

Supervision Report: Digest

CHAPTER 1.

SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

Supervisory functions of the Banco de España

- 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.
- Microprudential supervision, which is exercised within the framework of the Single Supervisory Mechanism (SSM), aims to ensure the solvency, liquidity, sound functioning and prudential regulation compliance of credit institutions and other institutions in the financial system.
- The purpose of macroprudential policy is to safeguard financial stability, through the use of macroprudential instruments, to prevent and mitigate systemic risks and vulnerabilities.
- The supervision of the conduct, transparency and customer protection of the institutions registered in its official registers, as well as the verification of effective compliance with the rules, seeks to further strengthen institutions' culture towards a responsible banking model, in order to guarantee an appropriate financial relationship with their customers.
- The supervision of the provision of payment services aims to safeguard security in payment service provision and promote an integrated, secure and efficient payments market. In addition, the Banco de España also carries out the oversight of payment systems and instruments to promote their proper functioning, and shares with the National Securities Market Commission (CNMV) the oversight of securities infrastructures.
- Lastly, 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 countering the financing of terrorism (AML/CFT).

Supervisory and oversight staff

- At 31 December 2023, the Banco de España had 894 employees performing supervisory and oversight functions, as compared to 849 employees at 2022 year-end (+5%). Of these, 47.9% are men and 52.1% are women, although the distribution varies among the professional groups.

CHAPTER 2.

MICROPRUDENTIAL SUPERVISION

The Spanish banking sector

- In 2023, the total consolidated credit balance of Spanish credit institutions decreased due to the significant contraction of operations in Spain in all segments and the decrease in cash balances at central banks and in demand deposits at other credit institutions. There was no significant deterioration in credit quality indicators, and the NPL ratio remained at similar levels to 2022 year-end, albeit with slight upturns in NPLs in the consumer and mortgage segments.
- Following the decline in 2022, liquidity coverage ratios (LCR) have remained stable with comfortable levels in 2023, in a context of early and ordinary TLTRO III (Targeted Longer-Term Refinancing Operations III) repayments and lower credit demand.
- Institutions continue to show increasing levels of profitability. The evolution of interest rates has driven the growth of net interest income during 2023. In addition, the improvement in operating profit that exceeded the increase in overhead costs led to a favourable performance of the efficiency ratio.
- Solvency levels remain at record highs (16.9% of total capital at September 2023, with an average of 16.6% for SIs and 20.4% for LSIs).
- In short, the impact of the pandemic has been overcome, with higher levels of profitability and solvency, but signs of a slowdown in financial activity are beginning to emerge, calling for caution. In view of the situation of uncertainty, it would be desirable for institutions to take advantage of this current favourable moment and apply prudent policies in their capital planning and returns and in their credit risk coverage.

Supervisory priorities in 2024 for credit institutions and focal points

- The European Central Bank (ECB) set the priorities for significant institutions (SIs) for 2024-2026 around three major objectives: i) increase resilience to macro-financial and geopolitical shocks and, to this end, continue to strengthen credit risk management and funding and interest rate risk management; ii) accelerate the effective remediation of shortcomings in governance and in the management of climate-related and environmental risks; and iii) further progress in digital transformation and building robust operational resilience frameworks.
- In line with the above, the Banco de España has identified as a priority for less significant institutions (LSIs) in 2024 the treatment of credit risk, liquidity and IRRBB risk policies and procedures, internal governance, climate risk management, business models and sustainability, and operational risk (in particular, technology risk).
- The supervisory focal points for SIs in 2023 were grouped into three broad areas: i) increasing resilience to macro-financial and geopolitical shocks; ii) addressing institutions' structural vulnerabilities (regarding governance, technology risk and digital transformation); and iii) continuing to adapt the business strategy and risk management framework to climate risk. For LSIs, work was focused on credit risk management, business models and sustainability, operational risk (in particular, technology risk), governance, capital planning, and risks linked to climate change.

