SUPERVISION REPORT

2020

BANCO DE ESPAÑA
Eurosistema

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Foreword by the Governor Pablo Hernández de Cos

2020 has been marked by the unprecedented global health and economic crisis triggered by COVID-19. Activity and employment have experienced a very pronounced fall, which has been especially intense in those countries, like Spain, whose business sectors have smaller-sized firms, more temporary employment and a higher weight of the economic sectors that have been hardest hit, owing to the greater social interaction required. This sharp initial impact has been followed by a recovery that remains partial, uncertain and uneven. In any event, this crisis has highlighted the importance of resolutely tackling the structural challenges faced by our economy.

The economic authorities have taken forceful action to address the challenges prompted by the COVID-19 crisis, and the degree of coordination achieved has been particularly positive. Given the global nature of the crisis, cross-country coordination was essential in order for any response to be effective. This was especially important in European Union (EU) countries, owing to our high degree of economic and financial interconnectedness and the institutions that we share. The swift and forceful monetary policy measures taken by the European Central Bank have allowed financial conditions to remain highly favourable in all countries. This have paved the way for fiscal policy measures at both national and EU level (in particular through the approval of the Next Generation EU programme), aimed at preventing the pandemic's economic effects from becoming persistent and adversely affecting long-term growth potential.

In the financial arena, the European authorities with prudential powers, in coordination with national and international authorities as well, adopted numerous decisions to enable the financial system to contribute to overcoming the crisis. The prudential supervisors revised their guidelines on capital and liquidity buffers and allowed banks to temporarily operate below the regulatory level set for some of these requirements, in order to help them continue to provide the financing needed by households and firms in an adverse environment. Various recommendations have also been approved on restricting dividend distribution, aimed at increasing the build-up of banks' loss-absorbing resources amid the heightened uncertainty. The accounting authorities have also been explicit about the need to bear in mind the exogenous and, in principle, temporary nature of the crisis when applying regulations, which include the flexibility required to accommodate this situation.

In this context, the banking sector has played a key role in applying some economic support measures, by facilitating the transmission of monetary policy decisions, ensuring accommodative financial conditions and implementing some of the financial and tax initiatives, such as the moratoria and State guarantee schemes. This has borne out the importance of the improvements made over the last decade in the quality of the sector's balance sheet and in its solvency levels, which have left it better placed to absorb the impacts of this crisis and to continue lending. In this respect, we should note the effect of the far-reaching international financial reform which has, so far, allowed the financial system to act as a mitigating, as opposed to an amplifying, factor of the impact of this crisis.

This improved starting position, together with the swiftness, decisiveness and complementarity of the response from the different authorities, helped to absorb the initial impact of the shock, contributed to maintaining the provision of credit to the economy and prevented systemic risks from materialising. However, we have to acknowledge that the crisis has had a considerable impact on non-financial companies' income statements and on household income, impairing their solvency. Similarly, financial institutions' results deteriorated significantly in 2020, owing above all to the anticipated credit impairment provisions. Banks must continue to recognise this deterioration in an appropriate and timely manner. Only in this way will it be possible to have a reliable diagnosis of the situation that prevents dislocations when allocating financial resources to productive activities and fosters the adoption of the measures needed for a robust and sustained recovery.

Looking to the coming months, it is important to recognise that the final impact of the crisis on the banking sector will depend both on its scale and duration and on the effectiveness of the economic policies in alleviating its effects on households and firms. The current status of the economic recovery (partial, uncertain and uneven) warrants maintaining a large part of the exceptional economic support measures, in particular for certain sectors and individuals.

One of the most concerning consequences of the persistence of the crisis is that the initial liquidity difficulties of the hardest-hit non-financial corporations could morph into solvency problems. Should such solvency problems materialise, they would not only lead to a destruction of the productive system and employment, but they would also eventually affect the financial position of the banking sector, which might respond by restricting lending. That would, in turn, fuel the negative effects on the capacity for recovery and medium-term economic growth.

Against this backdrop, March 2021 saw the approval of an aid package that could be a useful tool for specifically reducing the risk of the pandemic triggering the closure of those firms and businesses that are particularly stressed as a result of the pandemic, but which remain viable. To this end, a swift and homogeneous execution will be particularly important, as will allocation mechanisms to selectively and precisely focus this aid on viable firms with solvency problems, and an ongoing assessment of the amount of funds committed in the light of the course of the pandemic and the possible materialisation of risks. In the case of non-viable firms, winding-up processes would have to be expedited in order to prevent them from consuming resources that could be more beneficial in other activities.

This support would help prevent the crisis from taking on an additional financial element that would make it potentially much more persistent, as shown by the last global financial crisis. Thus, as it has been so far, the banking sector could continue to be part of the solution to the crisis, by lending to households and firms and helping to reactivate the economy when the pandemic is over. For this, a smooth functioning of the credit channel — of such importance in European economies and, of course, in the Spanish economy — will surely be required.

Beyond the short term, the crisis has further exposed the importance of tackling one of the sector's main challenges: its low profitability. To this end, banks need to improve their efficiency by cutting costs and making more use of new technologies.

Consolidation processes in the industry regained vigour in Spain last year with the announcement of two major operations and could prove to be an additional appropriate way of tackling future challenges from a better position. Nevertheless, the merits of each merger proposal need to be individually assessed. Our work as supervisors is to analyse the impact on financial stability, guarantee the solvency of the resulting institutions and their prudent and effective management, and oversee the execution of the operations to ensure that the potential synergies are indeed harnessed. In this regard, transnational European mergers would be particularly positive. They would deepen the Banking Union, reduce the sovereign-bank risk nexus, and provide greater potential for diversification.

Lastly, we need to continue emphasising that the response to the pandemic-induced crisis must continue to be European, in the banking sphere as well. In particular, it is essential that we complete the third pillar of the Banking Union (with the approval of a fully mutualised European Deposit Insurance Scheme), further develop the Capital Markets Union project and reach an agreement to create a common European procedure for the administrative winding-up of credit institutions that benefits from the instruments developed for their resolution.

Pablo Hernández de Cos

Governor of the Banco de España

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.

Supervision Report: Digest

CHAPTER 1. SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

Banco de España supervisory functions and their internal distribution

- The Banco de España has broad supervisory powers not only over credit institutions, but also over other financial institutions and undertakings related to the financial system operating in Spain. Specifically, it has powers over payment institutions (PIs), account information service providers, specialised lending institutions (SLIs), electronic money institutions (EMIs), mutual guarantee societies (MGSs), reguarantee companies, currency-exchange bureaux, appraisal companies, banking foundations and Sareb (the asset management company for assets arising from bank restructuring).
- Microprudential supervision aims to ensure that institutions and groups, considered individually, maintain adequate solvency and liquidity levels, comply with the prudential regulations in force and conduct prudent business and risk management. Credit institutions from countries participating in the Banking Union are supervised jointly by the European Central Bank (ECB) and the national competent authorities (NCAs) of such countries – including the Banco de España – under the Single Supervisory Mechanism (SSM). The Directorate General Banking Supervision (DGBS) performs this task at the Banco de España.
- In the macroprudential sphere, the Banco de España is the national designated authority for formulating, adopting and establishing macroprudential measures for credit institutions. The Directorate General Financial Stability, Regulation and Resolution (DGFSRR) is responsible for drawing up macroprudential policy measures.
- The Banco de España is also entrusted with supervising the conduct and transparency of the institutions in its Official Registers and with consumer protection. These tasks are performed by the General Secretariat.
- Supervisory responsibility for the provision of payment services is split among three Directorates General: the DGBS, the Directorate General Operations, Markets and Payment Systems (DGOMPS) and the General Secretariat. The DGOMPS is also in charge of overseeing financial market infrastructures and payment instruments.
- Turning to anti-money laundering and countering the financing of terrorism (AML/CFT), the Banco de España collaborates with the Commission for the Prevention of Money Laundering and Monetary Offences and its Executive Service.

CHAPTER 2. MICROPRUDENTIAL SUPERVISION

The Spanish banking sector

- Spanish banks were better placed to cope with the pandemic-induced crisis than in previous crises. Total consolidated lending surged in 2020, driven by the central bank stimulus packages and State guarantee schemes launched in response to the pandemic.
- The sector's solvency – which had continuously increased over recent years – has improved since 2020 H2. This is mainly because of the regulatory and supervisory measures implemented as a result of the crisis, which have eased some capital requirements and restricted dividend payments.
- Spanish banks' liquidity coverage ratio has also risen since 2020 H2 on account of the increase in their liquidity buffers as a result of the monetary policy measures in response to the crisis.
- Spanish banks' profitability, which had already shown weaknesses in recent years due to the low interest rate environment, fell sharply in 2020, mainly because of the write-downs recognised as a result of the crisis.

The response to the crisis, focal points in 2020 and supervisory priorities for 2021

- The COVID-19 crisis forced the supervisory actions and priorities for 2020 to be refocused to adapt them to the main pandemic-induced risks.
- The Banco de España urgently adopted the measures required to ensure that prudential supervision, along with its other functions, could remain in full effect under the new circumstances.
- Central banks, governments and supervisory and regulatory bodies adopted and published a raft of measures and recommendations to mitigate the impact of COVID-19 on the economy and financial stability. These measures include legislative moratoria and State guarantee schemes, in addition to those adopted by supervisory and regulatory authorities to relax capital and liquidity requirements and to alleviate the operational burden on banks.
- Supervisory efforts were refocused to ensure pandemic-related risks are adequately monitored, prioritising the impact on institutions' risk profile and operational continuity.
- Supervisory priorities for 2021 – credit risk management, capital strength, business model sustainability and governance – have naturally been shaped by the impact of COVID-19.
- Against the current background of ever-narrowing margins and write-downs as a result of the crisis, banks are consolidating to increase their resilience and boost their efficiency. Two consolidation projects are currently under way in Spain. The supervisor has published its supervisory expectations regarding consolidation projects and is following these projects closely to make sure that the resulting banks comply with prudential requirements and ensure effective and prudent risk management.

The response to the crisis, focal points in 2020 and supervisory priorities for 2021

- Over the last five years, Europe's regulators have pushed for improvements in the financial sector's technological and digital resilience. Two noteworthy initiatives because of their importance are the European Banking Authority (EBA) Guidelines on ICT and security risk management and the European Union's (EU) proposal for a Digital Operational Resilience Act.
- Initiatives have been launched to raise the banking sector's awareness of, and readiness for, the financial risks posed by climate change and environmental degradation. The ECB published its guide on climate-related and environmental risks and the Banco de España issued its related supervisory expectations.

Supervision of credit institutions

- Under the SSM, the ECB is the central microprudential supervisor, in collaboration with the NCAs. Ongoing supervision of significant institutions (SIs) is performed by joint supervisory teams comprising ECB and Banco de España staff. The Banco de España directly supervises less significant institutions (LSIs) according to a common policy laid down by the ECB.
- The COVID-19 crisis heavily influenced supervisory activity in 2020. In addition to the typical ongoing supervision, other tasks included monitoring of: the measures established by the Government (e.g. moratoria and State guarantees); the impact of COVID-19 on asset quality; contingency plans (honing in on cybersecurity and business continuity); liquidity; and the effects of the crisis on banks' activity, earnings and solvency.
- A simplified supervisory review and evaluation process (SREP) methodology was applied, prioritising in each area those aspects that could have been particularly affected by the crisis. The ECB and EBA 2020 stress tests were postponed to 2021. A top-down vulnerability analysis was conducted instead.
- In 2020, 600 ongoing off-site supervision actions were conducted on Spanish LSIs, the Official Credit Institute, branches of LSIs from other SSM participating countries and other EU Member States, and branches of non-EU credit institutions.
- Ongoing off-site supervision is supplemented with on-site actions (inspections and model investigations). The 2020 inspection plan for the SIs from SSM countries was revised as a result of the COVID-19 pandemic: inspections at advanced stages continued and the rest were suspended. On-site inspections resumed in 2020 Q4, all by remote and online means. In 2020 Banco de España staff participated in 20 on-site actions on SIs and in six on-site inspections of LSIs.
- The ECB and the Banco de España have recommended that institutions refrain from paying dividends to shareholders, to ensure that they have the capital necessary to continue lending to economic agents and to absorb potential losses. They also reiterated their expectations that banks adopt extreme moderation on variable remuneration.
- Within their respective areas of competence, the Banco de España and the ECB supervise compliance with the rules on the suitability of credit institutions' senior officers for the duration of their tenure. The Banco de España participated in 195 suitability assessments for senior officers at institutions, be they supervised directly by the SSM or by the Banco de España. The Banco de España also prepared a new questionnaire for assessing the suitability of senior officers of institutions other than CIs and SLIs. In cooperation with the NCAs, the ECB created a new portal to smooth the processing of institutions' suitability assessments.
- As a result of its supervisory tasks, the Supervisory Board of the ECB – of which the Banco de España is a member – adopted 478 decisions and actions affecting Spanish institutions that were reported to the Executive Commission. The Banco de España sent 99 letters to LSIs containing 405 requirements and recommendations.
- In 2020 two general inspections were launched to review LSIs' compliance with AML/CFT obligations, and the implementation of an AML/CFT action plan at one SI was revised. In 2020 EU institutions reiterated their commitment to AML/CFT through a series of initiatives. These included the European Commission's action plan for a comprehensive Union policy on preventing money laundering and terrorism financing.
- Each year the DGBS works on a training programme that fosters staff's professional development and excellence.

Supervision of other institutions, compliance with vetted access to activity and supervision of payment service providers

- The Banco de España has exclusive microprudential supervisory powers over SLIs, MGSs, reguarantee companies, appraisal companies, PIs, ELMIs, currency-exchange bureaux, account information service providers, banking foundations and Sareb. In 2020, 380 ongoing off-site supervision actions were performed by various means and three inspections were conducted.
- The Banco de España oversees compliance with vetted access to activity and takes action on those seeking to begin operations in the financial market without meeting the conditions of access. Supervisory actions relating to 29 legal entities were launched in 2020.
- Most of the supervision of payment service providers during 2020 was geared towards verifying compliance with Commission Delegated Regulation 2018/389 on strong customer authentication and common and secure open standards of communication.

CHAPTER 3. MACROPRUDENTIAL POLICY

The Banco de España's macroprudential tools	• The Banco de España regularly monitors the risks to and vulnerabilities of the financial system. In accordance with the prevailing legislation, the Banco de España regularly sets two macroprudential capital buffers to address the build-up of cyclical and structural risks. • The Banco de España held the countercyclical capital buffer rate at 0% for credit exposures in Spain in 2020 and does not expect to increase it over a prolonged period due to the macrofinancial impact of the pandemic. Five other systemically important institutions – one of which is also a global systemically important institution – were identified and their associated buffers were set. • In 2020 the Banco de España worked on drawing up a circular on how the new macroprudential tools applicable to credit institutions provided for in Royal Decree-Law 22/2018 and Royal Decree 102/2019 will be designed and used.
Macroprudential coordination at national level	• 2020 was the first full year of activity for the Spanish macroprudential authority (AMCESFI). The Banco de España, the National Securities Market Commission and the Directorate General of Insurance and Pension Funds participate in AMCESFI, which is attached to the Ministry of Economic Affairs and Digital Transformation. • AMCESFI stepped up its activity in 2020 as a result of COVID-19-related events. It also published its first annual report and launched its website.
SSM macroprudential tasks	• The Banco de España participates in the ECB's Financial Stability Committee and Macroprudential Forum. As part of the SSM, the Banco de España must regularly notify the ECB of each of its proposed macroprudential measures before they are adopted and subsequently announced.

CHAPTER 4. SUPERVISION OF INSTITUTIONS' CONDUCT

Ongoing oversight and supervisory actions	• The Banco de España supervises compliance by the institutions in its official registers with banking conduct regulation and discipline legislation. It also aims to ensure effective compliance with such legislation and to prevent and correct inappropriate practices, by promoting the implementation of a culture of conduct and adequate governance arrangements as a cornerstone of maintaining a viable and sustainable banking business model in the medium and long term. • In 2020 supervisory activity focused on monitoring banks' effective implementation of the conduct-related facets of the measures approved to contend with the economic effects of the pandemic. The Banco de España has worked to ensure citizens are provided with the necessary information on these measures and to support institutions in their implementation. • Other priority areas in the supervision of conduct have included: consumer lending (in particular, revolving credit cards), mortgage lending, advertising, customer service departments and the impact of digitalisation on the marketing of banking products. • Annual supervisory planning takes into account the information gathered in the course of supervisory and ongoing monitoring actions and focuses on those institutions considered a priority according to their conduct profile. During 2020 the Banco de España worked on drawing up a circular on confidential conduct-related information, which will result in better information being available for more efficient supervision.

CHAPTER 5. OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Oversight of payment systems and instruments	• The exceptional circumstances triggered by the COVID-19 crisis have had a significant impact on market infrastructures and payment schemes. Consequently, the Banco de España closely monitored the functioning of the Spanish retail payment system – the National Electronic Clearing System – and of the Spanish card scheme – Sistema de Tarjetas y Medios de Pago, S.A. –, and their respective managers' actions to contend with the situation. • Similar actions have been conducted within the Eurosystem. The Banco de España participated in those related to the pan-European payment infrastructures and systems operating in Spain. • Several major TARGET2 incidents occurred in 2020 that caused total system outages. The ECB is analysing the operator's management of the incidents and has launched an independent review of the business continuity model, the regular recovery tests, the change management procedures and the communication protocols.

Supervision of Iberpay (National Electronic Clearing System manager)	• The Banco de España is empowered to approve the articles of association of Sociedad Española de Sistemas de Pago, S.A. (Iberpay), the amendments thereto and the basic operating rules of the services it manages, which are its core purpose. It also assesses the technical instructions regulating the operating procedures of the National Electronic Clearing System and the basic rules relating to the complementary and ancillary services provided by Iberpay. • In 2020 the Executive Commission of the Banco de España approved the new National Electronic Clearing System regulation. The Banco de España analysed and approved the adoption of operating rules for four new Iberpay services and of 11 National Electronic Clearing System operating instructions.
Oversight of securities infrastructures	• In June 2020 the Swiss SIX Group acquired the BME group, which includes Iberclear and BME Clearing. The Banco de España closely monitored the purchase and approval process, paying special attention to its impact on financial and euro stability. • As a Eurosystem member, the Banco de España participated in assessing the eligibility of two new links between Iberclear and foreign central securities depositories in 2020.

CHAPTER 6. EXERCISE OF SANCTIONING POWERS

Sanctions	• Despite the stay between 14 March and 1 June 2020, the Banco de España concluded eight administrative proceedings, instituted a further three and resumed one that had been suspended for several years due to the concurrence with criminal proceedings in relation to the same facts. Transparency and consumer protection continue to account for the highest number of sanctioning proceedings.

CHAPTER 7. THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION BODIES

International activities	• In 2020 the organisation of these fora and the matters on their agendas were heavily affected by the COVID-19 crisis. The fora also tried to promote the flexibility required to mitigate the adverse effects of the crisis on the real economy and the financial system. • The Financial Stability Board prioritised the international coordination of the response to COVID-19, adapting its work programme to support the real economy, maintain financial stability and minimise the risk of fragmentation. The work of the Basel Committee on Banking Supervision, which is chaired by the Governor of the Banco de España, was also marked by the response to the impact of COVID-19. The strategic review to optimise its structure and internal processes in order to focus on emerging risks, the digitalisation of finance, and climate-related risks is noteworthy. • The EBA's work in response to the COVID-19 crisis notably included: the Guidelines on legislative and non-legislative moratoria; the statement on the use of capital and liquidity buffers; the easing of reporting requirements; the postponement from 2020 to 2021 of the stress test exercise; and the recommendations to the supervisor to take a pragmatic approach in the SREP and to banks to adopt a prudent approach to dividend payment. Brexit also had a significant impact on the EBA's work. • Under the coordination of its Advisory Technical Committee (chaired by the Governor of the Banco de España), the European Systemic Risk Board focused its work in response to COVID-19 on five priority areas: i) implications for the stability of the financial system of State guarantee schemes and other fiscal measures to protect the real economy; ii) market illiquidity and implications for asset managers and insurers; iii) the procyclical impact of ratings downgrades; iv) restraints on dividend payments by financial institutions; and v) liquidity risks arising from margin calls.

CHAPTER 8. NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

Regulatory developments	• The Banco de España issued five circulars in 2020: i) one on the Central Credit Register; ii) two amending Circular 4/2017 to credit institutions on public and confidential financial reporting standards and financial statement formats (one of which afforded them greater flexibility in the context of the COVID-19 crisis); iii) one on advertising for banking products and services; and iv) one establishing the accounting and reporting regime of PIs and ELMIs. • In 2020 the salient legislative developments for prudential supervision were the amendments to the Capital Requirements Regulation in response to the pandemic and the promulgation of a law on regulatory sandboxes and a royal decree on SLIs' legal regime.


BANCO
ESPAÑA

1

SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

1.1 Supervisory and oversight functions of the Banco de España

The Banco de España has broad supervisory powers not only over credit institutions, but also over other financial institutions or undertakings related to the financial system operating in Spain. Specifically, it is entrusted with the following functions: prudential supervision, supervision of the provision of payment services, supervision of conduct and transparency, and oversight of financial market infrastructures in Spain. It also collaborates with the Commission for the Prevention of Money Laundering and Monetary Offences (CPMLMO) and its Executive Service (SEPBLAC) in the anti-money laundering and counter-terrorist financing (AML/CTF) area. Figure 1.1 summarises the Banco de España's supervisory and oversight functions.

Prudential banking supervision has two levels: microprudential supervision and macroprudential policy. Chapters 2 and 3, respectively, describe the supervisory activity in those areas.

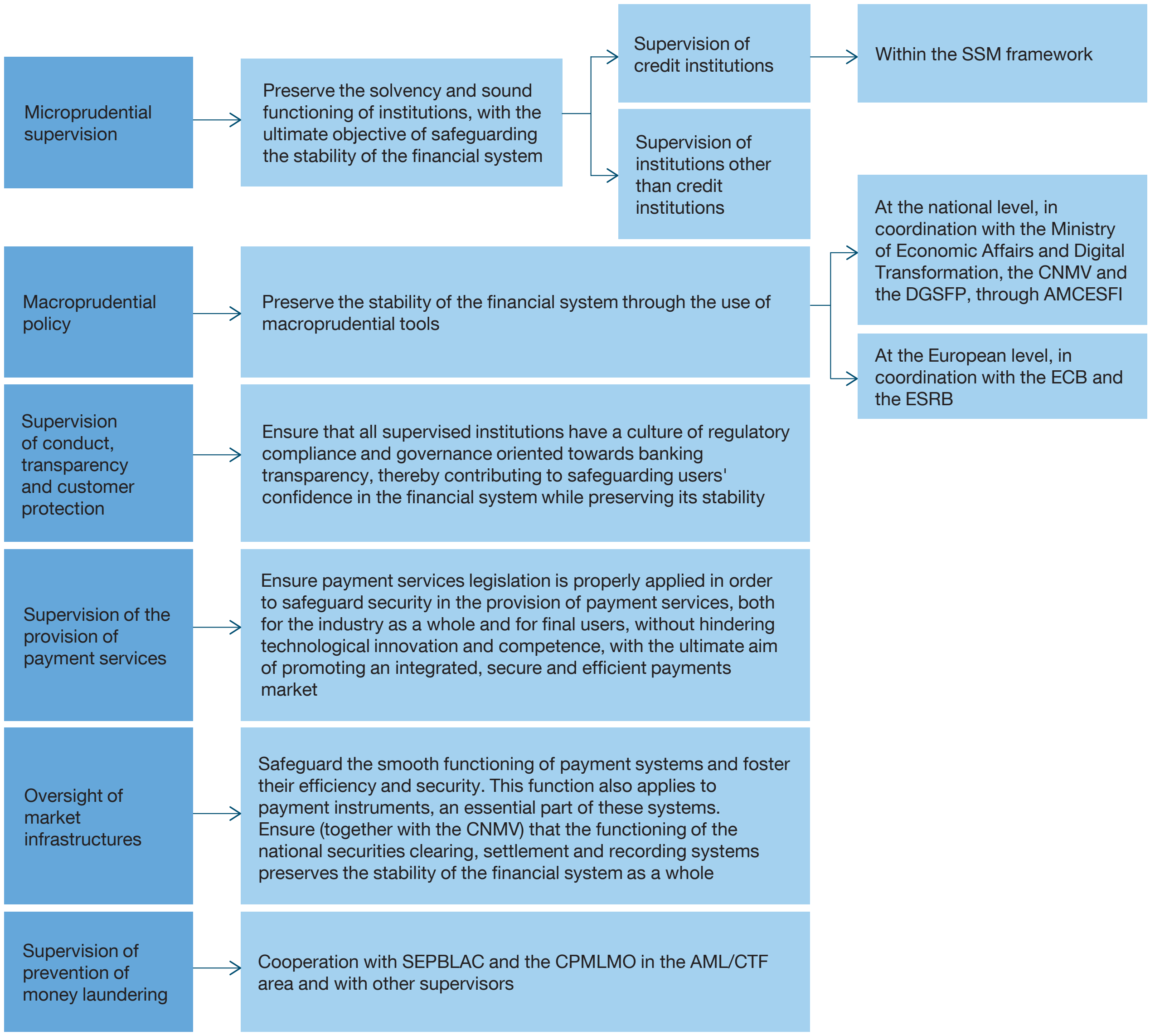
Microprudential supervision aims to ensure that institutions or groups, considered individually, maintain adequate solvency and liquidity levels, comply with the prudential regulations in force and manage their business and the risks they incur in a prudent manner, with the ultimate aim of ensuring the soundness of the banking system and preserving financial stability. Within the framework of the Single Supervisory Mechanism (SSM) the aim is also to promote greater financial integration in Europe and to ensure supervision is consistent across the participating countries.

The microprudential supervision of credit institutions of countries participating in the banking union is exercised jointly by the European Central Bank (ECB) and the national competent authorities (NCAs) of such countries – including the Banco de España – within a single supervisory mechanism (SSM). From October 2020 two European Union (EU) Member States that are outside the euro area, Bulgaria and Croatia, participate in European banking supervision. The two countries joined the SSM after establishing close cooperation agreements with the ECB.[1]

Within the SSM framework, the functions have been distributed between the ECB and the NCAs as follows: the ECB is tasked with the direct supervision of

1 In accordance with Article 7 of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions.

Figure 1.1
THE BANCO DE ESPAÑA'S SUPERVISORY AND OVERSIGHT FUNCTIONS



SOURCE: Banco de España.

significant institutions (SIs),[2] i.e. those that are larger or have a greater relative significance, while NCAs are entrusted with the direct supervision of less significant institutions (LSIs).

The Banco de España is also the microprudential supervisory authority for other financial or financial system-related institutions operating in Spain but

2 However, the ongoing monitoring of SIs is performed through Joint Supervisory Teams (JSTs), comprising ECB and NCA staff of the countries in which each institution operates.

which are outside the scope of the SSM: the branches of non-EU credit institutions, the Official Credit Institute (ICO),[3] payment institutions (PIs), account information service providers, specialised lending institutions (SLIs), electronic money institutions (ELMIs), mutual guarantee societies (MGSs), reguarantee companies, currency-exchange bureaux, appraisal companies, banking foundations[4] and Sareb (the asset management company for assets arising from bank restructuring).[5]

Macroprudential policy is aimed at safeguarding financial stability through the prevention and mitigation of systemic risks and vulnerabilities, thereby helping the financial system to contribute to economic growth in a sustainable manner.

In the macroprudential sphere, the Banco de España is the designated national authority for formulating, deciding on and implementing macroprudential measures on credit institutions, pursuant to European capital requirements legislation and its transposition into Spanish law, and other Spanish capital requirements legislation.

Together with the two other financial supervision sectoral authorities – the National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds (DGSFP) – and the Ministry of Economic Affairs and Digital Transformation, the Banco de España participates in the Spanish macroprudential authority (AMCESFI), which aims to identify, prevent and mitigate systemic risk in order to contribute to preserving the stability of the Spanish financial system as a whole.

Additionally, the Banco de España is entrusted with supervising the provision of payment services. Following the entry into force in 2015 of the Second Payment Services Directive (PSD-2),[6] new payment services and new specialist payment service providers were regulated, and operational and security risk requirements were strengthened. Consequently, the supervision of technological aspects in the provision of payment services has become a key aspect of the supervisory function, as mentioned in Section 2.6. Box 1.1 describes the internal distribution of supervisory powers entrusted to the Banco de España in this connection.

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3 The ICO has the legal form of a credit institution, pursuant to Article 1 of Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions. However, it is supervised by the Banco de España, since it is excluded from the scope of the SSM under Article 1 of Council Regulation (EU) No 1024/2013 of 15 October 2013.

4 Law 26/2013 of 27 December 2013 on savings banks and banking foundations confers on the Banco de España control of compliance with certain rules related to the influence of the banking foundation over the management of the investee credit institution.

5 The Banco de España supervises fulfilment of Sareb's sole corporate purpose, in order to identify deviations therefrom jeopardising the attainment of Sareb's overall statutory objectives.

6 Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

Box 1.1

DISTRIBUTION OF COMPETENCES IN THE SUPERVISION OF PAYMENT SERVICES AT THE BANCO DE ESPAÑA

Royal Decree-Law 19/2018 of 23 November 2018 on payment services and other urgent financial measures, which transposes the Second Payment Services Directive to Spanish law, designates the Banco de España as the competent authority for ensuring and overseeing effective compliance with said Royal Decree-Law. In turn, the Banco de España distributes these responsibilities among several directorates general.

As regards supervision of the provision of payment services and payment services providers, it has opted for a model based on specialisation by subject, which involves three departments belonging to different directorates general.

The Payment Systems Department is responsible for supervising specialist payment service providers regarding the adequate management of operational and security risks and the protection of users' funds. It is also in charge of strong customer authentication requirements and secure standards of communication for all payment service providers, including credit institutions. Moreover, it is responsible for supervising access to payment systems, among other issues, and for monitoring fraud data and serious operational and security incidents.

Supervision Department III is responsible for supervising the solvency of payment service providers and the adoption of measures necessary to ensure compliance with own funds rules, the control regime for qualifying holdings and the review of professional indemnity insurance or an equivalent guarantee to which payment initiation or account information service providers are subject.

Lastly, the Institutions' Conduct Department performs supervisory actions relating to transparency, reporting requirements and customer relations applicable to payment services.

Royal Decree-Law 19/2018 establishes different forms of access to the activity of payment service provision, based on the type, origin and scope of action of the institution applying for it. Thus, payment institutions and electronic money institutions are subject to an authorisation and registration regime; account information service providers or institutions that are exempt owing to their small size are only subject to the registration regime; other providers (those known as "limited networks" or certain providers of telecommunication services) are subject to an ex-post notification and registration regime; and, lastly, payment service providers from other EU countries also have access to the Spanish market through the single European passport.

All of these access procedures are processed by the Deputy General Secretariat in collaboration with other Banco de España departments.

The Banco de España supervises the conduct, transparency and customer protection of the institutions in its Official Registers, whether they are credit institutions or other institutions offering banking services. Chapter 4 shows the supervisory actions conducted in this area.

The Banco de España also oversees financial market infrastructures. Specifically, it oversees payment systems and instruments and shares with the CNMV the oversight of the financial market securities infrastructures. Chapter 5 of this report includes information on the Banco de España's oversight activity in the last year.

The Banco de España cooperates closely with the CPMLMO and SEPBLAC in the supervision and inspection of compliance with AML/CTF obligations by institutions, pursuant to Spanish legislation and the cooperation and coordination agreement entered into with the CPMLMO.

