, the benchmark administrator.

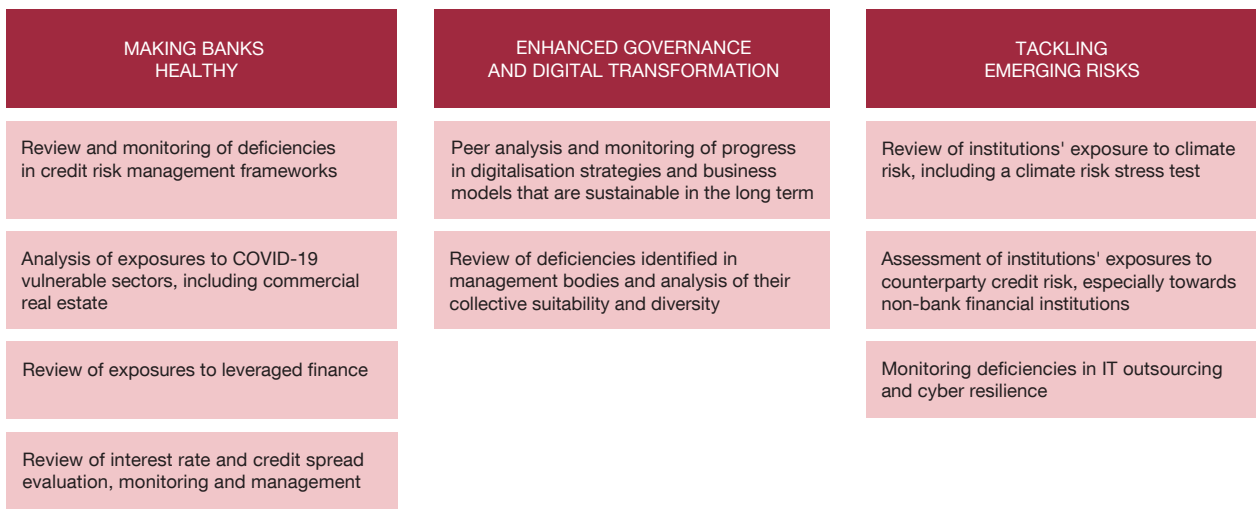
3 <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.reportpreparationsbenchmarkratereforms202007~bd86332836.en.pdf>.

2.1.3 Supervisory priorities in 2022

Based on an analysis of vulnerabilities in the banking sector and the identification of risks affecting banks, the SSM's supervisory priorities are set for the following time horizon (Figure 2.1). The intensity of the supervisory priorities should be adapted to the situation of each institution.

Figure 2.1

SSM SUPERVISORY PRIORITIES 2022



SOURCE: European Central Bank.

The defined priorities are set against the backdrop of an economic environment of recovery from the pandemic, although several uncertainties remain. While the euro area gross domestic product (GDP) would have reached pre-pandemic levels by the end of 2021, various uncertainties remain. On the one hand, this recovery is heterogeneous across countries, sectors and population groups. On the other hand, there is still uncertainty as to the evolution of the pandemic and various geopolitical risks remain, such as the risk relating to Russia's invasion of Ukraine. Moreover, the impact of the health crisis on credit quality could materialise to a greater extent once support measures are definitely withdrawn. Lastly, rising public and private debt levels and high market valuations increase vulnerability to potential abrupt shifts in interest rates and financial market corrections.

In this context, the first area of priority is geared towards tackling the impacts of the pandemic and promoting the banking sector's resilience in the context of exiting the crisis, paying particular attention to the possible deterioration of asset quality once public support measures are withdrawn and the moratoria and grace periods granted expire (Box 2.4), and to possible corrections in market valuations.

The second priority area is aimed at addressing institutions' structural vulnerabilities through digital transformation and improved governance. Institutions have accelerated their digitalisation plans to cope with the pandemic, serve their customers and handle growing competition from FinTechs and BigTechs. In a context of overcapacity and weak profitability, these initiatives may be an opportunity to increase efficiency and generate new income. In addition, work will

DEVELOPMENTS IN EASING AND STABILISATION MEASURES

In order to tackle and mitigate the economic and social impact of COVID-19, in 2020 most European countries introduced support programmes, such as moratoriums and public guarantees. Also, in the area of supervision, the authorities adopted measures focused on easing capital and liquidity requirements and lightening certain operational burdens imposed by supervision.

In 2021, the granting of moratoriums and of financing to companies with Official Credit Institute (ICO) guarantees was much lower than in 2020, since the latest deadline for granting moratoriums under the European Banking Authority's guidelines was March 2021, and the ICO guarantee programme, while remaining active throughout 2021, had already been largely used up in 2020.

On 30 September 2021, loans that had benefited from moratoria¹ in Spain amounted to EUR 44.1 billion (i.e., 4.3% of total company, household and self-employed portfolios), 89% of the moratoria had expired and their NPL ratio at that date was 10.6%.

In relation to the State guarantees granted in Spain, by September 2021 94% of the initial programme had been completed, representing a liquidity injection of EUR 131.6 billion (69.8% drawn down), of which 73% has been granted to the self-employed and SMEs and the remaining 27% to large companies. Of the total risk, the portion guaranteed by the ICO amounts to EUR 100.2 billion (76.1%). In terms of their accounting classification, ICO exposures continued to have low NPL ratios (2.7% in September 2021), although a significant portion were

Stage 2 exposures (21.1% in September 2021) and they were beginning to show signs of impairment.

In September 2021, 39% of these transactions still benefited from grace periods, most of which expire in mid-2022. Following the extensions of Royal Decree-Law 34/2020, the maturities, which were previously concentrated in mid-2025, have been distributed between 2025, 2026 and 2028, diluting any potential cliff effect.

As regards the easing of prudential requirements, it should be noted that, taking into account the economic and financial performance to date and the gradual return to normality in most banks, no further deferrals are foreseen for the easing measures and decisions implemented in 2020 in response to the pandemic crisis.

The supervisor expects institutions to comply with the overall minimum level of the 100% liquidity coverage ratio from 1 January 2022. However, it will continue to allow banks to operate below Pillar 2 guidance and the combined buffer requirement until at least the end of 2022, without this automatically triggering supervisory action. In June 2021 the supervisor extended until the end of March 2022 the exclusion of certain exposures to central banks from the leverage ratio; however, in February 2022 the European Central Bank announced that it no longer considered it necessary to extend the exclusion beyond 31 March 2022.

As regards institutions' profit distribution policy, in July 2021 the ECB and the Banco de España decided against extending their recommendations aimed at limiting dividend distributions and share buybacks.

¹ Moratorium data relating to significant institutions in Spain, since Common Reporting on moratoria is only reported by these institutions.

continue on improving management bodies' capacities to resolve internal control and data management problems.

Lastly, the third priority area relates to emerging risks. These include climate and environmental risk, counterparty risk, especially vis-à-vis non-bank financial institutions, and IT-related risk.

In addition, the Banco de España identified the risks particularly affecting Spanish LSIs. On this basis, the following six priority areas were established:

- i) credit risk management, especially considering the possible increase in non-performing loans as a result of the health crisis;
- ii) business models and sustainability, in an environment of ever-narrowing margins;
- iii) governance, with the focus on monitoring the measures adopted by cooperatives following the horizontal review carried out;
- iv) capital strength, especially in institutions with high capital concentration or have scant surplus capital over the regulatory requirements;
- (v) technological innovation, with the focus on outsourced core functions;
and
- (vi) risks arising from climate change and environmental deterioration.

2.2 Supervision of credit institutions

The ECB assumes direct supervision of SIs and performs indirect supervision of LSIs, in accordance with the division of tasks set out in Figure 2.2. Direct supervision of LSIs incorporated in Spain is the responsibility of the Banco de España.

At the end of 2021 there were 115 significant groups in the SSM, of which, as shown in Table 2.1, 10 were Spanish, accounting for 90.2% of the total banking assets of the Spanish banking system. This table shows that there were 57 LSIs incorporated in Spain, the asset weighting of which was 5.7% of the total Spanish banking system. In addition, Table 2.2 classifies the credit institutions operating in Spain by institution type and details the registrations and deregistrations in the year.

The supervision of both SIs and LSIs is carried out through two complementary channels: ongoing off-site supervision and on-site supervision. The objective of ongoing off-site supervision is to maintain an up-to-date assessment of the institutions' situation and risk profile, and to establish, on this basis and on the basis of their relative importance, the supervisory actions to be carried out and their depth.

In turn, on-site supervision includes inspections and internal model investigations. The inspections allow the verification of any of the elements affecting the institutions by analysing them in greater depth. Internal model investigations relate to the review and, where appropriate, authorisation of the models for calculating the capital requirements necessary to cover credit, counterparty, market and operational risks.

Figure 2.2

DISTRIBUTION OF SUPERVISORY POWERS

	Tasks assigned to the ECB within the SSM	Tasks assigned to the NCAs within the SSM
Supervision of SIs	Direct supervision of SIs	Assistance to the ECB for SIs supervision: participation in JSTs and in on-site inspections
Supervision of LSIs	Indirect supervision of LSIs	Direct supervision of LSIs
Common procedures	The common procedures are the responsibility of the ECB, with proposal by the NCAs: granting and withdrawal of authorisations to/from credit institutions and of authorisations to purchase/sell qualifying holdings in credit institutions	Preparation of proposals for SIs and LSIs
Sanctions	SIs: sanctioning powers in the event of non-compliance with directly applicable EU law, except non-pecuniary penalties and penalties on individuals LSIs: sanctioning powers in the event of non-compliance with an ECB decision or regulation	SIs: sanctioning powers, upon prior examination by the ECB, for non-compliance with national laws transposed from EU directives; for infringements by directors and managers; and for non-pecuniary penalties LSIs: sanctioning powers for other instances of non-compliance, in some cases after prior examination by the ECB
Macroprudential measures	Possibility of tightening certain macroprudential policy measures set by the national authorities, if deemed justified	Initiative to implement macroprudential policy measures in close cooperation with the ECB (and any other European bodies)
Tasks outside the SSM's scope: the Banco de España's powers		
Conduct and transparency	Supervision and sanctioning in the areas of market conduct, transparency and consumer protection of Spanish CIs and institutions other than CIs	
Supervision of other institutions	Supervisory and sanctioning functions regarding the Official Credit Institute and institutions other than CIs: SLIs, PIs, ELMIs, currency-exchange bureaux, mutual guarantee societies, reguarantee companies, appraisal companies, banking foundations, Sareb and branches of third-country institutions	
Money laundering	Cooperation with CPMLMO and SEPBLAC in AML/CTF	
Provision of payment services	Supervision of the provision of payment services	

SOURCE: Banco de España.

The Banco de España contributes significantly to the supervision of Spanish SIs, with a presence in the Joint Supervisory Teams (JSTs) and in inspections and model investigations.