Supervision of credit institutions

- Noteworthy among the recurrent ongoing off-site supervision tasks are those related to the SREP, which include most notably the requirements and recommendations related to capital, credit risk and governance. In addition, other actions are worthy of note due to the resources devoted and/or conclusions reached, such as in-depth reviews on NPLs and cross-institutional reviews of residential real estate financing, IFRS 9 provisioning models, digitisation or Pillar 3 disclosures on climate risk.
- A total of 19 on-site inspections were launched at Spanish SIs, focusing on credit risk (6 inspections), business model (3) and technology risk (2). Credit risk and interest rate and market risk inspections account for the bulk of findings. Also, 11 model investigations were conducted, all on credit risk, and most of them were focused on reviewing material changes to models to adapt to the new EBA guidelines.
- The SREP is also one of the central tasks in the ongoing supervision of Spanish LSIs. In addition, various actions were carried out, including most notably horizontal reviews on technology risk and climate risk. Overall, for LSIs and the ICO, 727 ongoing supervision actions were carried out during 2023. In addition, 11 on-site inspections were completed, with a special emphasis on the assessment of credit quality and foreclosed assets, governance and solvency, along with IT-related matters.
- As a result of the supervisory actions described for LSIs and the ICO, the Banco de España sent a total of 93 letters with 508 requirements or recommendations, mostly Pillar 2 requirements included in capital decisions, followed by governance, business model and operational requirements and recommendations.
- In 2023, Spanish SIs participated in the European stress tests. The results showed that Spanish SIs would have satisfactory capital levels in the adverse scenario. In turn, the Banco de España conducts annual stress tests on LSIs in the same framework and under the Forward Looking Exercise on Spanish Banks (FLESB) tool. The results showed that the aggregate solvency of all the LSIs in both scenarios would be high, above regulatory requirements.
- In December 2023, 19 Spanish credit institutions had issued covered bonds, with a total of 27 authorised programmes. In 2023, both individual monitoring of each of the issuing institutions and a horizontal analysis were carried out. Both the issuers and control bodies have adequately adapted to the new regime. In addition, in 2023 the Banco de España assumed the supervision of the specific framework for simple, transparent and standardised (STS) securitisations, provided for in Regulation (EU) 2017/2402, when the issuers of these instruments are credit institutions or other institutions under the supervision of the Banco de España.
- In relation to anti-money laundering and countering the financing of terrorism, in the course of 2023 the Banco de España completed the following inspections (all of which were commenced in 2022): 2 general actions, 1 specific inspection on internal control systems and, jointly with SEPBLAC, 15 thematic reviews of foreign exchange activity. Also, it commenced and concluded 4 inspections at currency-exchange bureaux.

Supervision of institutions other than credit institutions, of payment service provision and of compliance with vetted access to activity

- The Banco de España has exclusive microprudential supervisory powers over institutions other than credit institutions, on which 281 ongoing off-site supervisory actions were carried out in 2023 by various means; also, it commenced 3 inspections and a multitude of other supervisory procedures.
- In the 2023 supervision of payment service provision, a major part of the work was focused on reviewing compliance by payment institutions and electronic money institutions with the guarantee and protection requirements for payment service users' funds. Moreover, the analysis of the evolution of fraud data seems to confirm the growing impact and importance of digital fraud with respect to total fraud in payment transactions, especially in transfer and card transactions. Also, in 2023 there was a significant increase in communications related to the outsourcing of important operational functions.
- The Banco de España, as the body responsible for overseeing compliance with vetted access to activity, initiated 15 supervisory actions in 2023 (14 against legal entities and 1 against an individual that may have been carrying out restricted activities or making undue use of an unauthorised name). In the area of payment services, analyses of 8 potential cases of non-compliance with vetted access to activity commenced in 2023.

Application of financial technology innovation to supervisory functions (SupTech). The sandbox: controlled digital innovation testing space

- The roadmap until the end of 2024 to incorporate the use of innovative technology into the supervisory area (SupTech) presents 4 lines of work: i) in-house creation of SupTech tools; ii) active participation in SSM initiatives in this area; iii) fostering a culture of innovation; and iv) promotion of training in data science. The results of the external assessment of the SupTech function have already been published, highlighting strengths and possible areas for improvement in this area.
- In 2023 there were two new calls for applications to the controlled testing space, known internationally as the sandbox. Throughout 2023, projects from five different calls coexisted. There are various different types of promoter, including both supervised and non-supervised institutions, most notably consultancy firms, FinTechs and banks. None of the projects tested, from the launch of the sandbox to date, is applicable to the better performance of supervisory functions. The authorities responsible for the sandbox continue to work on improving its functioning.

