8

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

THE BANCO DE ESPAÑA'S REMIT

The Banco de España prepares circulars implementing higher-ranking regulations, and technical guidelines with criteria, practices, methodologies and procedures for compliance with supervisory regulations

NEW REGULATORY DEVELOPMENTS AT THE BANCO DE ESPAÑA

Since January 2023, the Banco de España has published three circulars on covered bonds, the Central Credit Register, and remuneration policy and conduct of activities without branches, as well as guidelines on governance and transparency of revolving credit

DRAFT CIRCULARS UNDER WAY AT THE BANCO DE ESPAÑA

Four circulars in the draft stage, two relating to reporting obligations to the Banco de España, one on institutions' conduct and another on the calculation method for institutions' contributions to the Deposit Guarantee Scheme.

OTHER NEW REGULATORY DEVELOPMENTS

Noteworthy developments at the European Union level include the publication of the Markets in Crypto-Assets Regulation, the amendment of the Capital Requirements Regulation and Directive, the new Directive on consumer credit and the European Commission's presentation of the digital finance package

8.1 Banco de España Circulars and Guidelines

8.1.1 Circular 1/2023

Banco de España Circular 1/2023 of 24 February 2023 to credit institutions, branches in Spain of credit institutions authorised in another Member State of the European Union and specialised lending institutions (SLIs) on the information to be submitted to the Banco de España relating to covered bonds and other loan mobilisation instruments, and amending Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial reporting rules and formats and Circular 4/2019 of 26 November 2019 to specialised lending institutions on public and confidential financial reporting rules and formats.

The publication of Royal Decree-Law 24/2021 establishes, among other issues, the reporting obligations to the Banco de España of credit institutions that issue covered bonds. These obligations relate to the eligibility of assets and cover pool requirements, the cover pool liquidity buffer and any other information that the Banco de España deems necessary for the exercise of its supervisory functions over covered bonds. This Royal Decree-Law also sets out the requirements relating to collateralised mortgage bonds, mortgage transfer certificates and loan mobilisation instruments or loans secured by first chattel mortgage or first non-possessory pledge that may be issued by credit institutions and SLIs. These new obligations to report information to the Banco de España can be found in Banco de España Circular 1/2023 of 24 February 2023. Institutions began to submit this information with reference data from March 2023.

8.1.2 Circular 2/2023

Banco de España Circular 2/2023 of 17 March 2023 amending Circular 1/2013 of 24 May 2013 on the Central Credit Register.

This Circular includes significant changes to the information that institutions must submit, the most relevant of which are as follows:

- since January 2023 reporting institutions must submit to the Central Credit Register all individualised transactions with borrowers with a cumulative exposure of €3,000 or more (previously €6,000);

- information in some modules is now shown in a more simplified way;

— the accounting data for loans to natural persons are included as additional information, as has been the case since 2018 for legal entities;

— the borrower's annual disposable income is requested at the outset of household lending processes.

8.1.3 Circular 3/2023

Banco de España Circular 3/2023 of 31 October 2023, amending Circular 2/2016 of 2 February 2016 to credit institutions on supervision and solvency, completing the transposition into Spanish legislation of Directive 2013/36/EU and Regulation (EU) No 575/2013, and Circular 1/2022 of 24 January 2022 to specialised lending institutions on liquidity, prudential rules and reporting obligations.

The amendment of Circular 2/2016 prohibits third country credit institutions with no branch presence in Spain from receiving deposits in the course of operations. This ban was introduced in 2022 in an amendment to Law 10/2014 of 26 June, on the regulation, supervision and solvency of credit institutions. In addition, some valuation methods were incorporated in the process of authorising the provision of services without any branches.

The amendment of Circulars 2/2016 and 1/2022 updates the current supervisory reporting of remuneration for both credit institutions and SLIs, bringing it proportionately into line with the guidelines of the European Banking Authority (EBA) on the benchmarking exercises on remuneration practices, the gender pay gap and approved higher ratios under Directive 2013/36/EU (EBA/GL/2022/06), and the guidelines on the data collection exercise regarding high earners under Directive 2013/36/EU and Directive (EU) 2019/2034 (EBA/GL/2022/08). This amendment aligns supervisory reporting with the market disclosure regime (Pillar 3) and includes two newly created data collection templates: one for reporting the gender pay gap and another to harmonise the benchmarking of approvals granted by shareholders to use higher ratios between variable and fixed remuneration.