Lastly, under Article 233(6) of the consolidated text of the Securities Market Law (LMV, by its Spanish abbreviation), the Banco de España is entrusted with supervisory, inspection and sanctioning functions regarding compliance with the obligations envisaged in Article 16 of Regulation (EU) 2016/1011 of the European Parliament by supervised institutions that contribute data for the indices developed by the Banco de España, and in Articles 28(2) and 29(1) thereof.

1.2 Organisation of banking supervision and oversight at the Banco de España

The supervisory function is performed by the Banco de España's different directorates general and departments:

— The Directorate General Banking Supervision (DGBS) is responsible for the ongoing remote supervision of institutions in connection with their solvency, liquidity and business management, and for the related on-site inspections and the review of internal models for calculating capital requirements. It further provides support to the Banco de España's representative on the Supervisory Board (SB) of the ECB. It also performs horizontal tasks, such as data analysis, methodology, planning, training, quality function, etc. and is responsible for accounting standards, among other functions.

— The General Secretariat is tasked with supervising market conduct; participating in the processes of senior officer suitability and of granting and withdrawal of institutions' authorisation; the register of credit institutions; and the handling of sanctioning proceedings.

— The Directorate General Financial Stability, Regulation and Resolution (DGFSRR) is responsible for macroprudential policy and performs the analytical work required for decision-making in this area; it also assesses and participates in the development of the regulatory framework applicable to supervised institutions. It is also responsible for receiving and monitoring institutions' supervisory reporting.

— Lastly, the Directorate General Operations, Markets and Payment Systems (DGOMPS) is responsible for overseeing financial market infrastructures and payment instruments. It is also responsible for ongoing supervision of payment service providers other than credit institutions (except for matters relating to solvency and customer relations) and of the payment services offered by all such providers.

Figure 1.2 provides greater details of the organisation of the supervisory and oversight functions performed by the Banco de España.

Figure 1.2
ORGANISATION OF SUPERVISION AND OVERSIGHT AT THE BANCO DE ESPAÑA

DIRECTORATE GENERAL BANKING SUPERVISION	Supervision Department I	— Ongoing remote supervision of the four largest Spanish SIs and of the branches and subsidiaries in Spain of European SIs, through the JSTs
	Supervision Department II	— Ongoing remote supervision of the other Spanish SIs through the JSTs
	Supervision Department III	— Ongoing remote supervision and on-site inspections of: • Spanish LSIs • Other institutions outside the scope of the SSM: ICO, SLIs, PIs, account information service providers, EMIs, MGSs, reguarantee companies, currency-exchange bureaux, appraisal companies and Sareb • Other branches and subsidiaries in Spain of foreign institutions
	Supervision Department IV	— Monitoring market risk, operational risk and structural liquidity and interest rate risks — On-site inspections and internal model reviews of SIs within the SSM
	Supervision Department V	— Stress tests — Identification and assessment of risks from a microprudential standpoint — Supervisory methodology — Definition of supervisory policies and bank accounting regulation — Analysis and assessment of technology risk — Supervision of AML/CTF procedures
	Organisation and Quality	— Quality control in the supervisory process — Training of DGBS staff
	SSM Coordination	— Preparation and monitoring of annual supervision planning — Support to the Banco de España representative on the SB — Management of information received within the scope of the SSM
DIRECTORATE GENERAL FINANCIAL STABILITY, REGULATION AND RESOLUTION	Financial Stability and Macroprudential Policy Department	— Analysis of financial system risks and vulnerabilities — Formulation of macroprudential policy proposals — Coordination with AMCESFI and, at European level, with the ESRB and with the ECB's macroprudential function
	Financial Reporting and CCR Department	— Receipt, quality control and forwarding of supervisory information that credit institutions are required to submit to the ECB, within the SSM, and to the Banco de España, in the exercise of their supervision powers and of information from other supervised institutions — Management of the Central Credit Registry
	Regulation Department	— Analysis, definition and monitoring of regulatory policies at the global and European levels — Coordination with the EBA and other international fora and bodies — Development and interpretation of prudential regulations
GENERAL SECRETARIAT	Institutions' Conduct Department	— Supervision of market conduct and compliance with legislation on transparency of information and customer protection in the marketing of banking products and services — Definition of regulatory and supervisory policies concerning market conduct
	Deputy General Secretariat	— Participating in the assessment of compliance with the suitability requirements of senior officers — Maintaining the Senior Officer Register — Participating in the granting and withdrawal of institutions' authorisation — Maintaining the Register of Institutions, Agents and Articles of Association — Managing the single European passport
	Legal Department	— Conducting sanctioning proceedings
DIRECTORATE GENERAL OPERATIONS, MARKETS AND PAYMENT SYSTEMS	Payment Systems Department	— Ongoing supervision of compliance with legislation specific to PIs, account information service providers and EMIs, except in relation to solvency, conduct and transparency — Supervision of the provision of payment services by payment service providers — Definition of supervisory policy regarding the provision of such services — Supervision of Iberpay, as the management company of the National Electronic Clearing System — Oversight of financial market infrastructures and of payment instruments

SOURCE: Banco de España.

1.3 Supervisory and oversight staff

At 31 December 2020, the Banco de España had 847 employees performing supervisory and oversight functions (compared with 818 employees in 2019). Of these 847 employees, 539 belong to the DGBS, 182 to the DGFSRR, 58 to the Institutions' Conduct Department, 46 to the Deputy General Secretariat and 22 to the DGOMPS.

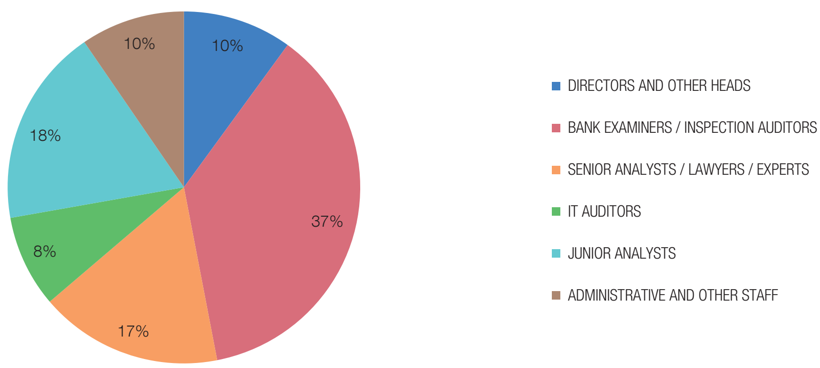
In the DGBS two selection processes were completed in 2020 to cover the following positions: seven IT audit experts and five credit risk measurement model specialists. In 2021 up to 11 bank examiners for credit institutions are expected to join under the selection process currently under way. The DGFSRR conducted a selection process for ten specialists in regulation, which was completed in January 2021.

Two experts in payment and securities settlement systems joined the Payment Systems Department, following the relevant selection process, to strengthen the oversight function. A selection process was also conducted for seven IT audit experts, with the aim of continuing to provide the necessary resources to carry out the supervisory tasks related to operational and security risks in payment services, and to appropriately address the supervision of specialised payment services providers.

Chart 1.1 shows the distribution, by professional group, of Banco de España employees who carry out supervisory and oversight functions.

Chart 1.1
% OF EMPLOYEES WHO PERFORM SUPERVISORY AND OVERSIGHT FUNCTIONS, BY PROFESSIONAL GROUP
At 31 December 2020

The predominant professional group continues to be that of bank examiners and inspection auditors. The staff composition in the different groups has remained stable in comparison with previous years.



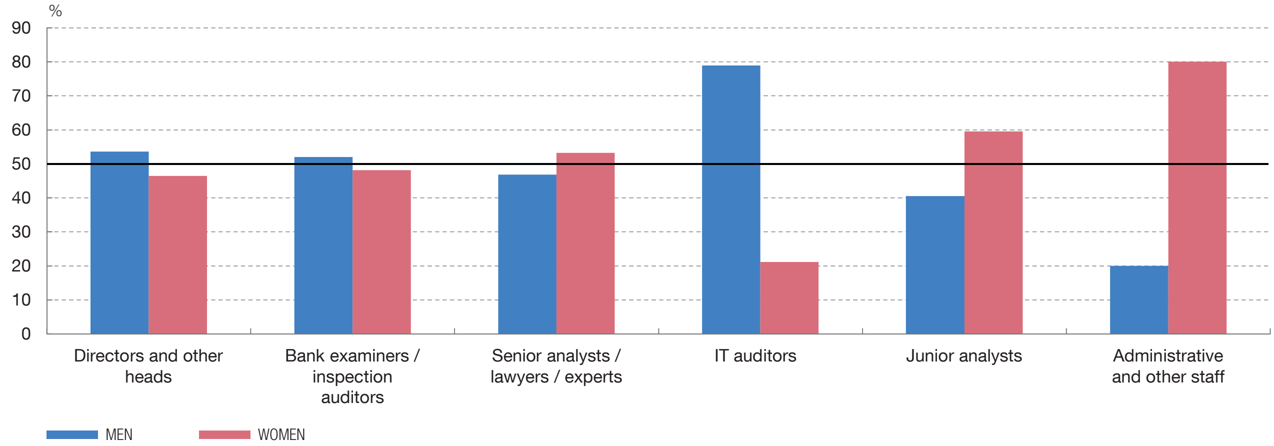
SOURCE: Banco de España.

Chart 1.2

SUPERVISORY AND OVERSIGHT STAFF, BY GENDER

At 31 December 2020

The proportion of men and women is close to parity in three professional groups, with "Directors and other heads" being particularly noteworthy. However, there are strong disparities in "IT auditors" and "Administrative and other staff".



SOURCE: Banco de España.

48% of supervisory and oversight staff are men and 52% are women. Chart 1.2 shows the distribution of men and women in each of the professional groups within this area.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2

MICROPRUDENTIAL SUPERVISION

2.1 The Spanish banking sector and supervisory priorities

2.1.1 The Spanish banking sector

The credit institutions making up the Spanish banking sector total €3,877 billion in consolidated assets. Of this total, 90% correspond to Spanish SIs and the remaining 10% to other credit institutions, which include Spanish LSIs, the subsidiaries and branches of foreign credit institutions in Spain and the ICO.

At the onset of the crisis prompted by the pandemic, Spanish banks were better prepared than they had been on previous occasions owing to the regulatory changes introduced in response to the global financial crisis and the efforts undertaken thereafter. Far-reaching balance sheet repair has taken place in recent years, particularly in terms of exposures in Spain, while solvency and liquidity levels have been bolstered significantly. However, profitability remains an issue amid a persistent low interest rate environment and strong competitive pressure from both inside and outside the sector.

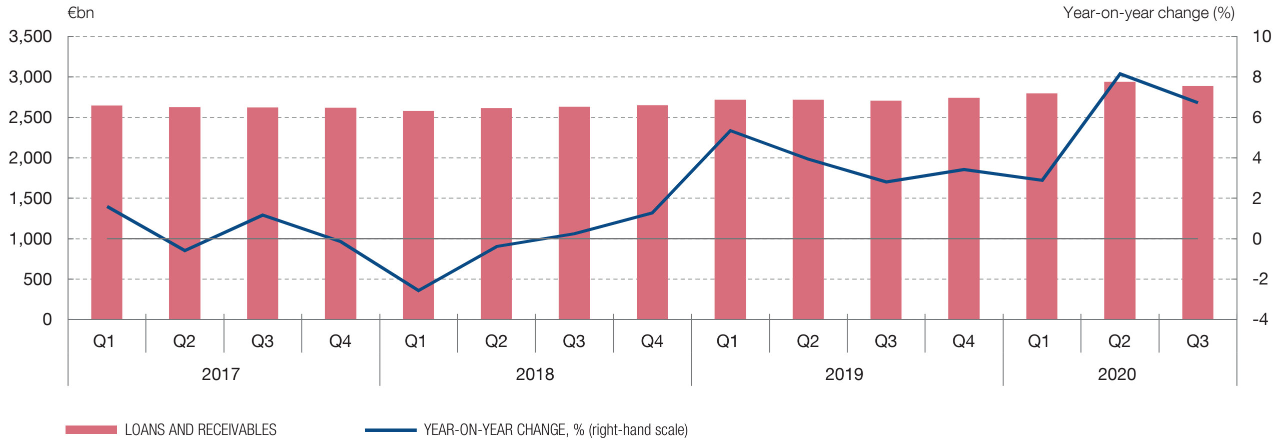
This stronger position meant credit institutions were more favourably positioned to cope with the problems stemming from the COVID-19 crisis. Since the outbreak of the pandemic, banks have provided economic agents with significant amounts of financing and have simultaneously offered considerable payment facilities, all underpinned by State programmes intended to support the economy (ICO guarantees and moratoria).

The total volume of loans extended by Spanish institutions at consolidated level rose significantly in 2020, particularly from Q2 onwards, fuelled by the stimuli implemented by central banks and robust growth in lending to firms following the launch of State guarantee schemes in response to the pandemic. This stands in contrast to the stability of the preceding years, with the slight exception of 2019. Chart 2.1 shows developments in the outstanding credit of Spanish institutions over the past four years.

The amount of non-performing loans (NPLs) appears to have stabilised during the last year, following several years of pronounced decline, as a result of institutions' efforts to clean up their balance sheets. Even so, the NPL ratio has continued to improve as a result of growth in the denominator, the volume of credit (see Chart 2.2). Both figures can be expected to begin rising in the foreseeable future, as the adverse effects stemming from the COVID-19 crisis materialise on banks' balance sheets.

Chart 2.1
LOANS AND CREDIT. DEVELOPMENTS

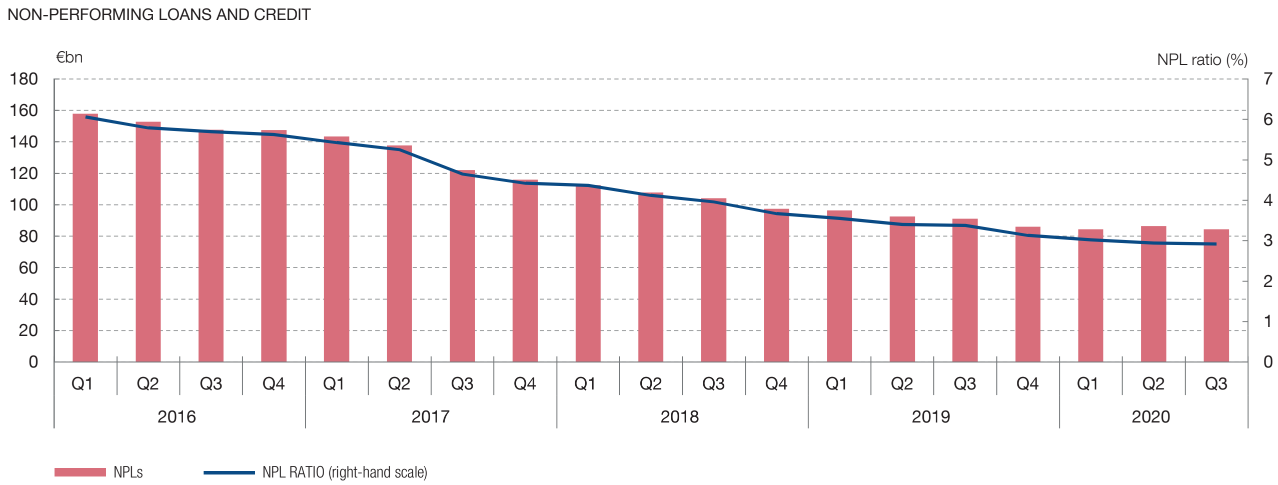
There was an increase in outstanding credit from 2020 Q2 onwards, owing to the stimuli introduced by central banks and the launch of State guarantee schemes for firms.



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

Chart 2.2
NPLs AND NPL RATIO

The steady decline in NPLs has come to a halt, although the ratio has continued to decline owing to growth of the denominator.



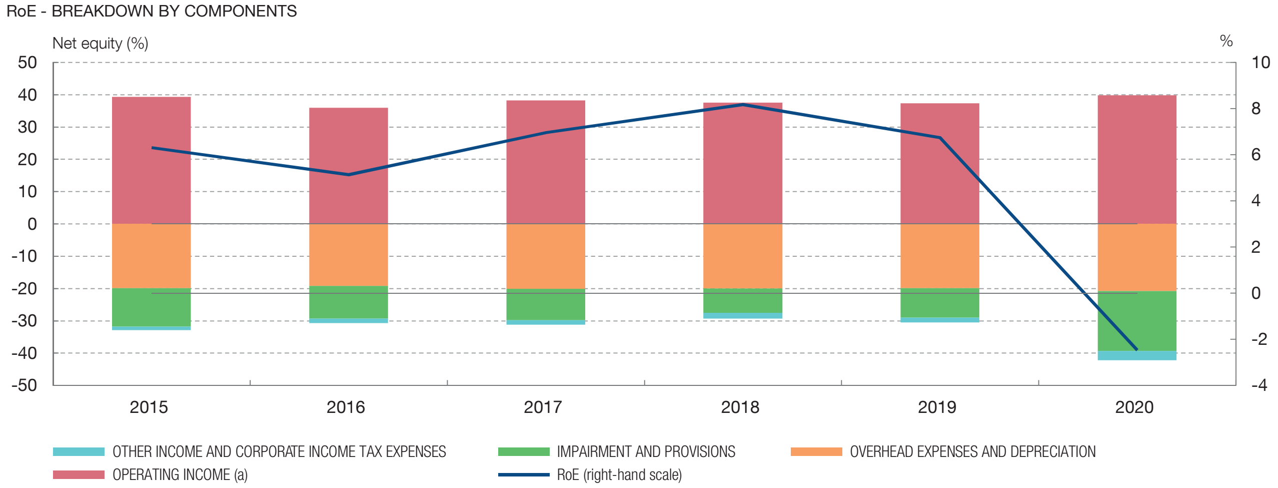
SOURCE: Banco de España (supervisory statistics on credit institutions).

The profitability of Spanish institutions, measured in terms of return on equity (RoE), declined significantly in 2020, particularly as a result of the extraordinary write-downs ensuing from the crisis prompted by the pandemic. As Chart 2.3 shows, RoE had previously stood between 5% and 8%, holding below the estimated cost of equity.

Chart 2.3

RoE BY COMPONENTS. ANNUAL CHANGE

Profitability declined sharply in 2020, due above all to write-downs in anticipation of a deterioration of the situation prompted by the pandemic.



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

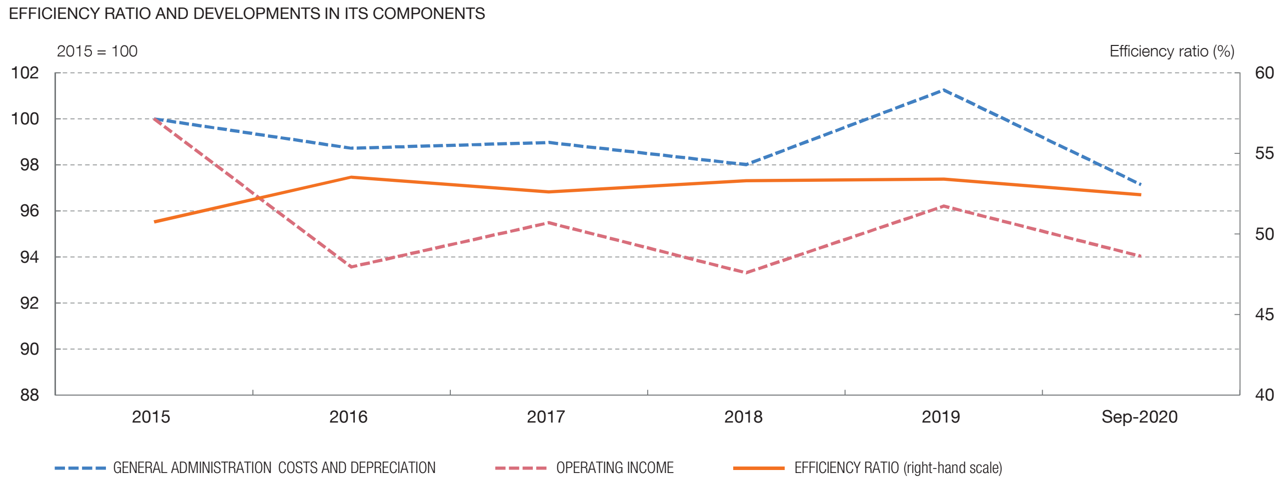
a Operating income is the sum of net interest income, net fee and commission income, net income from financial operations, net exchange differences and other net operating income.

The efficiency ratio has been quite stable in recent years, including in 2020 (see Chart 2.4). During this period, institutions have managed to offset the progressive decline in net interest income, and the resulting decrease in gross income, by reducing their overhead costs.

Chart 2.4

ANNUAL EFFICIENCY RATIO

Efficiency has held stable in the period thanks to the reduction of overhead costs, partly resulting from the adjustments implemented in previous years.

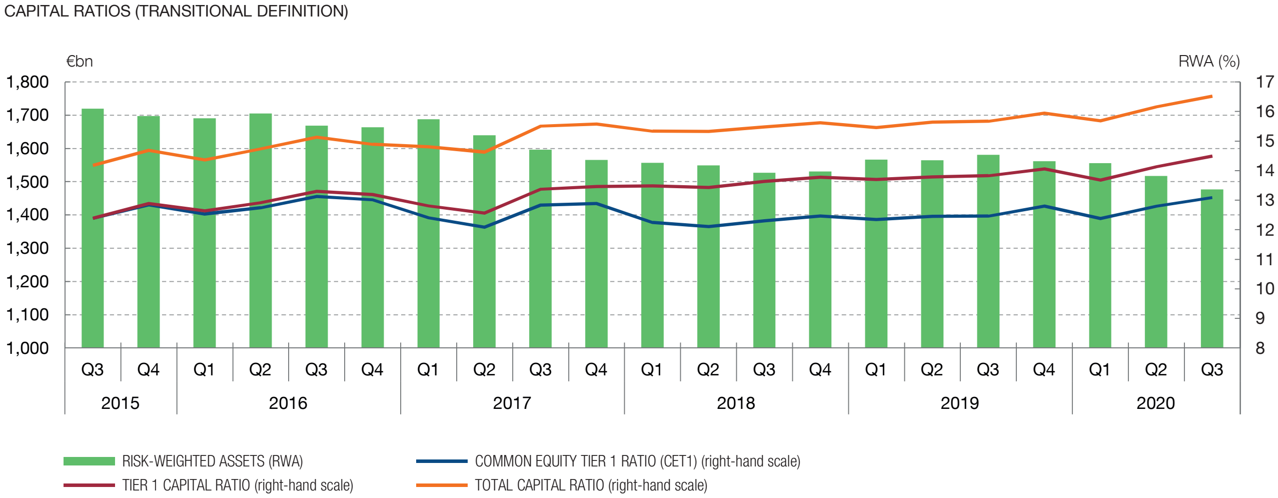


SOURCE: Banco de España (supervisory statistics on credit institutions).

The solvency of Spanish institutions has increased gradually since 2015, as Chart 2.5 shows. Until 2020, this increase took place despite the stricter criteria ushered in with the implementation of the new Basel III capital regulations. The increase observed as of 2020 Q2 owes, in part, to the regulatory and supervisory measures implemented as a result of the pandemic, which have eased some capital requirements and curtailed dividend distribution.

Chart 2.5
CAPITAL RATIOS (PHASED-IN)

Solvency increased following a decline in Q1, owing in part to the introduction of the quick fix and the recommendations to limit dividend payments.



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

The leverage ratio has recorded a relatively stable performance, with slight downside fluctuations (see Chart 2.6). In 2020 H1, the series was notably affected by a sharp reduction in the ratio, resulting from an increase in the denominator which mainly derived from the institutions' considerable recourse to ECB financing as a consequence of the pandemic. In Q3, this was offset by the regulatory changes introduced to mitigate the effect.

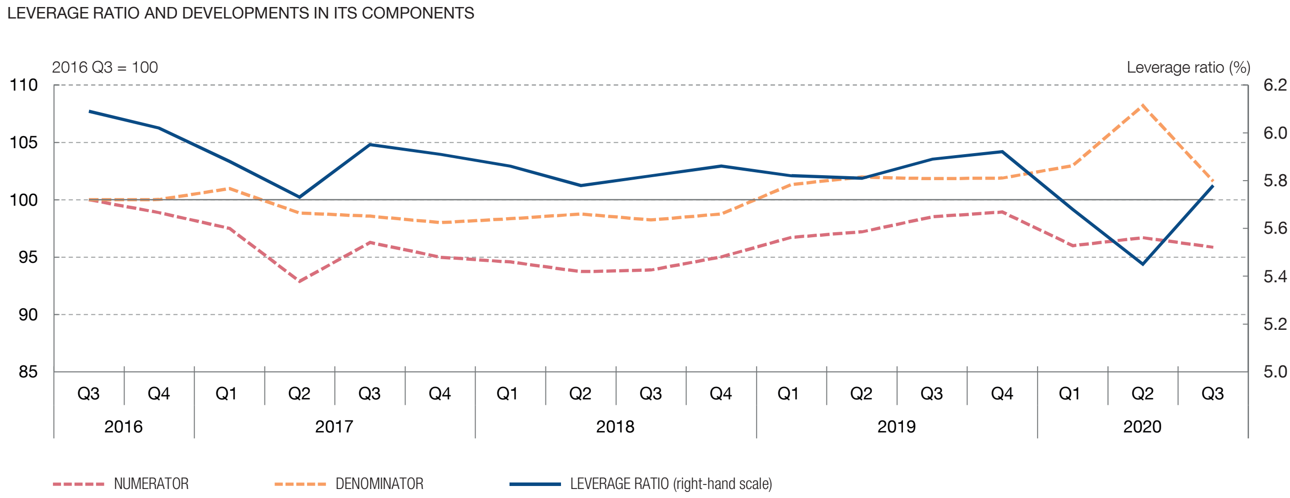
The loan-to-deposit ratio of non-financial corporations and households has been on a steady downward trajectory since 2015, as a result of deposits growing faster than loans. As of 2020, this trend was accentuated by the pandemic, which has generated a significant increase in deposits, exceeding the growth observed in credit. Chart 2.7 shows the change in this ratio during the last six years.

The liquidity coverage ratio of Spanish institutions rose again in 2020, following progressive increases between 2016 and 2018, and after holding relatively stable in 2019 (see Chart 2.8). The institutions' liquidity buffers have expanded further as a result of the

Chart 2.6

LEVERAGE RATIO AND DEVELOPMENTS IN ITS COMPONENTS

The leverage ratio declined in the early stages of 2020 owing to the institutions' considerable recourse to the ECB, with a subsequent correction due to the introduction of regulatory amendments.

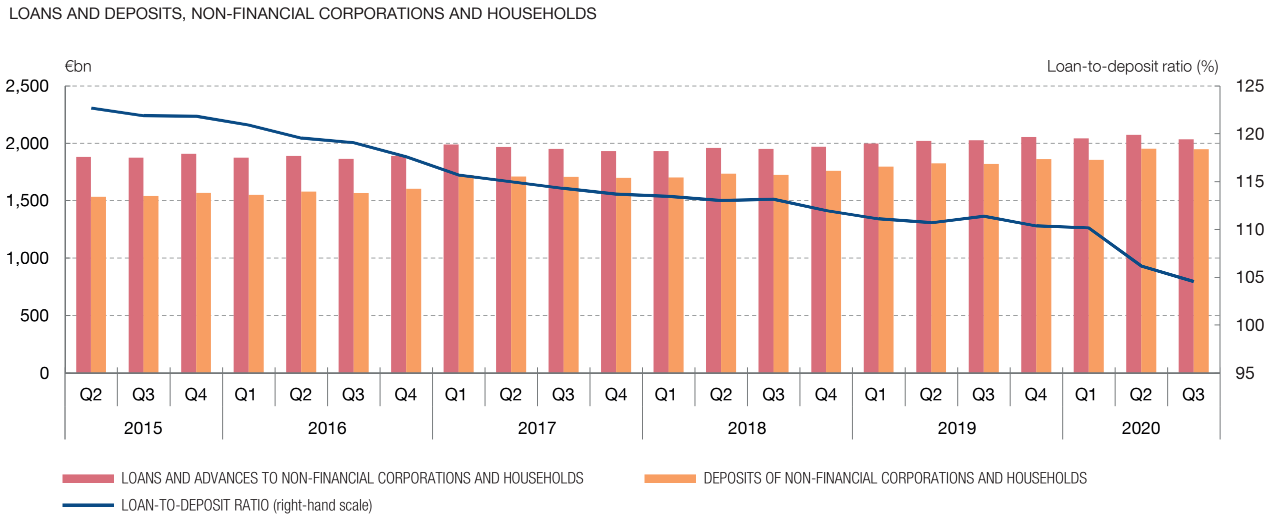


SOURCE: Banco de España (supervisory statistics on credit institutions).

Chart 2.7

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

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

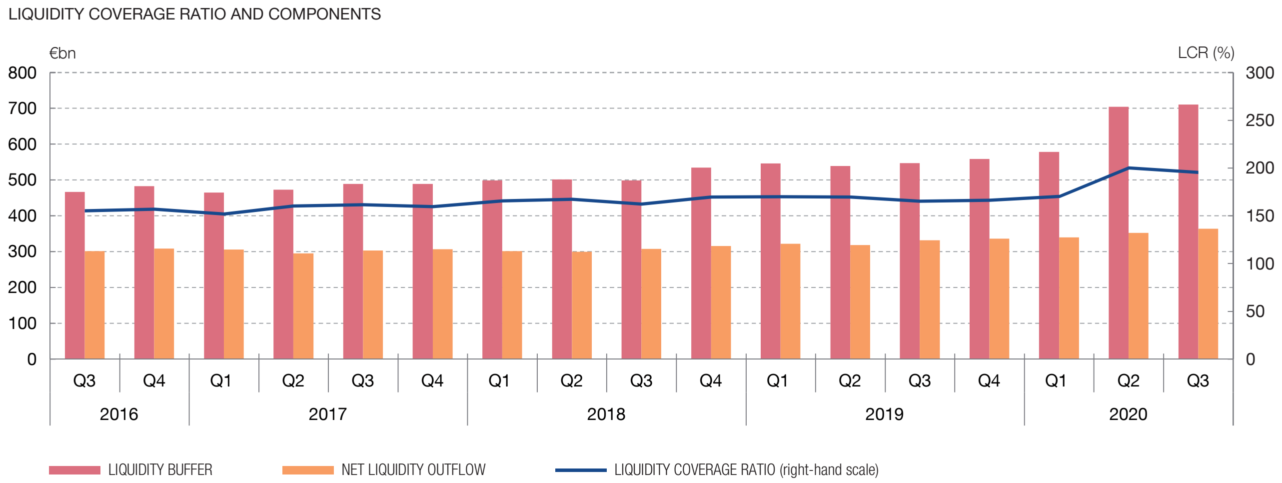


SOURCE: Banco de España (supervisory statistics on credit institutions).

onset of the pandemic in 2020 and the monetary policy measures implemented by the ECB in response. The implementation of the third series of targeted longer-term refinancing operations (TLTRO-III) in 2020 Q2 had a particularly visible impact.

Chart 2.8
LIQUIDITY COVERAGE RATIO

The institutions' liquidity rose markedly in 2020 owing to considerable recourse to ECB funding for precautionary reasons.