The Banco de España also participates in decision-making affecting credit institutions through its representatives on the ECB Governing Council and on

Table 2.1

SPANISH CREDIT INSTITUTIONS

Data at 31 December

	2020		2021	
	Groups	Assets (%)	Groups	Assets (%)
Significant institutions				
Spanish groups of credit institutions	12	90.7	10	90.2
EU subsidiaries and branches (a)	27	3.8	26	3.6
Less significant institutions				
Spanish credit institutions (b)	59	5.1	57	5.7
Branches of institutions from non-SSM EU countries	2	0.0	0	0.0
Branches of institutions from SSM EU countries (a)	33	0.3	40	0.3
Non-EU branches	3	0.2	4	0.2
TOTAL	136		137	

SOURCES: European Central Bank and Banco de España.

NOTE: The figures for the institutions' assets have been obtained after the data cut-off date.

- a** Two or more branches/subsidiaries are deemed to belong to the same group when they are part of a higher consolidated group, even if the latter is not Spanish.
- b** Including subsidiaries from EU and non-EU countries.

Table 2.2

REGISTER OF CREDIT INSTITUTIONS

Data at 31 December

	2016	2017	2018	2019	2020	2021		
						Registrations	Deregistrations	Year-end
Credit institutions	208	207	198	197	193	10	8	195
Banks	60	59	52	52	51	1	4	48
Savings banks	2	2	2	2	2			2
Credit cooperatives	63	63	62	61	61			61
ICO	1	1	1	1	1			1
Branches of EU credit institutions	77	78	78	78	75	8	4	79
Branches of non-EU credit institutions	5	4	3	3	3	1		4
Controlling companies	4	3	5	6	5		5	0
TOTAL	212	210	203	203	198	10	13	195

SOURCE: Banco de España.

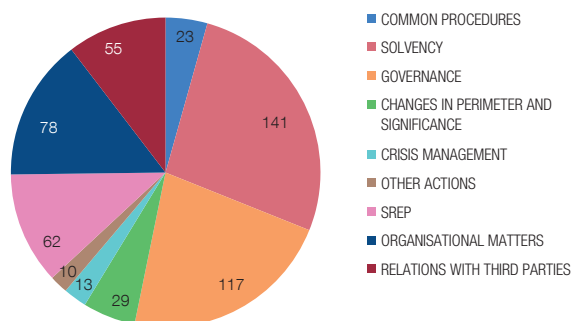
the SB. In 2021, the SB has taken a total of 2,362 decisions, of which 528 affected Spanish institutions, as shown in Chart 2.9. Of the 528 decisions, 282 were addressed directly to Spanish SIs, 10 to Spanish LSIs and 236 were more general decisions, which also affect Spanish entities. These decisions are regularly reported to the Executive Commission of the Banco de España.

Chart 2.9

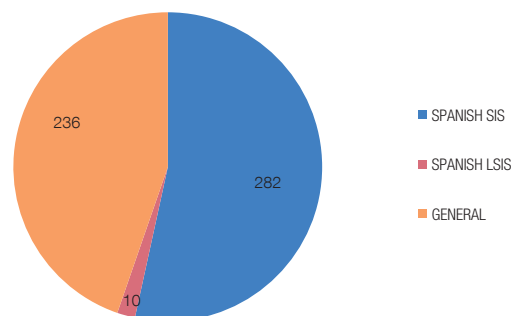
DISTRIBUTION OF THE ECB DECISIONS AND ACTIONS IN 2021 NOTIFIED TO THE EXECUTIVE COMMISSION

In 2021, there was a significant increase in SREP decisions with respect to the previous year, in which a simplified approach was adopted. There was also an increase in decisions linked to relations with third parties and to organisational issues. Lastly, the number of actions in the crisis management area fell, since this area includes the actions relating to the management of COVID-19.

1 BY CATEGORY



2 BY TYPE OF INSTITUTION



SOURCE: Banco de España.

2.2.1 Ongoing supervision of significant institutions

The JSTs are tasked with the ongoing supervision of SIs. The JSTs of Spanish SIs comprise ECB and Banco de España staff and, where appropriate, staff from other NCAs of SSM countries where the institutions operate. Each JST performs its tasks under the coordination of an ECB representative who, in turn, is assisted by a coordinator from the Banco de España.

The Bank participates in the JSTs for the 10 groups of Spanish credit institutions classified as significant pursuant to the SSM’s² criteria, and likewise in some of the JSTs for 25 significant banking groups from SSM countries that have a presence in Spain (operating through 4 subsidiaries and 40 branches established in Spain). At the end of 2021, the Banco de España contributed a total of 131 employees to the JSTs of Spanish banks.

As detailed below, prominent among the ongoing off-site supervisory tasks are those related to the Supervisory Review and Evaluation Process (SREP) – the most demanding in terms of effort and time. In addition, the JSTs conduct institution-specific in-depth reviews (deep dives) to analyse the areas that may be of greater supervisory concern or to obtain more in-depth knowledge of specific aspects and verify the functioning of certain policies or procedures.

2 Following the two mergers announced in 2020 and completed in 2021 (CaixaBank-Bankia and Unicaja-Liberbank), the number of groups of significant Spanish credit institutions fell from 12 to 10.

A significant portion of resources are also consumed by cross-institutional reviews, which are conducted uniformly for all or several SSM institutions in areas that represent a priority from a supervisory point of view. Also worthy of note in 2021 are the following horizontal reviews, some of which were initiated the previous year:

- Monitoring of NPL coverage and of compliance with the Addendum to the ECB Guidance to banks on non-performing loans.
- In December 2020, Dear CEO letters were sent on the identification and measurement of credit risk in the context of the COVID-19 pandemic, reporting on supervisory expectations for credit risk management and provisioning. Weaknesses identified in the review of institutions' responses have been taken into account in the SREP and institutions have been requested to correct them.
- Analysis of sectors vulnerable to the COVID-19 crisis. A cross-cutting review of the institutions most exposed to the hospitality sector was launched at the beginning of the year and, subsequently, a review was commenced on the commercial real estate sector.
- Analysis of the degree of alignment of institutions' practices with the ECB's *Guide on climate-related and environmental risks* and review of the self-assessment exercise carried out by the institutions (Box 2.5).
- Review of the executive role of the heads of supervised institutions and of existing counterbalancing measures, where appropriate.
- Review of recovery plans, including most notably the assessment of overall recovery capacity, which provides an overview of the extent to which the institution could restore its financial situation after a significant deterioration therein.

Another significant area of activity is the collaboration of JSTs in on-site actions, described in detail in section 2.2.3. The JSTs are involved in the preparation and definition of the objectives of each action, and in the monitoring of shortcomings identified and of implementation of measures to remedy them. It is also common practice for some JST members to form part of the inspection teams, in order to share information and knowledge on the institution.

In addition, there are other tasks, such as: i) processing authorisations; ii) coordination with other supervisors, mainly through supervisory colleges; and (iii) participation in stress tests conducted by the ECB and the EBA.

With regard to the above-mentioned SREP, it is worth recalling that last year the ECB decided, in view of the COVID-19 crisis, to follow a simplified,

SUPERVISION OF CLIMATE AND ENVIRONMENTAL RISKS

Credit institutions face a number of emerging and evolving risks that may materialise in both the short and long term, such as the risks arising from climate change and environmental degradation. Tackling these risks will undoubtedly be one of the main challenges for institutions and supervisors in the coming years.

Therefore, it is essential that institutions assess this situation and have in place adequate mechanisms and procedures to react to these risks, and that the banking supervisor designs and calibrates its supervisory response appropriately.

To this end, both significant institutions (SIs), under the direct supervision of the European Central Bank (ECB), and less significant institutions (LSIs), under the supervision of the Banco de España, have been asked to carry out a self-assessment exercise regarding the degree to which their banking practices match the supervisory expectations on the management of climate risks and risks deriving from environmental deterioration, published in the last quarter of 2020.¹ In the case of SIs, this exercise was supplemented with the submission of implementation plans aimed at improving this alignment.

The aggregate results of the recent assessment carried out by the ECB in collaboration with some national competent authorities (including the Banco de España) have been published in a report in November 2021, which highlights the following messages:

- institutions have made some progress in adapting their banking practices, but most of them are aware that they are in the early stages of development;
- those institutions that have carried out a comprehensive assessment of climate and environmental risks foresee a material impact on their risk profile in the next three to five years, and they identify credit, operational and business model risks as being the most sensitive;
- although institutions have started to take the first steps, especially in relation to transition risks, they still have a lot of work to do in terms of managing risks deriving from climate change.

In addition, under its mandate to assess the possible inclusion of environmental, social and governance (ESG) risks in the supervisory review and evaluation, the European Banking Authority published in June 2020 a report² on how climate and environmental risks should be incorporated into the regulatory and supervisory framework for credit institutions and investment firms.

Finally, the ECB will pursue two main initiatives next year in the area of climate risk supervision: a climate stress test and a thematic review of the assessment of institutions' progress in coming into line with supervisory expectations.

¹ See the “ECB Guide on climate-related and environmental risks”, published in November 2020, and the “Guide to supervisory expectations relating to the risks posed by climate change and environmental degradation”, published by the Banco de España in October 2020.

² See “EBA report on ESG risks management and supervisión”, published in June 2021.

pragmatic and flexible approach. In 2021 the return to relative normality allowed the JSTs to apply the full SREP methodology, as set out in the EBA guidelines (EBA/GL/2014/13) and in the SSM supervisory manuals.

The SREP findings provide a snapshot of where each bank stands with respect to capital and liquidity requirements, and they also make it possible to perform a suitability assessment of their governance and their risk controls. Naturally, this analysis helps determine the appropriate degree of supervisory intensity for each institution as part of the next supervisory review programme, but more importantly, it is through this annual process that the capital requirements (P2R) and

guidance (P2G) are set for the following year. In addition, qualitative requirements are established in line with the situation of each institution.

The so-called “P2R” is a specific Pillar 2 capital requirement that covers the risks which are underestimated or not covered by the minimum capital requirement (Pillar 1). P2R is binding, i.e. any breaches can have legal consequences, e.g. in terms of restricting dividend payments and the payment of interest on certain issues that are eligible for inclusion in capital. The ECB publishes specific P2Rs for each institution under its supervision, so this information has been made public³.

With regard to the methodology followed in the SREP for determining P2R, the ECB introduced several amendments in 2021 to reflect changes made in the Capital Requirements Directive V (CRD-V)⁴ and in EBA guidelines. Greater emphasis has been placed, inter alia, on each institution’s internal capital adequacy assessment process (ICAAP) and on peer comparisons. The coverage shortfalls in non-performing exposures, determined in line with supervisory expectations, were also included in the P2R calculation and, with the aim of improving transparency towards banks, a SREP summary letter was sent for the first time, reviewing the main requirements and areas of supervisory attention identified in the SREP.

The P2G is a bank-specific recommendation that reflects the level of capital that the ECB expects banks to maintain. P2G acts as an additional buffer to ensure that banks withstand a stressed period, but it is not legally binding.