8.1.4 Circular 1/2024

Banco de España Circular 1/2024 of 26 January 2024 to banks, credit cooperatives and other supervised institutions in relation to information on the capital structure and amending Circular 1/2009 of 18 December 2009 to credit institutions and other supervised institutions in relation to information on the capital structure and non-voting equity units of credit institutions, and on their branches.

A circular on capital structure was published in February 2024 that comprehensively and fully regulates the new information on this matter, repealing the existing legislation contained in Chapter I of Circular 1/2009 of 18 December 2009, since, in recent years, amendments have been

made to Spanish legislation that make it advisable to update and harmonise these requirements. In addition, the new Circular also repeals Chapter III of the aforementioned Circular 1/2009, relating to registration in the Senior Officer Register and the submission of information on other positions held by senior officers in other companies, since the rules contained in that chapter were obsolete and had been superseded by subsequent legislation of equal or higher rank. However, institutions still fall under the reporting obligations on this matter that derive from the legislation applicable to them.

The scope of application includes banks, credit cooperatives, SLIs, payment institutions and electronic money institutions.

8.1.5 *Guidelines on the governance and transparency of revolving credit for institutions subject to Banco de España supervision*

These guidelines contain the best market practices identified in the exercise of the Banco de España's supervisory function, along with the criteria and procedures that it deems suitable for ensuring compliance with the rules applicable to the design and arrangement of revolving credit,[1] to help supervised institutions comply with and implement them and encourage responsible practices in marketing this type of credit.

In preparing these guidelines, consideration was given both to the specific regulations for this type of product approved in 2020 and to the EBA's guidelines on "product oversight and governance arrangements for retail banking products",[1] "remuneration policies and practices related to the sale and provision of retail banking products and services"[2] and "loan origination and monitoring",[3] adopted by the Banco de España.

8.2 Other draft circulars in progress

A circular is being drafted to payment service providers on the information to be submitted to the Banco de España and other measures applicable to these providers.

The draft circular comes in response to the need to further develop some of the provisions of the regulations governing payment services, to ensure their appropriate implementation and their supervision by the Banco de España, as the authority tasked with guaranteeing and monitoring effective compliance. This requires providing details of some of the obligations set out therein and the relevant information to be available, particularly in relation to the following:

— outsourcing of functions by certain payment service providers;

1 EBA/GL/2015/18.
2 EBA/GL/2016/06.
3 EBA/GL/2020/06.

— reasonable grounds for suspecting fraud in unauthorised payment transactions;

— denial of access to a payment account by an account servicing payment service provider to a payment initiation service provider or an account information service provider;

— operational and security risks, and notification of major operational or security incidents;

— compliance with the standards for strong customer authentication and common and secure open standards of communication.

In addition, a review will be undertaken of Banco de España Circular 5/2016 of 27 May 2016 on the calculation method to be used to ensure that the contributions of institutions belonging to the Deposit Guarantee Scheme for Credit Institutions are proportionate to their risk profile, in order to enable implementation, by means of the appropriate regulatory amendments, of the Guidelines (revised) on methods for calculating contributions to deposit guarantee schemes (DGSs) under Directive 2014/49/EU, repealing and replacing Guidelines EBA/GL/2015/10 (EBA/GL/2023/02). These guidelines, published by the EBA on 21 February 2023 and adopted as their own by the Banco de España on 18 September 2023, aim to clarify and enhance the method for calculating institutions' contributions to DGSs to ensure that these contributions are better aligned with the risk profile, thus enabling the target level of the DGS fund to be met and maintained.

The review of Circular 5/2016 falls within the Banco de España's remit as the competent authority responsible for developing the calculation method for contributions to the DGS.

A circular is also being drafted on requirements and obligations relating to institutions' conduct, transparency of banking services and customer protection, repealing Banco de España Circular 5/2012.

This draft circular addresses the need to rationalise and update the regulations on conduct, banking transparency and customer protection currently set out in Banco de España Circular 5/2012 of 27 June 2012 to credit institutions and payment service providers on the transparency of banking services and responsible lending. Since this circular was approved, both the regulatory framework for the different banking products and services and the business models of supervised institutions have undergone major changes, mainly as a result of the headway made in new technologies and the gradual digitalisation of financial services, which warrant a comprehensive review of the regulatory developments contained in the circular and an assessment of whether it is fit for purpose.

