

Supervision Report: Digest

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CHAPTER 1.

SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

Supervisory functions of the Banco de España	<ul style="list-style-type: none"> The Banco de España has various supervisory powers over credit institutions and over other financial institutions or undertakings related to the financial system operating in Spain. The microprudential supervision of credit institutions conducted by the Banco de España within the Single Supervisory Mechanism (SSM) aims to ensure their solvency and liquidity, as well as compliance with prudential regulations. Macroprudential policy, in turn, is aimed at safeguarding the stability of the financial system as a whole. The Banco de España is also tasked with the supervision of the conduct, transparency and customer protection of the institutions registered in its official registers. The Banco de España is responsible for the supervision of payment service provision. In addition, it is also responsible for the oversight of payment systems and instruments, and it shares with the National Securities Market Commission (CNMV) the task of oversight of securities infrastructures. The Banco de España cooperates with the Commission for the Prevention of Money Laundering and Monetary Offences and its Executive Service (SEPBLAC) in the area of anti-money laundering and counter-terrorist financing (AML/CTF). Royal Decree-Law 24/2021 strengthens the supervisory regime for covered bonds, which is attributed to the Banco de España. This new supervisory function, which also includes the authorisation of the issuance programmes of these bonds and their monitors, commenced in 2022.
Supervisory and oversight staff	<ul style="list-style-type: none"> At 31 December 2022, the Banco de España had 849 employees performing supervisory and oversight functions (compared with 844 employees at the end of 2021). 49% of supervisory and oversight staff are men and 51% are women, although the distribution varies among the professional groups.

CHAPTER 2.

MICROPRUDENTIAL SUPERVISION

The Spanish banking sector	<ul style="list-style-type: none"> Spanish institutions maintain adequate solvency levels —above the levels reached in December 2019, prior to the health crisis— although the system's solvency ratios contracted slightly in 2022. The growth trend in the total volume of loans of Spanish institutions continued in 2022, with an increase in lending activity at foreign subsidiaries and stability in transactions in Spain. The deterioration of the macroeconomic environment has not yet been reflected in the credit quality indicators, where the NPL ratio decreased slightly in 2022, although an increase in the near future cannot be ruled out as borrowers' payment capacity may deteriorate due to the negative effects of the current macroeconomic environment. In 2022, profitability remained at levels similar to those of 2021 —after leaving behind the negative values of 2020 triggered by the health crisis— with an increase in profit from ordinary business, while impairment losses remain moderate. However, given the uncertainty associated with the current macroeconomic scenario, banks should take advantage of this improvement in profitability in order to strengthen their resilience. The high liquidity coverage ratio of Spanish institutions remained stable in 2022. However, the normalisation of monetary policy and the upcoming Targeted Longer-Term Refinancing Operations III (TLTRO III) maturities are likely to cause banks to reduce their liquidity surpluses, although they will remain ample.
Supervisory priorities in 2023 for credit institutions. Focal points in 2022	<ul style="list-style-type: none"> The European Central Bank (ECB) has set the priorities for significant institutions (SIs) in 2023 around three major objectives: i) to increase resilience to short-term macro-financial and geopolitical shocks, by continuing to focus on the review of credit risk so that institutions remedy any shortcomings they may have in their management, with particular attention to exposure to sectors that are more sensitive to the current macroeconomic environment, while funding risk will also be reviewed; ii) to increase efforts to tackle institutions' structural vulnerabilities, addressing technology risks and the implications of digital transition (in this regard, it is important that institutions assess the opportunities and risks of undertaking a robust digital transformation so that their business models are sustainable in the long term); and iii) to adapt the business strategy and risk management framework to incorporate climate risk.
Supervisory priorities in 2023 for credit institutions. Focal points in 2022	<ul style="list-style-type: none"> In line with the priorities set by the ECB, the Banco de España has identified as a priority for less significant institutions (LSIs) in 2023 the review of credit risk, business models, operational risk (in particular technology risk), governance, capital planning and, lastly, environmental and social risks. The supervisory focal points for the SIs in 2022 were grouped into three broad areas: i) promoting the post-pandemic strengthening of institutions, paying special attention to credit risk; ii) addressing institutions' structural weaknesses through digital transformation and improved governance; and iii) assessing the response to emerging risks, including climate, counterparty and operational risks. For LSIs, on the other hand, work focused on credit risk management, business models, governance, capital strength, technological innovation and risks linked to climate change.

