Interview with the Deputy Governor Margarita Delgado Tejero

The crisis brought about by the pandemic has conditioned economic and supervisory activity this year. What is your assessment of the authorities' response to this crisis?

Unlike other crises, this one is exogenous and arose unexpectedly. This explains to a large extent why the response of the public authorities was different from that of the previous financial crisis.

The lockdown and social distancing measures triggered by the outbreak of the pandemic in early 2020 slowed down economic activity, placing liquidity strains on firms and individuals. I believe that the authorities' rapid response, of a markedly countercyclical and expansionary nature, was satisfactory, as it helped to mitigate the impact of the pandemic on the economy. Of the measures taken by the authorities, I would highlight the interventions by central banks to ensure the stability and liquidity of the financial system; the fiscal and financial policy measures adopted by governments to alleviate temporary liquidity difficulties stemming from the crisis and to help firms and households access financing; and, lastly, the easing measures adopted by banking regulators and supervisors to ensure banks continue to provide financing to firms and households.

In your view, how is the economy faring and how long should the support measures remain in place?

The uncertainty we experienced in the wake of the outbreak of the health crisis is unprecedented. Although the economy is showing a considerable degree of resilience and the mass vaccination of the population could allow us to return to previous activity in the near future, uncertainty remains high and some sectors are still inevitably severely affected. Support measures are therefore still necessary to prevent the destruction of the productive system. I think that, against the current backdrop, the risks of withdrawing them too soon far outweigh those of withdrawing them too late.

The measures should be withdrawn cautiously, without setting a strict timeline and paying attention to how the economic situation evolves. If deemed necessary, there should be no problem in extending the support measures or implementing new ones. However, they should focus on those sectors that are still being penalised by the restrictions rather than be applied across the board, as was the case after the outbreak of the crisis. Of course, this should not be at the expense of a credible fiscal consolidation plan, which will have to be implemented when circumstances so permit.

You mentioned that fiscal and financial policy measures were adopted to alleviate liquidity stress and encourage lending with the aim of countering the effects of the pandemic. What are these measures and what role has the banking sector played in their implementation?

In addition to furlough schemes, which have undoubtedly contributed decisively to alleviating the situation of firms forced to close during lockdown, the measures I am referring to are moratoria and State guarantee facilities. Their implementation requires the involvement of the banking sector. Banks' operating capacity and knowledge of their customers' financial needs have been decisive in the success of these measures.

The moratoria initially approved in Spain established a temporary deferral of mortgage and consumer loan repayments for individuals who are economically vulnerable as a consequence of the COVID-19 crisis. This measure was subsequently extended to companies in sectors particularly hard hit by the crisis: tourism and transport. The banking sector also promoted sectoral agreements to broaden eligibility.

The second measure consists of the State guarantees managed through the Official Credit Institute, whereby a certain percentage of the financing granted by financial institutions to firms and the self-employed (up to 80% of the principal) is guaranteed. Spanish banks have been very active in granting this type of loan, providing access to liquidity for a large number of firms, thus helping to protect economic activity and employment.

All this shows that the banking sector's role in the crisis, channelling these measures, has been very significant. What would you highlight about the measures adopted by banking regulators and supervisors?

The first thing I would emphasise, without a doubt, is that the response of international regulators and supervisors was swift and coordinated. This was essential to ensure its effectiveness.

In terms of European regulation, I would underline, first, the publication of the legislative package dubbed the "quick fix", which eases certain capital requirements for banks and, second, the European Banking Authority guidelines on moratoria, which explain how to apply the flexibility allowed by prudential regulations to loans subject to moratoria, while carefully assessing the credit quality of these loans.

Meanwhile, supervisors (both the European Central Bank (ECB) and the Banco de España) adopted measures aimed at alleviating the operational burden of supervisory activity on institutions, so that they could focus on continuing their business and providing their services to the public. Additionally, to avoid or minimise potential unwanted procyclical effects which may arise from the application of the capital framework, banks were allowed to operate temporarily with a lower capital level than that set out in the Pillar 2 guidance and below the minimum liquidity coverage ratio, and to use the existing capital buffers.