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

2.1.2 Response to the crisis and supervisory focal points in 2020

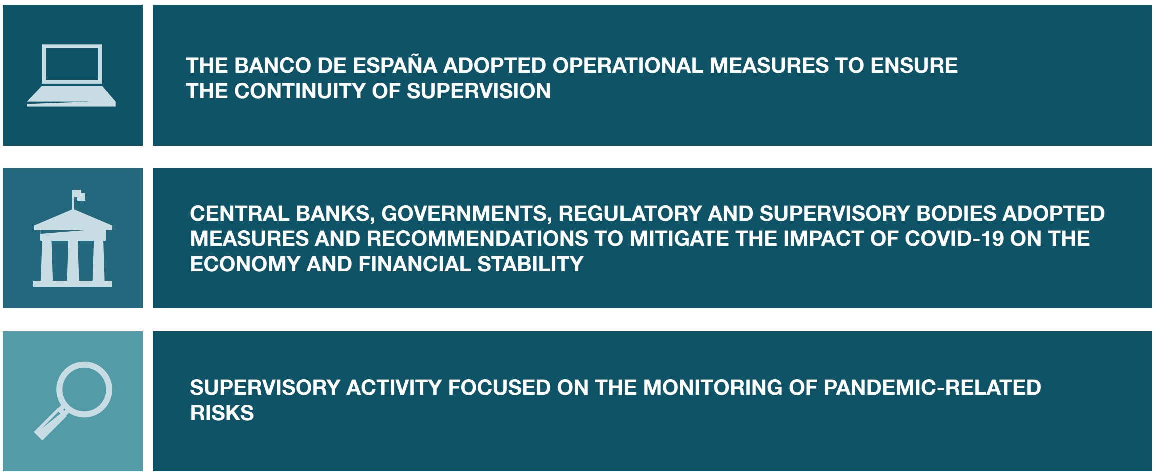
In 2019, the ECB established a series of supervisory focal points for 2020, grouped into the following priority areas: i) the continuation of balance sheet repair, which includes monitoring the reduction of NPLs; ii) strengthening institutions' future resilience through stress testing, examining the quality of banks' credit underwriting criteria, assessing IT and cyber risks, etc.; and iii) other priorities, mainly monitoring Brexit-related work.[1]

However, in 2020 supervisory activity was conditioned by the crisis prompted by COVID-19, which forced the supervisory priorities and actions to be refocused in view of the main risks arising from the pandemic (see Figure 2.1).

First, like the ECB, the Banco de España urgently adopted the measures required to ensure that prudential supervision, along with its other functions, remained in full effect under the new circumstances. The supervisory activity successfully accommodated the sudden and widespread shift to remote working and simultaneously managed to intensify the ongoing contact with institutions.

1 For further details, see Banco de España (2020), "Supervisory priorities in 2020", Section 2.1.2, Report on Banking Supervision in Spain, 2019.

Figure 2.1
RESPONSE TO THE COVID-19 CRISIS



SOURCE: Banco de España.

Second, central banks, governments and supervisory and regulatory bodies have adopted and published a broad set of measures and recommendations to mitigate COVID-19's impact on the economy and on financial stability, and to minimise the medium and long-term effects of the shock.

Aside from the monetary policy measures adopted by the ECB, which have allowed institutions broad access to liquidity, notable among the financial and fiscal initiatives in Spain are the legislative moratoria and the State guarantee schemes (see Box 2.1). The legislative moratoria have afforded protection to the most vulnerable groups, as well as the sectors hardest hit by the crisis. Aside from applying the legislative moratoria, institutions have fostered sector agreements via their associations to ensure more cases of application; as a result, this financial relief initiative has reached more beneficiaries and payment deferrals have been extended.

For their part, the State guarantee programmes support firms' access to much-needed liquidity, thereby protecting economic activity and employment. Spanish institutions have very actively extended these State-guaranteed loans, enabling a large number of firms to access such financing and helping to sustain the business sector.

European regulators have conducted an urgent review of capital requirement regulations. These so-called "quick fix" amendments are intended to maintain institutions' capacity to lend and to absorb pandemic-related losses, while simultaneously preserving their resilience (see Section 8.3 for further details).

For their part, the supervisory authorities have eased capital and liquidity requirements, and have also fostered the flexible application of accounting

Box 2.1

STABILISATION MEASURES: MORATORIA AND ICO GUARANTEES

The grave pandemic-induced economic crisis has forced the majority of European countries to implement urgent and specific support programmes, such as the moratoria and State guarantees.

A moratorium temporarily defers loan repayments for a set period of time. Initially legislative moratoria for mortgage loans and non-mortgage loans to vulnerable individuals affected by the pandemic were established (Royal Decree-Laws 8/2020 and 11/2020). Specific legislative moratoria were subsequently approved for firms in the tourism and transportation sectors (Royal Decree-Laws 25/2020 and 26/2020). In addition to the legislative moratoria, financial institutions voluntarily implemented banking sector moratoria via their associations,[1] thus widening the group of beneficiaries of debt deferrals and extending the grace periods.

In Spain at 31 December 2020, more than 1.3 million moratoria on payments had been granted to around 1.8 million beneficiaries, of whom 77% were wage and salaried workers and 23% were self-employed. In total, these deferrals have affected exposures amounting to €54 billion, of which 42% correspond to legislative moratoria and 58% to banking sector moratoria.

The central government has provided State guarantees on a certain percentage (up to 80% of the principal) of financing extended to firms and the self-employed to cover liquidity needs and for new investments. To be eligible, the borrowers had to be domiciled in Spain and not be in default nor subject to insolvency proceedings.

Two guarantee facilities have been implemented for up to €100 billion and €40 billion, respectively (Royal Decree-Laws 8/2020 and 25/2020). Overseen by the Official Credit Institute, both facilities are processed through the credit institutions, which assess the viability of the borrowers and assume the risk for the unsecured portion of financing.

In Spain at 31 December 2020, some 944,000 loans had been guaranteed, corresponding to more than 591,000 firms and accounting for 87% of the initial programme. This injected €114 billion of liquidity, 70% of which was extended to the self-employed and SMEs and the remaining 30% to large firms.

The banking sector has been in constant contact with the economic authorities, creating an environment of close cooperation that has allowed the measures to be introduced swiftly and smoothly.

Thus, banks have played an essential role in channelling government support. The management capability of financial institutions, in particular credit institutions, has meant measures could be taken to protect the most vulnerable groups and the sectors hardest hit by the crisis, such as transportation and tourism. In addition, they have allowed more people to benefit from these financial relief measures through the banking sector moratoria.

With the support of State guarantees, banks have continued to provide access to credit and liquidity, and have helped address and mitigate the economic and social impact of COVID-19.

1 Banking sector moratoria agreements were established by the Spanish Banking Association, the Spanish Confederation of Savings Banks, the National Union of Credit Cooperatives and the National Association of Specialised Lending Institutions.

standards (see Box 2.2). These relief measures, agreed upon by the ECB and the Banco de España within the scope of their responsibilities, are in keeping with the initiatives implemented by other authorities, such as the Single Resolution Board, the European Banking Authority (EBA), the European Systemic Risk Board (ESRB) and the European Securities and Markets Authority.

Further, supervisors have eased the operational burden of supervisory activity to encourage institutions to concentrate efforts on ensuring their operational continuity and on performing their critical economic functions. For example, the EBA and ECB stress tests due to take place in 2020 have been postponed until 2021, certain deadlines to implement action plans ensuing from

Box 2.2

RELAXING APPLICATION OF PRUDENTIAL REGULATIONS AND ACCOUNTING STANDARDS. ECB AND BANCO DE ESPAÑA MEASURES

In response to the extraordinary situation prompted by the pandemic, the authorities swiftly adopted a raft of monetary, fiscal and financial policy measures aimed at mitigating the impact of the crisis.

The initial supervisory measures focused on easing capital and liquidity requirements and lightening certain operational burdens imposed by supervision.

The easing of capital and liquidity requirements has allowed institutions to temporarily operate below the levels set for their Pillar 2 Guidance (P2G), capital conservation buffer and liquidity coverage ratio (LCR).

The supervisor expects institutions to replenish LCR levels by end-2021 at the earliest and P2G levels a year later (no sooner than end-2022), although those dates may be put back depending on the economic situation and each institution's particular position, with a view to heading off procyclical effects.

Furthermore, the change in the composition of P2R, originally envisaged in the Capital Requirements Directive V for January 2021, was brought forward to March 2020: P2R should have the same capital composition as that of Pillar 1, meaning at least 56.25% of P2R should be held in common equity Tier 1 capital (CET1) and 75% in Tier 1 capital, instead of 100% in CET1 as established hitherto.

To complement these capital measures, the macroprudential authorities eased the countercyclical capital buffer in those Single Supervisory Mechanism countries where it was activated or scheduled to be activated over 2020-2021.

In addition, it is worth mentioning that both the Banco de España and the European Central Bank (ECB) announced greater supervisory flexibility in the prudential treatment of loans backed by State guarantees.

Furthermore, in line with statements made by international regulators and supervisors, the Banco de España and the ECB also encouraged institutions to make use of the flexibility afforded by International Financial Reporting Standard 9. Specifically, they indicated that measures such as moratoria and State guarantees should not automatically mean worse credit risk classifications for exposures. This would afford institutions greater scope to discriminate between viable and non-viable credit transactions. Likewise, they were reminded that the remaining lifetime of a loan should be considered when determining whether there has been a significant increase in credit risk (entailing a deterioration of their accounting classification).

Broadly speaking, these measures are geared towards forestalling the potential procyclical effects of capital and liquidity requirements, and the application of the accounting framework, such that the institutions remain unfettered in their capacity to lend to the overall economy, at a time when this is an essential function to mitigate the impact of the crisis[1].

1 For a more extensive summary of the prudential and accounting regulation flexibility measures, see R. Anguren, L. Gutiérrez de Rozas, E. Palomeque and C.J. Rodríguez García (2020), "The regulatory and supervisory response to the COVID-19 crisis", *Financial Stability Review,* No 39, Autumn, Banco de España.

recent on-site inspections have been extended and some of the planned on-site actions have been postponed.

Further, the ECB and the Banco de España have recommended that institutions refrain from paying dividends to shareholders, so as to ensure that they have the maximum possible capital available to provide financing to economic agents and to absorb potential losses. They have also reiterated their expectations that institutions be extremely moderate with regard to variable remuneration over the same period (see Section 2.2.4 for further details). Figure 2.2 shows a summary of the main measures and recommendations adopted by the supervisors.

Figure 2.2
MEASURES AND RECOMMENDATIONS OF SUPERVISORY AUTHORITIES

FLEXIBILITY IN CAPITAL AND LIQUIDITY REQUIREMENTS

- Institutions have been temporarily allowed to operate with lower capital levels than set out for the P2G, the capital conservation buffer and LCR.
- The composition of the P2R has been amended setting as the mininum requirement the same composition as for Pillar 1.
- Macroprudential authorities have relaxed the CCyB in those SSM countries where it was activated or due to be activated over the course of 2020-2021.

FLEXIBILITY IN APPLICATION OF ACCOUNTING STANDARDS

Supervisors have urged use of the flexibility allowed by the accounting framework of the IFRS-EU 9 for financial instruments. Measures such as moratoria or State guarantees do not necessarily entail the reclassification of an exposure to a lower credit quality category.

OPERATIONAL FLEXIBILITY

- Certain on-site actions scheduled for 2020 have been postponed or cancelled.
- The pragmatic approach to the SREP has been applied.
- Certain flexibility has been allowed to institutions in the preparation and updating of recovery plans.
- EBA and ECB stress tests scheduled for 2020 have been postponed until 2021.
- Certain deadlines to implement action plans ensuing from supervisory actions have been extended.

RECOMMENDATION NOT TO PAY DIVIDENDS AND TO MODERATE VARIABLE REMUNERATION

- Institutions have been asked to consider refraining from paying dividends in cash and buying back shares, or limiting such remuneration until 30 September 2021.
- Institutions have been asked to be extremely moderate in their variable remuneration until 30 September 2021.

SOURCE: Banco de España.

Lastly, supervisory efforts have been refocused to ensure adequate monitoring of pandemic-related risks, prioritising their impact on institutions’ risk profiles and operational continuity. For instance, particular emphasis was initially placed on institutions’ liquidity and contingency plans, particularly in relation to cybersecurity and business continuity. Analysis of the impact of the crisis on asset quality has partly focused on the application of moratoria and the use of State guarantee facilities. Finally, the effects on institutions’ activity, income statement and capital levels have been monitored.

2.1.3 Supervisory priorities in 2021

Each year’s supervisory priorities for the SSM as a whole are determined by means of an analysis conducted by the ECB in cooperation with the NCAs. This

Figure 2.3
SSM SUPERVISORY PRIORITIES 2021

CREDIT RISK MANAGEMENT	STRENGTHENING THE CAPITAL OF INSTITUTIONS	BUSINESS MODEL SUSTAINABILITY	GOVERNANCE
Review of the procedures and practices for the management, monitoring and reporting of this risk	Monitoring of the institutions' capital plans, with emphasis on dividend distribution and share buyback policies	Review of the strategic plans and measures presented by the institutions to remedy shortcomings	Monitoring of the institutions' crisis management procedures and capacity to adapt
Identification of asset impairment and management thereof	EU-wide stress test (postponed in 2020)	Assessment of headway made in digitalisation plans and impact on business models	Assessment of management systems for the provision of relevant management information and data
			IT and cyber risk
			Assessment of ML/TF risk

SOURCE: ECB.

analysis considers the economic and financial environment, regulatory developments and the main risks and vulnerabilities facing the banking system. The supervisory priorities eventuate in a series of supervisory actions, some of which take place over a time horizon of several years. The Banco de España likewise sets each year's supervisory priorities for LSIs.

The pandemic, its effects on the banking sector and the uncertainty surrounding the expectations for economic recovery played a key role in identifying the main risks for 2021. Ultimately, these were identified as follows: i) the pandemic's protracted impact on economic activity and the potential rise in NPLs; ii) price corrections on financial markets; iii) cybercrime and technological challenges; and iv) geopolitical uncertainties.

A further series of risk factors have been detected, the majority of which have persisted for several years, including those related to money laundering and terrorist financing (ML/TF), climate change and Brexit.

In addition, this year a series of vulnerabilities, both external and internal, have been identified for SSM institutions which may exacerbate the above-mentioned risks. Specifically, these include vulnerabilities relating to credit risk management and coverage, low structural income and profitability levels, information technology (IT) shortcomings, governance and strategic management that could

Box 2.3
SUPERVISORY POLICY IN MERGERS BETWEEN INSTITUTIONS

Declining profitability in recent years, together with the financial and economic situation triggered by the COVID-19 crisis, is prompting the consolidation of the financial system in several countries, among them Spain, where some institutions have decided to merge. These mergers aim to make the banks more resilient and boost their capacity to serve the economy in the context of the pandemic. Institutions need to strengthen their efficiency in light of narrowing margins and the write-downs that may be necessary.

These mergers will allow the resulting institutions to achieve economies of scale, make efficiency gains and improve their capacity to tackle new challenges – such as digitalisation – and, consequently, expand the supply of banking products through new channels.

In consolidation processes, supervisory authorities are tasked with making sure that the resulting business combination complies with prudential requirements and ensures effective and prudent risk management.

In the interest of transparency and clarity in its supervisory approach to merger and concentration processes, in January 2021 the ECB approved a guide that sets out the following supervisory expectations:

i) The sustainability of the resulting institution's business model. ECB Banking Supervision will analyse the business viability of the submitted merger plan, assessing the resulting institution's solvency and ability to generate profit going forward. Such ability must be based on efficiency gains, via a reduction in costs; geographic, product, and customer complementarity; and value generation at the resulting institution.

Further, merger projects must be based on a credible business plan, with reasonable and conservative assumptions.

ii) Robust governance and risk management requirements. The internal governance and organisational structure of the combined institution must satisfy the principles established in the EBA guidelines on internal governance (EBA/GL/2017/11). To this end, ECB Banking Supervision must check that governing bodies are adequately composed and function smoothly, that responsibilities are clearly allocated and that remuneration systems setting the right incentives are established.

Furthermore, the guide establishes that the supervisor will make use of its supervisory toolkit to smooth the completion of merger projects, through: i) non-penalisation of merger plans with higher capital requirements; ii) prudent recognition of badwill, which must help strengthen balance sheets at the time of integration; and iii) temporary acceptance of the use of internal capital requirement calculation models.

The principles set out in the above-mentioned guide on banking consolidation are being deployed in Spain, where there are two processes under way. First, the merger between CaixaBank and Bankia, which will be completed over the course of 2021 and will foreseeably result in the leading bank in terms of operations in Spain. Second, Liberbank and Unicaja are also negotiating their consolidation to create Spain's fifth-largest bank in terms of assets. It cannot be ruled out that other institutions attempt to merge in the future, with a view to gaining in profitability, size and competitiveness.

be improved, long-standing cost inefficiencies, high levels of public and private debt, surplus capacity in the banking sector and fragmentation in the regulatory and legal framework.

Mindful of these risks and vulnerabilities, the supervisory priorities for 2021 have been grouped into the following general categories (see Figure 2.3):

— credit risk management.

— strengthening the capital of institutions.

Box 2.4

NEW DEVELOPMENTS IN REGULATIONS ON TECHNOLOGY-RELATED RISKS AND THEIR SUPERVISION

In an increasingly digital world, financial institutions rely entirely on technology to implement their business models and to smoothly and securely offer the products and services that their customers demand. In order to ensure the institutions' operational resilience, i.e. their capacity to continue providing services in the face of any adverse situation, it is crucial to ensure the resilience of their IT systems, not only against the increasingly frequent and sophisticated cyberattacks financial institutions suffer, but also against other types of disruptive situations, such as natural disasters or the global COVID-19 pandemic.

Over the past five years, Europe's regulators have pushed to improve the resilience of the financial sector, with particular emphasis on IT and digital resilience. Two initiatives stand out:

i) European Banking Authority (EBA) guidelines on ICT and security risk management (EBA/GL/2019/04).

ii) The EU proposal for a Digital Operational Resilience Act (DORA).

The EBA guidelines, which have been in force since 30 June 2020, apply to credit institutions, payment institutions, account information service providers, electronic money institutions and investment firms. Their implementation should always take into account the principle of proportionality. They also include obligations for the competent authorities.

Among these guidelines' most notable aspects are their requirements regarding governance and strategy, risk management and security and business continuity testing, which heighten and align the standards.

Meanwhile, the text of the legislative proposal for a new regulation, DORA, was published in late September 2020 and is currently being discussed by the European Council and European Parliament. DORA is part of the European Commission's digital finance strategy, and its aim is to mitigate the risks associated with digitalisation and strengthen the resilience of the European financial sector.

For the first time in the European Union, a single regulation on technological resilience will apply to all types of financial institutions, in proportion to their size and complexity. The text includes requirements for institutions on managing technology-related risks, managing and notifying technological incidents, resilience testing of systems and managing relations with third parties. It also fosters information sharing between institutions and cooperation between authorities.

One of the main new developments introduced by DORA is an oversight framework for critical technology providers in the financial sector. Given that financial institutions are increasingly reliant on their technology providers, this proposal represents a very significant step towards improving the resilience of the European financial sector as a whole.

— business model sustainability. In addition to reviewing strategic plans and assessing the headway made in digitalisation plans, also subject to close monitoring are consolidation processes in the interest of shoring up the resilience and efficiency of institutions in the face of the continuous narrowing of margins and the foreseeable increase in write-downs owing to impairments arising from the COVID-19 crisis (see Box 2.3).

— governance. In addition to observing crisis management procedures, assessing the systems that provide management data and evaluating ML/TF risk, in the realm of IT and cyber risk particular emphasis will be placed on IT outsourcing (see Box 2.4).

Under a similar process, the following supervisory priorities were established for LSIs in 2021: i) asset quality and credit risk management; ii) profitability and business

Box 2.5

BANCO DE ESPAÑA SUPERVISORY EXPECTATIONS ON CLIMATE CHANGE AND ENVIRONMENTAL RISK, AND THE ECB GUIDE

Climate change and environmental degradation represent a global concern that has prompted initiatives in various fields. These reflect the need for measures geared towards achieving the demanding global warming reduction targets.

New risk factors are emerging as a result of the measures introduced to transition to an environmentally friendly low-carbon economy, along with the physical risks deriving from climate change and environmental events. These are having an impact on financial risks, which has attracted the attention of supervisors and central banks. Both are therefore adding to their work agendas analysis of the financial risks associated with climate change and environmental degradation.

The Banco de España and the European Central Bank (ECB) have been party to the debates surrounding the energy transition and its implications for credit institutions in the euro area. In this regard, and besides their participation in a number of international fora and bodies, they have implemented public initiatives in the interest of raising the banking sector's awareness and readiness.

One good example of these initiatives is the publication of the Banco de España supervisory expectations document on risks posed by climate change and environmental degradation, and the ECB guide on climate-related and environmental risks. Both documents recognise climate-related and environmental risks as sources of financial risk; institutions must therefore begin to factor these into their oversight of the traditional banking risks (credit risk, market risk, liquidity risks and operational risk). While these expectations are not binding for the institutions, they do provide guidance on how to incorporate and approach climate-related and environmental risks in the following aspects:

i) Business model and strategy: institutions are expected to incorporate those risks that may be material in both the short and long term.

ii) Governance: ultimate responsibility for integrating these risks in the overall strategy, and for establishing the necessary mechanisms to review these arrangements, is expected to lie with the board of directors.

iii) Risk management: institutions are expected to consider the risks posed by climate change and environmental degradation seamlessly within its existing risk management procedures and to adopt a comprehensive approach to their identification, assessment, monitoring and mitigation.

iv) Disclosures: institutions are expected to publish material information on significant events, taking into account their characteristics and, in particular, their time horizons.

The ECB guide is directly applicable to significant institutions and recommends that national competent authorities apply the guide in a proportionate manner in their supervision of less significant institutions (LSIs), whereas the Banco de España supervisory expectations are addressed to the LSIs under its supervision.

Although the two documents differ in the degree of detail of the expectations, both envisage the institutions applying the expectations based on the materiality of their exposure to climate-related and environmental risks, which is not necessarily linked to their size.

Both the Banco de España and the ECB are aware of the novel nature of this subject matter and the considerable uncertainty regarding the materialisation of these risks, along with the challenges relating to methodology and the availability of information that institutions face when identifying and measuring such risks. They are therefore of the view that the institutions need time; accordingly, they do not expect all of the expectations set out in these documents to be implemented immediately, and instead will assess their gradual deployment as part of the supervisory dialogue.

models; iii) governance; iv) the strength of own funds; and v) IT risk, cybersecurity and operational resilience.

As regards the first of the priorities, credit risk management, two specific credit risk monitoring tasks conducted by the Banco de España in 2020

should help to quantify and monitor the potential impact on the Spanish banking system in 2021:

— **credit portfolio segmentation based on the level of vulnerability to the crisis prompted by COVID-19:** in view of the evidence that the crisis will have a highly uneven impact, the different credit exposures are classified in order to segment the portfolio into exposures potentially more or potentially less affected by the crisis.

— **definition and monitoring of early warning indicators:** given that the mitigating measures implemented by authorities may delay the onset of the more or less traditional signs of credit impairment, monthly monitoring has begun of new leading indicators based on broader definitions of risk that factor in the information received on State-guaranteed transactions and transactions subject to moratoria. This makes it possible to anticipate the course of credit impairment.

2.2 Supervision of credit institutions

In the framework of the SSM, the ECB heads the supervisory function with the participation of the NCAs. According to the allocation of supervisory tasks (see Figure 2.4), the ECB is directly responsible for the supervision of SIs (115 significant groups at end-2020, of which 12 are Spanish), while the Banco de España is responsible for the direct supervision of the LSIs incorporated in Spain, which at end-2020 amounted to 59 institutions or groups (the SSM as a whole includes a total of 2,320 LSIs). Table 2.1 shows the weight of the different credit institution categories in Spain, differentiating between SIs and LSIs. Table 2.2 classifies the credit institutions operating in Spain by institution type.

However, the Banco de España contributes significantly to the supervision of Spanish SIs, both through off-site ongoing supervision work via the JSTs and through on-site inspections and model investigations performed on those institutions.[2]

The activities involved in the microprudential supervision of credit institutions are grouped into two distinct areas: off-site ongoing supervision and on-site supervision.

The first of these assesses the institutions' situation and risk profile in order to prioritise the work that needs to be conducted and the depth thereof.

2 The Banco de España contributes not only its experience, but also the bulk of the inspectors, IT auditors and junior analysts comprising the JSTs for Spanish SIs and the teams participating in on-site actions.

Figure 2.4
DISTRIBUTION OF SUPERVISORY POWERS

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

SOURCE: Banco de España.

In turn, on-site supervision comprises two types of action: inspections and model investigations. The latter specifically review capital requirement calculation models, whereas the former serve to verify any other area relating to the institutions.

The SSM makes significant efforts to standardise supervisory procedures and practices, complying with the principles and standards set out in the Capital

Table 2.1
SPANISH CREDIT INSTITUTIONS

The number of credit institutions in Spain remained stable, while the volume of assets increased by 5% overall. In relative terms, the most marked increases came in the segments of Spanish LSIs and of EU SI subsidiaries and branches.

Data at 31 December

	2019		2020	
	Groups	Assets (%)	Groups	Assets (%)
Signifcant institutions				
Spanish groups of credit institutions	12	91.3	12	90.7
EU subsidiaries and branches (a)	26	3.6	27	3.8
Less significant institutions				
Spanish credit institutions (b)	59	4.6	59	5.1
Branches of institutions from non-SSM EU countries	4	0.0	2	0.0
Branches of institutions from SSM EU countries (a)	33	0.3	33	0.3
Non-EU branches	3	0.1	3	0.2
TOTAL	**137**		**136**	

SOURCES: ECB and Banco de España.
NOTE: The figures for the institutions' assets have been obtained after the data cut-off date.

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

Table 2.2
REGISTER OF CREDIT INSTITUTIONS

Data at 31 December

	2015	2016	2017	2018	2019	2020		
						Registrations	Deregistrations	Year-end
Credit institutions	220	208	207	198	197	2	6	193
Banks	67	60	59	52	52		1	51
Savings banks	2	2	2	2	2			2
Credit cooperatives	65	63	63	62	61			61
ICO	1	1	1	1	1			1
Branches of EU credit institutions	79	77	78	78	78	2	5	75
Branches of non-EU credit institutions	6	5	4	3	3			3
Controlling companies	3	4	3	5	6		1	5
TOTAL	**223**	**212**	**210**	**203**	**203**	**2**	**7**	**198**

SOURCE: Banco de España.

Requirements Directive (CRD),[3] the Capital Requirements Regulation (CRR)[4] and the guidelines issued by the EBA.

3 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

4 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

Box 2.6

ORGANISATIONAL RESTRUCTURING OF ECB SUPERVISION

European Central Bank (ECB) Banking Supervision underwent far-reaching restructuring in October 2020. This was in response to the new strategic orientation building on the experience gained during the initial years of the Single Supervisory Mechanism (SSM), with a view to furthering the supervisory arm's development to ensure more effective and efficient supervision.

At the SSM's inception (November 2014), microprudential supervision at the ECB was structured into a Secretariat to the Supervisory Board (SB) of the ECB and four directorates general (DG): DG-MS1 and DG-MS2 for the direct supervision of significant institutions (SIs); DG-MS3 for the indirect supervision of less significant institutions (LSIs) and DG-MS4 for on-site inspections and horizontal and specialised functions. Certain subsequent adjustments had been made (such as the secretariat's conversion into a directorate general), but the overall organigram remained unchanged.

In July 2020, reorganisation plans for the ECB were submitted to the SB, as a key step towards shifting the supervisory focus.

The former DG-I, DG-II and DG-III were reorganised into three other DG, with the same ongoing supervisory functions for the institutions supervised directly or indirectly by the ECB, but grouping the institutions based on their business models: DG Systemic and International Banks, DG Universal and Diversified Institutions and DG Specialised Institutions and Less Significant Institutions. The aim was to shift towards more risk-focused supervision, create more synergies and allow a better comparison of common risks and challenges. Meanwhile, the integration of SI and LSI supervision will help to eliminate overlaps and ensure greater supervisory consistency.

The former DG-IV is now split into two: DG Horizontal Line Supervision (DG-HOL) and DG On-Site and Internal Model Inspections (DG-OMI).

DG-HOL retains some of the traditional horizontal areas, while also incorporating specialisation based on risks or supervisory areas (business model and capital adequacy, credit risk, market and liquidity risks, non-financial risks and stress tests), with the aim of creating groups of experts that will be in close contact with the joint supervisory teams and the on-site inspection teams. The aim was to strengthen risk-related technical skills in the supervision of institutions.

For its part, the DG-OMI, which is dedicated to on-site supervision, will comprise four divisions: financial risks inspections, non-financial risk inspections, internal models investigations and operations and integration.

A further new development was the creation of the Directorate Supervisory Strategy and Risk (D/SSR), responsible for strategic analysis and planning, resource allocation, defining and monitoring supervisory risk appetite and analysing the quality and consistency of supervision. It is organised into four areas: strategic analysis, financial risk, non-financial risk and strategic planning office. The D/SSR includes the second line of defence.

The former DG Secretariat was converted into the DG SSM Governance and Operations. It retains the same functions as before (secretariat to the SB; authorisations; fit and proper, which is separated from the previous function; and sanctioning proceedings), while a new technology and innovation division is added.

To ensure more effective and efficient supervision, in 2020 the ECB undertook organisational restructuring of these supervisory tasks (see Box 2.6). **The working groups and expert networks from the various member countries play a key role,** by analysing and developing technical and supervisory policy proposals with the aim of improving the functioning of the SSM. Further, they help to prepare and discuss the proposals that are subsequently debated by the SB and, if appropriate, approved by the ECB Governing Council. The Banco de España participates actively in most of these groups, participating in nearly 100 working groups with more than 100 supervisory staff members. In some cases, the Banco de España chairs or co-chairs these groups (see Box 2.7).

Box 2.7
LEADERSHIP OF PARTICULARLY SIGNIFICANT SSM PROJECTS

As a member of the Single Supervisory Mechanism (SSM), the Banco de España co-chairs certain projects with the European Central Bank (ECB). Of these, the two working groups described below stand out as particularly significant.

First, the working group on implementation of a new risk-by-risk approach to setting Pillar 2 capital requirements (P2R) in the SSM. After several years of applying the SREP methodology to determine the measures and requirements notified annually to the institutions, the SSM is revising the methodology for calculating institution-specific capital requirements.

The aim is to determine additional capital requirements on a risk-by-risk basis, paying particular attention to Pillar 2 risks, and bolstering the use of all kinds of available information, attaching greater importance to information stemming from each institution's internal capital adequacy assessment process.

Second, the SSM working group tasked with aligning and proposing improvements for the management of inspection teams in on-site supervisory actions.

To this end, the group is drawing up a document of recommended good practices, taking into account the experience of those who have participated in on-site actions since the SSM's inception, along with the opinions of their managers at the ECB and at the national competent authorities (NCAs).

This document has a dual aim: i) to optimise the utilisation of resources in on-site actions (particularly in cross-border inspections, which involve members of different NCAs and are harder to manage); and ii) to boost all participants' professional development.

The Banco de España also takes part in decision-making relating to credit institutions through its representatives on the Governing Council of the ECB and on the SB, where decisions are taken on a collegiate basis.

The Executive Commission of the Banco de España remains apprised of supervisory and other decisions about relevant SSM issues adopted by the Governing Council of the ECB, with the support of the SB (see Chart 2.9)**. In particular, the Director General Banking Supervision reports to the Executive Commission on the following matters:**

— supervisory decisions regarding SIs, including capital and liquidity decisions.