In 2021 the SSM introduced a new approach for determining bank-specific P2G levels, which is based on their periodic stress test results. It is a two-step methodology: i) In the first step, banks are placed in one of four buckets according to the depletion of their capital ratios in the stress test. Each bucket has a corresponding range of P2G, which overlaps with neighbouring buckets. ii) In a second step, supervisors set the final P2G within the range of the bucket, taking into account banks’ individual situations, such as their risk profiles and the year in which their capital reached its lowest point during the stress test⁵.

The stress tests that were originally scheduled for 2020, but which had to be postponed due to the COVID-19 crisis, were carried out in 2021. The EBA exercise includes stress tests on 50 EU credit institutions, 38 of which are supervised by the SSM (Box 2.6). Also, in parallel, and following criteria consistent with those

3 See the website <https://www.bankingsupervision.europa.eu/banking/srep/html/p2r.en.html>.

4 Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers, and capital conservation measures.

5 For more details, see the website <https://www.bankingsupervision.europa.eu/banking/srep/html/p2g.es.html>.

2021 EUROPEAN STRESS TEST

Due to the pandemic, the European Banking Authority’s stress test scheduled for 2020 was postponed to 2021. 50 groups of European credit institutions, representing approximately 70% of the European Union banking sector assets, participated in this test. In the case of Spain, four institutions took part: Santander, BBVA, Sabadell and Bankinter. Caixabank did not take part since it was in the process of merging with Bankia.

These tests are intended to assess the banks’ resilience to two macroeconomic scenarios – a baseline and an adverse scenario– and they represent a transparency exercise seeking to strengthen market discipline. Compared with previous years, the design of this year’s adverse scenario has put further stress on bank balance sheets, following the significant fall in GDP in 2020.

Charts 1 and 2 show the stress test results in terms of phase-in and fully-loaded Common Equity Tier 1 (CET-1).

These results reflect Spanish banks’ resilience to the adverse scenario, with satisfactory capital levels despite their higher severity. Spanish banks’ fully-loaded CET-1 ratio fell by an average of 290 b.p., less than that of the European banks participating in the stress test taken as a whole (485 b.p.). This is due, among other factors, to the improvement that has been taking place in their balance sheet repair.

As in previous years, no minimum capital thresholds were set. However, the outcome of the adverse scenario served as the basis for determining Pillar 2 Guidance, and the supervisory review and evaluation process also took into account certain qualitative aspects of the conduct of this exercise.

Chart 1
TRANSITIONAL CET1 RATIO ADVERSE SCENARIO

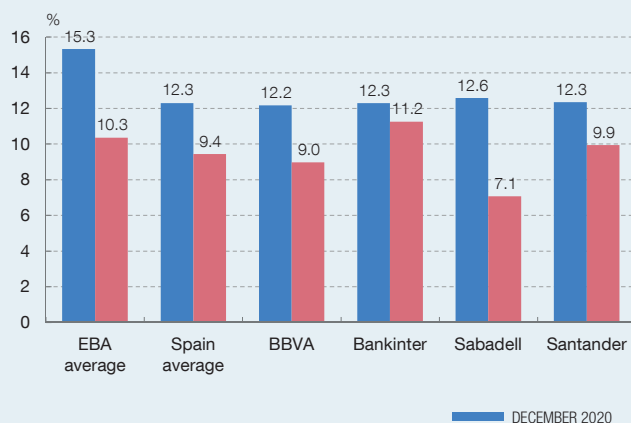
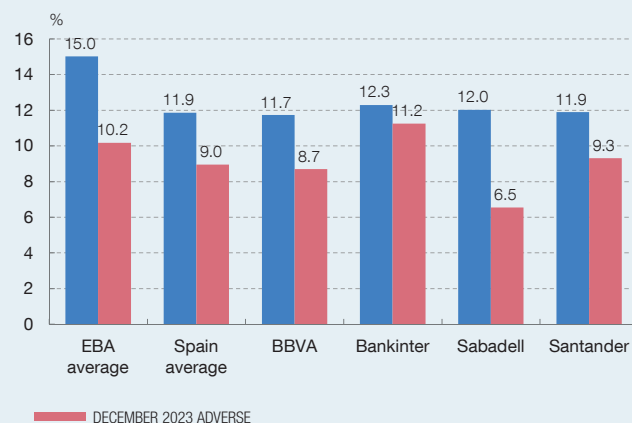


Chart 2
FULLY-LOADED CET1 RATIO ADVERSE SCENARIO



applied in the EBA exercise, the ECB conducted stress tests on a further 51 medium-sized euro-area SIs.

As could be expected, the scenarios applied in the stress tests took into account the effect of the pandemic; thus, the adverse scenario assumes that a prolonged impact of COVID-19 would extend the low interest rate environment.

The results for the adverse scenario show a reduction in the Common Equity Tier 1 (CET1) ratio for the 89 SSM supervised credit institutions included in the

stress tests by -5.2 pp to 9.9% in 2023⁶ and, therefore, it can be concluded that the eurozone banking system shows considerable resilience to such a negative scenario at the aggregate level.

The main capital depletion in the adverse scenario arises from the projected credit losses and the lower net interest and fee income, as well as the impact of credit spread shocks on portfolios measured at fair value.

2.2.2 Ongoing supervision of less significant institutions, non-EU branches and the ICO

The Banco de España is responsible for the direct supervision of Spanish LSIs, while the ECB is responsible for their indirect supervision. The Banco de España likewise performs supervisory functions on the branches of LSIs from other SSM countries and the rest of the EU, along with the branches of non-EU credit institutions. This set of institutions accounts for 6.2% of the Spanish banking system's assets. Chart 2.10 details the weight of each institution type, calculated based on their total assets. The Banco de España also supervises the ICO.

The action plan, which details the following year's supervisory activities, is prepared on the basis of the supervisory priorities. The monitoring tasks were focused on the supervisory priorities set for 2021 which concerned the effects of the crisis on the supervised institutions, paying particular attention to their credit quality and operational risk, especially in relation to cybersecurity and business continuity.

As part of ongoing supervision, each institution's performance is monitored periodically. The monitoring may vary in depth and is conducted in accordance with the principle of proportionality, considering factors such as each institution's risk profile, size, volume of retail deposits and business model. This is based on quarterly alerts using the information in the confidential reporting and the Banco de España's central credit register (CCR) in order to detect potential future problems relating to liquidity, solvency or business model sustainability.

In addition to the recurring aspects that are typically assessed on a quarterly basis (solvency, liquidity, profitability and management and governance quality), this year, in view of the persistence of the COVID-19 crisis, monitoring was bolstered for aspects relating to credit risk and the impact on profitability and liquidity.

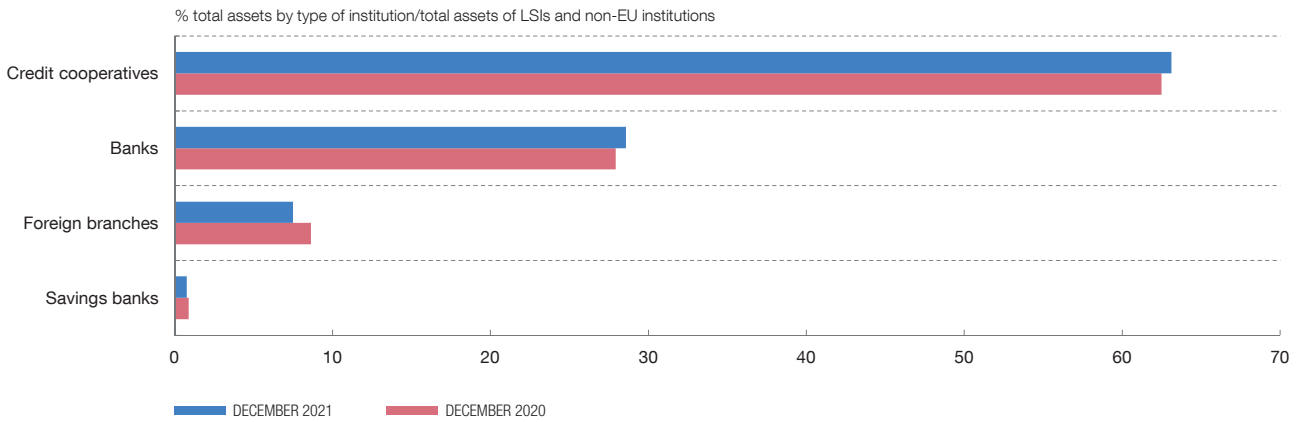
In 2021, quarterly monitoring was conducted for the 57 Spanish LSI groups.

⁶ For further information on this exercise and the results thereof, see the ECB [press release](#) of 30 July 2021.

Chart 2.10

WEIGHT OF THE VARIOUS TYPES OF LSIs AND NON-EU BRANCHES

The asset volume of LSIs and non-EU branches as a whole grew by 21%, with a more pronounced increase in the cooperatives segment, followed by banks, where there was a noteworthy registration of a new banking subsidiary of a Swiss institution.



SOURCE: Banco de España.

NOTE: The figures for the assets of institutions in 2021 were obtained after the data cut-off date.

Other actions as part of ongoing supervision include reviews of external audit reports, internal capital and liquidity adequacy assessment reports and recovery plans, and meetings with the external auditor and with persons in positions of responsibility at the institutions.

As is the case for SIs, the SREP is one of the key tasks of ongoing off-site supervision, and in 2021 a P2G was set for each institution for the first time.

The SREP conclusions take into account the results of the stress test known as the Forward-Looking Exercise on Spanish Banks (FLESB), which is conducted annually by the DGFSRR to assess the resilience of Spanish institutions⁷. Once the related 2021 SREPs had concluded and the institutions’ representations had been considered, the Banco de España adopted the 2022 capital decisions for LSIs and the P2G.

The Banco de España has continued to cooperate with other NCAs in the context of the supervisory colleges of LSIs in other SSM countries with subsidiaries in Spain. It participated in a total of three colleges⁸ in 2021, contributing to joint decisions on capital and liquidity requirements.