8.3 Other new regulatory developments

Also worth mentioning is Regulation (EU) 2023/1114 of the European Parliament and of the Council of 31 May 2023 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 (the MiCA Regulation).

The MiCA Regulation was published in the Official Journal of the European Union on 9 June 2023. This regulation establishes a regulatory framework for crypto-asset activities and markets and introduces requirements on the issuance, offer to the public and admission to trading of crypto-assets, and on the provision of crypto-asset services. It also includes a specific arrangement for the supervision of these activities, as well as a sanctioning regime for all of them.

The MiCA Regulation defines crypto-assets as a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology (DLT) or similar technology. However, MiCA does not apply to all the crypto-assets that fall under this definition. It excludes from its scope, among other things, crypto-assets that qualify as financial instruments or other products that are already regulated in existing legislation on financial services, and crypto-assets that are unique and not fungible with other crypto-assets. The European Central Bank and national central banks of Member States, when acting in their capacity as monetary authorities, are also outside its scope. Lastly, MiCA is not applicable to crypto-asset services that are provided in a fully decentralised manner without any intermediary.

The MiCA Regulation classifies crypto-assets into three categories: asset-referenced tokens (ARTs), electronic money tokens (EMTs) and crypto-assets other than ARTs and EMTs that are not excluded from the regulation's scope.

For each of the above-mentioned categories, the MiCA Regulation contains certain requirements relating to their issuance, offer to the public and admission to trading, varying in scope depending on the category. These requirements include the need to draw up and publish a white paper, before issuance, setting out the main features of such issuance, the rights and obligations of the issuers vis-à-vis the holders, etc. (in some cases, authorisation from the competent authority will also be required). In addition, the regulation establishes rules and requirements for the operation, organisation and governance of issuers of crypto-assets and requirements for the protection of holders of crypto-assets.

The MiCA Regulation also regulates the provision of crypto-asset services, for which authorisation as a crypto-asset service provider must generally be obtained from the competent authority, subject to compliance with the established requirements. In the case of authorised institutions (credit institutions, central securities depositories, investment firms, market operators, electronic money institutions, management companies managing undertakings for collective investment in transferable securities and alternative investment fund managers), certain services may be provided without such authorisation.

Specifically, the MiCA Regulation covers the following crypto-asset services: custody and administration of crypto-assets on behalf of clients; operation of a trading platform for crypto-assets; exchange of crypto-assets for funds or other crypto-assets; execution of orders for crypto-assets on behalf of clients; placing of crypto-assets; reception and transmission of orders for crypto-assets on behalf of clients; providing advice on crypto-assets; portfolio management of crypto-assets; and transfer services for crypto-assets on behalf of clients.

The MiCA Regulation shall enter into force on 30 December 2024, except for the provisions regarding ARTs and EMTs, which shall apply from 30 June 2024.

The year also saw the adoption of Law 6/2023 of 17 March 2023 on securities markets and investment services. Pursuant to Article 251 (last paragraph) of this law, the Banco de España is entrusted with the supervision, inspection and sanctioning of non-compliance with the obligations under the MiCA Regulation of issuers of ARTs and EMTs.

Also noteworthy was the European Commission's launch of the digital finance package in June. This package contains the measures described in Box 8.1.

In addition, mention should be made of Directive (EU) 2023/2225 of the European Parliament and of the Council of 18 October 2023 on credit agreements for consumers and repealing Directive 2008/48/EC (CCD2), referred to in Box 4.2. The new directive aims to strengthen consumer protection and remove any obstacles to the cross-border consumer credit market, to this end extending its scope of application to cover certain agreements that were excluded from the previous regulation with a view to further harmonising the framework. Other key aspects include the provision for creditors and consumer credit intermediaries to be subject to an admission and registration process, and to supervision, in the Member States, and the duty of Member States to introduce measures to ensure that consumers do not bear excessively high borrowing rates, annual percentage rates or total costs of credit.

Lastly, in the area of prudential banking regulations, the Committee of Permanent Representatives of the Governments of the Member States to the European Union (Coreper) and the European Parliament's Committee on Economic and Monetary Affairs (ECON) approved the amendments to Regulation (EU) No 575/2013 (CRR-III) and Directive 2013/36 (CRD-VI). The primary objective of these regulations, in particular the CRR, is to translate the latest amendments to the Basel framework into European legislation (see Box 8.2).