— the supervisory priorities and the annual supervisory examination programme for the coming year.

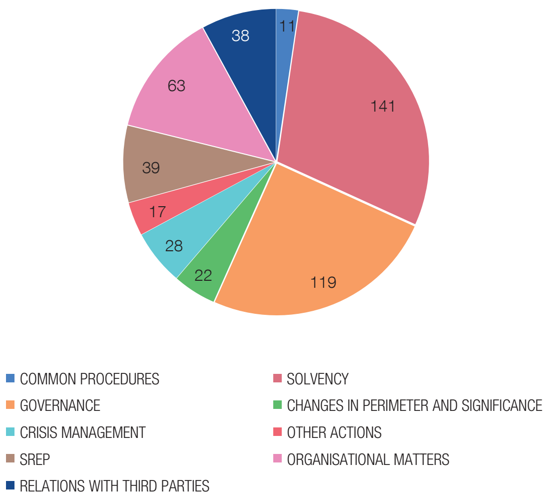
— general SSM matters of particular interest.

— the situation of Spanish institutions.

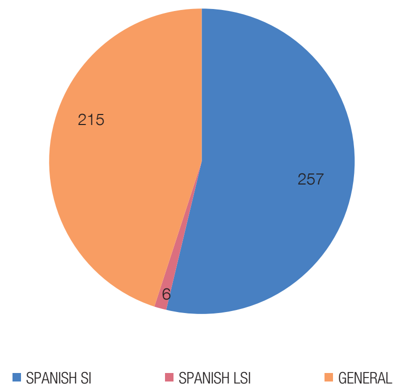
Chart 2.9
DISTRIBUTION OF THE ECB DECISIONS AND ACTIONS IN 2020 NOTIFIED TO THE EXECUTIVE COMMISSION

In 2020, the number of SREP decisions declined due to adoption of the pragmatic approach. Another notable change was the increase in decisions concerning governance, while the actions relating to the management of COVID-19 were recorded in the crisis management area.

1 BY CATEGORY



2 BY TYPE OF INSTITUTION



SOURCE: Banco de España.

2.2.1 Ongoing supervision of significant institutions

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

The Banco de España participates in the JSTs for the 12 groups of Spanish credit institutions classified as significant pursuant to the SSM's criteria, and likewise in some of the JSTs for 27 significant banking groups from SSM countries that have a presence in Spain (operating through six subsidiaries and 40 branches established in Spain). At end-2020, the Banco de España contributed to the JSTs for Spanish banks a total of 157 employees from the Inspection I and Inspection II departments.

The JSTs focus on off-site ongoing supervision, aiming to maintain an up-to-date opinion on the situation and risk profile of the institutions. To this end, annual planning is conducted for the ongoing supervisory tasks, whose frequency and intensity is determined by the supervisory significance of the institutions. Prominent among the off-site ongoing supervisory tasks are those related to the Supervisory Review and

Evaluation Process (SREP) – the most demanding in terms of effort and time –, including the annual determination of capital and liquidity requirements. In addition, the JSTs' tasks include the following: i) one-off detailed reviews specific to each institution; ii) participation in cross-cutting reviews, which are conducted for all SSM institutions in relation to areas of interest; iii) cooperation in on-site supervisory actions; and iv) reviews of recovery plans, processing of authorisations, coordination with other supervisors, provision of support to horizontal groups by contributing their practical experience, etc.

However, the 2020 supervisory activity was highly conditioned by the COVID-19 crisis, with a necessary adjustment to the new circumstances and a refocusing of efforts to ensure adequate monitoring of the pandemic-related risks. Accordingly, work on certain lower priority activities had to be scaled down in order to focus the ongoing supervision on how COVID-19 is impacting institutions' risk profiles and operational continuity. To conduct this monitoring, the supervisor asked institutions to report regularly on those aspects and has remained in permanent contact with the institutions through numerous remote meetings.

Specifically, in addition to the customary monitoring of the various risk areas, the JSTs have performed the following tasks:

— monitoring the impact of COVID-19 on asset quality. Much of the work performed by the JSTs has consisted of assessing credit quality developments for portfolios and monitoring the support provided by institutions to borrowers (moratoria, ICO-guaranteed loans, etc.).

— monitoring of the institutions' contingency plans, focusing particularly on cybersecurity and business continuity. In this connection, regular information has been requested on the widespread implementation of remote working and the impact thereof, and on the use of alternative channels to continue providing services to customers, along with infection trends among employees and branch closures (see Chart 2.10).

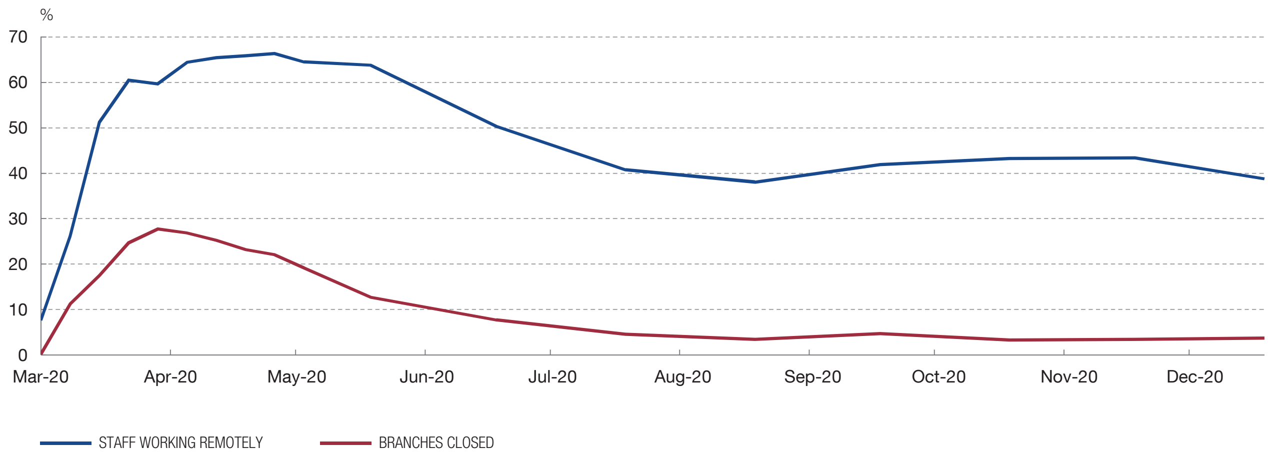
— monitoring of liquidity through regular meetings with institutions. Given that the supervisor's initial concerns regarding the impact of the crisis on banks' liquidity ultimately did not materialise, the frequency of these meetings was gradually reduced.

— assessment of the effects of the crisis on the institutions' level of activity (including in terms of new lending, card expenditure and cash withdrawals), income statement (especially in terms of credit risk provisions, including extraordinary provisioning) and capital levels.

— other tasks, such as the following: i) reviewing the activity of the new committees set up to monitor and address the impact of the crisis;

Chart 2.10
THE EFFECTS OF THE PANDEMIC ON BRANCH CLOSURES AND THE RISE OF REMOTE WORKING

The COVID-19 crisis has clearly had an influence on the widespread implementation of remote working at Spanish credit institutions. Although a large portion of staff returned to the workplace from June 2020 onwards, the percentage of employees who continued working remotely throughout the year remains quite high. Likewise, the state of alert and lockdown gave rise to the closure of nearly 30% of the branch network and prompted some institutions to permanently close a great deal of branches. However, despite the branch closures and the rise of remote working, it is worth noting that the institutions have managed to operate as normal.



SOURCE: Banco de España.

ii) verifying the sufficiency and suitability of reporting to the governing bodies on COVID-19-related matters; and iii) analysing the plans for the return to normality, succession planning, the updating of financial plans and budgets, changes to credit policies, the adaptation of risk appetite frameworks and assessing the sectors hardest hit by the crisis.

Mindful of the difficulty of implementing the SREP guidelines (EBA/GL/2014/13) to the fullest extent owing to the heightened uncertainty prompted by the crisis, the EBA stated that the principles of efficacy, flexibility and pragmatism should determine the 2020 SREP supervisory approach. With a view to identifying how such flexibility could be applied, the EBA published guidelines on a pragmatic approach to the SREP (EBA/GL/2020/10) and established a special procedure for the 2020 SREP.

The ECB adopted those guidelines and opted for a simplified approach to the SREP in 2020. The main characteristics of this simplified approach are as follows: i) focusing the analysis on the institutions' aspects and risks most affected by the crisis, considering the information available at the time of the assessment; ii) leaving the SREP scores unchanged, given the uncertainties in the current scenario; and iii) as a general rule, maintaining the same capital requirements (P2R) and guidance (P2G).

Specifically, the supervisory analysis of each risk area prioritised a series of key aspects that might have been particularly affected by the crisis, or that could impact the institution’s capacity to operate properly in future:

— the analysis of the business model focused on the near-term viability of each credit institution, taking into consideration the impact of the COVID-19 crisis on 2020 results, and the expected repercussions of the crisis on the institution’s medium-term sustainability.

— with regard to governance and risk management, close attention has been paid to the responsiveness demonstrated by each institution’s management body to the COVID-19 outbreak, along with the capacity to identify, measure and monitor the risks arising from the new economic situation.

— credit risk supervision reviewed the impact of the crisis on credit quality, the adaptation of processes to the new circumstances and the effectiveness of the mitigating measures introduced by each institution.

— with regard to market risk, the analysis included the impact of the COVID-19 crisis on the different business lines and products, along with profitability and risk deriving from the trading activity. The assessment also examined whether each institution’s risk metrics, market risk management system and hedging strategies remained valid in the new economic environment.

— the analysis of operational risk focused on business continuity and the maintenance of critical services. A particular focal point was how the new situation might heighten IT and cyber risk.

— lastly, in terms of liquidity risk, the supervisor paid particular attention to the net liquidity position, intraday liquidity and the funding position, to analyse the potential for the COVID-19 crisis to give rise to liquidity problems.

Further, both from the risk standpoint and at a more general level, the JSTs assessed the institutions’ capacity to manage the crisis and the impact thereof going forward (until the end of 2021 at least).

Lastly, the special circumstances under which the supervisory tasks were conducted in 2020 resulted in the postponement of the EBA and ECB stress test exercises scheduled for that year. These were replaced by what the ECB called a “vulnerability exercise” to analyse the banking system’s resilience to the impact stemming from the COVID-19 crisis. The sample included 86 euro area banks. Two scenarios were analysed: a baseline scenario, envisaging a cumulative drop in gross domestic product (GDP) of -0.2% in three years; and a more severe scenario, envisaging a decline of -5.5%. The EBA stress test methodology was used as a starting point, although certain aspects were adapted given that it would be an internal ECB exercise without interaction with the institutions. The essential elements of the EBA methodology were unchanged, such as the comprehensive coverage of risk areas and the static balance sheet assumption. However, the methodology was tailored based on the information available through supervisory reporting. The results were generated using the ECB's own models, making this a fully top-down exercise.[5]

In terms of crisis-related action, and in particular the review of recovery plans, the requirements were eased for institutions during this cycle owing to the exceptional circumstances. Among these relief measures, institutions were permitted to not include certain information in the recovery plan, in order to focus on the more relevant information in the context of the crisis.

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

The Banco de España is responsible for the direct supervision of Spanish LSIs, while the ECB is responsible for their indirect supervision. The Banco de España likewise performs supervisory functions on the branches of LSIs from other SSM countries and the rest of the EU, along with the branches of non-EU credit institutions. This set of institutions accounts for 5.6% of the Spanish banking system's assets. Chart 2.11 details the weight of each institution type, calculated based on their total assets. The Banco de España also supervises the ICO.

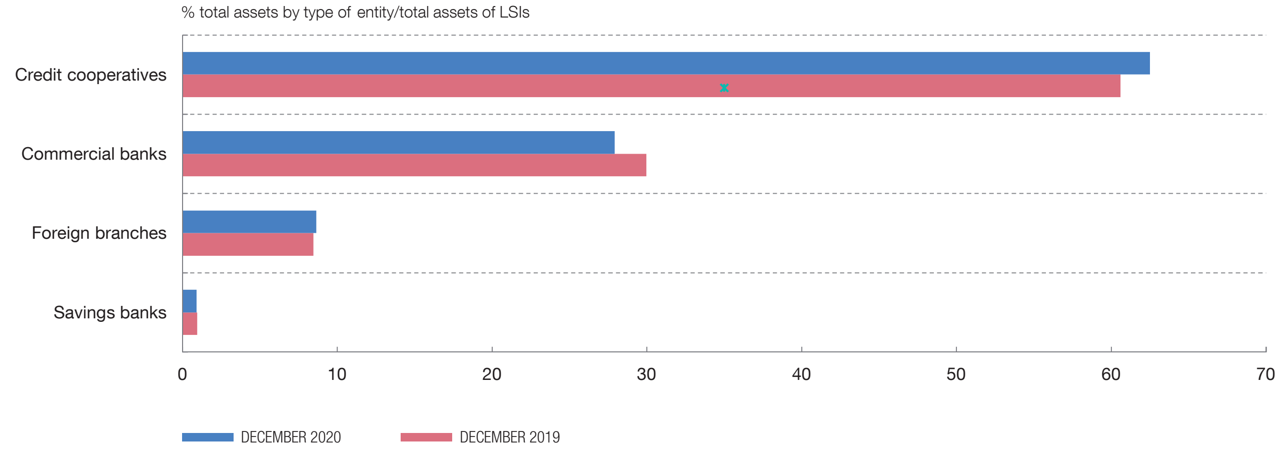
The annual action plan, which details the following year's supervisory activities, is prepared each year on the basis of the supervisory priorities. As part of ongoing supervision, each institution's performance is monitored periodically (quarterly or half-yearly). The monitoring may vary in depth and is conducted in accordance with the principle of proportionality, considering factors such as each institution's risk profile, size, volume of deposits raised on the retail market and business model. This is based on quarterly alerts using the information in the confidential returns and the Banco de España's central credit register (CCR) in order to detect potential future problems relating to liquidity, solvency or business model sustainability.

In 2020, **quarterly monitoring** was conducted for the 59 Spanish LSI groups.

5 For further information on this exercise and the results thereof, see the ECB press release of 28 July 2020.

Chart 2.11
WEIGHT OF THE VARIOUS TYPES OF LSIs

The asset volume of LSIs as a whole grew 15%, with a more pronounced increase in the credit cooperatives segment.



SOURCE: Banco de España.
NOTE: The figures for the assets of institutions in 2020 were obtained after the data cut-off date.

The supervisory monitoring focused on the supervisory priorities established for 2020 and on the new requirements arising from COVID-19 and its impact on the domestic economy. This entailed redirecting resources and supervisory work to ensure adequate monitoring of the pandemic-related risks.

To conduct this monitoring, the supervisor asked the institutions to provide periodic reporting on those aspects. Likewise, it has remained in constant contact with the institutions through numerous remote meetings, requesting contingency plans that envisage the potential effects of the crisis on operational risk, particularly in relation to cybersecurity and business continuity.

In addition to the recurring aspects that are typically assessed on a quarterly basis (solvency, liquidity, profitability, asset quality and governance), monitoring was bolstered for aspects relating to credit risk and the impact on profitability and liquidity. These include the following:

- **in credit risk monitoring**, in-depth assessment of aspects such as the sectoral segmentation of loan portfolios; credit quality indicators (e.g. late payments); take-up of legal moratoria and State guarantees; and reclassifications, rollovers and forbearance.

- **in profitability,** analysis of aspects relating to loan portfolio profitability and the potential impact of loan impairment.

— **in liquidity,** monitoring frequency varied based on the institutions' different situations.

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

As is the case for SIs, the SREP is one of the key tasks of off-site ongoing supervision. In 2020, a simplified SREP methodology was implemented, pursuant to the EBA guidelines on the pragmatic approach for 2020, which were adopted by the Banco de España on 21 September 2020. The SREP conclusions take into account the results of the stress test known as the Forward Looking Exercise on Spanish Banks (FLESB), which is conducted annually by the Financial Stability and Macroprudential Policy Department of the DGFSRR to assess the resilience of Spanish institutions.[6] Once the related 2020 SREPs had concluded and the institutions' representations had been considered, the Banco de España adopted the 2021 capital and liquidity decisions for LSIs.

The Banco de España has continued to cooperate with other NCAs in the context of the supervisory colleges of LSIs in other SSM countries with subsidiaries in Spain. It participated in a total of three colleges in 2020, which contributed to joint decision-making on capital and liquidity requirements.

In 2020, it completed its assessment of the recovery plans sent in 2019 Q4. The Banco de España also allowed some flexibility vis-à-vis the submission of recovery plans in 2020.

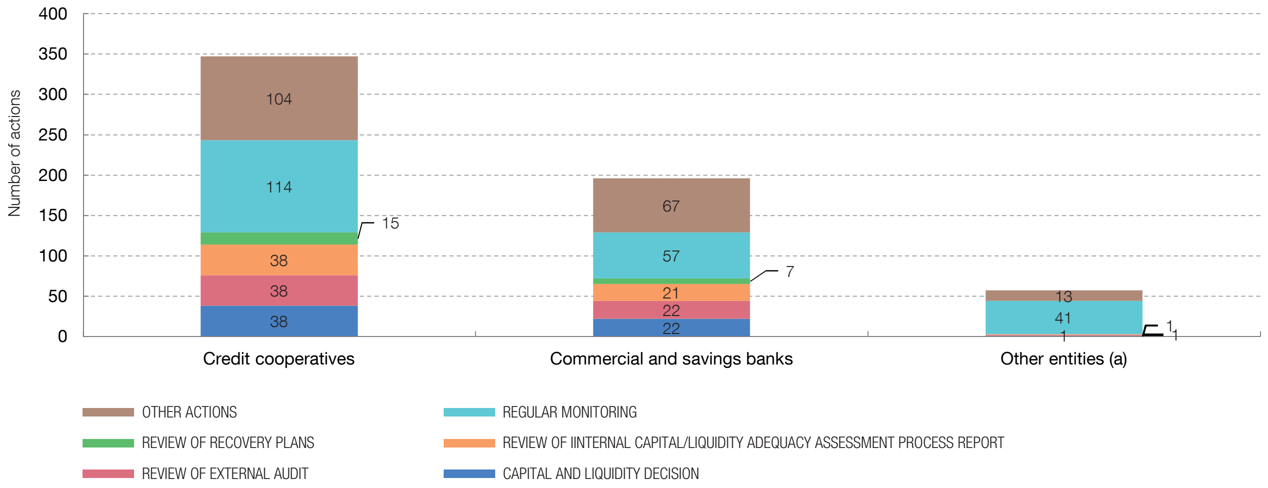
Since the branches in Spain of institutions with head offices in other EU Member States (including those of countries not participating in the SSM and those of LSIs of other SSM countries) are not subject to prudential or liquidity requirements at the branch level, periodic monitoring of the branch's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

Direct supervision of LSIs is supplemented by indirect supervision by the ECB, with the aim of:

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

Chart 2.12
NUMBER OF ONGOING OFF-SITE SUPERVISORY ACTIONS AT LSIs, NON-EU BRANCHES AND THE ICO

In 2020, a set of extraordinary initiatives were undertaken as a result of COVID-19, with the aim of obtaining up-to-date information on developments relating to risks and the institutions' economic and financial situation. At the same time, the number of actions declined, owing, among other reasons, to a lower number of meetings.



SOURCE: Banco de España.

a "Other entities" include foreign branches and the ICO.

— ensuring the uniform application of high supervisory standards.

— guaranteeing the consistency of supervisory outcomes in the Member States participating in the SSM.

As in previous years, in performing these two functions the ECB benefited from the full cooperation of the Banco de España.

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

In 2020, a total of 600 ongoing supervisory actions for these institutions were undertaken, as detailed in Chart 2.12 by institution type and by supervisory matter.

2.2.3 On-site supervision

Table 2.3 details the on-site inspections conducted at the head offices of credit institutions in 2020. On-site work was suspended owing to the lockdown in Spain imposed by the state of alert. The possibility of continuing the inspections already

Table 2.3
ON-SITE SUPERVISION OF CREDIT INSTITUTIONS. NUMBER OF ACTIONS

	2020		
	SIs	LSIs	Total
On-site inspections	10	6	16
at Spanish credit institutions	9 (a)	6	15
at credit institutions from other SSM countries	1		1
Internal model investigations	10	—	10
at Spanish credit institutions	9 (b)	—	9
at credit institutions from other SSM countries	1		1
TOTAL	**20**	**6**	**26**

SOURCE: Banco de España.

a Of which, 6 were led by Banco de España staff and 3 were led by staff from other authorities.
b Of which, 7 were led by Banco de España staff and 2 were led by staff from other authorities.

under way on a remote and online basis was assessed. The decision was made to continue those inspections that were in advanced stages and to suspend the rest. On-site inspections were resumed in the fourth quarter, all by remote and online means. The significant preparedness of both the supervisor and the supervised institutions meant the inspections could be completed without any significant incident relating to the fact that they were conducted remotely. In this regard, it is worth noting the headway made in applying new technologies to supervisory work (see Box 2.8).

The 2020 inspection plan for the SIs of SSM countries was revised as a result of the COVID-19 pandemic. For Spanish SIs, nine of the 28 inspections initially planned for 2020 were performed (six headed by the Banco de España and three by the ECB). In addition, the Banco de España led the inspection of a foreign SSM institution.

By risk type, the nine inspections of Spanish SIs were distributed as follows: two credit risk inspections for different portfolios; two technological risk inspections on cybersecurity and IT service outsourcing, respectively; two inspections relating to capital; two on governance, business model and profitability; and one on market risk.

The Banco de España also participated in two inspections of SIs from other SSM countries which were led by other supervisory authorities.

The pandemic had a more moderate impact on model investigations than on inspections. Despite remote work entailing an additional workload, as reflected in deadlines being extended somewhat, the 2020 plan remained at reasonably similar levels to previous years. In part, this was because model investigations take place at the institutions' request; for instance, when internal models need to be adjusted to ensure their adequate functioning, which requires prior supervisory validation.

Box 2.8

NEW TECHNOLOGIES IN SUPERVISION: SUPTECH[1]

The exponential technological advancement of recent years has led to deep digital transformation across all sectors of society. These advances have opened up new opportunities that are also being harnessed to improve supervisory capabilities.

As well as the availability of increasingly large amounts of data and more powerful computers, new methods of analysis, such as machine learning, have also emerged. Using these tools helps in decision-making processes and in identifying exceptions that are not apparent to the naked eye. Likewise, the implementation of suptech tools makes for more efficient supervisory processes and workflows through techniques such as robotic process automation. In short, new technologies allow supervisory authorities to perform their tasks more proactively and efficiently.

The Banco de España's 2024 Strategic Plan[2] sets out various initiatives to drive the digital transformation and incorporate new technologies across all areas. The Directorate General Banking Supervision (DGBS) has set up a multidisciplinary suptech forum, comprising inspectors and experts in models and in IT, to foster an innovation culture among supervisors.

As a result of the work conducted in this forum, the DGBS is currently designing a suptech-specific strategy and work plan, with a view to using these tools to their fullest. The aims are as follows: i) to drive coordination between areas in order to share knowledge and expertise in this field; ii) to identify key processes for digitalisation and for the use of new suptech tools; and iii) to assess the possibility of specialist profiles exploiting the information.

The DGBS has identified some tools that were already in use, including automated document validation and classification, error detection in leveraged transactions or the inference of relationships between borrowers. These tools will be the starting point for new developments that will be coordinated via this forum.

Rapid technological progress drives the need to bolster training. To this end, several courses have been created to incorporate new data analysis skills into the traditional skill sets.

In addition, the DGBS participates in the Single Supervisory Mechanism's digitalisation agenda initiatives and takes part in the various working groups set up to that effect. Among the most prominent is the group tasked with identifying opportunities for using suptech, with a plan devised to develop these over the coming years.

1 Suptech refers to the application of big data, artificial intelligence and other innovative technologies by financial supervisors to perform their functions (S. di Castri, S. Hohl, A. Kulenkampff and J. Prenio (2019), "The suptech generations", *FSI Insights on policy implementation,* No 19, October, Financial Stability Institute.

2 For more information on the Strategic Plan, see the press release of 15 January 2020, *The Banco de España launches its Strategic Plan 2024*.

Specifically, in 2020, nine reviews were conducted on Spanish institutions, eight of which focused on internal credit risk models and one on market risk models. As evidence of the Banco de España's active support for cross-border supervisory activities, two reviews of Spanish institutions were performed jointly with supervisors from the ECB and the National Bank of Belgium (NBB), respectively. In addition, the Banco de España led an investigation into counterparty risk in Italy.

After lockdown was imposed, all inspection action over the rest of the year was conducted remotely, making full use of audiovisual communication applications to support interaction with the institutions and communication between team members. The effectiveness and efficiency of the action was not significantly affected.

The pandemic has unquestionably resulted in less on-site activity relative to the previous year. However, specific projects have been launched to compensate for that reduced activity, involving most of the available inspectors. Notable among these were the analysis and assessment of the most common and most significant shortcomings identified in inspections conducted across the SSM, for the different areas and risk types. Another project entailed taking inventory of and systematically classifying a series of templates, tools and supervisory tests, with the ultimate aim of enhancing the quality and efficiency of on-site supervisory actions.

Lastly, the supervisory plan for LSIs is approved by the Banco de España's Executive Commission, since they are subject to the Banco de España's direct supervision. However, the ECB is kept apprised of the content of the plan. In 2020, six on-site inspections were performed at LSIs. Nine more are scheduled for 2021.

The on-site inspections conducted at LSIs during 2020 emphasised the assessment of credit quality, foreclosed assets, governance and solvency, along with IT-related matters.

The results of the inspection visits at LSIs are discussed with the institutions themselves through the so-called "preliminary conclusions letter" to establish the most significant points resulting from the inspection visits. Thereafter, the corresponding recommendation and requirement letters to the institutions are drafted, for approval by the Executive Commission of the Banco de España at the proposal of the DGBS (see Section 2.2.6 for further details).

2.2.4 Dividend distribution and variable remuneration policies

Institutions' profit distribution policies must comply with the precautionary principle and be designed to maintain an adequate level of capitalisation at all times. For this purpose, the competent authorities make an annual recommendation on the distribution of profit. In February 2020, the Banco de España issued a recommendation for LSIs vis-à-vis dividend and variable remuneration policies, which also included the main aspects of the ECB's January 2020 recommendations for SIs.

In response to the situation stemming from the COVID-19 pandemic, on 27 March the ECB issued a new recommendation in which it asked SIs not to pay dividends nor assume irrevocable dividend commitments for 2019 and 2020 until 1 October 2020, and to refrain from share buybacks aimed at remunerating shareholders in cash. That same day, the Banco de España extended this recommendation to the LSIs.

Pursuant to the ESRB recommendation of 27 May on restrictions on capital distributions during the pandemic, on 27 July the ECB agreed to extend its previous recommendation until 1 January 2021. It also published the text of a letter sent to the

CEO of each SI, asking the institutions to be extraordinarily prudent in the payment of variable remuneration. The Banco de España extended these measures to the LSIs on the same day.

Lastly, in coordination with the ESRB, the ECB issued a new recommendation on 15 December 2020 asking SIs to consider refraining from cash dividends and share buybacks, or to limit such remuneration, until 30 September 2021. Given the persisting uncertainty over the economic impact of COVID-19, the ECB expects dividends and share buybacks to remain below 15% of cumulated 2019-20 profit and not higher than 20 basis points of the Common Equity Tier 1 (CET1) ratio, whichever is lower. Institutions that intend to pay dividends or buy back shares need to be profitable and have robust capital trajectories. In another letter addressed to SIs, the ECB also reiterated its expectation that institutions exercise extreme moderation on variable remuneration until 30 September 2021. These measures were likewise adopted by the Banco de España in relation to LSIs.

2.2.5 Common procedures, suitability and other procedures

The Banco de España and the ECB, within the scope of their respective competences, supervise compliance with the rules on the suitability of credit institutions' senior officers for the duration of their tenure.

The Banco de España participated in 195 suitability assessments for senior officers at institutions supervised directly by the ECB and by the Banco de España (see Table 2.4). Marked improvements were noted in the applications submitted by the institutions; these were increasingly complete in terms of the required documentation and in the detail of the candidate assessments conducted by the institutions. Nonetheless, compliance with certain suitability requirements remains a concern for the supervisor, and requires closer attention from the institutions.

When the supervisor identifies a shortcoming in the course of the procedure, certain conditions, obligations and recommendations are attached to favourable suitability assessments. The most adequate measure is chosen based on the circumstances of each case. The most common measures are the following:

- i) Conditions relating to training, under which the institution commits to providing the candidate with the specific training considered necessary to adequately perform his/her duties. A transition period is sometimes agreed, during which the senior officer is ineligible to serve on board committees.

- ii) Monitoring obligations, particularly regarding the due application of conflict of interest policies and the candidate devoting sufficient time to the role.

Table 2.4
PROCEDURES IN RESPECT OF CREDIT INSTITUTIONS INVOLVING THE BANCO DE ESPAÑA

	Total
Qualifying holdings, merger, spin-off and other significant acquisitions	18
Cross-border activity of Spanish credit institutions	62
Branches in the EU	12
Branches in third countries	5
Freedom to provide services	33
Representative offices	12
Cessation of business	
Loans to senior officers	39
Suitability of senior officers	195
Procedures relating to own funds	78
Amendments to articles of association	16
Communications with other supervisory authorities or institutions	3
Other procedures	79
TOTAL	**490**

SOURCE: Banco de España.

iii) Recommendations generally relating to the management body as a whole (for instance, where one specific area of expertise or experience should be strengthened).

The personal and professional requirements applicable to independent directors are subject to particular attention, with some resolutions including warnings to ensure that such directors are aware of their special obligation to act as a counterweight on boards of directors and that they must have the necessary skills to indicate dissenting views against the institution's executives.

Following the appointment of a senior officer, the supervised institutions must continue their assessments and notify the supervisor of any circumstances that may affect compliance with the suitability requirements for serving senior officers. The most common changes reported by the institutions are as follows: a senior officer undertaking new responsibilities at the same institution, which may require specific expertise or skills; the assumption of new roles at other companies, potentially affecting the director's time commitment or giving rise to potential conflicts of interest; and criminal investigations or administrative sanctioning procedures involving a senior officer.[7]

7 To conduct this assessment, the Banco de España consults the experts' committee set up pursuant to the provisions of Royal Decree 256/2013 of 12 April 2013. This legislation incorporates into the regulations governing credit institutions the EBA's Guidelines of 22 November 2012 on the assessment of the suitability of members of management bodies and key function holders.

In cooperation with NCAs, the ECB has worked to improve and smooth the processing of suitability procedures at institutions. This resulted in the creation of a new IMAS portal, which has been operational since January 2021 for the credit institutions under the ECB's direct supervision. This system was designed to be user-friendly and to expedite the processing of procedures.

In turn, the Banco de España has prepared and published a new "Questionnaire for assessing the suitability of senior officers (institutions other than credit institutions and SLIs)", which is available on the Banco de España website and similarly aims to enhance efficiency, ease administrative burdens and streamline the process.

The health crisis prompted by COVID-19 has inevitably impacted suitability procedures, affecting timeframes and driving the use of digital and online resources, such as the Banco de España's electronic register. During the initial phase of the state of alert, resolution deadlines were suspended pursuant to the regulations established to that effect, candidate interviews were paused and the deadlines granted to institutions to provide their candidates with the required skills training were extended, in view of the potential difficulties in this respect.