- In just ten years, the SSM has become a robust, credible, adaptable and internationally respected banking supervisor. However, further improvement is required and the challenges ahead will need to be addressed with ambition. Future challenges include the following: to increase effectiveness, by enhancing the risk approach and the focus on results; to improve consistency; and to increase efficiency, by using SupTech tools and leaving more room for supervisory judgement. In any case, the supervision of the future will need to have the necessary flexibility to respond to an increasingly dynamic environment.
- In the crisis that hit several US regional banks and Switzerland's Credit Suisse in the first half of 2023, deposit withdrawals and liquidity pressures forced the intervention of supervisory and resolution authorities to safeguard the stability of the banking system. This crisis offers valuable lessons for the supervisory approach; of particular note is the importance of a holistic analysis of business models and of paying attention to asset and liability management and the need to act swiftly to remedy detected shortcomings, with the focus on the effectiveness of supervisory measures.
- Effective supervision should ensure that institutions have adequate capital and liquidity and that indicators of key risks are kept at manageable levels. In recent years, developments in the banking sector in Spain and in Europe have, on the whole, been very favourable, helped by supervisory activity under the SSM framework, which is more demanding and seeks a more prominent impact. The effectiveness of supervisory action is linked to the selection of an appropriate combination of supervisory measures, with an ambitious use of qualitative measures and efforts to communicate with institutions. This increased level of scrutiny has led to progress by institutions, although not with the same intensity and pace for all risks.
- Climate and environmental risks have been among the supervisory priorities in recent years and have required supervisors to play an active role, with supervisory activities, dialogue with institutions and publication of observed good practices. Also, it is important to note the significance of transition plans, which must necessarily be based on the plans produced by their main counterparties.
- The Digital Operational Resilience Act (DORA) was published in December 2023, and its date of application is January 2025. The feature that makes it a global benchmark is the establishment of an oversight framework for critical technology suppliers. The implementation of this oversight mechanism will require a significant effort by all financial sector authorities to develop procedures and methodologies in order to carry out the effective supervision of large and complex companies and to equip themselves with the necessary additional resources.
- There has been a growing use of machine learning techniques for credit risk measurement and management. In authorising the use of these techniques in internal ratings-based models, the supervisor is faced with the difficulty in interpreting and explaining the models' results. They are also generating interest in the area of loan origination, due to the increased predictive capacity; however, such uses will be subject to a specific regulatory framework, which is currently pending approval, and will be subject to the requirements set out in the General Data Protection Regulation.
- One of the pillars of the Banco de España's drive for technological innovation is the in-house development of SupTech tools. Four lines of work can be distinguished in this development: i) improvement of the quality of the Central Credit Register (CIRBE); ii) detection of changes in trends and anomalous data based on machine learning algorithms; iii) graphical representation of large amounts of data to facilitate their interpretation and analysis; and iv) exploration of predictive capacity based on CIRBE information and exploitation of information from unstructured texts.
- The EU plans to create the new AML/CFT authority —AMLA— and to strengthen legislation with a new directive and a regulation. The Banco de España will actively contribute to the articulation and coordination of AML/CFT supervision by AMLA, building on the experience gained over the Single Supervisory Mechanism's ten years of existence.

CHAPTER 3.