From the macroprudential standpoint, following the outbreak of the pandemic, most of the authorities of the countries that had previously required a countercyclical capital buffer to be built up proceeded to release it. In Spain, such buffer build-up had not been required owing to an absence of systemic risk warnings. However, the Banco de España, in coordination with other authorities, has signalled its intention of keeping this buffer deactivated until the economic and financial effects of the crisis have been overcome.

Lastly, the Banco de España, in line with the statements of other accounting and securities regulators, issued a briefing note clarifying the accounting framework requirements for adequately classifying transactions and for preventing expected loss estimates from proving inappropriate in the situation arising from COVID-19. However, the note also recalled that this should be done without detriment to the proper identification of transaction impairment and a reasonable estimate of credit risk allowances or provisions.

All these measures are aimed at enabling banks to absorb the impact of the crisis and continue to provide financing to those households and firms that need it to invest in viable projects.

So, as far as supervisors are concerned, have only easing measures been taken to ensure the provision of funds to the economy?

No. As is common knowledge, in addition to the aforementioned easing measures, both the ECB and the Banco de España have issued recommendations for banks to refrain from, or limit, the distribution of dividends and to be extremely prudent in the payment of variable remuneration. These measures, which are in line with the recommendations of the European Systemic Risk Board, have not been without criticism from the banking sector. It is therefore important to explain that, given the context of high uncertainty in which we find ourselves, these recommendations aim to preserve banks' capital so that they can continue to lend and, if necessary, absorb potential future losses.

It is understood that these measures are aimed at preserving the sector's solvency at a time of uncertainty. But what is the current situation in terms of banks' solvency and profitability?

Spanish banks, like their European counterparts, are facing the crisis in better shape than on previous occasions. In recent years they have significantly improved their levels of liquidity and solvency in absolute terms. Also, their capital ratios are built on the basis of a more rigorous definition of own funds and risk-weighted assets.

Despite these strengths, there is no denying that profitability remains the sector's main challenge in ensuring business sustainability. The improvement of profitability is threatened not only by the pandemic, but also by the adverse impact on net interest income of the low interest rate environment. In addition, the foreseeable increase in credit impairment losses and the difficulty in generating income as a consequence of the decline in economic activity are elements to be taken into account.

What measures can be taken to improve profitability?

One way of increasing profitability is improving efficiency, which can be achieved by pressing ahead with the digitalisation process. This process not only saves costs, but also increases revenue by using available information to offer services that are more tailored to the customers' needs. In fact, this resource is already being used by European banks and particularly by Spanish banks, which have been significantly increasing their IT and digital innovation budgets. However, the situation arising from COVID-19 has accelerated the digital transformation of banks and customers. Banks should seize this opportunity to continue along that path.

Of course, bank mergers are also a way to gain efficiency and improve the ability to face new challenges. However, not all mergers serve an economic purpose. We should not forget that mergers are complex processes. The supervisor's role is limited to ensuring that, on the basis of a credible business plan using reasonable and conservative hypotheses, the resulting institution will have a viable and sustainable business model over time. Supervisors must also be satisfied that it has an appropriate corporate governance and organisational structure, and can manage risks effectively and prudently.

How has banking supervision adapted to the COVID-19 crisis?

The crisis brought about by COVID-19 made it necessary to adapt the supervisory process to the new circumstances. First, all supervisory activity had to be carried out remotely, using technological tools enabling remote meetings to be held and information to be shared quickly and securely. On-site actions are carried out remotely for the time being, taking full advantage of audiovisual communication applications for interacting with banks. By contrast, ongoing remote supervision activity was not as affected, except for the need to intensify contacts with institutions to have the most up-to-date information, given the current context of uncertainty.

Naturally, efforts were redirected towards monitoring those risks that had gained more prominence. Thus, at first special attention was paid to banks' liquidity situation, the normal functioning of the services they provide and the operational risk arising from the new working environment and the increased use of technology. Subsequently, considering the impact of the pandemic on economic activity and on customers' financial situation, the focus turned to credit risk analysis, without neglecting other risks.

Technology has been a crucial factor during this pandemic to allow financial institutions to continue providing services to customers. However, the increased use of technological solutions has also entailed an increase in the associated risks. How have Spanish banks adapted to this?

Spanish banks have reacted appropriately and swiftly to this global disruption. After a few minor incidents in the early days, they were able to adapt quickly and continue providing services to citizens, and even step up their digitalisation.