However, the situation has boosted the use of electronic and online resources, in particular: i) the Banco de España's electronic register, as a means of initiating the administrative procedure for suitability assessments, reducing paper usage and streamlining assessment processing; and ii) candidate interviews by videoconference, avoiding unnecessary risks for all concerned.

2.2.6 Letters

As a result of the above-described supervisory actions carried out in 2020, a total of 99 letters were sent to LSIs, with requirements and recommendations made by the Banco de España in the exercise of its supervisory powers. Chart 2.13 provides a breakdown of these letters by type of institution and subject matter. Of these, 57 related to capital decisions, 33 to recovery plan reviews and nine to on-site inspections.

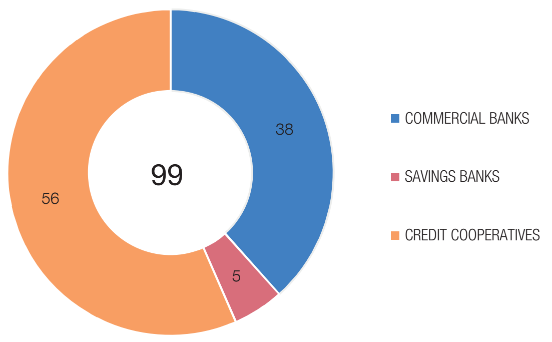
Chart 2.14 shows the breakdown by subject matter of the 405 requirements and recommendations contained in the 99 letters sent to credit institutions. The requirements notified to LSIs in 2020 largely related to solvency – specifically to capital decisions –, since all institutions are asked each year to satisfy a capital requirement level, and included improvements to recovery plans and internal capital and liquidity adequacy assessment reports.

Most of the requirements arising from the inspections related to governance, followed by credit risk. These governance requirements were issued to improve the composition and functions of committees, internal control and contingency planning.

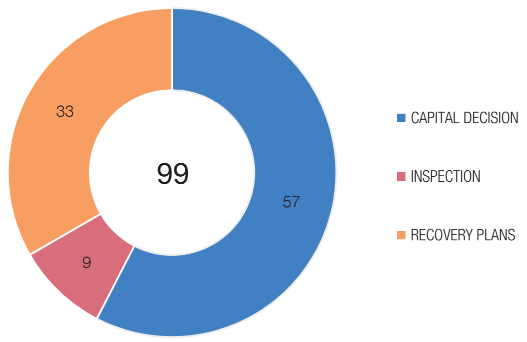
Chart 2.13
NUMBER OF LETTERS ADDRESSED TO CREDIT INSTITUTIONS

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

1 BY TYPE OF INSTITUTION (2020)



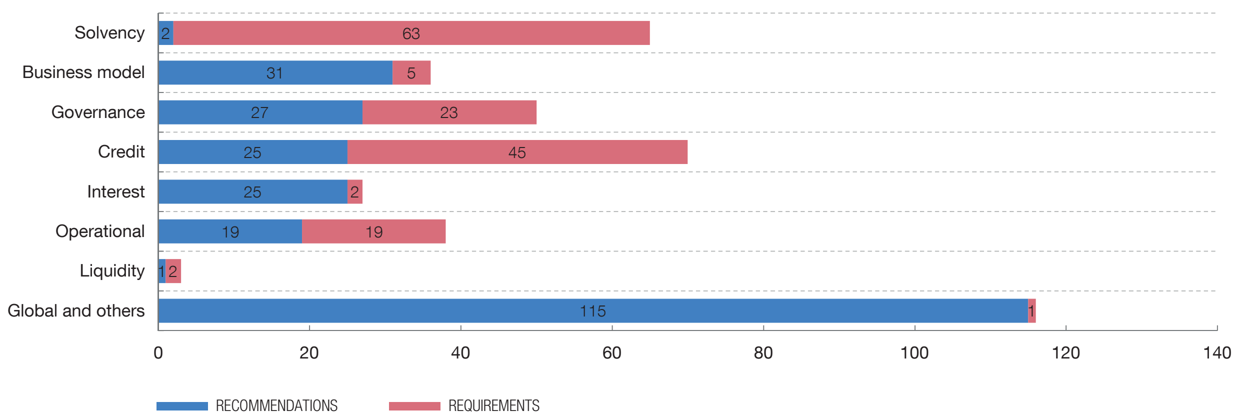
2 BY SUBJECT MATTER (2020)



SOURCE: Banco de España.

Chart 2.14
NUMBER OF RECOMMENDATIONS AND REQUIREMENTS NOTIFIED TO CREDIT INSTITUTIONS

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



SOURCE: Banco de España.
NOTE: "Global and others" comprise recommendations set out in 33 letters on recovery plans and in others relating mainly to improvements to internal capital and liquidity adequacy assessment process reports.

Credit risk requirements, which are accounted for by the type of business (retail banking) pursued by these institutions, related mostly to reclassifications to non-performing, and to the need to increase loan-loss provisions and to improve the specific internal controls in place for credit risk.

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

2.2.7 Other actions

The Banco de España cooperates closely with the CPMLMO and SEPBLAC in the supervision and inspection of compliance with AML/CTF obligations by institutions supervised by the Banco de España, pursuant to Spanish legislation and the cooperation and coordination agreement entered into with the CPMLMO.

The Banco de España further strengthened this function in 2020. Two general inspections were launched, focused on reviewing two LSIs' compliance with AML/CTF obligations, along with a specific monitoring action to check the implementation by a SI of an AML/CTF action plan. The inspections were ultimately performed remotely owing to the restrictions prompted by the COVID-19 pandemic. Also subject to review was compliance with the recommendations and requirements issued by the Banco de España and the CPMLMO, respectively, to financial institutions as a result of inspections conducted in prior years.

Likewise, the methodology for assessing ML/TF risk for credit institutions established in Spain was updated; on that basis, their ML/TF risk profile was devised and their supervisory priority established.

It is also important to underline the contributions to national initiatives, such as the transposition of Directive (EU) 2018/843 to Spanish legislation and the 2020 National Analysis of ML/TF risks, along with active participation in several international working groups, in cooperation with the Secretariat of the CPMLMO and SEPBLAC. For more details on the main ongoing initiatives in the EU, see Box 2.9.

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

With regard to international organisations, in 2020 the Banco de España cooperated with the International Monetary Fund (IMF) on the latter's biannual assessment, pursuant to Article IV of the Fund's Articles of Agreement. The spring assessment had to be postponed due to the pandemic and was replaced by

Box 2.9

ANTI-MONEY LAUNDERING: A PRIORITY FOR THE EU

In 2020 the institutions of the European Union (EU) reiterated their commitment to anti-money laundering and countering the financing of terrorism (AML/CFT) through various initiatives, most notably the following:

EUROPEAN COMMISSION. The European Commission has published a new methodology for identifying high-risk ML/TF countries and has updated its list of countries[1] based on this approach. It has also prepared an Action Plan for an EU-wide approach to AML/CFT, which rests on six pillars:

1 Making sure the existing rules are effectively implemented, ensuring the effective transposition and implementation of the directives and full use of the enhanced mandate of the European Banking Authority (EBA).

2 Establishing a single rulebook, turning certain parts of the current minimum requirements directive into directly applicable provisions set out in a European regulation.

3 Bringing about EU level AML/CFT supervision.

4 Establishing a support and cooperation mechanism for Financial Intelligence Units (FIUs) to support the analysis of suspicious cross-border transactions.

5 Enforcing Union-level criminal law provisions and strengthening supra-national judicial and police cooperation, along with public-private partnerships.

6 Strengthening the EU's position in the world by playing a leading role in implementing the international AML/CFT standards established by the Financial Action Task Force.

This plan has been submitted for public consultation, with the corresponding legislative proposals likely to be presented in 2021 Q1.

EU COUNCIL. In November 2020, ECOFIN published conclusions that welcomed the initiatives set out by the Commission in its Action Plan and established guidance on the regulation, EU-level supervision and the cooperation and support mechanism for the Member States' FIUs. In particular, it set out which areas must be subject to uniform regulation and the establishment of an EU-level AML/CFT supervisor, with direct supervisory powers over certain high-risk obliged institutions, which would cooperate closely with national authorities.

EBA. In 2020 it began fulfilling its enhanced mandate to lead, coordinate and monitor AML/CFT efforts undertaken by all financial sector operators and the competent EU authorities. In addition to the initiatives undertaken through the AML CFT Standing Committee (see Section 7.2.1), the EBA has begun to develop guidelines on cooperation between prudential supervisors, AML/CFT supervisors and FIUs, pursuant to the mandate of Article 117(6) of Capital Requirements Directive V, and has published an opinion (EBA/Op/2020/18) on how to take money laundering and terrorist financing risks into account in the supervisory review and evaluation process (SREP). The Banco de España, along with SEPBLAC, has actively participated in the initiatives led by the EBA.

EUROPEAN CENTRAL BANK (ECB). 2020 saw the first regular exchange of information between the ECB and the national AML/CFT authorities pursuant to the January 2019 agreement.[2] The aim is to incorporate relevant information obtained from the AML/CFT supervisors into the SREP of significant institutions.

Meanwhile, on the supervisory cooperation front, in 2020 some EU Member States established AML/CFT colleges in accordance with the European Supervisory Authorities' joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions.[3] There is a two-year transitional period to establish the colleges under these guidelines, in force since January 2020. Colleges for firms assessed as high risk for ML/TF purposes should be established first. In 2021 the Banco de España and SEPBLAC will jointly establish the first AML/CFT colleges for Spanish institutions.

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1 Commission Delegated Regulation (EU) 2020/855 of 7 May 2020 amending Delegated Regulation (EU) 2016/1675 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council, as regards adding the Bahamas, Barbados, Botswana, Cambodia, Ghana, Jamaica, Mauritius, Mongolia, Myanmar/Burma, Nicaragua, Panama and Zimbabwe to the table in point I of the Annex and deleting Bosnia-Herzegovina, Ethiopia, Guyana, Lao People's Democratic Republic, Sri Lanka and Tunisia from this table.

2 Multilateral agreement on the practical modalities for exchange of information pursuant to article 57a(2) of Directive (EU) 2015/849.

3 Joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions (JC/2019/81).

virtual meetings that took place in April. The quarterly meetings were likewise held remotely. The findings of the analysis were shaped by the COVID-19 crisis. While signalling that the financial system's strength helped to mitigate the impact of the crisis, the IMF emphasised the need to maintain robust supervision, to adopt relief measures and to implement prudent dividend policies. It also underlined the need to strengthen crisis management frameworks, both at the national and European levels. It likewise noted the efforts to reinforce the framework for combating ML/TF.

The Banco de España also coordinated visits from the European Commission, the ECB and the European Stability Mechanism (ESM), in connection with post-programme surveillance (PPS),[8] during which the Spanish economy's actual financial position was analysed from a macroprudential and microprudential standpoint, including the situation of banks which had received State aid during the financial programme.

2.3 Supervision of institutions other than credit institutions

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

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

2.3.1 Supervisory actions

In 2020, 380 off-site ongoing supervision actions were performed by various means: periodic monitoring, reviews of external audit reports and other actions, as detailed in Chart 2.15.

8 Since the end of the programme (January 2014), under which Spain received financial support from the ESM, and under the framework of the PPS (Article 14 of Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability), the European Commission, in coordination with the ECB, organises biannual visits to Spain that include meetings with the Banco de España.

Table 2.5
REGISTER OF OTHER INSTITUTIONS

Year-end data

	2014	2015	2016	2017	2018	2019	2020
Institutions with an establishment	195	192	194	186	186	187	534
SLIs	47	39	35	31	31	27	26
SLI-PIs		5	8	8	8	9	8
Branches of financial institutions subsidiaries of EU credit institutions							1
Real estate lenders							99
Real estate credit intermediaries							234
Branches of EU real estate intermediaries							1
Mutual guarantee societies	24	21	21	19	18	18	18
Reguarantee companies	1	1	1	1	1	1	1
Appraisal companies	40	36	37	35	35	32	32
Currency-exchange bureaux (a)	10	13	12	14	14	16	17
PIs	45	43	41	39	40	42	47
PIs exempt under Article 14 of Royal Decree-law 19/2018							1
Payment service providers excluded under Article 4 of Royal Decree-law 19/2018							3
Account information service providers						1	1
Hybrid PIs (b)		2	3	3	4		
Branches of EU PIs	8	12	15	14	12	12	14
ELMIs	4	3	4	5	5	7	9
Branches of EU ELMIs	2	2	2	2	4	8	8
Banking foundations (c)	13	14	14	14	13	13	13
Sareb (d)	1	1	1	1	1	1	1
Institutions without an establishment	318	401	484	556	597	712	833
ELMIs	55	75	112	156	187	242	294
PIs	263	326	372	400	410	454	506
Account information service providers						16	33

SOURCE: Banco de España.

a Not including establishments authorised only to purchase currency using euros.
b Reclassified as PIs.
c Banking foundations are not registered in the Register of Institutions of the Banco de España. At 31 December 2020, the Banco de España had competence over five of the 13 banking foundations.
d Sareb is not registered in the Register of Institutions of the Banco de España.

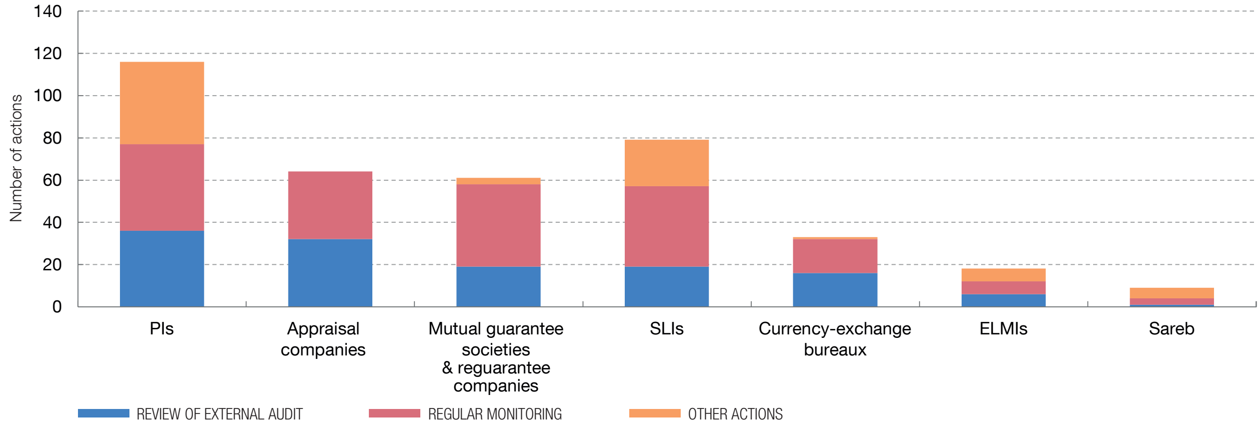
In addition, a total of three on-site inspections were performed in 2020: two inspections of appraisal companies and one of an SLI. A further five are planned for 2021.

Following the supervisory actions, four letters were sent to these institutions, addressed to the parties detailed in Chart 2.16. Chart 2.17 shows the number of recommendations and requirements, by area, contained in these letters.

Chart 2.15

NUMBER OF ONGOING OFF-SITE SUPERVISORY ACTIONS AT OTHER INSTITUTIONS

2020 saw an intensification of non-recurring actions in the PIs and ELMIs segments. Further, for the first time actions corresponding to the SLIs of EU SI groups were included and those of the PIs and ELMIs of Spanish SIs.



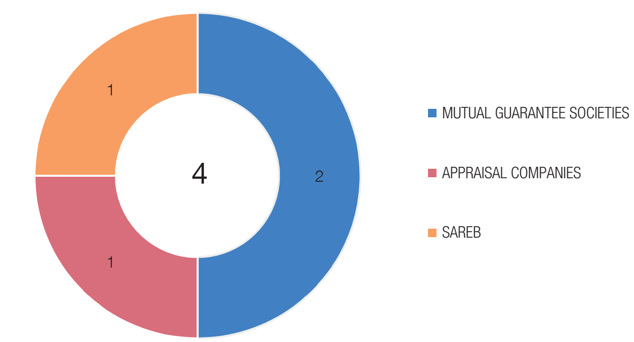
SOURCE: Banco de España.

Chart 2.16

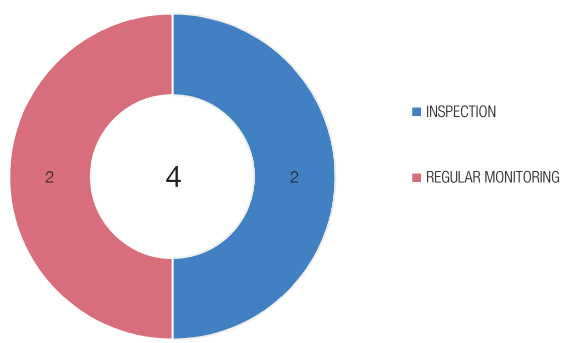
NUMBER OF LETTERS ADDRESSED TO OTHER INSTITUTIONS

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

1 BY TYPE OF INSTITUTION (2020)



2 BY SUBJECT MATTER (2020)

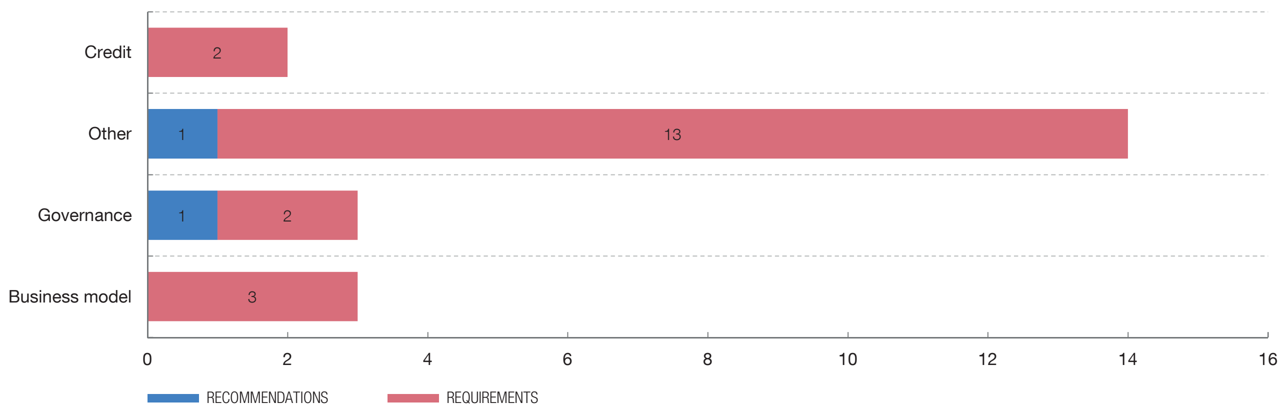


SOURCE: Banco de España.

Chart 2.17

NUMBER OF RECOMMENDATIONS AND REQUIREMENTS NOTIFIED TO OTHER INSTITUTIONS

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



SOURCE: Banco de España.

2.3.2 Authorisations and other procedures

The Banco de España participates in the granting and withdrawal of start-up licences for these institutions and in other procedures relating to the pursuit of their activities. However, the scope of its involvement is not the same for all types of institutions. The Banco de España is the competent authority for registering, and granting and withdrawing the licenses of, SLIs which provide payment services (SLI-PIs) or which issue electronic money, ELMIs, PIs, exempt payment service providers pursuant to Article 14 of Royal Decree-Law 19/2018, account information service providers, real estate lenders, real estate credit intermediaries and currency-exchange bureaux. It is also the competent authority for the official recognition of appraisal companies. By contrast, it merely issues a mandatory report on the authorisation of SLIs, MGSs and reguarantee companies, the granting of which is the prerogative of the Ministry of Economic Affairs and Digital Transformation. Likewise, it is tasked with verifying that the institutions that report incurring any of the exclusions referred to in Article 4(k) and (l) meet the necessary criteria.

In 2020, a total of 388 institution start-up requests and a total of ten deregistrations were processed, as shown in Table 2.6.

Table 2.6
CHANGE IN THE NUMBER OF NON-CREDIT INSTITUTIONS. 2020 VS. 2019

	Value at 31.12.2019	Registrations	Deregistrations	Value at 31.12.2020	Change 2020-2019
SLIs	27		2	25	-2
SLI-PIs	9		1	8	-1
Branches of financial institutions subsidiaries of EU credit institutions	0	1		1	1
Real estate lenders	0	102		102	102
Real estate credit intermediaries	0	256		256	256
Branches of EU real estate intermediaries	0	2		2	2
Mutual guarantee societies and reguarantee companies	19			19	0
Appraisal companies	32			32	0
Currency-exchange bureaux (a)	16	1		17	1
PIs	42	6	1	47	5
PIs exempt under Article 14 of Royal Decree-law 19/2018	0	2		2	2
Payment service providers excluded under Article 4 of Royal Decree-law 19/2018	0	9		9	9
Account information service providers	1	1	1	1	0
ELMIs	7	3	1	9	2
Branches of EU PIs	12	3	1	14	2
Branches of EU ELMIs	8	2	3	7	-1
TOTAL	**173**	**388**	**10**	**551**	**378**

SOURCE: Banco de España.

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

Table 2.7
OTHER PROCEDURES CONDUCTED BY THE BANCO DE ESPAÑA IN RESPECT OF OTHER INSTITUTIONS

Number of procedures in 2020	PIs	ELMIs	SLIs	Mutual guarantee societies	Appraisal companies	Currency-exchange bureaux	Sareb	Banking foundations	**Total other Institutions**
Qualifying holdings, merger, spin-off and other significant acquisitions	7	4	7		3				**21**
Cross-border activity of Spanish institutions (a)	1,820	10	4						**1,834**
Branches in the EU	7		4						**11**
Branches in third countries									**0**
Freedom to provide services	275	7							**282**
Agents	1,538	3							**1,541**
Cessation of business	1		1						**2**
Suitability of senior officers	52	22	33	48	17	1			**173**
Procedures relating to own funds	1	1	7	3					**12**
Amendments to articles of association	2		4	4					**10**
Authorisation of management protocol and financial plan								16	**16**
Communications with other supervisory authorities or institutions							1		**1**
Other procedures	3	2		1			1		**7**
TOTAL									**2,076**

SOURCE: Banco de España.

a Each daily notification per institution and recipient country is deemed a procedure.

Similarly, in 2020 a further 2,079 procedures relating to supervisory powers over these institutions were performed, as detailed in Table 2.7.

2.4 Compliance with vetted access to activity

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

2020 saw supervisory action performed relating to 29 legal entities which may have been carrying out restricted activities without authorisation or making undue use of a name pertaining to supervised institutions, the outcome of which could lead to the adoption of penalties.

2.5 The quality function and training activities

2.5.1 The quality function

The primary mission of the quality function is to ensure excellence and consistency in the DGBS' activities, and to help drive efficiency and effectiveness in supervisory tasks.

The Organisation and Quality Division of the DGBS acts as second line of defence, ensuring the quality of the DGBS' processes, activities and tools, fostering consistency and uniformity in its activities, simplifying processes and verifying compliance with internal regulations.

This group is responsible for the quality of the direct supervision of LSIs and other institutions supervised by the DGBS outside the scope of the SSM, for the horizontal functions of the DGBS and for the review of activities not within the SSM scope (e.g. AML/CFT). It is also the DGBS' point of contact with the Internal Audit Department of the Banco de España, and cooperates with the ECB's Supervisory Quality Assurance (SQA) Division.

The 2020 quality plan was amended to accommodate the special circumstances generated by COVID-19 and to help ease the pressure on the DGBS work teams. As a result, the number of quality reviews envisaged in the annual plan was reduced, although some actions and projects that had not been anticipated at the start of the year were carried out.

Partnership with the SSM's SQA Network also continued, although the situation prompted by the pandemic meant the meetings were held remotely and more frequently than usual. Against this backdrop, the participation in three significant projects should be noted: i) a streamlining project to optimise and improve SSM processes; ii) a digitalisation project to instil a digital culture among supervisors; and iii) a common European platform for sharing information requirements and expertise among staff.

2.5.2 Training activities

Each year the DGBS works on a training programme to foster excellence and professional development among employees, through a set of training

Figure 2.5
INTERNAL TRAINING

- Training more tailored to the work than is available on the market
- Optimisation of knowledge, generating a multiplier effect
- Example of win-win situations benefiting both the organisation and the trainer
- General incentive for the study and research of professional subject matters
- Internally conveying culture and knowledge within the organisation

SOURCE: Banco de España.

activities to strengthen the skills and expertise required for the satisfactory performance of supervisory activities. So as to identify the training needs and deliver the training programme, the opinions of the training recipients are gathered. Much of the DGBS training activities are conducted internally,[9] given the benefits that this offers (see Figure 2.5).

2020 was shaped by the exceptional circumstances arising from March as a result of COVID-19. This posed a major challenge for the DGBS training team, which was forced to suspend all face-to-face sessions (the usual format) and to seek out new teaching methods.

To address this challenge and continue the training activities on a remote basis, new online conferencing applications were adopted. Likewise, a blended learning method known as MVO has been designed, which combines three types of teaching through deliverable materials, video tutorials and online sessions. This approach allows for greater flexibility and compatibility with the normal supervisory tasks.

At the international level, the training provided by the DGBS is supplemented by other programmes offered by the ECB (within the SSM framework) and other courses run by various international organisations. In addition, DGBS staff have access to the FSI Connect programme, a remote training site provided by the Financial Stability Institute of the Bank for International Settlements (BIS).

Active cooperation continues with the Association of Supervisors of Banks of the Americas, both to prepare its own training plan and to determine certain basic principles for training programme design. Courses were also organised for that body and other central banks in Latin America, which involved speakers from the DGBS.

9 The aim is to organise training activities that are designed and delivered by and for staff members.

2.6 Supervision of payment service providers

Much of the supervisory activities performed in this domain during 2020 were geared towards verifying compliance with Commission Delegated Regulation 2018/389 on strong customer authentication and common and secure open standards of communication.[10]

These activities included monitoring the process of improving and adapting the specific interfaces offered by account servicing payment service providers (ASPSPs)[11] to third-party payment service providers (TPPs)[12] for the purposes of accessing customers' payment accounts. This process was largely shaped by the publication in June 2020 of the EBA Opinion on obstacles in specific interfaces.[13] In the Opinion, the EBA stated that some aspects of the interfaces observed in the European market created obstacles to the provision of services by TPPs; for example, failure to accept all of the strong authentication procedures offered to customers by ASPSPs, issues regarding inefficient redirection approaches and multiple and unnecessary authentication steps.

Consequently, the Banco de España asked Spanish ASPSPs whose specific interfaces included any of these obstacles to set out an action plan for eliminating these obstacles prior to 31 December 2020, at the same time as it monitored due compliance. The gradual alignment of these interfaces with the standards laid down by the EBA may be behind the decline in the number of notifications relating to problems with such interfaces in the second half of the year.

Second, regarding compliance with the Commission Delegated Regulation, monitoring has been conducted of the plans to migrate to strong customer authentication solutions for e-commerce card-based payment transactions, which were agreed in late 2019 with card-issuing payment service providers and with the

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

11 Payment service providers which provide a payer with one or more payment accounts and are responsible for their servicing.

12 These currently include three types of institutions:

- Account information service providers, offering an online service providing aggregated information about one or more payment accounts held by the payment services user at one or several other payment service providers.
- Payment initiation service providers, offering an online service to initiate a payment order at the request of the payment service user with respect to a payment account held at another payment service provider.
- Payment service providers issuing card-based payment instruments, providing payers with a payment instrument to initiate and process payment transactions, having first obtained confirmation from the ASPSP that funds are available in the payer's payment account.

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

acquirers of the transactions paid for using these cards, within the framework of the supervisory flexibility introduced by the EBA under the respective Opinions issued in June[14] and October[15] 2019.

So as to check that the migration plans are progressing as expected, the Banco de España has met with representatives of the issuers and acquirers, merchants, card schemes and processing entities. In addition, the Banco de España monitored the key variables of the migration process, initially on a quarterly basis (with the exception of the June reporting, which was omitted to allow institutions to focus their efforts on overcoming the effects stemming from the health crisis) and on a weekly basis from October onwards. The granularity of the information, which in some cases was envisaged in the EBA Opinions, was likewise increased as implementation reached its latter stages, with a view to identifying and remedying the difficulties identified, amid close collaboration between all of the parties involved.

Third, and likewise relating to compliance with the Commission Delegated Regulation, the first resolutions were issued regarding the application of the exemption from strong customer authentication for secure corporate payment processes and protocols, available only to payers who are not consumers.

These resolutions have been issued both for particular payment solutions that are designed and managed fully and exclusively by the corresponding payment service providers, and in relation to certain configurations of various host-to-host connectivity protocols and direct channels. The majority of these resolutions have been favourable and have been limited specifically to the configurations submitted, with a view to ensuring that adequate endpoint authentication and data encryption mechanisms are in place to guarantee the authenticity and integrity of the data transferred.

As for other payment service provision-related procedures, there has been a significant increase in notifications of delegation of operational functions and substantial changes of activity, with the latter largely related to the digitalisation of money remittance services.

In 2020, work continued on the reporting of statistical data on fraud, following the amendment in January of the EBA Guidelines on fraud reporting (EBA/GL/2018/05) via the publication of EBA/GL/2020/01. This reporting entails the receipt, cleansing and submission to the ECB of half-yearly aggregated data for 285 payment service providers. Further, the Banco de España has participated in drafting the new ECB Regulation on payment statistics, which will include fraud reporting,

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14 EBA Opinion on the elements of strong customer authentication under PSD2 (EBA-Op-2019-06).

15 EBA Opinion on the deadline and process for completing the migration to strong customer authentication (SCA) for e-commerce card-based payment transactions (EBA-Op-2019-11).

Box 2.10

NEW PAYMENT SERVICES BUSINESS MODELS

Royal Decree-Law 19/2018, which transposes into Spanish legislation the second payment services directive (PSD2), regulates two new payment services (payment initiation and account information) for the first time.

The inclusion of these two new services has encouraged the emergence of new and different business models, mainly for three reasons: the legal certainty afforded by the new regulatory framework, the competition stoked by the emergence of new providers and technological developments.

The new services are based on third-party providers (TPP) – payment initiation service providers and account information service providers – accessing users' payment accounts at other payment service providers. Such access, which requires the account holder's prior and express authorisation, under no circumstance grants the TPP access to the funds held in the account.

Turning to the account information service, business models incorporating a "fourth party" that has a business and contractual relationship with the TPP and the payment services user are becoming increasingly commonplace. In these fourth-party models, the information obtained by the TPP is not directly provided to the account holder. Instead, with the latter's authorisation, the information is provided to the "fourth party" so that it can offer the account holder certain additional services (e.g. financing, personalised offers, business services, etc.) whose swift and efficient provision would not be possible without the information provided by the TPP.

A prime example of these new business models would be using the payment account information of merchants' customers to feed credit scoring tools, thus enabling merchants to decide online about the possibility of financing their customers' purchases and the related financing conditions.

The possibility of combining the payment initiation service and the account information service has encouraged sophisticated forms of these services to emerge.

For example, business models geared towards managing firms' cash. Here, the ability to view online aggregate information about one or more payment accounts can be combined with the possibility of reacting instantaneously to that information, ordering payment transactions from the same interface used to view the information. Thus, instant access to all manner of personalised reports (forecasts, reconciliations, etc.) is enhanced by the opportunity to immediately take full advantage of that information through the appropriate fund movements.