MACROPRUDENTIAL POLICY

Banco de España's macroprudential policy tools	<ul style="list-style-type: none">• Under current legislation, the Banco de España can set macroprudential capital buffers to address the build-up of systemic risks.• In 2023, the Banco de España maintained the countercyclical capital buffer (CCyB) at 0% for credit exposures in Spain: it considered it to be an appropriate macroprudential policy response given the absence of imbalances in Spain's credit cycle, in an environment characterised by geopolitical tensions, high inflation rates and the tightening of the ECB's monetary policy.• In 2023, 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 2024 (O-SIIs) and 2025 (G-SII).• The Banco de España modified its methodology for determining O-SII capital buffers to adapt it to the ECB's new revised minimum buffer framework. This change brought about an increase of 0.25 pp in 2023 in the O-SII buffers applicable in 2024 for two institutions.
Macroprudential coordination at the national level	<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 Economy, Trade and Business and in which the CNMV and the Directorate General of Insurance and Pension Funds also participate.
Macroprudential tasks at the European level	<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 member, it notifies the ECB of all its proposals for macroprudential measures prior to their adoption and announcement.

CHAPTER 4.

SUPERVISION OF INSTITUTIONS' CONDUCT

Objectives	<ul style="list-style-type: none">• Beyond the verification of compliance with applicable regulations, the fundamental objective of conduct supervision is to foster a culture of compliance at institutions, aimed at establishing business models and organisational structures that ensure sound market practices, with particular attention to institutions' customer relations.• Supervisory attention is focused on assessing the institution's internal control framework, thereby helping strengthen the conduct of supervised institutions and identify best market practices. In doing so, the principle of proportionality is applied. Also, the exchange of information and the transmission of relevant messages to institutions is fostered, including, among other aspects, the communication of supervisory priorities and expectations.
Supervisory activity	<ul style="list-style-type: none">• Ongoing monitoring allows potential conduct risks to be anticipated and contributes to the design of the supervisory strategy and to the planning of supervisory actions. Also, the interaction with institutions allowed them to modify certain aspects proactively and prior to the adoption of supervisory measures, which confirms the effectiveness of collaborative mechanisms between supervisor and institutions.• A number of supervisory actions were carried out in 2023 in areas such as consumer credit (point-of-sale deferred payment solutions, tacit overdrafts and responsible lending), basic payment accounts and alleviation measures for groups facing difficulties.• Supervisory activity, supported by an increasingly developed and comprehensive regulation, has helped strengthen the culture of conduct compliance.
Supervisory measures	<ul style="list-style-type: none">• As a result of the corresponding supervisory actions, the following measures were adopted in 2023: 1 sanctioning proceeding initiated, 57 advertising requirements, 44 requirements on other matters and 76 recommendations and clarifications. Institutions' compliance with the supervisory measures adopted is positively assessed.

CHAPTER 5.

OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Oversight of payment systems and instruments

- The Banco de España, together with the Eurosystem, completed the oversight of the T2-T2S consolidation project, which culminated on 20 March 2023 with the successful implementation of the new TARGET system, comprising the T2, T2S and TIPS settlement services.
- The Sistema de Tarjetas y Medios de Pago (STMP), which is responsible for clearing the bulk of card transactions at the national level, was identified as a prominently important retail payment system and is subject to the Eurosystem's oversight framework. As regards Redsys and Cecabank, they became monitored by the Banco de España as providers of critical STMP services, since they execute the processes of calculating the net interbank obligations (clearing) resulting from these retail operations.
- Instant transfers represented over 52% of total transfers in Spain, while in the European Union they accounted for just over 15%, according to statistics from the second quarter of 2023.
- In relation to the Eurosystem oversight framework for electronic payment instruments, schemes and arrangements (the PISA framework), the Banco de España participated in the assessment of the set of schemes operated by the European Payments Council (EPC), in particular the SEPA direct debit and credit transfer schemes.

Supervision of Iberpay (management company of the National Electronic Clearing System)

- The Banco de España approved a new SNCE regulation. In addition, it assessed 11 operating instructions of the SNCE, which the Banco de España did not oppose. These include issues such as the adaptation of the subsystems' rules to the new regulation, the incorporation of the responsibilities of the participants in the transfer subsystems in relation to recall requests due to fraud, the finalisation of the project involving the replacement of the physical exchange of documents by the exchange of images, the incorporation into the regulations of each subsystem of the relevant sectoral agreements on responsibilities between institutions, and the adaptation of the instant SEPA transfer subsystem rules to the new version of the EPC's SEPA Instant Credit Transfer Rulebook.