However, neither institutions nor supervisors can let our guard down. The situation is dragging on longer than expected and we have seen a significant increase in the number of attacks targeting banks. It is therefore essential that we continue to work to improve the technological resilience of the financial sector. With this aim, in September the European Commission published its proposal for a regulation on digital resilience (DORA) and, in December, the Banco de España approved the adoption of an advanced cybersecurity testing framework called TIBER-ES.

The Law for the digital transformation of the financial system (sandbox) was approved in November 2020. What is the purpose of this regulation and what is your assessment of the projects submitted to date?

The approval of the financial sandbox in Spain allows technology-based innovations applicable to the financial system, which in some cases may not fully fit in the current legal framework, to be introduced in a gradual and controlled manner. It is a very ambitious initiative, only present in some European countries (with a more limited scope than in Spain), which aims to grant third parties access to financing as a driver of the economy and to attract talent in a very competitive international technological environment.

Naturally, the controlled testing environment allows us supervisory authorities to make sure that the digital transformation projects do not impinge on the level of consumer protection, financial stability or market integrity, and that the financial system is not used for money laundering.

The first period for submitting projects ended on 23 February. 67 initiatives were submitted, of which 44 were initially assigned to the Banco de España as lead supervisor owing to their nature. Logically, it is too early to assess the functioning of the sandbox and the projects submitted, but the possibility of having this controlled environment to test new solutions will foster innovation and investment in new technologies. It is clear, however, that it also poses challenges for supervisors and authorities.

Despite the COVID-19 crisis, progress has continued to be made in terms of measuring and managing climate risks. What elements would you highlight in this area?

Following the outbreak of the health crisis, some people thought environmental issues in financial activity would be put on the back burner. Honestly, I think rather the opposite has been the case, probably because we are very much aware that climate change and environmental risks can have a major impact on the economy and the financial system. Naturally, the European reconstruction funds, approved after the outbreak of the health crisis but largely linked to meeting the decarbonisation goals by 2050, also played a role.

In the field of banking supervision, I would undoubtedly highlight the publication of supervisory expectations, both by the ECB and by the Banco de España, within their respective remits. The aim is to encourage banks, who are in general increasingly active and interested in this field, to properly measure and manage these risks.

At the same time, we are making progress in incorporating these elements into the stress tests we conduct in the banking system. The methodological challenges are considerable, since we need a tool that can analyse policies or events for which there is no past experience and whose impact extends over a lengthy timeframe of around five years.

Lastly, I would like to mention a problem that hampers our progress in this field and which is often cited: the lack of reliable information. Obviously, banks need information to integrate environmental aspects into their risk measurements; supervisors need it to assess the impact of certain measures or scenarios on the solvency of banks or on the country's economy; investors, to bear it in mind in their decisions on buying or selling financial instruments; and consumers, to make informed decisions on purchases or engaging services.

In short, without sufficiently consistent and reliable information, risks cannot be discerned or analysed. The good news is that there are numerous initiatives at European level that seek to improve this transparency, including the approval of the long-awaited taxonomy in 2020, along with the work currently under way to revise the non-financial reporting directive and establish European standards for green bonds. Lastly, it should be noted that the recent consultation by the IFRS Foundation on the possibility of drawing up sustainability standards is a good example of the growing importance of this issue.

We have talked about the measures taken by supervisors and banks to address the fallout of the crisis. In this context, what is your assessment of the actions taken by the banking sector and the potential impact that the pandemic could have on its reputation?

The Banco de España has monitored the measures adopted by banks to ensure the continuity of their financial services — for example, those relating to the maintenance or temporary closure of branches, ATM operability or the strengthening of online banking channels — and we must emphasise the sector's supportive and committed attitude towards its customers in these difficult circumstances. The banking sector must use the current setting to uphold its role and lay the foundations on which to build the sector's future reputation.

It is clear that a viable and sustainable business model in the medium term requires an atmosphere of mutual trust and satisfaction between institutions and their customers. In short, it is necessary to implement an appropriate culture of compliance. To be successfully implemented, this culture must be resolutely supported by senior management and the management teams as a key element to enhance the sector's reputation and underpin healthy and prudent revenue generation.