Box 8.1

MODERNISING PAYMENT SERVICES AND OPENING FINANCIAL SERVICES DATA: THE LEGISLATIVE PROPOSALS OF THE EUROPEAN COMMISSION

The European Commission put forward three legislative proposals in June 2023 relating to payment services and data sharing in financial services. They are as follows:

a) a draft regulation for payment services in the internal market (Payment Services Regulation, PSR);

b) a draft directive on payment and electronic money services in the internal market (PSD3), repealing Directive 2015/2366 (known as PSD2) and the E-Money Directive;

c) a legislative proposal for a regulation on a framework for financial data access (FiDA).

According to the European Commission, these proposals are intended to improve consumer protection and competition in electronic payments, as well as empower consumers to securely share their data so that they can better access financial products and services.

PSR and PSD3 represent an evolution of PSD2, intended to:

a) harmonise arrangements for payment services and electronic money;

b) combat fraud by enabling payment service providers to share information among themselves, strengthening customer authentication, extending refund rights of consumers who fall victim to fraud and checking alignment of payees' IBAN numbers with their names in credit transfers;

c) improve consumer rights, making more information available to them;

d) harmonise regulations for banks and non-banking institutions, allowing the latter access to payment systems and securing their rights to a bank account;

e) improve the functioning of open banking; and

f) improve the availability of cash in shops and via automated teller machines.

FiDA establishes a framework of rights and obligations for sharing data on loans, savings, investments, pensions and insurance (excluding life insurance) for financial service customers, including the following:

a) Customers have the right to access their data held by financial institutions and share them with other financial institutions, including new financial information services providers.

b) Financial institutions must make customer data – subject to prior customer permission – available to other institutions via technical infrastructure. To do so, the proposal aims to encourage financial institutions to put in place technical interfaces and to standardise customer data and technical interfaces as part of creating financial data sharing schemes, in which both data holders and data users become members.

Box 8.2

FINAL PHASE OF BASEL III IMPLEMENTATION IN THE EUROPEAN UNION

The Committee of Permanent Representatives of the Governments of the Member States to the European Union (Coreper) and the European Parliament's Committee on Economic and Monetary Affairs (ECON) have approved the amendments to Regulation (EU) No 575/2013 (CRR-III) and Directive 2013/36 (CRD-VI).[1]

The main aim of this reform was the implementation in the EU of the final amendments to the Basel capital framework (Basel III), with two distinct documents:

— Amendment of Regulation (EU) No 575/2013 (CRR-III). This is the fundamental part of the reform, including changes to the calculation methods for own funds requirements.

— Amendment of Directive 2013/36 (CRD-VI). While this incorporates changes relating to implementation of Basel III, its fundamental purpose is to enhance the way institutions address environmental, social and governance (ESG) risks, as well as enhance the supervisory framework for institutions and harmonisation of divergent national laws.

CRR-III will enter into force on 1 January 2025. Turning to CRD-VI, Member States will have 18 months from its publication to transpose it into national legislation. In December 2023 the European Banking Authority (EBA) published a roadmap[2] on strengthening the prudential framework, ensuring an international level playing field and providing the industry with clarity on how the EBA will develop the mandates to implement the legislation and how it expects to finalise the most significant components prior to the application date. All of the above will facilitate banks' implementation of the package.

I Main changes introduced by CRR-III

One of the aims of Basel III[3] is to mitigate the variability and lack of comparability of banks' risk-weighted assets (RWAs) entailed by the use of internal models. To this end, a series of measures is introduced that CRR-III incorporates into EU legislation. The adoption of Basel III in the EU is, broadly speaking, complete and consistent with the international framework, although it introduces some European specificities not covered by the Basel framework.

The most significant changes introduced in CRR-III for the EU-wide implementation of Basel III are as follows.

— Output floor: it sets a lower limit for overall RWAs for any bank at 72.5% of RWAs calculated using the standardised approach. In the EU, the output floor will apply at all levels of consolidation, although each Member State may derogate from the individual or subconsolidated level for banking group entities within its jurisdiction. Certain transitional arrangements have also been introduced (in addition to those set out in Basel III) to phase in the framework, so that the output floor will only be fully applicable by 2032.