<p>Supervision of credit institutions</p>	<ul style="list-style-type: none"> • The core task of the ongoing monitoring of SIs is the supervisory review and evaluation process (SREP), which serves not only to determine the institution's risk profile, but also to assess the adequacy of its governance and risk controls. The SREP is complemented by other supervisory tasks, such as on-site inspections, institution-specific in-depth reviews and cross-institutional reviews of priority areas. All the findings from these various activities are used to adopt Pillar 2 capital and liquidity decisions (P2R). The average P2R of Spanish SIs remained stable in 2022, as did capital guidance (P2G), since no full stress test was carried out in the year. • Among the supervisory activities on SIs, cross-institutional reviews are becoming increasingly important, and in 2022 they addressed the degree of implementation of the European Banking Authority (EBA) guidelines on loan origination, the analysis of the impacts of the war in Ukraine, banks' digitalisation strategy and climate risks. • The main objective of this thematic review on climate risk was to check whether institutions adequately identify and manage climate-related and environmental risks, and to analyse their governance strategies and frameworks relating to these risks. In addition, during the first half of 2022 the ECB also conducted a climate risk stress test, intended as a learning exercise both for institutions and for the supervisor, which had no direct impact on capital. The conclusion drawn from the two exercises is that although the institutions have made progress, there is still some way to go. • 595 activities were planned for Spanish SIs in 2022 (data up to 15 September 2022), which were largely performed within the SREP framework. In the last quarter of the year, supervisory activity continued as normal and around 200 further actions were added. • As part of ongoing supervision of LSIs, each institution's progress is monitored periodically and, as is the case for SIs, the SREP is one of the central tasks of ongoing off-site supervision. As a result of this process, the Banco de España adopted the capital and liquidity decisions for the 56 LSIs or LSI groups. The average P2R of Spanish LSIs increased slightly in 2022. With regard to P2G, the 2021 statement to institutions has remained unchanged, as it is updated every two years. Horizontal reviews were also carried out during the year: on the business model of retail banking institutions, on the notification of the delegation of critical functions or services (outsourced activities), on technology risk and on climate risk. • In 2022 a total of 732 ongoing off-site supervisory actions were carried out in relation to Spanish LSIs, the Official Credit Institute, branches of LSIs in other ECB countries and the rest of the European Union (EU), as well as branches of non-EU credit institutions. • For both SIs and LSIs, ongoing monitoring is complemented by on-site actions, which can be of two types: inspections, and internal model investigations. In 2022, 18 inspections and 11 internal model investigations were conducted at Spanish SIs. Additionally, 3 cross-border missions were carried out at non-Spanish SIs. As regards LSIs, the Banco de España conducted 10 inspections. • As a result of its supervisory activity, the ECB Supervisory Board —of which the Banco de España forms part— took 518 decisions and actions affecting Spanish institutions. The Banco de España, in turn, sent 114 letters to LSIs, with 520 requirements and recommendations. • With the entry into force in 2022 of the strengthened supervisory regime for covered bonds, the Banco de España assumed the ongoing supervision thereof. In 2022 it authorised, for the 19 issuing institutions, 5 monitors and 27 bond programmes covering all current covered bond issues at that date. • In 2022, 4 inspections reviewing compliance with AML/CTF obligations were completed and 2 more were initiated. Also, a thematic inspection is underway, jointly with SEPBLAC, on foreign exchange activity, which has been identified as a ML/TF risk operation. 	<p>Cover</p> <p>Contents</p> <p>Presentation by the Governor</p> <p>Interview with the Deputy Governor</p> <p>Supervision Report: Digest</p> <p>Chapter 1</p> <p>Chapter 2</p> <p>Chapter 3</p> <p>Chapter 4</p> <p>Chapter 5</p> <p>Chapter 6</p>
<p>Supervision of other institutions, compliance with vetted access to activity and supervision of payment service provision</p>	<ul style="list-style-type: none"> • The Banco de España has exclusive microprudential supervisory powers over institutions other than credit institutions, on which 261 ongoing off-site supervisory actions were carried out in 2022 by various means and 5 inspections. • The Banco de España, as the body responsible for overseeing compliance with vetted access to activity, initiated actions in 2022 in 26 possible cases of transactions being carried out without complying with the conditions of access, including most notably 13 cases of possible non-compliance with vetted access to activity by payment service providers. • In addition to the tasks involved in the ongoing monitoring of payment service provision, supervisory work in 2022 included most notably the assessment and monitoring of problems relating to the proper functioning of the specific interfaces offered by account servicing payment service providers, and the first application of the revised EBA guidelines on major incident reporting under the Payment Services Directive. Over the course of 2022, the way in which payment institutions and electronic money institutions provide certain payment services evolved, e.g. making the payment initiation service available to users at the physical points of sale or finding ways to add value to the account information service. 	<p>Chapter 7</p> <p>Chapter 8</p>
<p>Application of financial technology innovation to supervisory functions (SupTech)</p>	<ul style="list-style-type: none"> • In 2022 there were two new calls for applications to the controlled testing space, known internationally as Sandbox. In the course of 2022, the protocols were signed and testing began for two projects from the second and third calls, and testing was completed for the six projects from the first call that signed a protocol with the Banco de España. In most cases, added value was found in these projects, and it was concluded that they may represent a potential benefit to financial service users, as well as an increase in efficiency of institutions or markets. According to the Banco de España's assessment, none of the projects that completed their passage through Sandbox in 2022 provided mechanisms for the better exercise of the supervisory function. 	<p>Chapter 9</p> <p>Index of photographs</p>