An important part of this culture is the role played by customer services, not only in handling customer complaints and claims, but also in providing early warning of the lack of adequate response in certain areas or products which are sources of customer dissatisfaction. In this respect, the Banco de España will publish supervisory criteria aimed at strengthening the functioning of these services, so that institutions can react in a proper and timely manner to problems in the marketing of financial products and services.

The COVID-19 crisis has not only affected the banking sector, but also other key parts of the financial system within the Banco de España's remit. How would you describe the impact on financial market infrastructures and on payments in particular?

The Banco de España, as part of its oversight function, has closely followed the impact of the pandemic on the operation and risk management of market infrastructures. All the infrastructures and their critical suppliers massively adopted teleworking, coordinating teams remotely and reinforcing their operation with special emphasis on cybersecurity. As a result, market infrastructures — an essential economic activity — continued to operate uneventfully. Indeed, the volumes processed reflected significant fluctuations in investment and consumption. For example, domestic card purchases recorded declines of 50% and of up to 90% in travel and the tourism sector in general. However, as expected in a context of restrictions on movement, retail payments via remote channels grew by more than 40%. In addition, up to 83% of all face-to-face card and mobile payments were contactless.

Have the changes in individuals' payment habits you mentioned entailed an added concern for the supervisory authorities?

The main concern was ensuring the availability of effective and secure payment mechanisms in an environment of high growth in remote transactions. Noteworthy in this respect are the efforts made to implement strong customer authentication in e-commerce card payments, which has enhanced security. This has entailed a very significant effort for the whole ecosystem, in a complicated setting like the one we have faced.

Given the new context, what do you expect from supervisory action in the coming years? Will it be influenced by the pandemic?

The credit support measures (guarantees and moratoria) together with the aforementioned actions by regulators and supervisors, have succeeded in mitigating the huge initial impact of the crisis and preventing the situation of corporate illiquidity from necessarily developing into a solvency crisis. However, banks need to prepare for that impact now. Specifically, they should identify at an early stage those customers who have a viable business, despite sporadic difficulties, for whom taking action on their debts may be an appropriate option, distinguishing them from clearly non-viable cases, for which arrangements for an orderly exit from the market should be encouraged.

For our part, supervisors should continue to closely monitor institutions to ensure they have effective procedures and sufficient operational capacity to manage credit risk and to ensure that it is properly assessed, classified and measured on balance sheets. This, along with other possible measures that could be adopted, should help contain the deterioration of bank asset quality and mitigate the risks that have increased owing to the crisis.

In Europe, it will also be necessary for measures to be taken in a coordinated manner, as was the case during 2020. This coordination is essential to promote financial stability, maintain a level playing field in an increasingly interconnected world and avoid financial fragmentation arising from purely national responses.

You stressed that the international response to the pandemic was coordinated and that this coordination has been essential to ensure its effectiveness. In what aspects do you think progress still needs to be made?

Since the creation of the Single Supervisory Mechanism and the Single Resolution Mechanism, significant progress has been made in the Banking Union. This paved the way for coordinated action in this crisis. However, as I have repeatedly stated in recent years, this union will not be complete until what is known as the "third pillar" has been created, i.e. a fully mutualised European Deposit Insurance Scheme.

Such a fund would contribute to increasing the stability of the Banking Union and would have a strong impact on citizens' trust, both of which are essential in the current context. It would also align responsibility in the case of resolution or winding-up of an institution. Currently, the ultimate backstop for insuring deposits in a failed institution rests with national institutions, while supervisory and resolution responsibilities lie with other pan-European institutions.

Moreover, with the experience gained over these years, and in view of the great challenge COVID-19 could pose in the foreseeable future for the banking sector, it would be desirable to improve the European crisis management framework to include adequate tools to address individual as well as systemic crises.

Lastly, at the national level, I would like to highlight that the creation in 2019 of the Spanish macroprudential authority (AMCESFI) has contributed to strengthening and facilitating over the last year the coordination of the Banco de España with the Ministry of Economic Affairs and Digital Transformation and the other sectoral supervisors (the National Securities Market Commission and the Directorate General of Insurance and Pension Funds). This helped to devise a joint response to the crisis from the Spanish authorities.