— Credit risk: the new regulation enhances granularity and sensitivity to certain classes of exposure in the standardised approach (e.g. retail or equity exposures). Internal models are no longer permitted for certain exposures (equity), the advanced internal ratings-based (A-IRB) approach is no longer an option for other exposures (financial institutions and large corporates) and new restrictions are placed on institutions' estimates of parameters. In addition, various transitional arrangements have been agreed in the EU that go beyond Basel III so that banks can gradually adapt to the new rules, e.g. the application of valuation haircuts on leased assets.

— Operational risk: as set out in the Basel framework, internal models may no longer be used in the EU to calculate own funds requirements for this type of risk, but legislators exercised the option provided in Basel III to disregard historical losses when calculating requirements. As such, capital needs will be determined solely by the "business indicator component", which measures an institution's volume of business. At this point, it should also be noted that CRR-III goes further than Basel III to introduce the possibility of the supervisor allowing a bank to calculate the interest component (which is part of the business indicator) separately for each subsidiary in a group, under certain conditions.

1 On 6 December 2023 in Coreper and 11 December 2023 in ECON.
2 *EBA Roadmap on strengthening the prudential framework.*
3 Finalising Basel III. In brief.

— Market risk: Basel III's new market risk calculation approaches are introduced (the alternative internal model approach, the alternative standardised approach and the standardised approach), but the European Commission is empowered to adopt a delegated act to modify the framework or postpone its application if differences are observed between the EU's adoption of international standards and that of third countries.

— Credit valuation adjustment (CVA) risk: internal calculation models are eliminated and new calculation methods based on Basel III are introduced (standard, basic and simplified alternative – the latter on the basis of proportionality).

With regard to the impact of the reforms, a recent EBA study, carried out in September 2023, assessed the burden the new regulation would place on EU banks, showing that, in general, European banks' minimum Tier 1 capital requirements would rise by 9.0%. This impact would be around 12.6% if the European specificities other than the Basel III's allowed options were not considered, although most of this discrepancy is the result of particularities that already exist in the current version of the regulation, such as the SME supporting factor or EU exclusions from CVA calculations.

Lastly, bearing no relation to the adoption of Basel III, CRR-III introduces transitional arrangements for the prudential treatment of banks' exposures to crypto-assets, which will remain in force until the Commission delivers its legislative proposal (to be published by 30 June 2025 at the latest), implementing at EU level the framework agreed by the Basel Committee. CRR-III also regulates the information that institutions must disclose about their crypto-asset exposures.

II Main amendments brought about by CRD-VI

The amendments introduced by CRD-IV have two key objectives. First, to strengthen the treatment of ESG risks and, second, to harmonise supervisory powers within the EU.

The banking package seeks, among other things, to strengthen the focus on ESG risks in the prudential framework with a view to addressing the possible impacts of climate change and other ESG risks on credit institutions. New developments notably include the inclusion of ESG risks in the supervisory review process (SREP) and the possibility of using the systemic risk buffer to address climate-related risks. In addition, CRR-III extends the application of ESG disclosure requirements to all credit institutions, taking into account the principle of proportionality, and introduces new requirements for reporting ESG risks to the supervisor.

Finally, regarding the harmonisation of supervisory powers, three aspects should be noted.

a) Third-country branches: the current regime applied to these branches is subject to national legislation and is highly divergent. CRD-VI, first of all, establishes the obligation for foreign banks wishing to engage in deposit-taking or lending activities in a Member State to request authorisation to set up a branch. Moreover, it establishes minimum capital and liquidity requirements for these branches and recognises the minimum supervisory powers that competent authorities should have, including the power to require the transformation of a branch into a subsidiary, in certain circumstances.

b) Additional harmonisation of the fit and proper framework: "large" institutions (assets exceeding €30 billion) must request a "suitability assessment" from their supervisor when planning to appoint a new member to the management body. This is so that the supervisor, in the event of doubt regarding the suitability of the proposed candidate, may engage in an "enhanced dialogue" with the institution to address these concerns and ensure that the candidate meets the suitability requirements when they take up the position.

c) New supervisory powers: institutions must notify the supervisor of any acquisition or sale of investments in any type of entity when the amount thereof exceeds 15% of the acquiring entity's total assets. Following assessment of the transaction, the supervisor may decide to oppose it. In addition, the supervisors must approve all mergers and divisions of entities.

4 The full EBA report can be found here.