Oversight of securities infrastructures

- With respect to T2S, 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.
- In relation to BME Clearing, the Banco de España issued six mandatory reports in accordance with Articles 86.4 and 94 of the Securities Markets and Investment Services Law —all of them favourable— related, inter alia, to adaptations to Regulation (EU) 23/2021 on a framework for the recovery and resolution of central counterparties, and to the opening of a new digital asset segment.

CHAPTER 6.

EXERCISE OF SANCTIONING POWERS

Penalties

- Sanctioning powers, as a necessary supplement to the supervisory function, continued to be exercised in 2023. The largest number of sanctioning proceedings were concentrated in the prudential area, notably those relating to internal control, risk management and governance, and the maintenance of sufficient capital. The sanctioning proceedings relating to transparency and customer protection were due to shortcomings in the offer and marketing of credit cards, in the accrual of interest, in the charge and settlement of interest and fees, and in pre-contractual and contractual information, among others.

CHAPTER 7.

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

Global fora	<ul style="list-style-type: none">• During 2023, the Financial Stability Board further elaborated on resolution-related issues, with the review of the banking turmoil at the beginning of the year from this perspective and the publication of a framework for the resolution of central counterparties. Also, it continued to work on strengthening the non-bank financial intermediation sector, analysing vulnerabilities associated with structural changes (in particular vulnerabilities related to crypto-assets, climate change, cyber incidents and risks linked to the services of external providers) and improving cross-border payments.• The Basel Committee on Banking Supervision —chaired by the Governor of the Banco de España— made progress on its work on the digitalisation of finance, developed a Pillar 3 proposal as part of its holistic approach to address the financial risks arising from climate change, revised the Core Principles for Effective Banking Supervision and continued to promote the full, consistent and timely application of the Basel framework. In relation to the March 2023 episodes, the Committee published a report with regulatory and supervisory analysis and lessons.
European fora	<ul style="list-style-type: none">• In 2023, the European Banking Authority worked actively to ensure an effective and consistent level of prudential regulation and supervision; to this end it prepared a significant number of technical standards, guidelines and reports. Also, as a consequence of the turmoil in March, it intensified the assessment of risks and vulnerabilities in the European banking sector. In July it published the results of its analysis of unrealised losses in European banks' fixed income portfolios, which concluded that they were contained.• The European Systemic Risk Board —whose Advisory Technical Committee has been chaired by Pablo Hernández de Cos since 2019— focused its work on the analysis of issues of relevance to financial stability, such as cyber resilience, financial innovation and the situation of the real estate market.• The Banco de España is a member of the Governing Council of the International Financial Consumer Protection Organisation, of the Committee on Payments and Market Infrastructures of the Bank for International Settlements and of the Network for Greening the Financial System.

CHAPTER 8.

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

Banco de España's new regulatory developments	<ul style="list-style-type: none">• In 2023 the Banco de España published three circulars on the following subjects: i) new reporting obligations to the Banco de España on covered bonds and other loan mobilisation instruments (Circular 1/2023); ii) amendments to the reporting obligations to the Banco de España's Central Credit Register (Circular 2/2023); and iii) ban on collecting deposits under the regime for the provision of services without a branch by third country credit institutions and review of the information to be reported on remuneration (Circular 3/2023). In addition, guidelines on the governance and transparency of revolving credit were published, which include best practices as well as criteria and procedures considered adequate for regulatory compliance.• There are four draft circulars in progress: two on reporting obligations to the Banco de España; one on conduct requirements; and one on the calculation of contributions to the Deposit Guarantee Fund.
Other new regulatory developments	<ul style="list-style-type: none">• In the EU, the following are worthy of note: i) the regulation on crypto-assets (MiCA); ii) the amendment to the regulation and the directive on prudential requirements and supervision (CRR and CRD); iii) the digital finance package presented by the European Commission, which includes a review of the European rules on payment services and a legislative proposal for open finance (FIDA); and (iv) the directive on credit agreements for consumers.• Noteworthy at the national level is the approval of Law 6/2023 on Securities Markets and Investment Services, which entrusts the Banco de España with the supervisory, inspection and sanctioning tasks arising from the MiCA regulation.