CHAPTER 3. MACROPRUDENTIAL POLICY

<p>Banco de España's macroprudential policy tools</p>	<ul style="list-style-type: none"> • In accordance with current legislation, the Banco de España regularly sets macroprudential capital buffers to address the build-up of cyclical and structural risks. • In 2022, the Banco de España decided to maintain the countercyclical capital buffer at 0% for credit exposures in Spain. This decision was in line with European Systemic Risk Board (ESRB) Warning 7/2022 on the vulnerabilities of the EU financial system. This was deemed to be an appropriate macroprudential policy response, given the current adverse economic environment, marked by geopolitical uncertainty, high inflation rates and the tightening of the ECB monetary policy. • In 2022, one global systemically important institution (G-SII) —which is also a domestic systemically important institution (O-SII)— and three other O-SIIs were identified, and their associated capital buffers were set for 2023 and 2024, respectively. • The new Banco de España Circular 3/2022 finalised the transposition of Directive (EU) 2019/878 (CRD-V), including its macroprudential aspects. • The results of the 2022 forward-looking exercises to measure the resilience of institutions to adverse macro-financial scenarios show that this resilience would remain high at the aggregate level. However, due to high uncertainty and the heterogeneity among institutions, extra prudence is recommended in provisioning and capital policies. 	<p>Contents</p> <p>Presentation by the Governor</p> <p>Interview with the Deputy Governor</p> <p>Supervision Report: Digest</p>
<p>Macroprudential coordination at the national level</p>	<ul style="list-style-type: none"> • The Banco de España is one of the member institutions of the Spanish macroprudential authority (AMCESFI), which is attached to the Ministry of Economic Affairs and Digital Transformation and in which the CNMV and the Directorate General of Insurance and Pension Funds also participate. 	<p>Chapter 1</p>
<p>Macroprudential tasks at the European level</p>	<ul style="list-style-type: none"> • The Banco de España participates in the Financial Stability Board and the ECB's Macroprudential Forum. As an SSM authority, the Banco de España notifies the ECB of all its proposals for macroprudential measures prior to their adoption and announcement. 	<p>Chapter 2</p> <p>Chapter 3</p>

CHAPTER 4. SUPERVISION OF INSTITUTIONS' CONDUCT

<p>Objectives</p>	<ul style="list-style-type: none"> • Supervision of conduct aims to verify compliance with transparency and customer protection legislation, and with good banking practice criteria and the supervisory expectations conveyed to institutions. It also seeks, more broadly, to transform institutions' culture of conduct • To this end, the creation of the new Directorate General Financial Conduct and Banknotes was approved in 2022, in order to continue with the Banco de España's strategy geared at ensuring the transparency of financial institutions' relationships with their customers and the responsible banking model. 	<p>Chapter 4</p> <p>Chapter 5</p>
<p>Supervisory activity</p>	<ul style="list-style-type: none"> • The monitoring tasks seek to gain knowledge of institutions' business models and strategies, and of other significant issues, such as product offerings, the treatment of claims or how to address the problems of mortgage debtors in vulnerable situations. • In 2022, ongoing supervision was completed with the performance of 146 supervisory actions, focusing on the review of areas such as consumer credit —responsible lending, revolving credit or tacit overdrafts—, payment services —marketing in branches, account switching, contractual changes or basic payment accounts— and real estate lending. Also, special attention was paid to the way in which institutions ensure transparency in digital environments. 	<p>Chapter 6</p> <p>Chapter 7</p>
<p>Supervisory measures</p>	<ul style="list-style-type: none"> • As a result of the corresponding supervisory actions, the following measures were adopted in 2022: i) 1 sanctioning proceeding initiated; ii) 81 advertising requirements issued; iii) 25 requirements issued on other matters; and iv) 57 recommendations made. • In addition, in the monitoring of supervisory measures, there was a general improvement in institutions' conduct due to compliance with these measures. 	<p>Chapter 8</p> <p>Chapter 9</p>