Since the branches in Spain of institutions with head offices in other EU Member States (including those of countries not participating in the SSM and those of LSIs

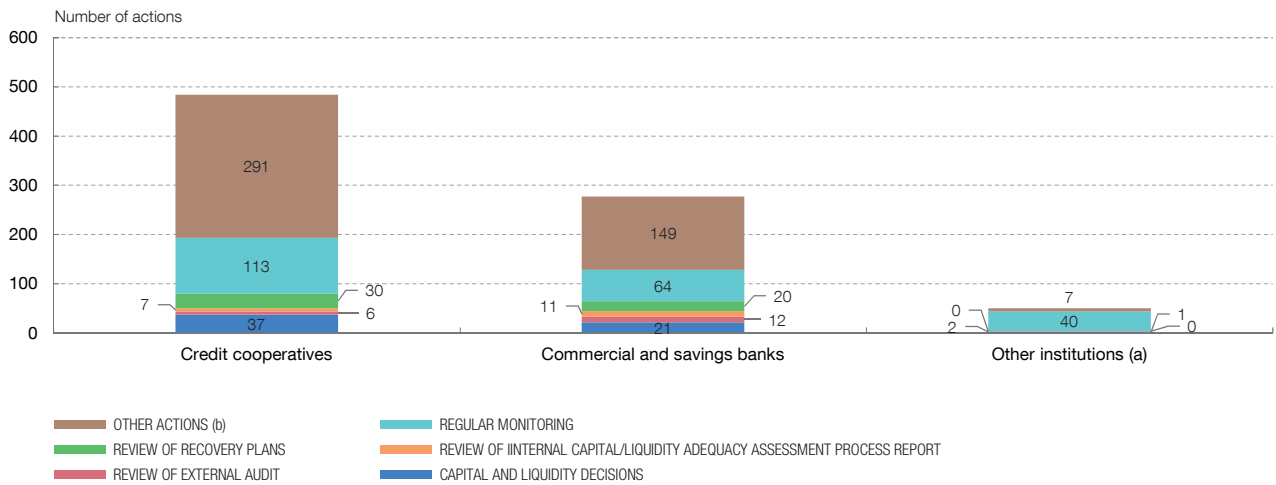
7 For a summary of the results of the latest stress tests, see Banco de España (2020), “Risks to the financial sector and its resilience”, Chapter 2, Financial Stability Report, Autumn 2020.

8 One of the subsidiaries has become a branch, so there will no longer be a college for it in 2022.

Chart 2.11

NUMBER OF ONGOING OFF-SITE SUPERVISORY ACTIONS AT LSIs, NON-EU BRANCHES AND THE ICO

New developments in 2021 were the reviews in institutions which had been granted larger moratoria and/or State guarantees, the detailed monitoring of the supervision requirements and recommendations, and the transversal review of the decisions on dividend payments, outsourcing and governance and on the analysis of resolution plans.



SOURCE: Banco de España.

- a "Other institutions" include foreign branches and the ICO.
- b "Other actions" includes meetings with institutions, monitoring of requirements and recommendations, and ad hoc monitoring generally relating to the supervisory priorities defined in the year and to each institution's characteristics, risk profile and performance.

of other SSM countries) are not subject to prudential or liquidity requirements, periodic monitoring of the branch's performance is conducted, meetings are held with the management staff and information is regularly exchanged with the authorities of the branch's home country, under the terms established in Commission Implementing Regulation (EU) No 620/2014 of 4 June 2014 laying down implementing technical standards with regard to information exchange between competent authorities of home and host Member States.

As regards the branches in Spain of institutions with head offices in non-EU countries, the Banco de España's supervision also includes half-yearly monitoring, external audit reviews and regular meetings with branch management.

In 2021, a total of 861 ongoing supervisory actions for these institutions were undertaken, as detailed in Chart 2.11 by institution type and by supervisory matter.

2.2.3 On-site supervision

On-site supervision supplements the ongoing off-site supervision of institutions. It is carried out by different teams to those tasked with ongoing

Table 2.3

ON-SITE SUPERVISION OF CREDIT INSTITUTIONS. NUMBER OF ACTIONS

	2021		Total
	SIs	LSIs	
Inspections	16	6	22
at Spanish credit institutions	15 (a)	6	21
at credit institutions from other SSM countries	1		1
Model investigations	14	—	14
at Spanish credit institutions	13 (b)	—	13
at credit institutions from other SSM countries	1		1
TOTAL	30	6	36

SOURCE: Banco de España.

a Of which, 12 were led by Banco de España staff and 3 were led by ECB staff.

b Of which, 11 were led by Banco de España staff, 1 by Banco de Portugal and 1 by persons responsible from the ECB.

monitoring, with the aim of reinforcing their independence and the objectivity of the conclusions of their work.

In 2021, inspections and internal model investigations were mainly conducted off-site, using telematic means. From October 2021, the first steps were taken towards a hybrid model of actions, combining off-site work by inspectors with occasional visits to institutions' head offices.

Table 2.3 details the actions carried out in 2021 in which the Banco de España played a major role (i.e., all actions relating to Spanish institutions and the actions relating to institutions in other SSM countries led by Banco de España staff). The Banco de España also participated in an inspection of an SI of another SSM Member State, without leading it.

By type of risk, the 15 inspections conducted on Spanish SIs in 2021 were distributed as follows: 9 were focused on credit risk, and the others on technology risk (3), governance (1), interest rate risk (1) and business models (1).

A very substantial percentage of these inspections — 60%— were part of so-called “campaigns”. The inspections that fall within the scope of a campaign share the same subject matter and type of risk, use a common methodology and tools, and are monitored centrally by ECB teams in which inspectors from national supervisory authorities also participate.

Of the campaigns under way in 2021, the most relevant for Spanish institutions was the one aimed at reviewing the models for estimating mortgage and SME loan loss provisions, within the framework of International Financial Reporting Standard 9. Specifically, seven Spanish institutions were included in this campaign.

Most of the model investigations were focused on credit risk models, while two were focused on market risk. In terms of content, the bulk of missions were aimed at reviewing material changes to models arising from adaptations to the new EBA guidelines (mainly guidelines on the estimation of PD and LGD, and new definition of default) and from the resolution of outstanding obligations arising from the specific internal model review.

Lastly, the supervisory plan for LSIs is approved by the Banco de España's Executive Commission, since they are subject to the Banco de España's direct supervision. However, the ECB is kept apprised of the content of the plan. In 2021, six inspections were performed at LSIs. A further eight are planned for 2022.

The inspections conducted at LSIs during 2021 emphasised the assessment of credit quality, foreclosed assets, governance and solvency, along with IT-related matters. Section 2.2.6 includes information on the content of the letters sent as a result of inspections.

2.2.4 Dividend distribution and variable remuneration policies

Institutions' profit distribution policies must comply with the precautionary principle and be designed to maintain an adequate level of capitalisation at all times. For this purpose, the competent authorities make an annual recommendation on the distribution of profit.

In response to the situation generated by the COVID-19 pandemic, the ECB and the European Systemic Risk Board (ESRB) issued a series of recommendations in 2020 aimed at limiting dividend distributions and share buybacks. In particular, the ECB recommendations were addressed to the significant institutions and groups that it supervises directly. Also, through letters sent to the CEO of each SI, the ECB asked the institutions to be extraordinarily prudent in the payment of variable remuneration. The Banco de España extended these measures to the LSIs.

Against the background of the results obtained in the EU bank stress tests, and of macroeconomic projections pointing to the start of economic recovery, the ECB decided on 23 July 2021 not to extend its previous recommendation on the distribution of profit, so that it ceased to be in force from 30 September. Similarly, the ESRB announced the lifting of its dividend recommendation as of the same date.

Instead of the previous recommendation, on the same date, the ECB published a press release in which, while not setting limits, it recommends banks to remain prudent in their dividend distribution and share buyback decisions, taking into particular consideration the sustainability of their business models. In particular,

the ECB recommends that the impact on capital projections of future loss materialisation after the support measures expire should not be underestimated.

Moreover, the ECB and ESRB statements reiterated the expectation that institutions should adopt a prudent and forward-looking approach in their variable remuneration policies. In particular, the ECB adds that it will continue to assess these policies and their impact on institutions' ability to maintain a sound capital base, as part of its supervisory review process.

In this course of action, on 23 July 2021 the Banco de España also agreed not to extend the limitation on dividend distributions, which had been in force until 30 September, and to extend the ECB's new supervisory expectations to LSIs that are under direct supervision by the Banco de España.

2.2.5 Common procedures, suitability and other procedures

Common procedures are those relating to the authorisation to carry on the activity of credit institutions, the withdrawal of such authorisation and the acquisition of qualifying holdings. They are set out in ECB Regulation (EU) No 468/2014 establishing the framework for cooperation within the SSM between the ECB and NCAs. In these procedures, for Spanish institutions, the Banco de España makes an initial assessment and formulates a draft decision for each specific case. Subsequently, on the basis of this proposal and any additional work it deems appropriate, the ECB adopts a definitive decision. Noteworthy among the rest of the procedures is the suitability procedure.

In this respect, in 2021 the Banco de España participated in the authorisation of credit institutions, submitting two proposals for final authorisation to the ECB. Table 2.4 shows the details of other common procedures and the rest of the procedures on credit institutions in which the Banco de España has participated.

On 27 January 2021, the ECB launched the so-called "IMAS Portal" for both significant and less significant credit institutions. This portal, developed by the ECB in cooperation with the NCAs, was created to respond to the sector's needs and as a step forward in automating and reducing the bureaucracy of other authorisation procedures. Also, the [IMAS Portal](#) is configured as a user interface that allows credit institutions to interact directly with the supervisor and see the status of procedures in real time, thus increasing the transparency of these supervisory actions while reducing operational risk.

Since its entry into operation, the IMAS Portal has been implemented in the following procedures, although the degree of participation of the various NCAs is still uneven:

Table 2.4

PROCEDURES IN RESPECT OF CREDIT INSTITUTIONS INVOLVING THE BANCO DE ESPAÑA

	Total
Qualifying holdings, merger, spin-off and other significant acquisitions	16
Cross-border activity of Spanish credit institutions	71
Branches in the EU	22
Branches in third countries	4
Freedom to provide services	35
Representative offices	10
Cessation of business	
Loans to senior officers	36
Suitability of senior officers (a)	233
Procedures relating to own funds	89
Amendments to articles of association	22
Climate change	55
Communications with other supervisory authorities or institutions	23
Other procedures	41
TOTAL	586

SOURCE: Banco de España.

a Includes 17 suitability assessments on senior officers of mixed financial holding companies.