Also, this business model may be used by both the firm benefiting from the aforementioned services, when it is the recipient of the information, and by providers specialising in this type of tool, which, with the firm's authorisation, would act as "fourth party" as described above.

Payment initiation service providers are improving the user experience by enabling payment at physical stores via the initiation of transfers that could be ordered through the payment initiator, by using QR codes for instance.

Lastly, there is no obligation to provide these payment services on an exclusive basis, which allows for business models where entities are their own providers of these services. An example of this would be insurance or management companies, where these payment services are used to more efficiently pursue the business or professional activities constituting their main corporate purpose.

However, given that this regulatory framework is relatively recent, the new business models are in their infancy and novel forms of interaction between the parties will likely emerge in the future.

along with the payments statistics manual, whose publication is scheduled for 2021 Q1, once the new Regulation has been published.

Internationally, the Banco de España has also been involved in revising the EBA Guidelines on major incident reporting under PSD2 (EBA/GL/2017/10), seeking to optimise and simplify the reporting process, whose publication is scheduled for late 2021. Other noteworthy work includes that relating to the EBA's PSD2 Q&A Network, which aims to foster a consistent interpretation of the more ambiguous concepts and aspects of the Regulation, including the Level 1 text, through the European Commission.

Lastly, the transposition of PSD2 gave rise to the regulation, for the first time in Spain, of new payment services: payment initiation services and account information services. Box 2.10 explains how these new services have generated new business models.

3

MACROPRUDENTIAL POLICY

3.1 Macroprudential tools

Macroprudential policy brings together a set of prudential tools designed to mitigate identified risks and vulnerabilities for financial stability and increase institutions' shock-absorbing capacity. It takes an overall view of the financial sector as a whole, analysing the interplay between the different financial institutions and sub-sectors and examining their potential implications for the real economy, as a complement to microprudential supervision, which is focused on the individual situation of each bank.

The Banco de España performs regular exercises to identify and monitor the risks and vulnerabilities of the financial system and systemically important banks. These periodic analyses are essential for defining its stance on the macroprudential tools available for credit institutions. As the designated authority in this regard, the Banco de España regularly sets two macroprudential capital buffers to address the build-up of cyclical and structural risks, respectively: i) the countercyclical capital buffer (CCyB); and ii) the buffers for Spain's global and domestic (other) systemically important institutions (G-SIIs and O-SIIs, respectively). Moreover, the changes to the CRR and the CRD approved in 2019 have entailed adjustments to the design and application of various macroprudential tools available to the Banco de España.[1]

In 2020 the Banco de España continued to work on a circular on new macroprudential tools,[2] which will provide for the possibility of a sectoral CCyB, limits on the concentration of exposures, and the power to impose certain (borrower-based) conditions on lending (see Section 8.2).

3.1.1 Countercyclical capital buffer

The Banco de España sets the CCyB rate for credit exposures in Spain on a quarterly basis. The CCyB is a capital requirement designed to ensure that banks gradually build up an additional capital reserve in financial upturns, when conditions are favourable. Unlike capital requirements not linked to the financial cycle, this buffer would be released in the next downturn so as to absorb potential credit losses

1 For more information, see Box 3.1 "New macroprudential regulatory developments in the European Union", *Report on Banking Supervision in Spain,* 2019, Banco de España (2020).

2 For more information, see Box 3.2 "Calculating the credit-to-GDP gap and financial cycle duration in Spain", *Financial Stability Report,* Spring, Banco de España (2019).

and help mitigate the contraction in credit flows to the real economy inherent to such adverse situations. This buffer should also be released in response to exogenous shocks materialising that are not connected to the financial cycle itself, such as those triggered in the wake of the pandemic.[3]

The Banco de España decided to maintain the CCyB rate at 0% for credit exposures in Spain in 2020 and does not expect to increase it over a prolonged period, at least until the main economic and financial effects arising from the pandemic have dissipated. The scale and duration of the negative shock prompted by the COVID-19 crisis have exceeded initial forecasts, which might suggest a slower and more uneven economic recovery than expected. Given the severity of the crisis, and to avoid procyclical effects,[4] the Banco de España has reiterated its intention not to increase the rate of this instrument, so as to thus contribute to sustaining the flow of credit and mitigate negative pressures on economic growth. Consequently, the CCyB rate will be held at 0%, at least until the Spanish economy has resumed a path of recovery.[5]

In the wake of the pandemic, the set of indicators habitually analysed for setting the CCyB rate has lost a large part of its informative value, as they were not conceived for the materialisation of exogenous shocks like the current crisis. The swift and pronounced fall in activity triggered by the COVID-19 crisis has led to abrupt changes in the indicators calculated using GDP that do not stem from a build-up of cyclical risk (see Chart 3.1). Accordingly, the sharp drop in GDP in 2020 has pushed the adjusted credit-to-GDP gap above the 2 pp threshold[6] for the first time since the Banco de España began setting the CCyB. This threshold represents the limit beyond which this indicator would be taken to signal imbalances that would suggest setting a positive CCyB rate. Nevertheless, this increase in the credit-to-GDP gap should not be interpreted as a systemic alert requiring the activation of the CCyB. On the contrary, it demonstrates that this indicator is intended for expansionary phases of the credit cycle, rather than situations, such as the present, involving a sharp fall-off in activity on account of factors wholly exogenous to the financial system. Although the stimulus policies implemented, such as the moratoria and guarantee schemes, have supported growth in bank lending, chiefly in 2020 Q2, these measures were designed to mitigate the effects of the slump in economic activity following the outbreak of the COVID-19 pandemic. Nor, then, can this credit growth be interpreted as an increase in financial imbalances.

3 By way of example, the mitigating impact of the macroprudential measures adopted in EU countries is set out in Box 3.1 "Impact of the pandemic on growth-at-risk and mitigating impact of the macroprudential measures adopted", *Financial Stability Report, Autumn,* Banco de España (2020).

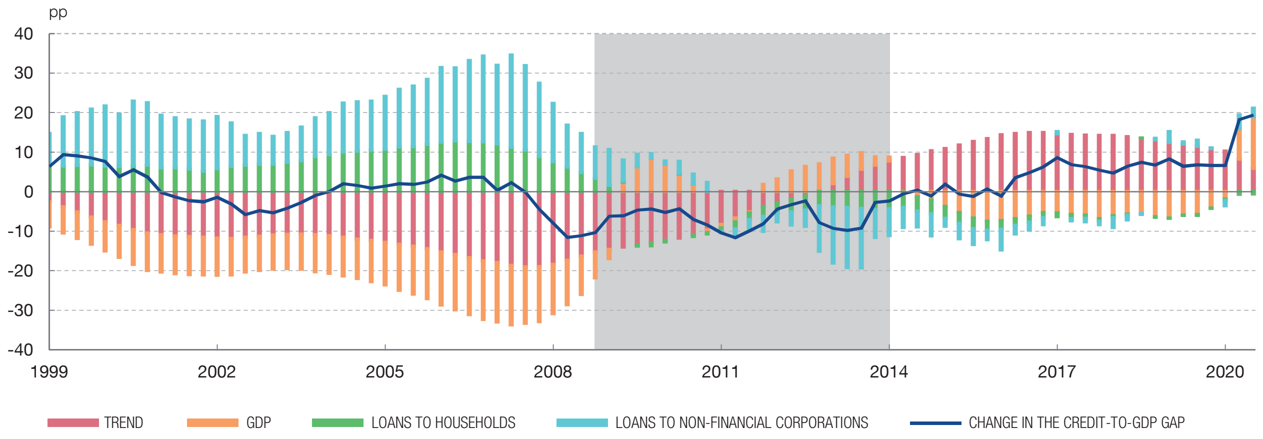
4 Macroprudential policy tightening could have procyclical effects in downturns like the present one, as it could hamper the provision of financing to the economy, which could in turn exacerbate economic conditions.

5 See press release of 21 December 2020 "The Banco de España holds the countercyclical capital buffer at 0%".

6 For more details, see J. E. Galán (2019), "Measuring credit-to-GDP gaps. The Hodrick-Prescott filter revisited", *Occasional Paper* No 1906, Banco de España.

Chart 3.1
CHANGE IN CREDIT-TO-GDP GAP BY COMPONENT
Year-on-year change

The main reason for the widening in the credit-to-GDP gap in 2020 was the abrupt decline in GDP. Consequently, this indicator should not necessarily be interpreted as a sign of systemic imbalances.

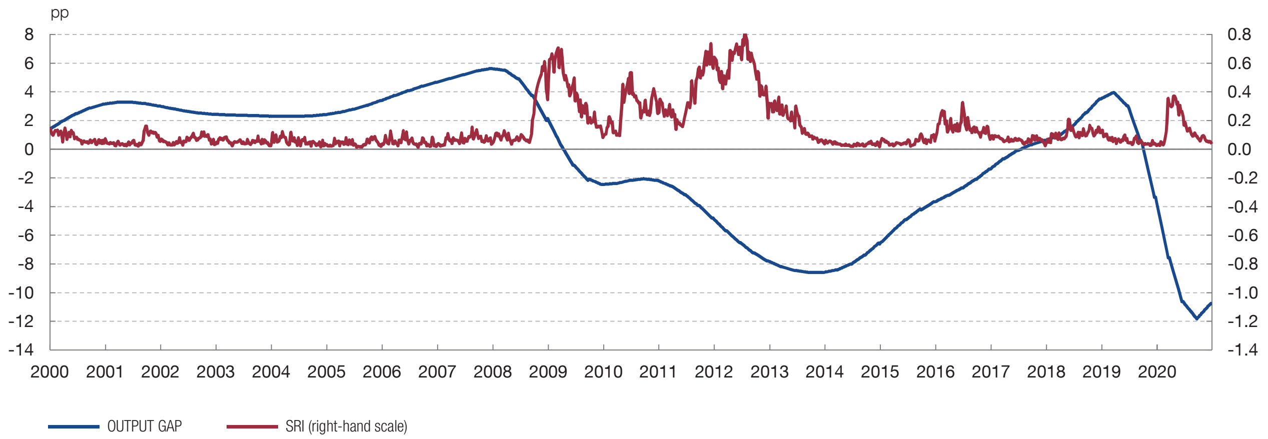


SOURCE: Banco de España.
NOTE: The solid line represents the year-on-year change, in percentage points, of the credit-to-GDP gap. This gap is calculated as the difference between the credit-to-GDP ratio and the trend estimated using a one-sided Hodrick-Prescott filter. The gap is adjusted to adapt its calculation to a shorter cycle duration that is more consistent with the empirical evidence in Spain. To this end, a smoothing parameter of 25,000 is considered. The bars represent the contribution of the main factors comprising the gap to its year-on-year change. The shaded area denotes the last period of systemic banking crisis (2009 Q1-2013 Q4). The latest observation is for September 2020.

Against the current backdrop of crisis, indicators that elucidate the degree of macroeconomic and financial stress become more relevant for CCyB decision-making. In the context of a shock such as that triggered by the pandemic, risk aversion and volatility usually increase significantly in the financial markets at the same time as the shock materialises. This sharp negative impact subsequently passes through to the real economy with some delay. Consequently, the most useful indicators for risk monitoring and macroprudential decision-making are the financial stress indicators, followed by the macroeconomic imbalance indicators. For this reason, since the onset of the pandemic, the Banco de España has monitored stress in the financial markets using a specific indicator, namely the “systemic risk indicator” (SRI). This indicator shows that, following the high level of financial stress between March and May 2020, the markets gradually calmed down again, despite the sharp year-on-year contraction in economic activity for 2020 as a whole. This downturn in the macroeconomic environment has been reflected in the output gap, which measures the deviation in economic growth observed vis-à-vis the Spanish economy’s potential. Having been in positive territory before the pandemic, in 2020 Q3 this indicator fell to its lowest negative value in its time series. In short, simultaneous monitoring of stress in the financial markets and of the downturn in macroeconomic conditions is more informative at such junctures than traditional indicators such as the credit-to-GDP gap (see Chart 3.2).

Chart 3.2
SYSTEMIC RISK INDICATOR (SRI) AND OUTPUT GAP

Indicators on the level of financial stress, such as the SRI, and those on developments in the macroeconomic environment, such as the output gap, become more relevant for guiding CCyB decision-making in the current context, marked by the pandemic.



SOURCES: Datastream and Banco de España.
NOTE: The SRI aggregates 12 individual indicators of stress (volatilities, interest rate spreads, maximum historical losses, etc.) from different segments of the Spanish financial system (markets for money, government debt, equity and financial intermediaries). In calculating the SRI, the effect of cross-correlations is taken into account, whereby the SRI registers higher values if the correlation between the four markets is high (i.e. situations where there is a high –or low– level of stress in the four markets at the same time) and its value is lower when there is less or negative correlation (i.e. situations in which the level of stress is high in some markets and low in others). See Box 1.1 "Systemic risk indicator", *Financial Stability Report,* May, Banco de España (2013). The output gap is the percentage difference between observed GDP and potential GDP. Values calculated at constant 2010 prices. See P. Cuadrado and E. Moral-Benito (2016), "Potential growth of the Spanish economy", *Occasional Papers* No 1603, Banco de España.

3.1.2 Systemically important institutions

Each year the Banco de España identifies systemically important institutions and sets their macroprudential capital buffers. As part of its mandate, the Banco de España applies the EBA guidelines – based, in turn, on the framework of the Basel Committee on Banking Supervision (BCBS) – to identify the institutions domiciled in Spain that could be considered “systemically important” at domestic level. Specifically, institutions are classified as systemically important if the financial system and the real economy would be severely affected in the event that these banks had solvency problems. To reduce the likelihood of collapse of these institutions and to correct any possible competitive edge they may obtain in the funding markets owing to their status as systemically important institutions, the regulations require that they be subject to additional capital requirements.

Banks’ systemic importance is assessed on the basis of different dimensions of banking activity. The G-SII and O-SII identification methodologies use similar indicators relating to balance sheet size; interconnectedness with the banking and non-banking financial system; substitutability of the services provided in the event of failure; complexity of activities pursued; and volume of cross-border activity.

Table 3.1
SYSTEMICALLY IMPORTANT INSTITUTIONS AND ASSOCIATED CAPITAL BUFFERS

Legal Entity Identifier (LEI)	Institution	Designation	Capital buffer requirement in 2020
5493006QMFDDMYWIAM13	Banco Santander, SA	G-SII and O-SII	1.00%
K8MS7FD7N5Z2WQ51AZ71	Banco Bilbao Vizcaya Argentaria, SA	O-SII	0.75%
7CUNS533WID6K7DGFI87	CaixaBank, SA	O-SII	0.25%
SI5RG2M0WQQLZCXKRM20	Banco de Sabadell, SA	O-SII	0.25%
549300GT0XFTFHGOIS94	BFA Tenedora de Acciones, SAU (Bankia, SA)	O-SII	0.25%

SOURCE: Banco de España.

Since end-2015, the Banco de España has announced the list of Spanish systemically important institutions each year. In November 2020 it announced the designation of one G-SII for 2022 and five O-SIIs for 2021, and their macroprudential capital buffers[7] (see Table 3.1), with no changes vis-à-vis the previous year.

3.2 Macroprudential coordination at national level

2020 was the first full year of activity for AMCESFI.[8] AMCESFI is set up as a collegiate body attached to the Ministry of Economic Affairs and Digital Transformation, with the participation of the Banco de España, the CNMV and the DGSFP, in their capacity as sectoral supervisory authorities. AMCESFI monitors and regularly analyses systemic risk factors, and issues opinions, warnings and recommendations on relevant matters for financial stability. The Banco de España plays a prominent role within AMCESFI, as the Governor of the Bank is the vice-chair of its Board, and the Deputy Governor sits on the Board and chairs its Financial Stability Technical Committee (FSTC). Further, the Bank's Director General Banking Supervision and Director General Financial Stability, Regulation and Resolution are ex officio members of the FSTC.

AMCESFI's activity increased during 2020 as a result of COVID-19-related events. It has continuously monitored the macro-financial situation in Spain, in keeping with its founding remit of serving as an institutional framework for meetings to coordinate and share information among national authorities entrusted with the preservation of financial stability. In 2020, its Board met five times and its FSTC held 12 meetings to discuss topics relating to the financial sector's situation, the support measures in response to the pandemic and the proposed macroprudential measures of the sectoral authorities. The main developments at EU and global bodies and committees dealing

7 See the press release of 27 November 2020 "Banco de España updates the list of systemically important institutions and sets their macroprudential capital buffers".

8 AMCESFI was created in 2019 by Royal Decree 102/2019 of 1 March 2019.

with reforms to the financial system and other coordinated international financial policies were also discussed.

In 2020 AMCESFI published its first annual report, for 2019,[9] and launched its website. In accordance with the control and transparency obligations stipulated in Royal Decree 102/2019, the Third Deputy Prime Minister and Minister for Economic Affairs and Digital Transformation presented this report before the pertinent parliamentary committee on 3 September 2020. The report reviews the developments in the Spanish financial system in 2019 and offers an analysis of cross-sectoral interconnectedness, together with a compendium of relevant statistical indicators. In parallel, AMCESFI developed its own website (www.amcesfi.es) so as to have a common platform for disseminating information on its activities and future publications.

3.3 SSM macroprudential tasks

As part of the SSM, the Banco de España has a duty to regularly notify the ECB of each of its proposed macroprudential measures prior to their adoption and announcement. In 2020, the Banco de España informed the ECB of four quarterly CCyB measures and of the annual measures to designate G-SIIs and O-SIIs, together with the macroprudential capital buffers set for them.[10] This is part of a regular process whereby the ECB's governing bodies scrutinise – together with the national authorities of the SSM countries – national macroprudential policies.

The Banco de España is a member of the ECB's Financial Stability Committee (FSC) and Macroprudential Forum (MPF). Through its technical working groups, the FSC analyses the risks and vulnerabilities for financial stability and seeks to promote coordination among the national designated authorities of the SSM countries in the formulation of macroprudential policy measures. In 2020, the FSC's work programme was adapted to address matters specifically associated with the impact of COVID-19 on the financial system. The work of the FSC is regularly presented to the MPF, which brings together members of the Supervisory Board and the Governing Council of the ECB.

9 AMCESFI (2020), *Annual Report 2019*.

10 National authorities must also provide information on the systemically important institutions in advance to the EBA, the European Commission and the ESRB.

4

SUPERVISION OF INSTITUTIONS' CONDUCT

Appropriate conduct of institutions, and in particular the way they interact with customers, is a key element for the proper functioning of the financial system and for maintaining a viable and sustainable banking business model in the medium and long term.

The situation ensuing from the pandemic also marked the pursuit of conduct-related supervisory activity in 2020, and has made clear the relevant role played by the banking sector, through which some of the measures aimed at alleviating the financial situation of households and firms have been implemented. From the outset of this crisis, the Banco de España has worked to ensure citizens are provided with the necessary information on these measures and to support institutions in their implementation.

Moreover, this environment has helped speed up the growing digitalisation of the sector and its impact on the way services are provided. Supervision has focused on this aspect to ensure that institutions' activity and their relationship with customers complies with regulations and to underline the importance of an appropriate conduct culture based on responsible, ethical and transparent behaviour.

4.1 Conduct-related supervisory activity

The bulk of supervisory work this year focused on monitoring actions taken by institutions to respond to the needs arising from the pandemic and to comply with the measures adopted to counter its economic impact. See Box 4.1 for more details.

In addition, the planned supervisory activity continued through different supervisory and individual follow-up actions, grouped by type of institution or subject (such as advertising or claims).

Annual supervisory planning takes into account the information gathered in the course of supervisory and ongoing monitoring actions and focuses on those institutions considered a priority according to their conduct profile.[1]

1 For further details, see Banco de España (2019), "Institutions' conduct profiles", Box 4.1, *Report on Banking Supervision in Spain,* 2018.

Box 4.1

SUPERVISION OF THE IMPLEMENTATION OF FINANCIAL MEASURES TO ADDRESS THE ECONOMIC IMPACT OF COVID-19

With the aim of mitigating the adverse economic impact of the measures to prevent the spread of COVID-19, the Spanish government launched a package of urgent measures; among the most prominent were legislative moratoria and State guarantees for certain bank loans to firms, since these had to be implemented mainly through banks.

From the outset of this crisis, the Banco de España has worked: i) to ensure that banks provide citizens with the necessary information and that their relations are conducted in a climate of trust, and ii) to support institutions in the implementation of the above-mentioned measures.

In addition, since the state of alert was declared in March 2020, the main supervised institutions were contacted to ascertain and analyse the measures that were being adopted to ensure continuity in the provision of services to their customers (including the temporary opening or closure of branches, ATM operability or the strengthening of online banking channels). Institutions' implementation of the measures approved to address the economic fallout of the pandemic was also monitored by analysing: i) the specific reporting on moratoria by the institutions; ii) claims and telephone and written enquiries submitted to the Banco de España; and iii) information provided by the institutions via their websites.

This information was analysed both on an overall basis and on a specific basis for those institutions already subject to individual monitoring.

It should be noted that the exchange of information and the coordination between certain areas of the Banco de España was strengthened with the aim of establishing supervisory synergies.

Although administrative procedures were suspended during the state of alert, the Banco de España reactivated the claims mechanism to support customers as well as the institutions who had to continue to handle their claims.

In any case, considering the severe disruption wrought by COVID-19 on Spanish society and the Spanish economy, the Banco de España, in cooperation with the rest of the national and international supervisory authorities, will continue to supervise institutions' conduct in relation to these measures or others that may be adopted, and to contribute to maintaining the stability of the financial system.

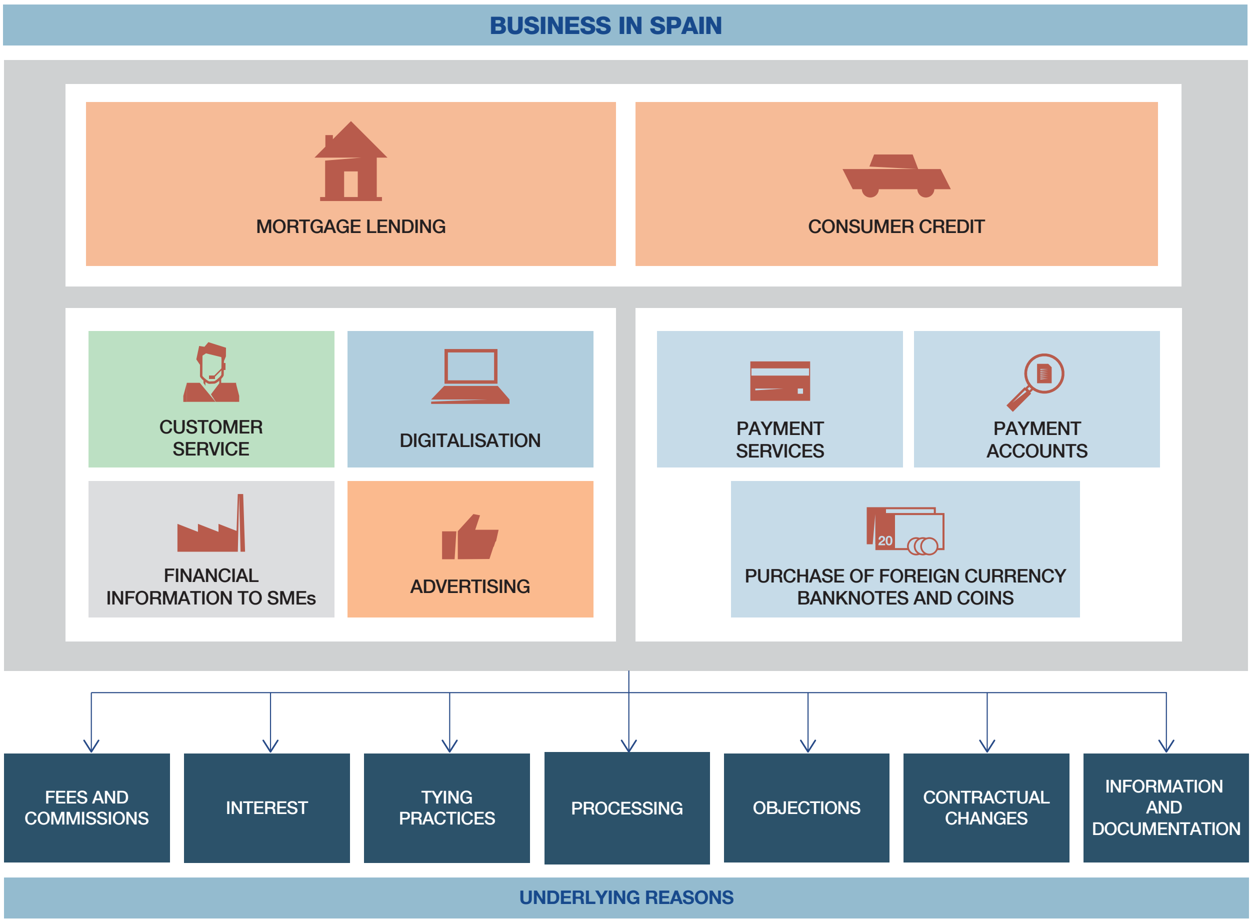
The main areas of conduct supervision, shown in Figure 4.1, materialised in the supervisory actions shown in Chart 4.1.

Supervision of consumer credit took on an important role during 2020. This essentially involved verifying the degree of compliance with the organisational and disciplinary rules of Law 16/2011 of 24 June 2011 on credit agreements for consumers. In particular, work has been completed on the verification of the marketing of revolving credit cards,[2] financing for car purchase, credit linked to the supply of goods or the provision of services and other consumer financing with no specific purpose, and loans granted in the form of overdrafts on sight deposits. Responsible lending practices and policies in this financing area have also been reviewed.

These supervisory actions on consumer credit have generally been cross-institutional in nature, making it possible to analyse how different institutions

2 For further details, see Banco de España (2020), "Marketing of revolving credit cards", Box 4.1, *Report on Banking Supervision in Spain,* 2019.

Figure 4.1
SUPERVISION OF CONDUCT: MAIN AREAS OF ACTIVITY



SOURCE: Banco de España.

handle the same subject matter, provide a homogeneous response to the common shortcomings detected, identify best banking practices and work on drawing up supervisory guidelines on the marketing of revolving credit.

Given its particular importance, mortgage lending has also been the focus of much of the annual supervisory effort. The Banco de España is aware of the importance of institutions ensuring transparency both in the marketing of such loans and over their life. Thus, work has continued to verify that “floor clauses”, i.e. clauses that set a lower limit on interest rates, are properly applied in accordance with regulations and the provisions of mortgage loan agreements. The information provided on interest rates and the measures applied to protect mortgagors in serious economic difficulties were also checked.

The main aspects **relating to the review of advertising of banking products and services** are shown in Figure 4.2. Banco de España Circular 4/2020 of 26 June 2020 was approved in relation to this issue. This new rule constitutes an essential

Chart 4.1
CONDUCT-RELATED SUPERVISORY ACTIONS IN 2020, BY AREA

During 2020, in addition to the work on the follow-up of the measures adopted by institutions in the wake of the COVID-19 pandemic, conduct-related supervisory activity focused mainly on the areas of activity relating to mortgage lending, consumer credit, revolving credit cards and deposits. The supervisory effort during 2020 was marked by the above-mentioned supervision and follow-up work on the financial measures to counter the economic impact of the pandemic.

1 SUPERVISORY ACTIONS (a)

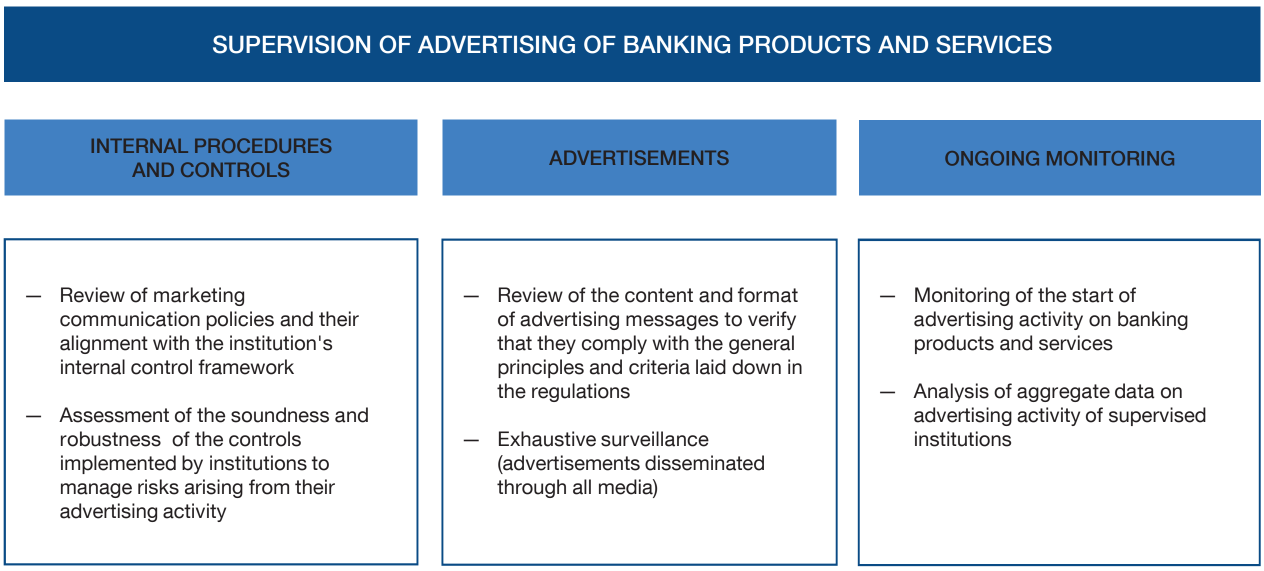
2 OF WHICH, UNPLANNED

Number

SOURCE: Banco de España.

a Of these supervisory actions, 103 were initiated before the start of 2020.

Figure 4.2
SUPERVISION OF ADVERTISING ACTIVITY



SOURCE: Banco de España.

Box 4.2

SUPERVISION OF CUSTOMER SERVICE DEPARTMENTS

The proper functioning of institutions' customer service departments (CSDs) is a key element to resolve conflicts between institutions and their customers. During 2015 and 2016, several cross-institutional supervisory actions were carried out aimed at assessing CSDs in detail and, where necessary, remedy the shortfalls detected.

Based on the experienced gained, an addendum was published to the 2016 Annual Claims Report identifying the best practices observed in institutions' CSDs.

As a continuation of this effort, in 2020 work was conducted on supervisory guidelines on the organisational and operational criteria of the CSDs of institutions supervised by the Banco de España.[1] These guidelines will be published over the course of 2021. Specifically, the guidelines are structured along two main lines:

— General principles applicable to the organisation and functioning of CSDs.

— Basic supervision principles that can be divided into three blocks: the composition and functioning of CSDs, claim and complaint handling and, lastly, communication and control mechanisms.

These criteria have been defined bearing in mind both the applicable national regulations and the supervisory guidelines adopted by the Banco de España in this area, in particular those of the Joint Committee of the European Supervisory Authorities on claim and complaint handling for the securities and banking sectors (JC 2018 35).

Recurrent supervisory activities carried out in relation to CSDs include, inter alia, the review of the internal rules governing their functioning and analysis of the suitability of their head officers.

The management body of the institution must approve the customer protection regulations governing the functioning of the CSD. Subsequently, these internal rules must be verified by the Banco de España, which will check that they comply with the provisions of the applicable legislation (except for savings banks or credit cooperatives whose activities are confined to one region, in which case the verification shall be the responsibility of the regional competent body).