CHAPTER 5. OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Oversight of payment systems and instruments	<ul style="list-style-type: none"> By the end of 2022, most of the milestones of the action plan developed in response to the TARGET service incidents occurring in 2020 had been completed. The uncompleted actions will be finalised in the first quarter of 2023, since they are linked to the entry into operation of the consolidation of TARGET2-TARGET2-Securities. The implementation of the Eurosystem oversight framework for electronic payment instruments, schemes and arrangements (the PISA framework) commenced with the identification of the schemes subject to the framework. The Banco de España shares the leadership with the ECB in the monitoring of American Express as a pan-European card scheme. The fraud ratio for transactions with cards issued in Spain, in terms of number of transactions, was 0.025% in the first half of 2022, as compared with 0.032% in 2020, partly due to the implementation of strong customer authentication in remote transactions. 	Cover Contents Presentation by the Governor Interview with the Deputy Governor
Supervision of Iberpay (management company of the National Electronic Clearing System)	<ul style="list-style-type: none"> The Banco de España assessed eight operating instructions for the National Electronic Clearing System (SNCE), which the Banco de España did not oppose. These instructions include issues such as the replacement of the physical exchange of documents by the exchange of images through the SNCE and the launch of the first use in the SEPA payment requests subsystem by the SNCE. 	Supervision Report: Digest Chapter 1
Oversight of securities infrastructures	<ul style="list-style-type: none"> The increase in both energy prices and their volatility has led to a significant increase in initial margin requirements in the energy derivatives segment of the Central Counterparty, BME Clearing, with no impact on participants' compliance. With respect to TARGET2-Securities, monitoring continued on the implementation of recommendations as a result of the assessment of compliance with the principles for financial market infrastructures issued jointly by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions, and on the assessment of the penalty mechanism for delays in the matching and settlement of instructions required by the Regulation on improving securities settlement and on central securities depositories. 	Chapter 2 Chapter 3 Chapter 3

CHAPTER 6. EXERCISE OF SANCTIONING POWERS

Penalties	<ul style="list-style-type: none"> Sanctioning powers, as a necessary supplement to supervisory powers, continued to be exercised in both the prudential area and the area of transparency and customer protection. In total, 14 proceedings were conducted against institutions and their directors and executives (a total of 97 natural persons). The prudential area continues to account for the largest number of sanctioning proceedings, where the most noteworthy proceedings are those relating to internal control, credit risk and governance and the proceedings conducted against appraisal companies. 	Chapter 4 Chapter 5
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CHAPTER 7. THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

Global fora	<ul style="list-style-type: none"> In 2022, the Financial Stability Board continued to analyse the effects of COVID-19 and to work on strengthening the non-bank financial intermediation sector, analysing vulnerabilities associated with structural changes (in particular those related to financial innovation and climate change) and monitoring the implementation and effects of reforms agreed following the 2008 global financial crisis. The Basel Committee on Banking Supervision, chaired by the Governor of the Banco de España, made progress in its work on the prudential treatment of cryptoassets, the treatment of banking union in the G-SII identification methodology, the development of a holistic approach to address financial risks arising from climate change and the assessment of the functioning of the Basel framework. 	Chapter 6 Chapter 7 Chapter 8
European fora	<ul style="list-style-type: none"> The EBA has worked actively to ensure effective and consistent regulation and supervision in the European banking sector. Along these lines, in 2022 it developed a large number of technical standards, guidelines and reports in the area of prudential regulation, resolution, digital finance and emerging risks, including climate and environmental risk, cyber risk and AML/CTF risk. In addition, it continued to strengthen the European stress testing framework and the EUCLID data platform. The ESRB —whose Advisory Technical Committee is chaired by the Governor of the Banco de España— worked intensively in 2022 on identifying and monitoring risks and vulnerabilities for the EU financial system, with a particular focus on the commercial real estate sector. 	Chapter 9 Index of photographs Banco de España publications

<p>Banco de España's new regulatory developments</p>	<ul style="list-style-type: none"> • In 2022, the Banco de España published three circulars on the following subjects: i) legal regime for financial credit institutions, including most notably the new liquidity requirements (Circular 1/2022); ii) statistical payment reporting obligations to the Banco de España by payment service providers and payment system operators (Circular 2/2022); and iii) prudential matters for credit institutions that represent the finalisation of the transposition of CRD-V into Spanish law, and the development of reporting obligations applicable to revolving credit (Circular 3/2022). • Three circulars are currently in progress, all on reporting to the Banco de España, in relation to: i) covered bonds and other loan mobilisation instruments; ii) capital structure; and iii) remuneration policy, for alignment with the new EBA models.
<p>Other new regulatory developments</p>	<ul style="list-style-type: none"> • At the national level, it is worth mentioning the Draft Securities and Investment Services Markets Law, which, among other things, will make the necessary adaptations for the implementation of the future regulation of markets in cryptoassets (MiCA). It provides for the Banco de España to be entrusted with the supervision, inspection and sanctioning of compliance with the obligations under the MiCA Regulation as regards issuers of electronic money tokens and asset-referenced tokens. • A regulation on instant transfers in euro is in progress in the EU, which aims, among other things, to ensure that payment service providers offer euro instant payments to their customers in an affordable and secure manner.

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