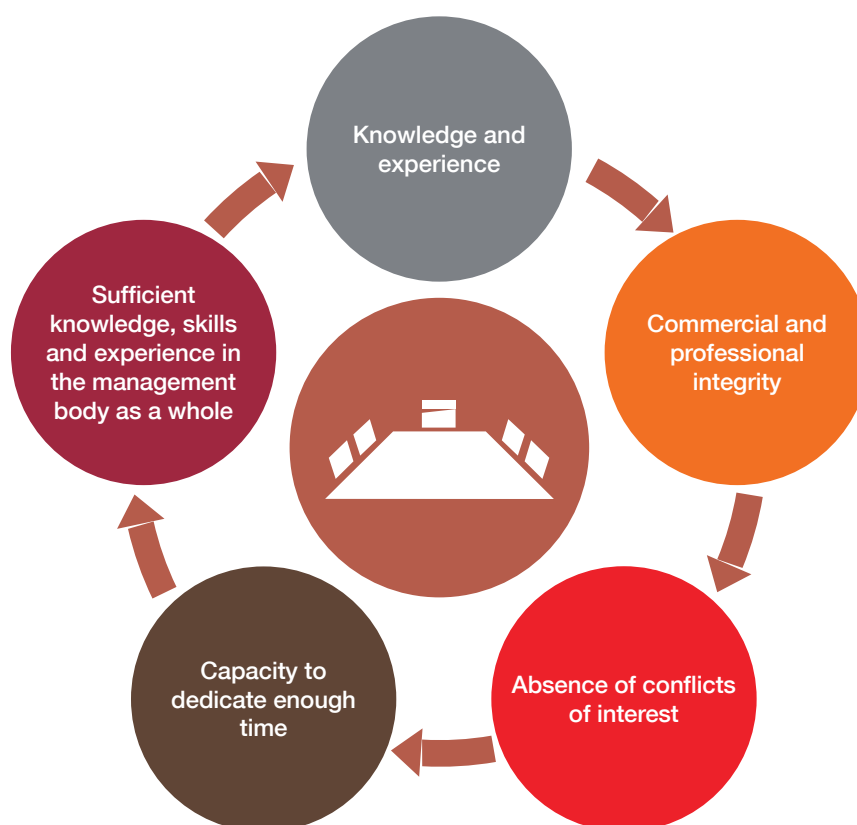
- Senior officer suitability assessments (limited to SIs).
- Passport notifications.
- Acquisition of qualifying holdings⁹ (credit institutions and third parties).
- Non-material model changes (limited to SIs).
- Authorisation for the creation of credit institutions (credit institutions and third parties).
- Voluntary withdrawal of authorisation.
- Approval of financial holding companies and mixed financial holding companies.

On 15 June 2021, as part of the commitment to increase European banking supervision transparency, a public consultation was launched on the “Guide to fit and proper assessments” and the new “Fit and proper questionnaire for senior bank

⁹ These four procedures are not currently available for Spanish institutions.

Figure 2.3

FIT AND PROPER REQUIREMENTS ASSESSED FOR DIRECTORS WITHIN THE SSM



SOURCE: Banco de España.

officials in the SSM”. Subsequently, following review and formal approval by the SB and the Governing Council of the ECB, the Guide and the Questionnaire were published on 8 December 2021.

The Guide seeks to explain in detail the supervisory policies that are applied in assessing the various fit and proper requirements for senior officials in credit institutions (see Figure 2.3). It also aims to reinforce and explain the supervisor’s expectations as to the collective suitability of the management body, and the individual accountability that would be expected of each of its members in this regard. In addition, it describes the process for assessing the suitability of a current senior official in the light of new facts that may affect his or her suitability¹⁰.

10 Without prejudice to the supervision that both the Banco de España and the ECB carry out within the remit of their respective powers, it is important to remember that those primarily responsible for analysing the suitability of senior officers are the institutions themselves or, as the case may be, the applicants or acquirers of qualifying holdings in them, both upon the appointment of the new senior officers and subsequently on an ongoing basis during the exercise of their functions.

The new suitability questionnaire was reviewed to promote greater convergence in the supervision of SSM suitability and to achieve greater efficiency in its processing. As a substantial new development, it is worth noting that the new questionnaire places special emphasis on activities relating to potential ML/TF, and it expressly covers matters such as *gender diversity* and specific knowledge of the management body on *climate-related and environmental risks*.

During the first half of 2022, the new questionnaire will be adapted to national specificities for its subsequent implementation by the NCAs.

2.2.6 Letters

As a result of the above-described supervisory actions carried out in 2021, a total of 108 letters were sent to LSIs and the ICO, with requirements and recommendations made by the Banco de España in the exercise of its supervisory powers. Chart 2.12 provides a breakdown of these letters by type of institution and subject matter. Of these, 57 related to capital decisions, 45 to recovery plan reviews and 6 to inspections.

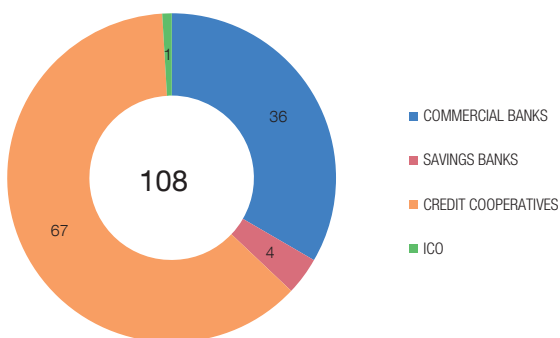
Chart 2.13 shows the breakdown by subject matter of the 373 requirements, recommendations and expectations contained in the 108 letters sent to credit institutions. The requirements notified to LSIs in 2021 largely related to solvency, since all institutions are set a capital requirement level each year; the requirements

Chart 2.12

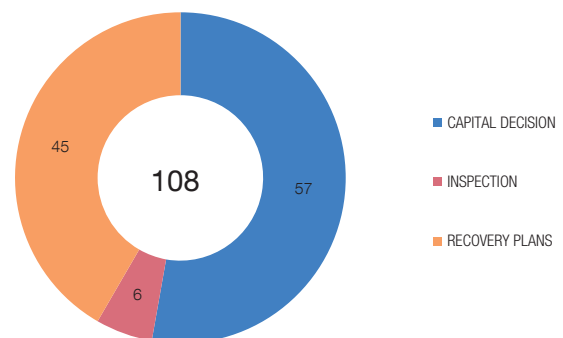
NUMBER OF LETTERS ADDRESSED TO CREDIT INSTITUTIONS

The majority of letters were addressed to credit cooperatives, since this group has the highest number of LSIs. The most common subject matters were capital decisions and recovery plans.

1 BY TYPE OF INSTITUTION (2021)



2 BY SUBJECT MATTER (2021)

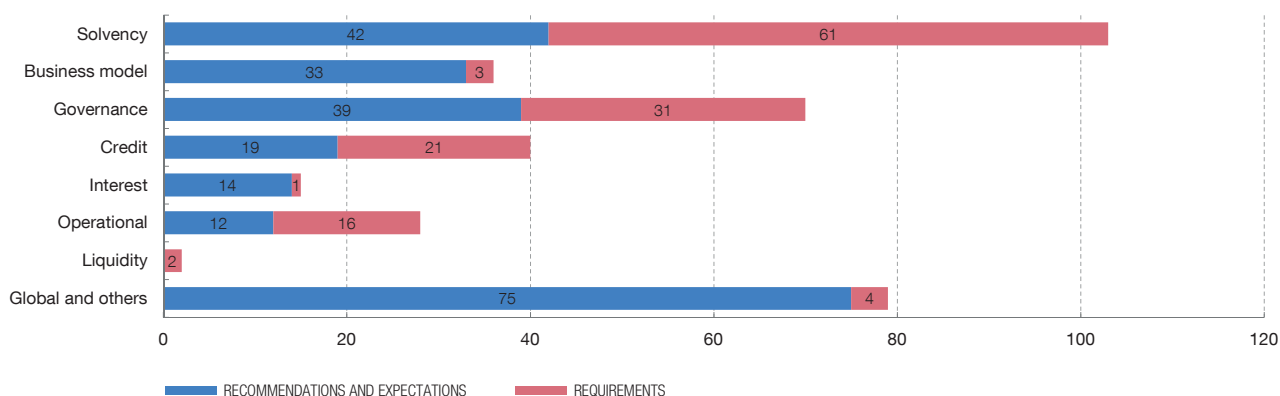


SOURCE: Banco de España.

Chart 2.13

NUMBER OF RECOMMENDATIONS AND REQUIREMENTS NOTIFIED TO CREDIT INSTITUTIONS

By specific areas, the requirements and recommendations on credit risk, solvency and governance stand out.



SOURCE: Banco de España.

NOTE: "Global and others" comprises recommendations set out in 45 letters on recovery plans and in others relating mainly to improvements to internal capital and liquidity adequacy assessment process reports.

also related to improvements to recovery plans and internal capital and liquidity adequacy assessment reports.

Most of the requirements arising from the inspections related to governance, followed closely by credit risk. These governance requirements were issued to improve the composition and functions of committees, internal control and contingency planning. Credit risk requirements related mostly to reclassifications to non-performing, and to the need to increase loan loss provisions and to improve the specific internal controls in place for credit risk.

The bulk of recommendations referred to business models: they advocate an increase in recurring sources of income and adjustments to overhead costs, to ensure the institutions' long-term sustainability.

2.2.7 Other actions

The Banco de España cooperates closely with the CPMLMO and SEPBLAC pursuant to Spanish legislation and the agreement entered into with the CPMLMO in the coordination of their respective supervision and inspection actions, updated in 2021 (Box 2.7).

The supervision and inspection of compliance with AML/CTF obligations was further reinforced in 2021. Three inspections were completed, two of which were

NEW AGREEMENT BETWEEN THE COMMISSION FOR THE PREVENTION OF MONEY LAUNDERING AND MONETARY OFFENCES AND THE BANCO DE ESPAÑA

In Spain, the Commission for the Prevention of Money Laundering and Monetary Offences (CPMLMO) is responsible for steering and promoting the anti-money laundering and counter-terrorist financing (AML/CTF) activities. Its Executive Service, Sepblac, in addition to being the financial reporting unit, supervises compliance with AML/CTF obligations by regulated institutions.

However, the risk of money laundering and terrorist financing is not the exclusive concern of AML/CTF authorities, as it has an impact on other risks to which institutions are exposed, on their solvency and on financial stability as a whole. Therefore, Spanish legislation recognises the need for prudential supervisors and the CPMLMO to cooperate, providing for the possibility of entering into agreements to coordinate their actions. The transposition of the Capital Requirements Directive V reinforces the importance of this cooperation.

It should be noted that the Banco de España and Sepblac have been cooperating closely for many years. The first cooperation agreement was signed in 2005, with successive versions in 2008 and 2013. In March 2021, a [new agreement was signed between the CPMLMO and the Banco de España for the coordination of their respective supervision and inspection actions](#), which clarifies the Banco de España's role and deepens supervisory cooperation and coordination.

On the one hand, the signing of the agreement enables the Banco de España to carry out supervisory functions on

AML/CTF legislation compliance in coordination with Sepblac, which allows synergies to be exploited and contributes to institutional efficiency. The Banco de España's powers in this area are limited to the supervision of certain AML/CTF obligations (due diligence, internal control and reporting) in respect of those regulated institutions under its supervision. In addition, the agreement includes a specialisation principle for the Banco de España, indicating that in supervising compliance with the above-mentioned AML/CTF obligations, it will focus preferentially on the review of the policies and procedures established in the institutions. However, when in the course of its supervisory actions it identifies possible suspicious transactions, it will refer them to Sepblac.