Furthermore, pursuant to Article 5 of Ministerial Order ECO/734/2004, the management body of each institution shall appoint a CSD head officer, who must be a person of commercial and professional integrity with appropriate knowledge and experience for the exercise of their functions. The institution must notify the appointment to the Banco de España and provide evidence of compliance with these requirements.

In the course of this work, a total of 514 letters were sent to various institutions in 2020 regarding the organisation and functioning of their CSDs. 102 files were processed on the suitability of the head officers of CSDs and 221 on the verification of their regulations.

All the CSD-related supervisory actions carried out are aimed at ensuring their proper functioning and organisation, so that they can efficiently handle and resolve claims and complaints, thereby contributing to improve customer protection and, consequently, the reputation of the institution itself and of the entire system.

1 Institutions subject to Ministerial Order ECO/734/2004 of 11 March 2004 on the customer service department and ombudsman of financial institutions (hereinafter, Ministerial Order ECO/734/2004).

regulatory framework for institutions to pursue this activity and a powerful tool for its proper supervision (see Section 8.1.4).

The activity of customer service departments (CSDs) was also supervised to verify the suitability of their head officers, the content of their operating rules and overall compliance with transparency obligations. As set out in Box 4.2, in 2020 work was carried out to draw up the first conduct supervision guidelines on the functioning of CSDs (see Section 8.2).

Box 4.3

SUPTECH TOOLS FOR CONDUCT SUPERVISION

Conduct supervision requires a large number of documents collected during supervisory actions to be analysed annually. They include largely unstructured information on which no automated processing (searches, extractions, mass selections) is possible. Consequently, analysing them is time-consuming and requires limiting the sample size of the files to be reviewed.

With the aim of improving efficiency and speed in the processing of this information, a first test was launched in 2019 to apply suptech tools to a supervisory action on consumer financing. To this end, machine learning and computer vision techniques were used with the aim of verifying the acceptance and signature of insurance policies linked to loan agreements.

In 2020, these same techniques were used for reviewing the proper application of mortgage deed clauses, including floor clauses, i.e. those that set a lower limit on interest rates. This is a particularly complex task owing to the difficulty inherent in managing a large volume of information and to the lack of standardisation of clauses (even within the same institution). To make this task easier, a file processing and reviewing tool has been developed for:

— Automatically reviewing files to search for standard clauses.

— Quickly navigating through relevant clauses in different files.

— Flagging relevant sections in the files to ensure immediate traceability between evidence and the conclusions of the review.

— Using machine learning and natural language processing techniques that feed back into the mass review process and the identification of new relevant clauses.

This tool has made it possible to increase the number of files and documents reviewed. Thus, a single supervisory team has analysed almost 4,000 mortgage deeds from nine different institutions in less than two months.

These examples show that the use of suptech tools makes it possible to increase the sample size of the reviewed files and to review a larger number of institutions by allowing inspection teams to focus on the tasks with the highest supervisory added value.

The Banco de España remains committed to innovation and digitalisation as a means of increasing the efficiency of supervision and exploring new areas of supervisory competence that benefit from the experience gained in the use of machine learning techniques.

Another aspect that received particular attention is the digitalisation of supervised institutions. To gain a better understanding of the sector's digital transformation and its impact on each stage of the life cycle of banking products and services (mainly current and savings accounts and consumer credit), a series of measures have been adopted to minimise the risks arising from the immediacy of taking out products digitally.

Digitalisation demonstrates the importance of institutions' transparency transcending formal considerations; not only must they conform to regulatory requirements, they must also use language that is clear and to the point, with scrupulous attention to form, for a better understanding and to better adapt to the channel through which the product is marketed.

New technologies have also been incorporated into the supervisory process itself, as detailed in Box 4.3, increasing the efficiency of supervision in the areas of banking transparency and customer protection.

Lastly, during 2020 work was carried out on the drafting of a circular on confidential conduct-related information, which will result in better information being available for more efficient supervision (see Section 8.2). The new information will improve knowledge of institutions' business models and market trends for banking products and services, including those that generate most controversy. This last aspect is relevant given the continuous innovation in this sector and the growing priority given to transparency and customer protection.

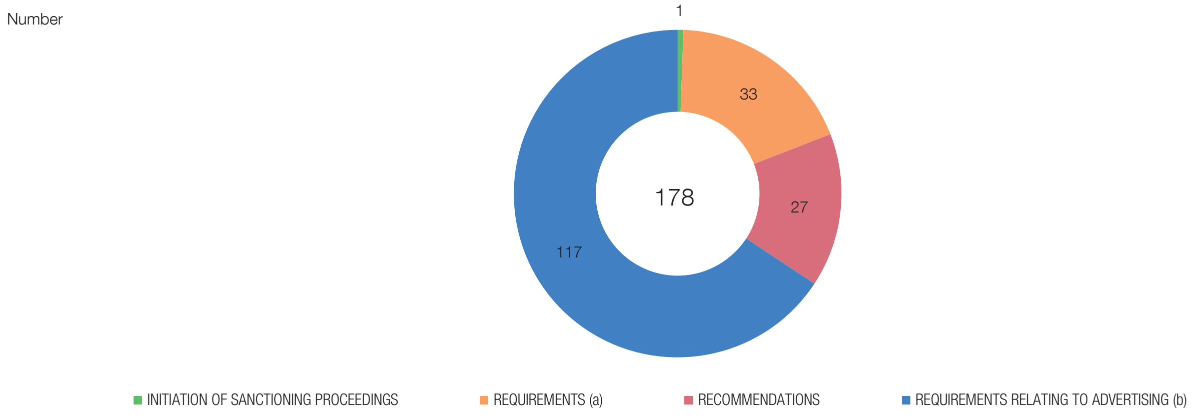
In short, the aim of conduct supervision is to better protect banking customers by preventing and correcting inappropriate conduct, encouraging institutions to implement, through their regulatory compliance function, a suitable culture of conduct in their relationship with customers, and to strengthen the role of their CSDs in order to maintain a sustainable and viable banking business model.

4.2 Adoption of supervisory measures

Noteworthy among the supervisory measures adopted in 2020 were the initiation of one sanctioning proceeding and the issue of 33 requirements. Chart 4.2 provides a breakdown of all these measures.

Chart 4.2
SUPERVISORY MEASURES ADOPTED AND REQUIREMENTS IN RELATION TO ADVERTISING IN 2020

During 2020, as a result of the supervisory actions carried out, one sanctioning proceeding was initiated and 33 requirements and 27 recommendations were issued focusing mainly on aspects relating to the marketing of revolving credit cards and to the mortgage portfolio, among others. In addition, as part of the supervisory activity on advertising, 117 requirements were issued, resulting in 56 withdrawals and 61 rectifications.



SOURCE: Banco de España.

a The 33 requirements contain 189 specific requirements for institutions.
b The 117 advertising-related requirements resulted in 56 withdrawals and 61 rectifications.

Effective compliance with the requirements and recommendations issued by the Banco de España in previous years was also checked. This follow-up work is key to verify that institutions remedy the shortcomings detected in the supervisory work, thus achieving effective customer protection.

As a result of the supervision of advertising activity, 117 requirements were issued to withdraw or rectify advertising that did not comply with regulatory requirements.

As for CSD supervision, in addition to the adoption of the above supervisory measures, 514 letters were sent during 2020 as a result of the verification of the operating rules of CSDs and suitability assessments on their head officers.

5

OVERSIGHT AND SUPERVISION OF MARKET INFRASTRUCTURES

Financial market infrastructures are a key component of the financial system, as most trade and financial transactions are cleared, settled and registered through them. Given their importance, the smooth operation of these infrastructures is a specific focus area for central banks, which justifies their supervisory and oversight role.

5.1 Oversight of payment systems and instruments

Payment systems provide essential services to the real economy, offering efficient mechanisms for the payment of any purchase of goods or services. Ensuring the smooth operation of payment systems has traditionally been the responsibility of central banks through their oversight function. This function extends to payment instruments, a key component of payment systems, as they enable end-users to transfer funds. Against this backdrop, the Banco de España is entrusted with overseeing the functioning of clearing and payment systems under Article 16 of Law 13/1994 of 1 June 1994 of Autonomy of the Banco de España.

Oversight is also one of the core functions assigned to the Eurosystem, of which the Banco de España is a member. This function is performed cooperatively, applying uniform criteria based on its oversight policy framework.

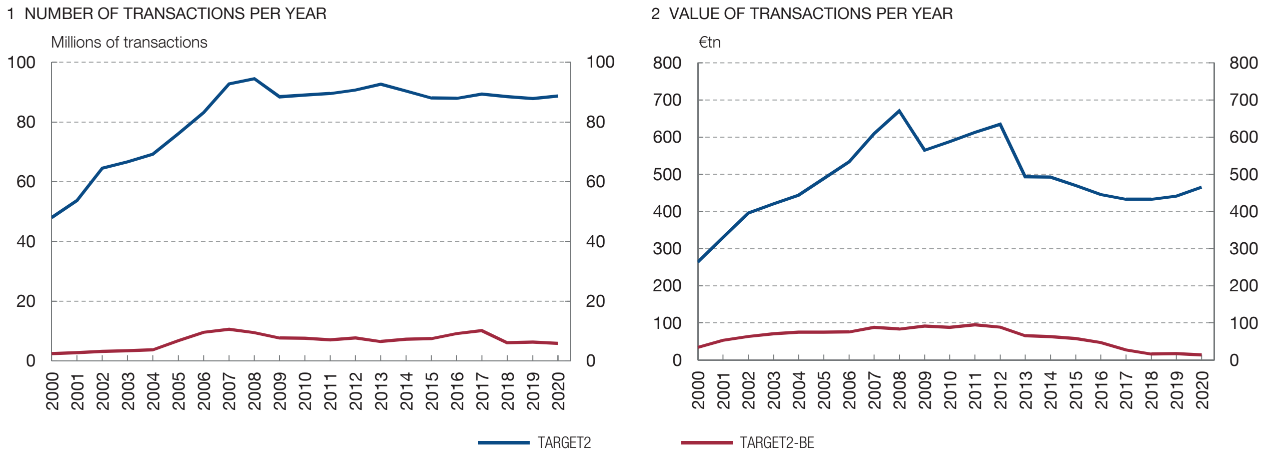
5.1.1 Payment systems

Within the Eurosystem's cooperative oversight arrangements, the Bank participates in the oversight of the real-time gross settlement system TARGET2, operated by the national central banks of the euro area countries and identified as a systemically important payment system (SIPS). The ECB coordinates these tasks and has primary responsibility for the ongoing oversight of the overall system. The majority of TARGET2 oversight activities are focused on the technical platform shared by the central banks using the system. Each central bank also monitors the specific aspects of its national component. In 2020 the Spanish component of TARGET2 processed a total of 5.9 million transactions, equivalent to a daily average of 23,000 transactions (see Chart 5.1).

The Banco de España also participates in the cooperative oversight of the other pan-European SIPSs, specifically EURO1 (large-value payment system), STEP2 (retail payment system) and RT1 (instant payment system), all of which are operated by EBA Clearing and for which the primary overseer is also the ECB, as well as Mastercard

Chart 5.1
OVERVIEW OF TARGET2 AND TARGET2-BE OPERATION

In 2020 the TARGET2-BE component represented 6.6% of the number of transactions processed in TARGET2 and 3% of the total value of the transactions.



SOURCE: Banco de España.

Clearing and Management System, operated by Mastercard Europe, whose oversight is jointly led by the ECB and the NBB and which was identified as a SIPS in May 2020.

The assessment of the degree of compliance of TARGET2, EURO1 and STEP2 with the new requirements introduced in the SIPS Regulation in 2018[1] continued in 2020. This Regulation also refers to the Eurosystem's cyber resilience oversight expectations (CROE) for financial market infrastructures.

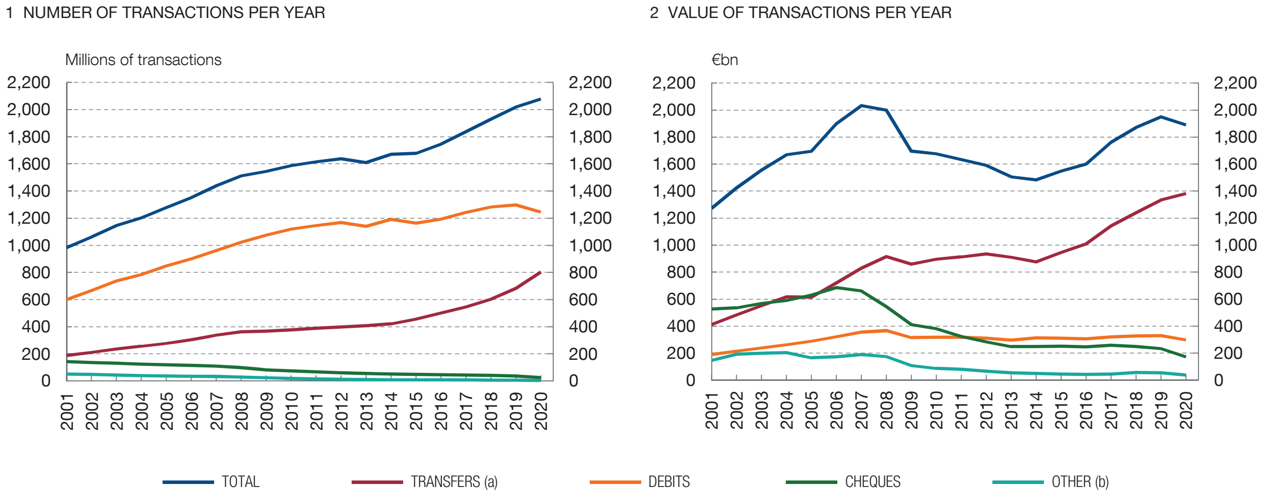
Also, as part of the Eurosystem's implementation of the Committee on Payments and Market Infrastructures (CPMI) strategy on reducing the risk of wholesale payments fraud related to endpoint security, a follow-up has been conducted of the EURO1 and TARGET2 security measures, with a view to fostering steps to reinforce them, if necessary.

Several major TARGET2 incidents occurred in 2020 that caused a total system outage. These included most notably one on 11 August, which lasted six hours and was due to a technical problem, and another on 23 October, lasting 11 hours, owing to a software defect in an external provider. The ECB is analysing the operator's management of the incidents and has initiated an independent review of the business continuity model, the regular recovery tests, the change management procedures and the communication protocols.

1 Regulation (EU) No 795/2014 of the ECB of 3 July 2014 on oversight requirements for systemically important payment systems (ECB/2014/28).

Chart 5.2
OVERVIEW OF SNCE OPERATION

Direct debits account for 60% of the number of transactions processed by the SNCE. In terms of value, credit transfers account for the highest share (73% of the total).



SOURCE: Banco de España, based on Iberpay data.

a Including instant transfers from 2018.
b Including bills of exchange and other.

Monitoring of the T2-T2S (TARGET2 and TARGET2-Securities platforms) consolidation project continued in 2020. This project, which was launched by the Eurosystem, will enable the two platforms to be consolidated from a technical and functional viewpoint. The aim is to meet market demands, optimising liquidity management and providing access from a single entry point and new functionalities. Following the financial community's suggestions, the extension by one year of the estimated timeline for the project was approved in July. The migration is scheduled for November 2022.

A review of the SIPS regulation was initiated in 2020, following a public consultation conducted that year, which includes, inter alia, more flexible criteria for identifying SIPS.

In the national arena, the Banco de España is the primary overseer of the National Electronic Clearing System (the SNCE, by its Spanish acronym), the Spanish retail payment system managed by Sociedad Española de Sistemas de Pago, SA (Iberpay). The SNCE processes a number of payment instruments, in particular credit transfers, including immediate or instant transfers, direct debits, cheques and bills of exchange. Chart 5.2 shows how its operation has been affected in 2020 as a result of the COVID-19 crisis, as mentioned in Box 5.1.

The COVID-19 crisis has had a significant impact on market infrastructures, including the SNCE, in 2020. The SNCE has operated fully remotely during certain

Box 5.1

IMPACT OF COVID-19 ON FINANCIAL MARKET INFRASTRUCTURES

Despite the significant effect of the COVID-19 crisis, market infrastructures have operated uninterruptedly as an essential activity. The Banco de España, through its oversight function at the national level and as part of the Eurosystem, has monitored the effects of the pandemic on securities infrastructures, payment systems and their critical service providers on an ongoing basis.

In Spain and in the rest of Europe, infrastructures and their ecosystems have responded to the crisis swiftly and effectively, introducing remote working on a large-scale, coordinating teams remotely and strengthening operations and security without incidents in the continuity of activity. However, it has been necessary to revise the priority of certain projects in progress and their planning for 2020-2021.

In payment systems, sharp declines in activity were observed in the retail segment during the most critical periods of the pandemic. These year-on-year declines were close to 50% in domestic purchases using cards, as a result of the decrease in private consumption, and nearly 90% for cross-border card transactions, reflecting the collapse of the tourism sector. Although less sharp, the fall in SNCE operations has also been significant. Thus, the year-on-year decline in the value of the transactions processed in the system was 11.8% during the three months with the strictest restrictions (from March to May 2020) with sharper falls in the debits and cheques subsystems during this period (almost 20% and 42% year-on-year, respectively). The habits of the end-users of payment systems also changed with the pandemic. During the lockdown periods retail payment transactions through remote channels grew over 40% year-on-year, compared with pre-COVID-19 levels of 23%. Up to 83% of all face-to-face card payments were contactless, including mobile payments, vis-à-vis pre-COVID-19 levels of 78%.

In contrast, the wholesale segment experienced greater activity year-on-year, except for foreign currency exchange transactions, which, as expected, decreased. These trends are reflected in TARGET2 figures, which recorded an increase in value but a decrease in the number of settled transactions owing to falls in customer operations.

This growth in the overall value of transactions settled in TARGET2 is in contrast with the across-the-board fall in wholesale operations via private operator systems, both in terms of value and of number of transactions. This could be the result of part of the traffic being diverted to TARGET2, as a risk-free mechanism operated by the Eurosystem and with settlement in central bank money.

Also notable were the developments in SWIFT messaging, which grew significantly in the initial phase of the crisis, associated with securities transactions, against a backdrop of high financial market volatility.

Infrastructures have proved the efficiency of their business continuity plans and their ability to rapidly adopt good practices, such as the creation of response plans with teams devoted to securing both critical functions and the supply chain (including external suppliers), dealing with staff shortage or lower staff availability and strengthening security in a setting of growing risk of cyberattacks.

periods, without this affecting the processing of transactions. A specific action plan was set up, within the general business continuity framework that was established by the company and reviewed by the Banco de España from the standpoint of oversight. Also, since the onset of the crisis, the Banco de España has stepped up the statistical follow-up of the SNCE's operations, and the exchange of information with the operator.

As part of its regular oversight activities, the Banco de España has continued to have regular contact with Iberpay for the purpose of assessing the implementation of its Eurosystem cyber resilience strategy for market infrastructures, and of certain measures to mitigate the risk of fraud or security problems that might derive from the access of its participants. These include the launch of the SNCE cyber security control framework, which encompasses very diverse measures, such as strengthening the security protocols. All of these measures aim to mitigate as much as possible the risk in the system arising from weaknesses that may be used by criminals to launch a cyberattack against the SNCE. Once again, the exceptional situation we are in since March 2020 requires stepping up efforts in this area, since, as has been demonstrated, cyberattack attempts in Spain and in the Eurosystem have increased, although none has been successful.

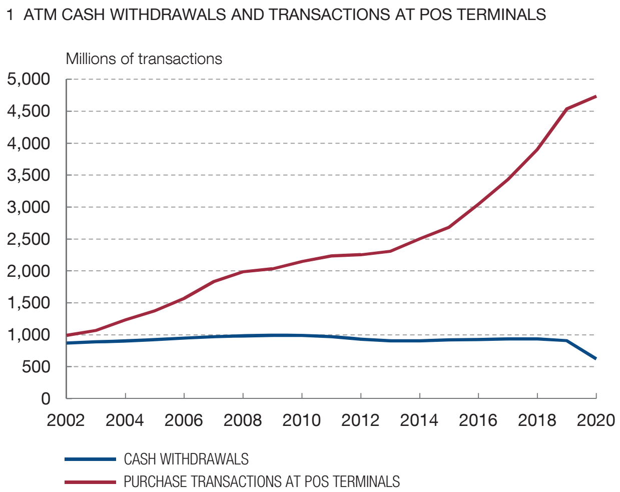
The SNCE did not experience any major incident in 2020. However, the TARGET2 incidents mentioned above gave rise to a delay in the settlement of certain SNCE operations.

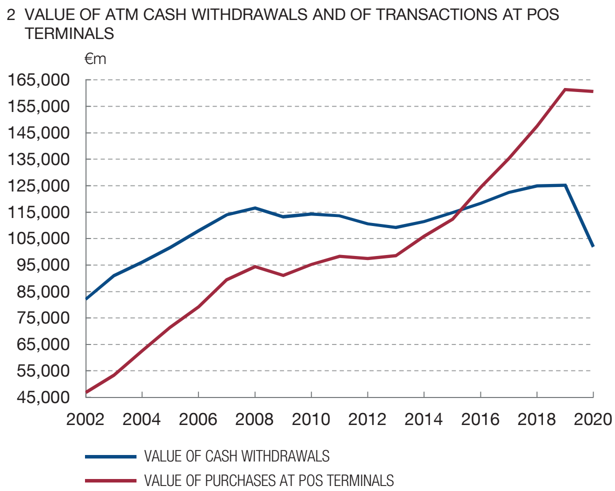
5.1.2 Payment instruments

The oversight of payment instruments is also conducted in a cooperative manner in the Eurosystem, applying the same common standards that comprise the Eurosystem's oversight rules, which are currently being revised (see Box 5.2). In particular, the oversight of pan-European payment schemes is carried out through a central bank which leads and coordinates the tasks in collaboration with the other central banks. The current pan-European payment schemes are the Visa Europe, Mastercard Europe,[2] American Express, SEPA Core Direct Debit and SEPA B2B

Chart 5.3
OVERVIEW OF OPERATION WITH CARDS

Fall in cash withdrawals and purchases with cards in 2020, in terms of both volume and value, deriving from the COVID-19 pandemic situation.





SOURCE: Banco de España, based on Sistema de Tarjetas y Medios de Pago, S.A. data.

2 It is important to distinguish Mastercard Europe's responsibility for the management of the card scheme from its role as SIPS operator.

Box 5.2

THE NEW EUROSYSTEM OVERSIGHT FRAMEWORK FOR PAYMENT INSTRUMENTS, SCHEMES AND ARRANGEMENTS

In order to promote the smooth operation of payment infrastructures and payment instruments by reinforcing their efficiency and security, the oversight function must have adequate tools, adapted, in particular, to any changes that may arise in the ecosystem overseen.

The Eurosystem has initiated a process to review the oversight framework for payment instruments for different reasons, including most notably:

i) Extending its scope, with the aim of considering all the developments that have arisen in the field of payments, especially in the past decade, and those which may arise in the future (for example, crypto currencies, functionalities provided by certain supplier companies of smartphones for making contactless payments, etc.).

ii) Simplifying it, establishing a single framework, although taking into account specificities when applied.

iii) Harnessing possible synergies with the payment systems oversight framework.

iv) Taking into account the experience acquired in implementing the current oversight framework for instruments.

The review work commenced in 2018. The new framework proposed is known as the oversight framework for payment instruments, schemes and arrangements (the PISA framework). It is comprised of three documents: i) the oversight framework itself, ii) the assessment methodology, which takes into account the specificities of each particular scheme or arrangement to which it applies, and iii) the exemption criteria, which are justified by a proportionality criterion.

The public consultation took place at end-2020 and the new framework is scheduled to be approved in 2021. The new aspects of the project include most notably the revision of terminology to adapt it to the current legislation (for instance, the Second Payment Services Directive). Additionally, new definitions have been included and new developments, such as crypto currencies, have been taken into account.

Also notable is the extension of its scope, which changed from focusing on certain payment schemes (cards, payment transfers, direct debits and electronic money) to including payment arrangements, both of which are defined below:

— A payment scheme is a set of formal, standardised and common rules enabling value between end-users to be transferred by means of electronic payment instruments. It is managed by a governance body.

— A payment arrangement provides certain functionalities which support payment users, customers of multiple payment service providers, in the use of electronic payment instruments. It is managed by a governance body which issues the relevant rules, terms and conditions for implementing the arrangement.

As an example, under the new PISA framework, an app provided by a smartphone manufacturer to make payments with it would a priori be considered as a payment arrangement, since the application allows the owner of the smartphone (the end-user) to use a payment instrument (for example, a debit card) to make payments (for instance, a payment in a physical store using contactless technology). Also, the use of such a card would be subject to a series of rules governed by the related card scheme and, therefore, this oversight framework would also apply to it.

Direct Debit schemes (the latter differs from the SEPA Core Direct Debit scheme in that none of the parties involved, not even the debtor, acts as a consumer), as well as the SEPA Credit Transfer (SCT) and the SEPA Instant Credit Transfer (SCT Inst) schemes. The primary overseer of Mastercard is the Belgian central bank (NBB), while that of all the others is the ECB. As regards the SEPA payment schemes, work was carried out to monitor the implementation of the recommendations made in previous assessment exercises, and to assess and monitor the updating of the scheme standards by their manager, the European Payments Council (EPC).

The Banco de España is the primary overseer of the national card scheme Sistema de Tarjetas y Medios de Pago, SA, the result of the merger of the former Spanish card schemes 4B, EURO 6000 and ServiRed. Monitoring of the implementation of the oversight recommendations issued in 2018 to the former card schemes concluded satisfactorily in early 2020.

As a result of the current crisis, the statistical monitoring of the operation of payment schemes and, in particular, of card schemes, has been strengthened (see Chart 5.3). Although the rate of card fraud by number of transactions in 2020 H1 was low (0.037%), it has increased slightly from previous figures.

5.2 Supervision of Iberpay

Under Article 17 of Law 41/1999 of 12 November 1999 on securities payment and settlement systems, management of the SNCE is entrusted to Iberpay, which in turn is supervised by the Banco de España. In the exercise of this function, the Bank is empowered to give prior approval to the company's articles of association and amendments thereto, and the basic operating rules of the systems and services that it manages, which are its core purpose.

In November 2020 the Executive Commission of the Banco de España authorised the proposed new SNCE regulation submitted by Iberpay. The regulation was modified to facilitate the access of payment service providers that are not credit institutions (payment institutions and electronic money institutions) to the SNCE. These will be accessible institutions designated by direct participants in the system, and shall in no case have member status. Direct participants in the SNCE will be able to identify transactions from payment services provided by such institutions, which will be considered for all purposes as transactions relating to the direct participants.

To encourage the participation of institutions in the European Economic Area (EEA) in the SNCE, a Dispute Resolution Committee was created to resolve potential conflicts between participants when any of them is not a member of a competent body from among those existing in the national sectoral associations.

In 2020 the Banco de España received the operating rules for four new services provided by Iberpay: account portability service, account holder confirmation service, fraud prevention service and remittance service for SEPA instant credit transfers. None of them were opposed by the Banco de España.

In 2020 a total of 11 operating instructions for the SNCE were also received, which were not opposed by the Banco de España. Notable among the changes introduced are: the elimination of individualised settlement in the cheque subsystem, the updating of institutions' ways of connecting to the SNCE and the inclusion of the SNCE cybersecurity control framework governance model.

5.3 Oversight of securities infrastructures

An inadequate functioning of securities infrastructures, where securities transactions are cleared, settled and registered, could have adverse effects on financial stability. Risks must therefore be managed efficiently to prevent disruptions arising in financial markets and passing through to other infrastructures with which they have interdependent relationships, such as payment systems, and their participants.

The CNMV is responsible for the supervision of securities infrastructures in Spain. Additionally, under Article 255 of the consolidated text of the LMV, the CNMV and the Banco de España are jointly entrusted with ensuring the smooth operation of Spanish securities clearing, settlement and registration systems so as to preserve the stability of the financial system as a whole. To this end, the two authorities shall assess the degree to which the procedures of the Spanish market infrastructures comply with international best practices and recommendations.

The Banco de España's oversight of Spanish securities infrastructures is justified by its interdependence with TARGET2, its importance for the conduct and transmission of monetary policy and the possibility of central banks providing emergency liquidity to Central Counterparties (CCPs).

Spanish securities infrastructures include the central securities depository, Iberclear (which manages the securities settlement system) and the CCP, BME Clearing.

The activity of the two most significant segments of BME Clearing has been uneven. As seen in Chart 5.4, the clearing activity in the fixed income segment has declined progressively, in part owing to the improvement in the financing conditions of institutions, while activity in the financial derivatives segment has remained relatively steady since 2016 both as regards the number of transactions and in nominal terms.

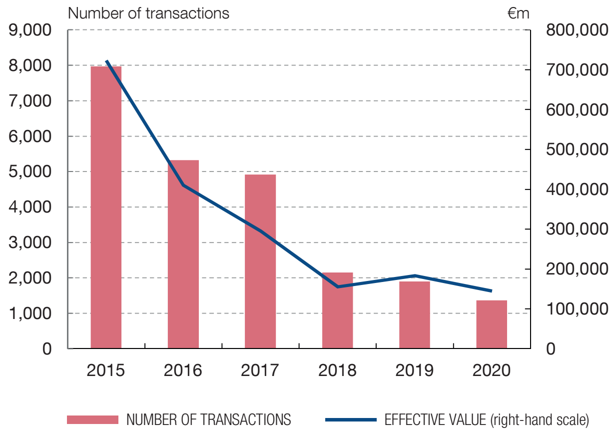
The CCP's financial resources arise mainly from members' margins and contributions to the default fund. The liquidity of these resources is essential in order to swiftly close positions in the event of a member defaulting. The liquidity of these resources at BME Clearing is quite high, as can be seen in Chart 5.5, with most being deposited in its account at Banco de España.

The performance of Iberclear's settlement activity differs by type of instrument (see Chart 5.6). As regards fixed-income securities, increases are

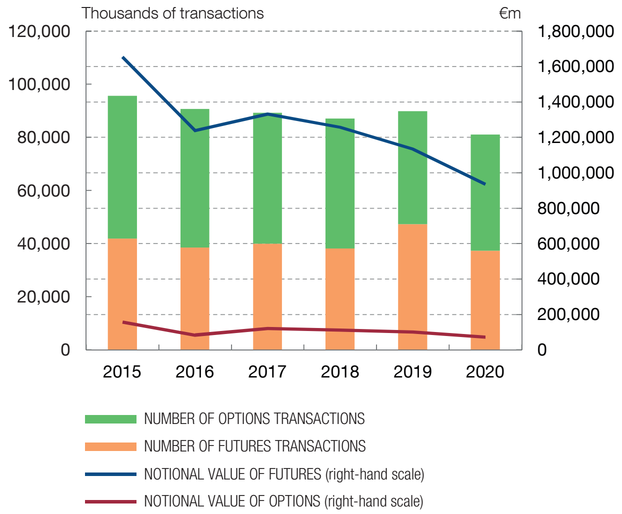
Chart 5.4
OVERVIEW OF BME CLEARING OPERATION

The clearing activity in the fixed-income segment (government bond repos), which for years broadened the range of cleared European sovereign debt, has declined, while that in financial derivatives remained steady.