On the other hand, the agreement furthers cooperation between the CPMLMO, Sepblac and the Banco de España. It includes coordination between the Secretariat of the CPMLMO, Sepblac and the Banco de España, both in planning and in inspection work, through the preparation of an annual plan with the inspections to be carried out by all supervisors, previously agreed upon in a coordinated manner and the approval of which corresponds to the CPMLMO; the development of common procedures and deadlines, as well as the possibility of carrying out joint inspections. A fluid exchange of information is also established between the Banco de España, Sepblac and the Secretariat of the CPMLMO. Also, it accommodates the creation of the Single Supervisory Mechanism and it adds provisions in order to structure the growing international cooperation activity.

general inspections, in which compliance with AML/CTF obligations was reviewed in one SI and one LSI (the latter commenced in 2020). The third inspection, with a specific scope, was focused on the review of the internal control systems implemented by an SI to ensure the application of AML/CTF policies to its group abroad. Also, three other general inspections were launched at two LSIs and one SI. All of the inspections were performed remotely, since the restrictions prompted by the COVID-19 pandemic remained in place.

The monitoring actions carried out include the review of compliance with the recommendations and requirements arising from two inspections conducted in previous years and of the degree of compliance with an AML/CTF action plan

established by an SI. In addition, the ML/TF risk profile of credit institutions incorporated in Spain was updated. It should be noted in this respect that the definition of a new methodology for the joint assessment of ML/TF risk was launched in collaboration with SEPBLAC.

Moreover, international cooperation was intensified significantly, in collaboration with SEPBLAC, both through bilateral initiatives with AML/CTF supervisors in other countries and through supervisory colleges. In 2021, the Banco de España and SEPBLAC jointly participated in 53 AML/CTF supervisory colleges of foreign credit institutions, SLIs and PIs operating in Spain, and they established the colleges of 2 Spanish institutions.

As in previous years, the Banco de España continued to participate actively in international and European forums (mainly the EBA's AML SC) and in regulatory initiatives, including most notably the technical contribution to the negotiations on the EU AML/CTF legislative package in July 2021. This provides for, inter alia, the creation of a European AML/CTF authority with direct and indirect supervisory functions, and the coordination of financial intelligence units and a more harmonised EU regulatory framework, including the sixth directive and a new European regulation.

The Banco de España also collaborates with the other national supervisors: the CNMV and DGSFP. With the CNMV, it cooperates in the supervision of consolidated groups, which include both credit institutions and investment firms. Also, in cooperation with the CNMV, it supervises activities related to financial markets. It works in coordination with the DGSFP when a consolidated group of credit institutions includes institutions that are subject to supervision on an individual basis by that body.

2.3 Supervision of institutions other than credit institutions

The Banco de España has exclusive microprudential supervisory powers over the following institutions other than credit institutions that provide financial services or perform functions related to the financial sector: SLIs, mutual guarantee societies (MGSs), reguarantee companies, appraisal companies, PIs, account information service providers, ELMIs, currency-exchange bureaux, banking foundations and Sareb. Table 2.5 lists these institutions.

The legal basis under which the Banco de España supervises these institutions and the approach to the tasks differ from case to case. Although the weight of these institutions in the financial system is not comparable to that of credit institutions, an effective regulatory and supervisory model for these institutions is necessary to promote the fluidity of financial intermediation mechanisms and to generate a climate of trust in financial institutions.

Table 2.5

REGISTER OF OTHER INSTITUTIONS

Year-end data

	2015	2016	2017	2018	2019	2020	2021
Institutions with an establishment	192	194	186	186	187	535	726
SLIs	39	35	31	31	27	26	23
SLI-PIs	5	8	8	8	9	8	9
Branches of financial institutions subsidiaries of EU credit institutions						1	1
Real estate lenders						99	136
Real estate credit intermediaries						234	384
Branches of EU real estate intermediaries						2	2
Mutual guarantee societies	21	21	19	18	18	18	18
Reguarantee companies	1	1	1	1	1	1	1
Appraisal companies	36	37	35	35	32	32	32
Currency-exchange bureaux (a)	13	12	14	14	16	17	16
PIs	43	41	39	40	42	47	49
PIs exempt under Article 14 Royal Decree-Law 19/2018						1	9
Payment service providers excluded under Article 4 of Royal Decree-law 19/2018						3	15
Account information service providers					1	1	1
Hybrid PIs (b)	2	3	3	4			
Branches of EU PIs	12	15	14	12	12	14	7
ELMIs	3	4	5	5	7	9	9
Branches of EU ELMIs	2	2	2	4	8	8	3
Service providers for the exchange of virtual money for fiat money							0
Service providers for the custody of electronic purses							0
Banking foundations (c)	14	14	14	13	13	13	10
Sareb (d)	1	1	1	1	1	1	1
Institutions without an establishment	401	484	556	597	712	833	437
ELMIs	75	112	156	187	242	294	169
PIs	326	372	400	410	454	506	240
Account information service providers					16	33	28

SOURCE: Banco de España.**a** Not including establishments authorised only to purchase currency using euros.**b** Reclassified as PIs.**c** Banking foundations are not registered in the Register of Institutions of the Banco de España. At 31 December 2021, the Banco de España had competence over five of the ten banking foundations.**d** Sareb is not registered in the Register of Institutions of the Banco de España.

2.3.1 Supervision actions

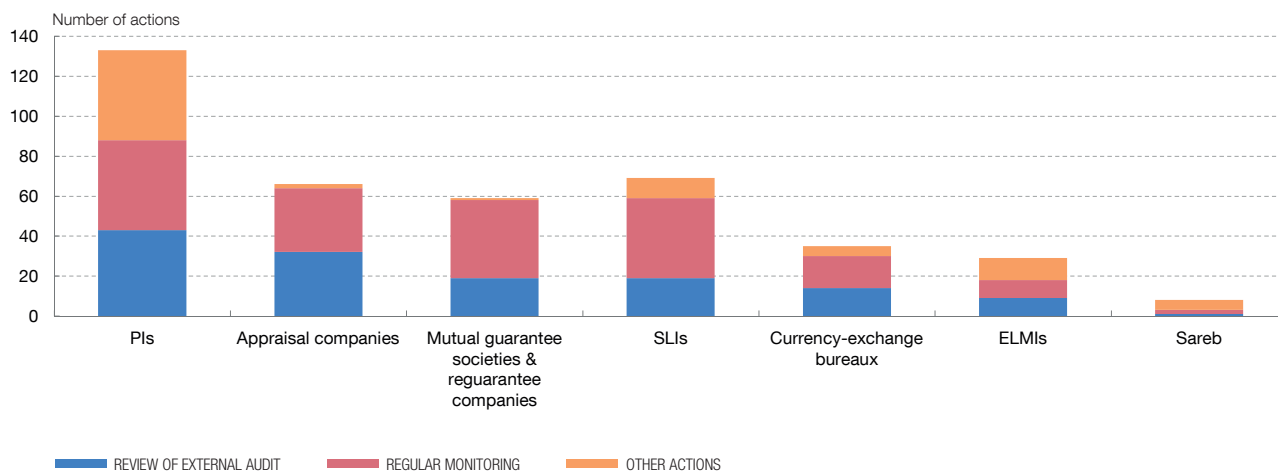
In 2021, 399 ongoing off-site supervision actions were performed by various means: periodic monitoring, external audit report reviews and other actions, as detailed in Chart 2.14.

In addition, a total of three inspections were performed in 2021 - two inspections of appraisal companies and one of an SLI - and another inspection commenced on an

Chart 2.14

NUMBER OF ONGOING OFF-SITE SUPERVISORY ACTIONS AT OTHER INSTITUTIONS

In 2021 there was an increase in the number of actions in PIs, and reviews of the external audit reports of independent SLIs were included.



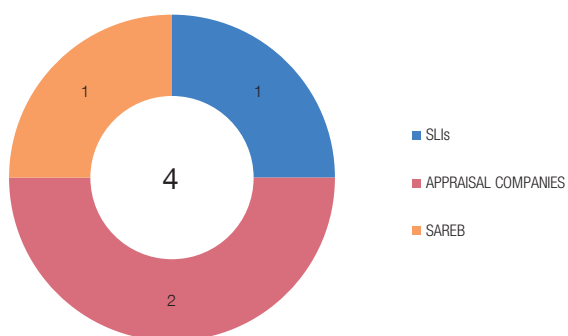
SOURCE: Banco de España.

Chart 2.15

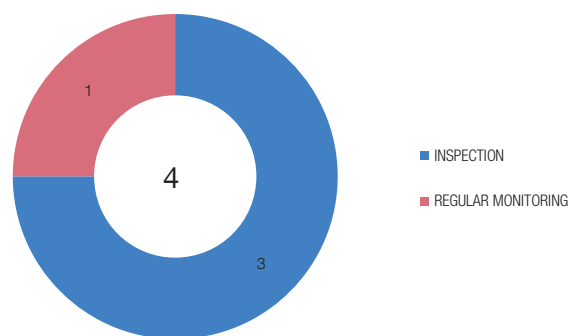
NUMBER OF LETTERS ADDRESSED TO OTHER INSTITUTIONS

Of the letters addressed to other institutions, one relates to the findings of ongoing supervisory actions and the other three relate to inspections.

1 BY TYPE OF INSTITUTION (2021)



2 BY SUBJECT MATTER (2021)



SOURCE: Banco de España.

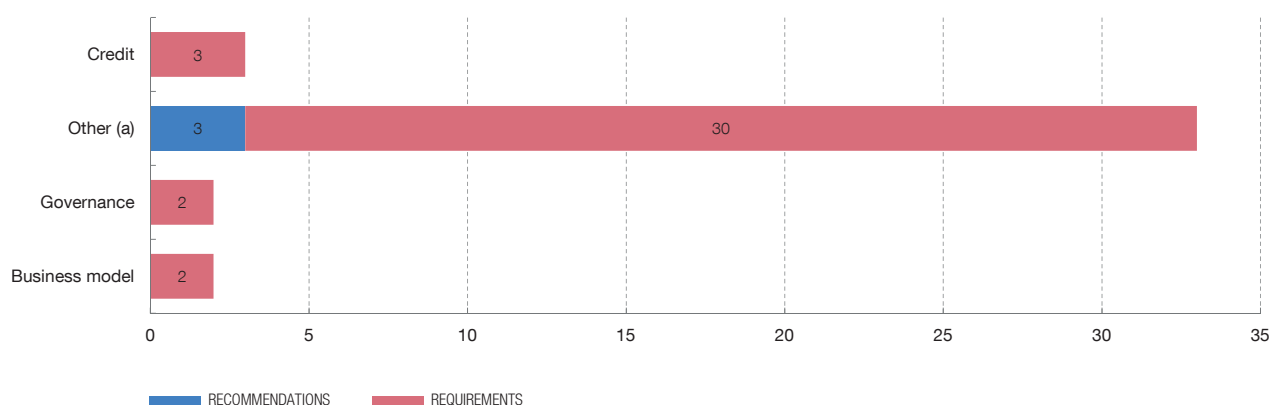
ELMI. For 2022, in addition to continuing with the inspection under way, four more are planned: two at appraisal companies, one at an ELMI and one at a PI.

Following the supervisory actions, four letters were sent to these institutions, addressed to the parties detailed in Chart 2.15. Chart 2.16 shows the number of recommendations and requirements, by area, contained in these letters.

Chart 2.16

NUMBER OF RECOMMENDATIONS AND REQUIREMENTS NOTIFIED TO OTHER INSTITUTIONS

By specific areas, the requirements and recommendations relating to business models and credit risk stand out.



SOURCE: Banco de España.

a "Other" mainly comprises improvements to be implemented in the application of assessment and internal control methodologies. The components of this group are very diverse, in terms of both the size of the institutions and their activity.

2.3.2 Authorisations and other procedures

The Banco de España participates in the granting of start-up licences of institutions other than credit institutions and in other procedures relating to the pursuit of their activities. However, the scope of its involvement is not the same for all types of institutions.

The Banco de España issues a mandatory report on the authorisation of SLIs, MGSs and reguarantee companies, the granting of which is the prerogative of the Ministry of Economic Affairs and Digital Transformation. Also, it is responsible for verifying that payment service providers which state that their activity falls under one of the exclusions contained in Article 4(k) or (l) of Royal Decree-Law 19/2018 meet the necessary criteria.

Thus, the Banco de España is the competent authority for registering, and granting and withdrawing the licenses of, SLIs which provide payment services (SLI-PIs) or which issue electronic money (SLI-ELMIs), ELMIs, PIs, exempt payment service providers pursuant to Article 14 of Royal Decree-Law 19/2018, account information service providers, real estate lenders, real estate credit intermediaries and currency-exchange bureaux. It is also the competent authority for the official recognition of appraisal companies. In addition, it is worth noting the creation in 2021 of the Register of service providers for the exchange of virtual money for fiat money and

the custody of electronic purses¹¹, provided for in the second additional provision of Law 10/2010 of 28 April on AML/CTF. At 31 December 2021, there was no entry in the register of any of these suppliers.

With regard to applications for authorisation and registration of new payment service providers, noteworthy is the relatively low number of applications for the extension of activity with respect to the total number of authorisation and registration applications (with one application for the extension of activity for every nine applications relating to newly created institutions). As a result, the observed trend leads to the consolidation of a payment service provider ecosystem which has ever more participants and, therefore, is increasingly heterogeneous, with an associated increase in the number of institutions to be supervised.

In particular, there has been a substantial increase in applications associated with so-called “payment institutions with low business volume” (legal entities and

Table 2.6

CHANGE IN THE NUMBER OF NON-CREDIT INSTITUTIONS. 2021 VS 2020

	Value at 31.12.2020	Registrations	Deregistrations	Value at 31.12.2021	Change 2021-2020
SLIs	25		2	23	-2
SLI-PIs	8	1		9	1
Branches of financial institutions subsidiaries of EU credit institutions	1			1	0
Real estate lenders	102	34		136	34
Real estate credit intermediaries	256	131	3	384	128
Branches of EU real estate credit intermediaries	2			2	0
Mutual guarantee societies and reguarantee companies	19			19	0
Appraisal companies	32			32	0
Currency-exchange bureaux (a)	17	1	2	16	-1
PIs	47	4	2	49	2
PIs exempt under Article 14 of Royal Decree-Law 19/2018	2	7		9	7
Payment service providers excluded under Article 4 of Royal Decree-Law 19/2018	9	6		15	6
Account information service providers	1	1	1	1	0
ELMIs	9			9	0
Branches of EU PIs	14		7	7	-7
Branches of EU ELMIs	7		4	3	-4
TOTAL	551	185	21	715	164

SOURCE: Banco de España.

a Not including establishments authorised only to purchase currency using euros.

11 The register can be accessed via the Banco de España’s electronic office: <https://sedeelectronica.bde.es/sede/es/menu/tramites/autorizaciones-de-entidades-de-credito-y-otros/registro-de-proveedores-de-servicios-de-cambio-de-moneda-virtual-por-moneda-fiduciaria-y-de-custodia-de-monederos-electronicos.html>.

Table 2.7

OTHER PROCEDURES CONDUCTED BY THE BANCO DE ESPAÑA IN RESPECT OF OTHER INSTITUTIONS

Number of procedures in 2021

	PIs	ELMIs	SLIs	Mutual guarantee societies	Appraisal companies	Currency- exchange bureaux	Sareb	Banking foundations	Total other institutions
Qualifying holdings, merger, spin-off and other significant acquisitions	3	3	5		2			2	15
Cross-border activity of Spanish institutions (a)	2,346	54	1						2,401
Branches in the EU	13		1						14
Branches in third countries									0
Freedom to provide services	105	52							157
Agents	2,228	2							2,230
Cessation of business		1	1						2
Suitability of senior officers	61	26	64	32	6	9			198
Procedures relating to own funds	3	3	3	1		3			13
Amendments to articles of association	4	1	10	4					19
Authorisation of management protocol and financial plan								10	10
Communications with other supervisory authorities or institutions			1						1
Other procedures	2		5		1	1			9
TOTAL									2,668

SOURCE: Banco de España.**a** Each daily notification per institution and recipient country is deemed a procedure.

individuals referred to in Article 14 of Royal Decree-Law 19/2018 of 23 November) and payment service providers excluded under Article 4 of Royal Decree-Law 19/2018.

In order to streamline the processing of certain procedures, the Banco de España has adopted as mandatory in 2021 forms that systematise the information to be provided in applications, and it has updated the “Information Guide”¹² to inform applicants of the formalities, requirements and criteria applied in these procedures. Both the forms and the Guide are published in the Banco de España’s Virtual Office.

Also, the Banco de España has joined the “Notifica” platform, to offer interested parties the opportunity to send communications and notifications by electronic means.

In 2021, a total of 185 institution start-up requests and 21 deregistrations were processed, as shown in Table 2.6.

12 See the update of the “Guía informativa para solicitantes de autorización de entidades de pago o de entidades de dinero electrónico, así como de registro de personas físicas o jurídicas prestadoras del servicio de información sobre cuentas o exentas a las que se refiere el artículo 14 del Real Decreto-ley 19/2018” (Information guide for applicants for authorisation of payment institutions or electronic money institutions, and for registration of natural or legal persons providing account information services or exempt according to Article 14 of Royal Decree-Law 19/2018, available in Spanish only).

Similarly, in 2021 a further 2,668 procedures relating to supervisory powers over these institutions were performed, as detailed in Table 2.7.

2.4 Compliance with vetted access to activity

Under Spanish legislation, several financial activities are subject to vetted access to activity, i.e. they can only be carried out by the institutions legally authorised to do so. The Banco de España's functions include overseeing compliance with this legislation, taking action on those seeking to begin operations in the financial market without meeting the conditions of access, whether by conducting activities legally restricted to credit institutions, payment service providers or other types of institutions supervised by the Banco de España, or through the use of generic names restricted to those institutions or any other name that may confuse the public.

In 2021, the DGBS performed supervisory actions relating to 16 legal entities which may have been carrying out restricted activities without authorisation or making undue use of a name pertaining to supervised institutions, the outcome of which could lead to the adoption of penalties.

In addition to the above actions, in the area of payment services, the analysis commenced in 2021 of 21 cases of possible non-compliance with the vetted access to activity established in Article 5 of *Royal Decree-Law 19/2018, of 23 November, on payment services and other urgent financial measures*. Most of these cases concern innovative business models, not always an easy fit within the rules, or certain formal irregularities detected in the activity of commercial establishments which, in reality, operate as agents or distributors in Spain of payment service providers.

2.5 Supervision of payment service providers

As in previous years, a significant portion of the supervisory tasks in 2021 was focussed on assessing compliance with Commission Delegated Regulation 2018/38913 for strong customer authentication and common and secure open standards of communication. The main efforts were geared, on the one hand, towards verifying the completion of the migration to strong customer authentication (SCA) solutions for e-commerce card payments after the end of the supervisory flexibility period mandated by the EBA on 31 December 2020; and, on the other, to take the supervision actions necessary to ensure that account servicing payment

13 Commission Delegated Regulation (EU) 2018/389 of 27 November 2017, supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication.

service providers (ASPSPs), which offer access to online payment accounts to other payment service providers through specific interfaces, have identified and removed potential obstacles to such access, in accordance with the EBA opinions of 4 June 2020¹⁴ and 18 February 2021¹⁵.

In addition, problems reported by payment service providers relating to the proper functioning of the specific interfaces offered by the ASPSPs have been assessed. These problems mainly consisted of one-off outages and deteriorations in the interface service, which, following the corresponding investigations, were addressed with plans to improve technical monitoring and reporting procedures and early resolution of incidents. To a lesser extent, problems have been reported regarding the functionalities offered by specific interfaces and the information they make available to third-party payment service providers, which have been resolved by bringing these functionalities into line with the requirements of Delegated Regulation 2018/389.

Boxes 2.8 and 2.9 further contextualise and explain these supervision activities and their outcomes.

Also in the framework of Delegated Regulation 2018/389, approval was granted for the requests submitted for the application of the SCA exemption in the provision of payment services through two secure corporate payment processes, available only to payers who are not consumers, as provided for in Article 17 of that Regulation.

With regard to other procedures in the area of payment services, in accordance with Article 23 of Royal Decree-Law 19/2018, a significant number of communications were received regarding the delegation of operational functions from specialised payment service providers, in order to verify compliance with the requirements applicable to outsourcing agreements and the governance framework.

In this respect, it is interesting to note two matters observed in the area of outsourcing, both in the authorisation processes and in supervision. On the one hand, payment service providers wishing to provide account information services often opt to outsource the bulk of the technological infrastructure necessary to carry out the activity. On the other, the use of public cloud-based infrastructure, software and services by payment service providers seems to be consolidating.

In addition to the analysis of 21 cases of possible non-compliance with the vetted access to activity (see section 2.4), a further 9 verification actions were initiated

14 EBA Opinion on obstacles under Article 32(3) of the Regulatory Technical Standards on strong customer authentication and common and secure communication (EBA/OP/2020/10).

15 Opinion of the European Banking Authority on supervisory actions to ensure the removal of obstacles to account access under PSD2 (EBA/OP/2021/02).

TOWARDS SEAMLESS PROVISION OF PAYMENT INITIATION AND PAYMENT ACCOUNT INFORMATION SERVICES

The payment initiation and payment account information services offered by payment service providers and, in particular, by providers specialised in the provision of these services (known as “third party payment service providers” or TPPs), are based on access by these providers to payment accounts held by users with account servicing payment service providers (ASPSPs, traditionally credit institutions). This allows the user to order payments through the initiator without needing to have a payment account with the initiator or a payment instrument, such as a card. The account information service allows aggregate information to be consulted on some or all of the payment accounts opened in the user’s name at various financial institutions, making it easier to view and analyse the user’s financial situation.

This access, which requires the prior express consent of the account holder, is most often enabled through specific interfaces, mainly through the development of application programming interfaces.¹

The enabling of these interfaces has required technological developments by the ASPSPs, to allow the provision of payment initiation and payment account information services in an efficient and secure manner. In particular, such interfaces should not present obstacles to users’ access to payment accounts through TPPs, such as preventing the use of credentials issued by ASPSPs to their customers, imposing the manner in

which payment accounts are to be accessed, requiring unnecessary authorisations or registrations from TPPs or imposing additional controls on the consent given by payment service users to the TPPs themselves. In short, the aim is to avoid specific interfaces forcing user experiences that discourage the use of such services, while maintaining security levels.

In order to facilitate the proper functioning of specific interfaces, the EBA published in June 2020 an opinion on obstacles (EBA/OP/2020/10), clarifying which implementations should be considered as an obstacle. As a follow-up to this opinion, in February 2021 it published a further opinion on supervisory actions (EBA/OP/2021/02) to ensure the complete removal of the above-mentioned obstacles to payment account access.

In order to comply with these opinions, several communications were made to the Spanish ASPSPs in late 2020 and early 2021 to identify any potential obstacles and, where appropriate, establish concrete plans to eliminate them. As a result of this exercise, at the end of 2020 the vast majority of Spanish ASPSPs declared that at that date they did not have any of the obstacles identified by the EBA. In the first half of 2021, the remaining ASPSPs completed their respective elimination plans, so that by June 2021 the number of specific interfaces that still had any obstacles was minimal, and the process was definitively completed in September.

¹ *Application Programming Interface (API)*: technology solution that brings together a set of definitions and protocols that are used to develop and integrate application software.

regarding possible regulatory non-compliance, relating mainly to the scope of the right of access to payment account services offered by credit institutions to other payment service providers and the delegation of important operational functions.

In terms of international coordination, in the area of payment service provider supervision, the Banco de España participated actively in the review of the EBA guidelines on major incident reporting under PSD2, which aimed to optimise and simplify the reporting process and resulted in new guidelines (EBA/GL/2021/03), published in June 2021. It has also participated in the interpretation and standardisation of certain concepts and aspects of the rule, both through the EBA’s PSD2 Q&A Network and the EBA Working Group on APIs.

THE IMPLEMENTATION OF STRONG AUTHENTICATION IN CARD-BASED E-COMMERCE

The period of supervisory flexibility regarding the implementation of strong customer authentication (SCA) for e-commerce card-based payments, which was introduced by the EBA in two opinions issued in June and October 2019, ended on 31 December 2020. In the course of this flexibility period, the Banco de España requested that card issuing payment service providers and acquirers of card-based transactions submit their respective SCA migration plans and it closely monitored key SCA migration variables. Also, it held an active and collaborative dialogue with representatives of issuers, acquirers, merchants, card schemes and processing entities, all of which are affected by the migration process, in order to achieve the objectives set within the deadline.

The process's difficulty led some national authorities in Europe to contemplate in the first quarter of 2021 the gradual introduction of implemented strong authentication solutions, either through a staggered requirement for SCAs in transactions of ever smaller amounts or through a flexible application of SCA exemptions. In accordance with the above-mentioned EBA opinion of October 2019, and on the basis of a set of data and indicators obtained

from a significant sample of the European issuer and acquirer market, the EBA prepared a report reflecting the status of migration at the end of April 2021.

This report was published in June 2021, concluding that there was a high degree of European industry readiness for the implementation of SCAs in e-commerce card-based payments. In particular, 98% of cards were ready to apply SCA, and 88% of users and 96% of merchants were signed up to the corresponding SCA solutions. However, as a reflection of the diversity of the players involved, the number of transactions in which these solutions were applied was still relatively low. The report also pointed to the existence of differences between jurisdictions, with some of them showing a certain delay in migration; this situation did not affect the Spanish market, which was in the leading group in the main migration indicators. Also, the report highlighted the reduction observed in fraud rates: around 50% for issuers and 40% for acquirers, indicative of the improved security levels brought about by the implementation of SCA. All of this led to the SCA migration being deemed a general success.

1 Opinion of the European Banking Authority on the elements of strong customer authentication under PSD2 (EBA-Op-2019-06) and Opinion of the European Banking Authority on the deadline for the migration to SCA for e-commerce card-based payment transactions (EBA-Op-2019-11).

DIGITALISATION CHALLENGES: SANDBOX

Law 7/2020, for the digital transformation of the financial system, was approved at the end of 2020. It created, for the first time, a controlled testing space in Spain, known internationally as Sandbox. Sandbox is a safe environment in which to test projects involving technology-based financial innovation applicable to the financial system, and in which risks to the financial system and to participants have been mitigated or minimised. The two fundamental objectives of this law are, therefore, to provide financial authorities with adequate instruments to fulfil their functions in the new digital context and to facilitate innovation in Spain.

The law provides for two annual cohorts to apply to the General Secretariat of the Treasury and International Financing (SGTFI) for access to Sandbox and for any promoter, or group of promoters, whether individuals or legal entities, to apply for entry into Sandbox. The supervisory authorities (Banco de España, National Securities Market Commission and the Directorate General of Insurance and Pension Funds) are responsible for the prior assessment of the project by means of a favourable or unfavourable report according to the criteria set out in Article 5 of this law.¹ In the light of this assessment, the SGTFI publishes the list of projects provisionally admitted to Sandbox. For projects that have received a favourable prior assessment, a process is initiated between the competent authorities and the promoter, the purpose of which is to sign a protocol containing the testing rules and conditions. With regard to the exit regime, the law provides for the possibility of shortening procedures in the event that a licence or authorisation is required for the subsequent performance of the professional activity.

The first call for applications was on 15 December 2020 through an SGTFI resolution, which set the deadline for submitting applications for access between 13 January and 23 February 2021. A total of 66 projects were submitted, of which around two thirds were initially allocated to the Banco de España, alone or together with other supervisory

authorities.² The Banco de España issued a favourable prior assessment with respect to 10 projects, 6 of which finally went on to testing, following the signing of the corresponding protocol. The second call was on 15 June (opening on 1 September and closing on 13 October), and a total of 13 applications were received, i.e. 80% less than in the first cohort. Of these applications, 8 initially corresponded to the Banco de España and 1 obtained a favourable prior assessment and is in the negotiation phase of the corresponding protocol. These fluctuations in the number of applications are to be expected as this is a new tool to which both promoters and authorities must adapt.³

It is worth noting that, regardless of the volume of applications, Sandbox has greatly fostered collaboration among the authorities involved in its operation, which has positive consequences both for the promoters and for innovation in the Spanish financial system. Similarly, in the Banco de España, collaboration among the various supervisory areas has increased notably due to the cross-cutting nature of Sandbox, giving rise to very positive synergies for our institution.

The attached charts show the wide variety of projects that have been analysed by the Banco de España this year. With regard to the projects previously assessed by the Banco de España (alone or together with other supervisors), the promoters belong to various sectors (see panel 1 of the chart), albeit noteworthy the greater weight, in this order, of consultancy firms, FinTechs and banks. In terms of the technologies in projects obtaining a favourable prior assessment (see panel 2 of the chart), distributed ledger technology and artificial intelligence predominate, followed by biometrics/digital identity. This plurality, combined with the large number of projects presented, gives an idea not only of the high innovative capacity of Spanish institutions, but also of their diversity, in terms of both the type of promoter and the technologies used. In this respect, Sandbox emerges as a very timely tool for adapting the

1 The requirements for access are that the project provides a technology-based innovation applicable in the financial system and that it is sufficiently advanced to be tested. In addition, innovative projects must contribute added value in at least one of the following manners: a) facilitating regulatory compliance; b) benefitting financial service users or increase customer protection; c) boosting efficiency of institutions or markets; or d) providing mechanisms to enhance regulation or financial supervision. Also, the supervisory authorities will take into consideration the impact of the project on the Spanish financial system.

2 Some of these projects (around one third) were either rejected by the SGTFI or were finally assigned to other supervisory authorities and, therefore, they were not formally assessed by the Banco de España. As regards the assessed projects, the main reasons for unfavourable assessment were: firstly, the lack of technology-based innovation applicable in the financial system; secondly, that the project is not useful or does not contribute added value with respect to existing uses; and lastly, the project's lack of maturity for testing.

3 The call for the third cohort took place on 22 December 2021. The application submission period will begin on 1 March and will end on 12 April 2022.

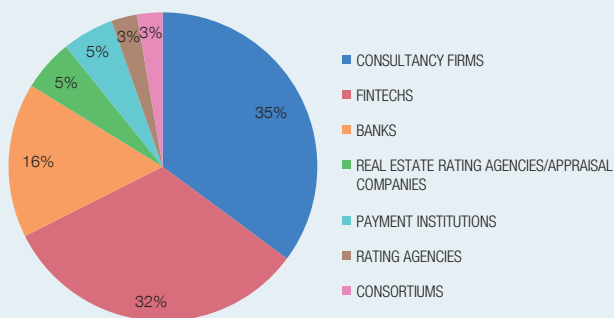
DIGITALISATION CHALLENGES: SANDBOX (contd)

financial authorities’ activity to the digital transformation of the financial system. In any case, it should be borne in mind that, since this tool is new, it will need to be adapted and improved. An example of the latter was the publication by the SGTFI of guidelines on access⁴ to the controlled test environment to be applied to projects submitted to Sandbox

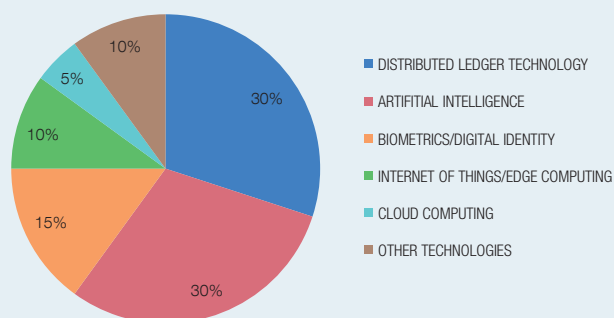
following their publication. These guidelines clarify issues such as the minimum information to be submitted, access requirements, types of communication between promoters and the SGTFI, and Sandbox deadlines. Lastly, the implications of Sandbox access for promoters are also clarified.⁵

Chart 1
PROMOTORS AND TECHNOLOGIES OF SANDBOX PROJECTS ANALYSED BY THE BANCO DE ESPAÑA

1 BY TYPE OF PROMOTOR (PROJECTS ASSESSED)



2 BY TYPE OF TECHNOLOGY (PROJECTS WITH FAVOURABLE PRIOR ASSESSMENT) (a)



SOURCE: Banco de España.

a Projects can use more than one technology. Technologies based on what the promotor reports in its request.

4 Available at <https://www.tesoro.es/solicitudes-para-el-espacio-controlado-de-pruebas>. The first version of these guidelines was published in June 2021. The second version was published in January 2022 for application to projects submitted from the third cohort onwards.

5 In accordance with Article 26 of Law 7/2020, supervisory authorities must include in this report an assessment of the implementation of the innovations tested in Sandbox and which are applicable to the enhanced performance of the supervisory function. However, as the testing of the first cohort has not yet been completed and the second cohort is in the protocol negotiation phase, the above-mentioned information will be included in future editions of this report.