1 CLEARING OF GOVERNMENT BOND REPOS



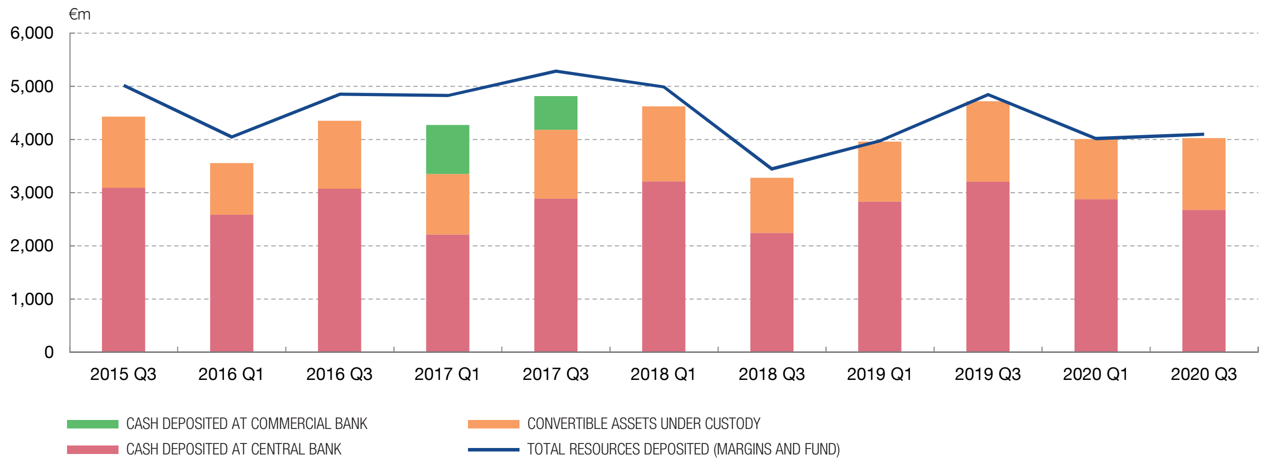
2 CLEARING OF FINANCIAL DERIVATIVES TRADED ON THE MEFF



SOURCE: BME Clearing.

Chart 5.5
RESOURCES DEPOSITED AND LIQUIDITY THEREOF

The cash deposited at the central bank, which has remained steady over time, is BME Clearing's main resource.



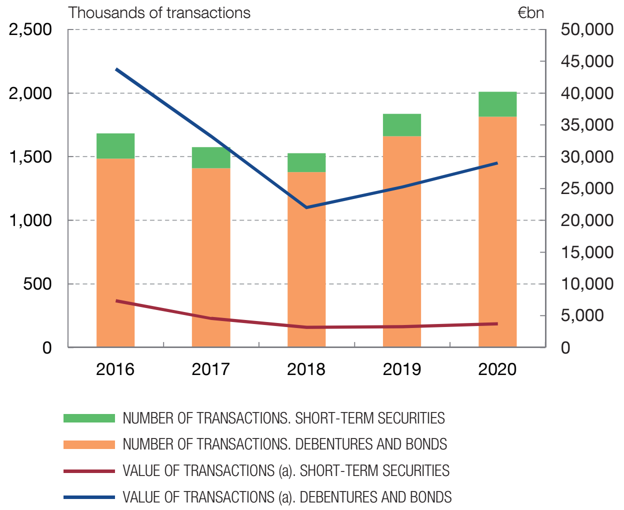
SOURCE: BME Clearing.

observed in terms of number of transactions and value, which are higher for debentures and bonds than for short-term securities. The equities settlement activity continues to decline in terms of value, with a slight increase in the number of transactions.

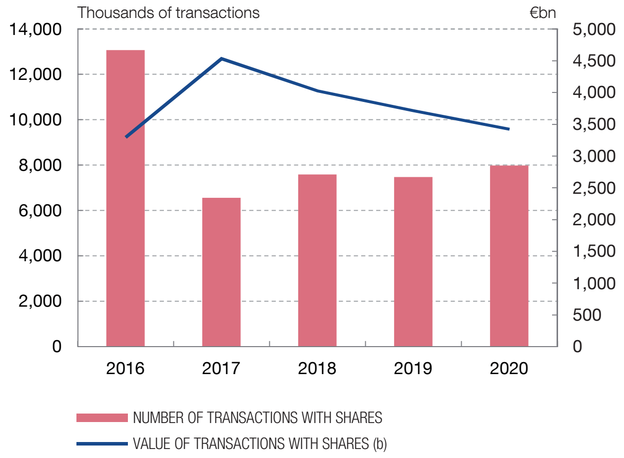
Chart 5.6
IBERCLEAR ACTIVITY DATA. TRANSACTIONS PROCESSED

Fixed-income transactions settled at Iberclear have increased in recent years, while the number of instructions relating to stock market operations remains steady.

1 FIXED-INCOME SECURITIES



2 EQUITIES



SOURCE: Iberclear.

a Nominal balances.
b Cash settled.

5.3.1 Activities resulting from national legislation

In compliance with Article 73 of Royal Decree 878/2015 of 2 October 2015, implementing the LMV, Iberclear provides information to the CNMV and the Banco de España on its exposures to operational risk and the specific measures to be adopted to identify, monitor, manage and reduce these risks, within the framework of the annual assessment and review of compliance with the requirements of the Regulation on improving securities settlement in the EU and on central security depositories (the CSDR).[3] Iberclear sends monthly information to the Banco de España on the activity of the links with foreign central security depositories, which enables the Bank to gain knowledge of cross-border mobilisation of securities.

Under Article 101 of the LMV, the Banco de España is also required to first provide a report before the CNMV can approve the internal rules of Iberclear and any amendments thereto. It also stipulates that circulars implementing these

3 Regulation (EU) No 909/2014 of the European Parliament and the Council, of 23 July 2014, on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012.

rules must be communicated to the Bank, as has been the case in 2020 with the circulars on the recycling period for matched transactions and the optional settlement procedure for financial intermediaries.

As regards BME Clearing, Articles 104 and 107 of the LMV stipulate that the Banco de España shall be required to provide a report prior to any amendments to the CCP's articles of association or internal rules, and to the establishment of any trade, clearing or settlement agreements with other entities. In 2020 the Banco de España issued a favourable report in connection with several changes made in the CCP energy segment.

In June 2020 the Swiss group SIX acquired the BME group, which includes Iberclear and BME Clearing. The Banco de España has collaborated with the National Commission on Markets and Competition, sending a letter of non-objection to this operation from the standpoint of the competition rules and has closely followed the purchase and authorisation procedure, paying special attention to its impact on financial stability and the euro.

5.3.2 Activities resulting from European legislation

The Banco de España, as relevant authority, monitored in 2020 the recommendations identified in the authorisation procedure for Iberclear in accordance with the CSDR, practically all of which have been addressed.

The Banco de España also participated in assessing the eligibility of two new relayed links, CBL_CBF Cascade_Iberclear and CBF Creation_CBL_CBF Cascade_Iberclear, against the Eurosystem's eligibility standards for the use of the securities settlement systems and their links in intraday credit operations.

The college of supervisors of BME Clearing is chaired by the CNMV and includes among its members the Banco de España, in its three-fold capacity as a central bank of issue of the euro on behalf of the Eurosystem, overseer of the CCP and supervisor of the CCP members in one of the three Member States with the largest contributions to the default fund. As a member of the college, it must issue an opinion when significant changes arise in the CCP and, among other things, it receives monthly information on its activity. This information allows the Banco de España to monitor the risks to which the CCP is exposed and the changes in its risk management framework. In 2020 the COVID-19 crisis did not have a significant impact on the activity of the CCP or on compliance by its members with their obligations.

The Banco de España also participates in the Eurosystem's cooperative oversight of the TARGET2-Securities platform. The implementation of the recommendations made in 2019 as a result of the assessment of compliance with the CPMI-IOSCO Principles for financial market infrastructures (PFMI) has been delayed until 2021 as a result of the COVID-19 crisis. Other specific assessments are being conducted, such as that of compliance with CROE (which is closely linked to that relating to TARGET2, as they share internal rules and operating procedures) and the assessment in accordance with the PFMI of the penalty mechanism for compliance with the settlement discipline rules of the CSDR.

Furthermore, the Banco de España participates in the T2S Cooperative Arrangement, which is comprised of central banks and securities supervisors, to oversee TARGET-2 Securities. Much of the activity in 2020 focused on the assessment of a major incident which occurred in May.

6

EXERCISE OF SANCTIONING POWERS

Sanctioning activities continued in a year marked by COVID-19, in which the time limits for sanctioning proceedings were suspended from 14 March to 1 June, owing to the declaration of the state of alert.

Nevertheless, proceedings continued to be initiated and resolved in 2020:[1] three proceedings were initiated; eight that had been initiated in 2019 were concluded; and one proceeding was resumed against a savings bank, its directors and management and the members of its audit committee, having been suspended for several years due to the concurrence with criminal proceedings in relation to the same facts.

Transparency and consumer protection continue to account for the highest number of sanctioning proceedings. Of the 12 proceedings under way during 2020, five were in this area (against three banks, one credit cooperative and one SLI). For instance, in the area of pre-contractual and contractual information offered to customers, conduct such as failing to duly provide the pre-contractual information in novations was sanctioned. Likewise, in the area of the Code of Good Practice (CGP) set out in the annex to Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgagors experiencing financial hardship, actions sanctioned included the failure to duly provide information on the CGP and the possibility of requesting it be applied, not only ab initio, but throughout the processing of the request, and the application of a restructuring term other than 40 years where there is no record of the customer requesting a different term.

Sanctioning activities involving supervised institutions other than credit institutions and their shareholders also continued. Proceedings notably included those brought against one PI and its officers (including the de facto director), an ELMI's shareholders, who acquired a qualifying holding in concert, and two appraisal companies and their officers. Sanctions were imposed on one appraisal company and its officers for having insufficient human resources, shortfalls in its procedure for monitoring incompatibilities (as the owners of the properties under valuation were not included in the procedure), and valuation methodologies that did not fully comply with the requirements of sector-specific legislation.

Companies not authorised by the Banco de España were also sanctioned, either for conducting activities reserved to credit institutions or for failing to provide the information requested during an inspection.

1 The Banco de España publishes information on sanctions on its website (Sanctions imposed by the Banco de España).

7

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

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

Participating in international banking supervision and regulation fora has been a strategic priority for the Banco de España for several years. This priority was bolstered in 2020 by the Strategic Plan 2024 which includes, as one of its objectives, boosting the Banco de España's influence within these organisations.

This year, the activity of these fora was affected significantly by the sudden and profound crisis triggered by COVID-19, both in their organisational aspects and, more notably, in the content of their agendas. Since the onset of the crisis, the focus has been on the different regulatory and supervisory measures needed in response, promoting the flexibility needed to mitigate the adverse effects of the crisis on the real economy while ensuring, in this climate of heightened uncertainty, close monitoring of its impact on the financial system in general, and on the banking system in particular.

The main international banking supervision and regulation fora in which the Banco de España participates are presented in Figure 7.1.

Figure 7.1
THE BANCO DE ESPAÑA'S PARTICIPATION IN INTERNATIONAL BANKING REGULATION AND SUPERVISION FORA

GLOBAL FORA	EUROPEAN FORA	OTHER FORA
- Financial Stability Board (FSB) - Basel Committee on Banking Supervision (BCBS)	- European Banking Authority (EBA) - European Systemic Risk Board (ESRB)	- FinCoNet - Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements (BIS) - Network of Central Banks and Supervisors for Greening the Financial System (NGFS)

SOURCE: Banco de España.

7.1 Global fora

7.1.1 Financial Stability Board

During 2020, the Financial Stability Board (FSB) prioritised the international coordination of the response to COVID-19, adapting its work programme

to support the real economy, maintain financial stability and minimise the risk of fragmentation. To this end, it drew up five principles, which were adopted by the G20 in April. These principles included recognising and using the flexibility built into international standards, acting consistently with these standards (and not rolling them back or compromising their underlying objectives) and coordinating on the timely unwinding of the measures taken.[1]

Moreover, the stress observed in March 2020 prompted the FSB to undertake a holistic review of the risks related to non-bank financial intermediation. The review concluded in November with the publication of a report underscoring the need to strengthen the resilience of non-bank financial intermediation and proposing a work programme to address the vulnerabilities identified (as regards money market funds and other open-ended funds, margining practices, etc.). In December, the FSB published its tenth annual monitoring report on the sector, which noted that growth therein in 2019 continued to outpace that of the banks (owing primarily to the performance of collective investment vehicles) and revealed data on the sector's performance in 2020 Q1.

In addition to this unexpected coronavirus-related work, the FSB continued to carry out its agenda. It published a roadmap to enhance cross-border payments and a report on the regulatory, supervisory and oversight challenges raised by "global stablecoins".[2] This report detailed some high-level recommendations addressed to authorities in order to promote an early adoption of common standards that mitigate the risks of fragmentation and regulatory arbitrage.

Moreover, the FSB worked actively on the risks related to the use of regulatory and supervisory technology (RegTech and SupTech). Specifically, it published a report addressing, in addition to the risks of these technologies, their benefits, opportunities and challenges, and the extent to which they have been adopted by authorities and regulated institutions. The FSB also published a report on effective practices to respond to, and recover from, cyber incidents, aimed at financial institutions, supervisors and other authorities.

Further, the FSB continued to monitor the implementation of the post-crisis reforms. It published a progress report on the reforms to interest rate benchmarks, focused on the transition away from LIBOR, which seeks to ensure that firms and market participants are prepared to complete this transition at end-2021. As regards

1 These principles were set out in the report of 15 April *COVID-19 pandemic: Financial stability implications and policy measures taken*, FSB (2020). In addition to the three principles mentioned, the report also includes: monitoring and sharing information on a regular basis to assess and address the risks arising from the pandemic, in order to maximise the global response, and seeking opportunities to temporarily reduce operational burdens on institutions and authorities, so as to assist them in focusing on the COVID-19 response.

2 Stablecoins are cryptocurrencies whose value is linked to fiat currencies or other assets. See D. Arner, R. Auer and J. Frost (2020), "Stablecoins: risks, potential and regulation", *Financial Stability Review,* No 39, Banco de España.

the resolution of financial institutions, the FSB published guidance with recommendations for CCP resolution, and the annual Resolution Report. This report contains a section dedicated to the lessons learnt during the pandemic. It underlines the importance of work to prepare for a potential resolution and estimates that G-SIIs already meet the 2022 TLAC requirement.

As part of its programme to assess the effects of the reforms, the FSB published a consultation report on the evaluation of the too-big-to-fail reforms. This report concludes that banks are now more resilient and resolvable than in the 2008-09 crisis and that the benefits of the post-crisis financial reforms adopted significantly outweigh the costs. However, it adds that there are still certain gaps that need to be addressed in order to remove the remaining obstacles to resolution.

Lastly, the FSB addressed the implications of climate change for financial stability. July 2020 saw the publication of a report taking stock of financial authorities' experience in including climate-related risks in their financial stability monitoring. In November, it published a report on the implications of climate change for financial stability, assessing the channels through which physical and transition risks could impact the financial system and how they might interact. In this document, the FSB also indicated that it will conduct work to assess the availability of data through which climate-related risks could be monitored. In December, the FSB published its response to the IFRS Foundation's consultation on sustainability reporting standards, in which the Board encouraged the Foundation to build on the work of the TCFD[3] for developing these standards.

7.1.2 Basel Committee on Banking Supervision

As with other international organisations, the BCBS's work in 2020 was marked by the impact of COVID-19 and the response to its effects (see Box 7.1). In this regard, the work of the Committee, which is chaired by the Governor of the Banco de España, served to coordinate the international response to the challenges posed by the pandemic for the global banking sector.

Further, during 2020 the BCBS conducted a strategic review to optimise its structure and internal processes in order to focus on emerging risks, including structural trends in the banking sector, the digitalisation of finance, and climate-related risks. Moreover, the Committee will monitor the implementation of Basel III through its Regulatory Consistency Assessment Programme and an evidence-based evaluation of the effectiveness of these reforms, also taking into consideration

3 Task Force on Climate-related Financial Disclosures, created by the FSB in 2015 to develop a series of recommendations applicable to firms on disclosures of the climate-related financial risks that they incur in their activity.

Box 7.1
THE BASEL COMMITTEE ON BANKING SUPERVISION AND THE CHALLENGE OF COVID-19

During 2020, a large part of the activity of the Basel Committee on Banking Supervision (BCBS) was focused on coordinating the international response to the impact of COVID-19 on the banking sector. In light of the sudden and swift global spread of the pandemic in the early months of the year and its increasing effects on economic activity, the Committee agreed a series of regulatory relief measures and modified its work plan to give priority to monitoring possible risks and vulnerabilities and adopting measures.

In this setting, the Committee's response had three objectives:

— Ensuring that banks continued to lend to creditworthy households and businesses, thereby mitigating part of the economic impact.

— Safeguarding the financial and operational resilience of the global banking system.

— Ensuring that banks and authorities had sufficient operational capacity to address the most immediate financial stability priorities.

Governments in many jurisdictions have approved extraordinary support measures to alleviate the economic effects of the pandemic, such as State guarantee schemes and moratoria on the payment of credit obligations. Against this backdrop, the Committee issued technical guidance to ensure that these measures, and their impact on reducing risk, were reflected in banks' capital requirements, thus contributing to achieving their objectives.

At the same time, and to avoid excessive procyclicality, the Committee announced that it expected banks to use the flexibility inherent in expected loss accounting frameworks. It also provided greater flexibility in the transitional arrangements which provide for deferring the impact of the expected loss framework on regulatory capital.

A key aspect in the pursuit of these aims has been the decision by the Group of Central Bank Governors and Heads of Supervision (GHOS) to defer the implementation of the outstanding Basel III standards by one year, up to January 2023, so that banks and supervisors have additional operational capacity to respond to the immediate impact of COVID-19. Both the GHOS and the BCBS have reiterated their expectations of a full, timely and consistent implementation of all Basel standards, based on the revised timeline.

Financial institutions now have tools they did not have in previous situations of economic stress: capital and liquidity buffers. These buffers are designed with the dual aim of ensuring that banks have loss-absorbing capacity without breaching their minimum requirements and of maintaining the flow of credit to the real economy by lending to creditworthy customers. Since the start of the crisis, the Committee has reiterated that a measured drawdown of existing buffers is in keeping with these objectives and indicated that supervisors will provide sufficient time for banks to restore these buffers, taking account of market and bank-specific conditions.

The impact of COVID-19 has accelerated some trends observed in recent years and underlined the importance of monitoring structural risks. The GHOS tasked the BCBS with continuing to pursue a coordinated response to the crisis, to preserve a level playing field and to avoid regulatory fragmentation, through:

— An ongoing monitoring and assessment of risks and vulnerabilities, together with the sharing of information and experiences among supervisors.

— The promotion of the use of the flexibility existing in the Basel framework, where relevant.

— The monitoring of the exceptional measures adopted by members, to ensure they are consistent with the objectives of the Basel framework and are unwound in a timely manner.

— The adoption, by the Committee, of additional measures, where necessary.

the lessons from the COVID-19 crisis. This new guidance brings to an end the post-crisis regulatory agenda of the last decade, and any potential adjustment to Basel III will therefore be limited and consistent with the Committee's evaluation work.

Turning to the analysis of climate-related financial risks, the Committee published the results of the stocktake on regulatory and supervisory approaches. It is also working on a series of reports covering matters such as the methodologies for measuring these risks, the transmission channels of such risks to the banking system and the development of effective supervisory practices to mitigate them.

As regards the standards for the capital requirements calculation, the Committee approved a technical amendment to the treatment of NPL securitisations and completed the review of the credit valuation adjustment (CVA) framework.[4] The adjustment to NPL securitisations seeks to adapt the general securitisation framework to the specific features of this type of underlying exposure. To this end, a prudent and simple approach is adopted, introducing certain floors and a fixed risk weight for the senior tranche. The deadline for implementation is set for 2023. Turning to the review of the CVA framework, the Committee made adjustments to adapt it to the changes approved in 2019 to the market risk framework (i.e. the Fundamental Review of the Trading Book, or FRTB) and to introduce recalibrated capital requirements under the basic and standardised approaches.

The Committee also published an update of its 2014 guidelines on the sound management of risks related to money laundering and financing of terrorism. This update includes aspects relating to interaction and cooperation between prudential and AML/CFT supervisory authorities.

Lastly, the Committee worked on matters relating to operational resilience and operational risk and on the transition to new benchmark rates. Consultative documents were published on operational resilience principles, aimed at increasing the capacity of banks to withstand potentially severe events, and on principles for operational risk management. Moreover, the Committee worked on the regulatory and supervisory implications of the benchmark rate reforms, and it published, together with the FSB, recommendations for authorities to support financial institutions and clients in this transition.

7.2 European fora

7.2.1 European Banking Authority

The EBA's agenda was also notably impacted by the COVID-19 crisis. Of the work carried out, mention should be made of the Guidelines on legislative and non-legislative moratoria (see Box 7.2); the statement published on the use of capital and liquidity buffers, where it suggested that supervisors allow institutions to operate temporarily below the capital level defined in the Pillar 2 Guidance (P2G); the easing of the

4 The CVA capital requirement covers possible mark-to-market losses on derivative instruments as a result of the deterioration in the creditworthiness of a counterparty.

Box 7.2

EBA GUIDELINES ON LEGISLATIVE AND NON-LEGISLATIVE MORATORIA ON LOAN REPAYMENTS APPLIED IN THE LIGHT OF THE COVID-19 CRISIS

On 2 April 2020, the EBA published the Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02), in order to clarify the prudential treatment of moratoria and to prevent a sudden increase in non-performing loans that would undermine their effectiveness.

These guidelines specify the prudential treatment of the moratoria and set the relevant qualifying criteria, which were initially as follows:

I They must either be based on national law or be private moratoria that form part of an industry- or sector-wide agreement.

II They have to apply to a broad range of customers and allow the borrower to take advantage of the moratorium without an ex ante assessment of their ability to pay.

III They change only the schedule of payments and offer the same conditions to all the exposures subject to the moratorium.

IV They do not apply to new loans granted after the date when the moratorium was announced.

V They were launched in response to COVID-19 and applied before 30 June 2020.

As regards the prudential treatment, the guidelines interpret how to apply the prudential definitions of "default" and "forbearance" to transactions subject to eligible moratoria.

Starting with the definition of "default", the guidelines provide that, when an exposure is subject to an eligible moratorium, the instalments in question will not be considered past due, and days past due will be counted on the basis of the schedule resulting from the application of the moratorium.

The guidelines also indicate that, throughout the duration of the moratorium, banks must continue to analyse their borrowers' creditworthiness and unlikeliness to pay in accordance with their relevant prevailing general policies.

When banks conclude that borrowers are unlikely to pay, they will be classified as defaulted. It is therefore a matter of distinguishing between those borrowers with viable businesses that are experiencing one-off liquidity difficulties owing to the measures imposed by governments and those with fundamental solvency problems. In the case of the latter, banks should not delay classification as defaulted or the recognition of losses.

Turning to the definition of "forbearance", the guidelines provide that transactions subject to an eligible moratorium should not automatically be reclassified as forborne. This flexibility is allowed, inter alia, because eligible moratoria are granted, as part of a general scheme, to borrowers meeting certain criteria, without said borrowers being subject to an individual ex ante assessment of their creditworthiness. Moreover, as the exposures are not considered forborne, they are also exempt from the distressed restructuring test set out in the EBA Guidelines on the definition of default (EBA/GL/2016/17).

Although these guidelines were originally to expire on 30 June 2020, the EBA decided to extend them for a further three months. As a result, the new maturity extensions agreed by banks would no longer be subject to the guidelines, but instead would have to be analysed on a case-by-case basis.

In late November, the new restrictions imposed by some European governments to address the second wave of the pandemic led the EBA to reconsider its decision and agree to reactivate its guidelines – retroactively from 1 October – until 31 March 2021. Two further conditions were imposed: i) a nine-month cap was set on the period during which an exposure subject to moratoria can benefit from the prudential treatment under the guidelines (except for moratoria granted before 30 September); and ii) the mechanism of the unlikeliness to pay assessment was reinforced, and institutions were requested to submit to their competent authorities their plans for applying this criterion.

supervisory reporting and disclosure requirements; the postponement to 2021 of the stress test exercise scheduled for 2020; and an extraordinary transparency exercise, whose results were published in June. Further, the supervisor was recommended to take a pragmatic approach in the SREP (for more details, see Section 2.2.1), and banks were urged to adopt a prudent approach to dividend payment and other distribution policies, including variable remuneration.

Brexit also had a significant impact on the EBA's work. The EBA published several statements warning institutions of the need to be ready for a possible "no-deal" Brexit and encouraging them to appropriately inform their customers of their contingency plans and services offered in the EU.

In prudential regulation, the EBA continued to advise the European Commission on the implementation of the final Basel III reform package in Europe. The decision to defer the implementation of Basel III by one year (until 1 January 2023) and the delay in the European Commission's draft legislative proposal led the Commission to request the EBA to update the 2019 impact study, including an impact analysis of different alternatives for implementation in Europe and an assessment of the effects of COVID-19. In its December 2020 report, the EBA continues to take a favourable view of the implementation of Basel III in Europe and estimates a slight decrease in the negative impact on capital. This, together with the transitional period for some aspects of the reform, will help lessen the effects of the pandemic on the final implementation of Basel III.

Moreover, the EBA worked actively on developing a regulatory technical standard on the prudential treatment of software assets, establishing a prudential amortisation framework in this respect.

In the prudential area, mention should also be made of the work to implement the FRTB, revive the securitisation market, and review its production on remuneration and internal governance to adapt it to CRD V and to the new regulation and directive on investment firms.

The Guidelines on loan origination and monitoring were also published, aimed at improving practices, mechanisms, processes and procedures in relation to credit granting, while respecting and protecting the interests of consumers (see Box 7.3).

In the reporting and transparency area, significant headway was made in the EUCLID project (see Box 7.4) and in the study to determine the costs that institutions incur when complying with the supervisory reporting requirements and whether these costs are proportionate compared to the benefits. The purpose of the study is to make recommendations to enable costs to be reduced by around 10%-20%, at least for small and non-complex institutions. The findings will be submitted to the European Commission in 2021.

Box 7.3
EBA GUIDELINES ON LOAN ORIGINATION AND MONITORING

The Guidelines on loan origination and monitoring of 29 May 2020 (EBA/GL/2020/06) were drawn up under a mandate from the Council of the European Union, as part of its action plan to tackle non-performing loans in Europe.

The guidelines specify the requirements of the Capital Requirements Directive[1] (CRD) and introduce special requirements relating to the creditworthiness assessment of consumers, as envisaged in the Mortgage Credit Directive (Directive 2014/17/EU) and the Consumer Credit Directive (Directive 2008/48/EC).

The objective of the guidelines is to improve practices, mechanisms, processes and procedures in relation to credit granting, in order to ensure that institutions have robust and prudent approaches to credit risk taking, management and monitoring, while respecting and protecting the interests of consumers. Consequently, they have a dual scope: prudential and conduct.

The guidelines are structured into different sections. These include overall internal governance arrangements for the credit-granting and monitoring process; the handling and use of the information and documentation required from borrowers and for the assessment of their creditworthiness; a section on the risk-based pricing of loans; a section on loan collateral valuation; and a loan monitoring framework.

The guidelines are addressed to competent authorities and financial institutions. They were adopted by the Banco de España in July 2020 and are applicable in full to lending by credit institutions and specialised lending institutions.

The sections on granting procedures, pricing and collateral valuation also apply to payment institutions and electronic money institutions (and, in the case of granting procedures, to real estate credit lenders) operating in more than one region, in respect of transactions within the scope of the Mortgage Credit Directive and the Consumer Credit Directive.

As regards the target scope of application, debt securities, derivatives and securities financing transactions are excluded, as are forborne and non-performing exposures. The sections on granting procedures and pricing only apply to loans to consumers and enterprises, i.e. excluding loans granted to financial institutions, sovereigns and public entities.

The implementation of the guidelines is also subject to the principle of proportionality, and specific criteria are established for each section.

The guidelines will enter into force on 30 June 2021 and will apply, in general and with exceptions, to loans granted as from that date, whereupon the EBA Guidelines on the creditworthiness assessment of consumers (EBA/GL/2015/11) will be repealed.

1 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

Turning to conduct and consumer protection, this year the EBA's efforts once again focused on achieving greater supervisory convergence, in particular in the implementation and application of the Guidelines on product oversight and governance arrangements for retail banking products. Different lines of work were also launched to fulfil the new consumer protection mandates recently included in the EBA Regulation[5] (in force since January 2020).

Moreover, within its financial innovation action plan, a line of work was launched to analyse digital platform-based business models and their potential impact on the financial sector,

5 Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.

Box 7.4

PROJECT EUCLID TO EXTEND EBA SUPERVISORY REPORTING TO ALL INSTITUTIONS

Project EUCLID (European Centralised Infrastructure for Supervisory Data) was launched in 2017 with the aim of implementing a new technological platform in the EBA that will serve as a single point of entry for all institutions' supervisory data. This platform will extend the current sample of institutions that report to the EBA, comprising the 200 largest institutions in the European Economic Area (EEA), to all EEA entities and banking groups (over 4,500 entities), at both individual and consolidated level.

Since early 2018, the EBA, the ECB and the NCAs have been working to achieve an efficient implementation of the project, from the standpoint of both process harmonisation and cost optimisation. To this end, criteria alignment, process automation, the minimisation of manual actions and, as far as possible, the removal of overlaps between the EBA and the ECB have been prioritised. Moreover, technical support has been given to areas such as institutions' qualitative information, the classification of institutions and the development of reporting requirements and data quality control and acceptance policies.

In mid-2019, two significant milestones were reached, with the integration of the Payment Institutions Register and the Credit Institutions Register in the EUCLID platform. The EBA also decided to incorporate credit institutions' resolution data into EUCLID.

Lastly, in preparation for the launch of the EUCLID platform, on 5 June 2020 the EBA published several decisions aimed at providing a legal basis for the new requirements derived from the project.

The EUCLID platform was launched in the summer of 2020, when the resolution data and, subsequently, the supervisory data of the institutions classified as large by the EBA were collected.

The project will conclude in 2021 Q1, when the December 2020 supervisory data of all EEA banking sector institutions (large and small) are collected. This will enable the EBA to advance towards its strategic objective of creating an "integrated data hub" of supervisory and resolution data at the service of competent authorities and the general public.

so as to strengthen supervisory knowledge and support the European Commission in the work on "platformisation", as part of the European Digital Strategy and the Digital Single Market.

In the area of payment services, the EBA's efforts focused on access to payment accounts by third party payment service providers and on the migration to strong customer authentication solutions under PSD2 in e-commerce card-based payment transactions. With regard to payment account access, in June the EBA issued an opinion identifying some aspects of specific interfaces as the main obstacles, with 31 December 2020 set as the deadline for their removal, except in duly justified, isolated cases. As regards the work on the migration to strong customer authentication solutions, the EBA cancelled the June quarterly report on progress made, owing to complications arising from COVID-19 and the concerns raised by the industry as to possible compliance with the migration plans agreed in late 2019. Nevertheless, the European authorities have not extended the period of supervisory flexibility set to end in December 2020.

As regards sustainable finance, in November the EBA published a discussion paper on the possible inclusion of environmental, social and governance (ESG) risks in the SREP. It is also developing implementing technical standards on the disclosure on ESG risks, to be submitted to public consultation in early 2021, and has begun the groundwork for complying with the mandate set out in Article 501c of CRR 2 as regards the potential inclusion of these exposures in Pillar 1.

Lastly, on 1 January 2020, the mandate of the three ESAs to contribute to preventing the use of the financial system for the purposes of money laundering and terrorist financing was consolidated within the EBA. To this end, the EBA was given new powers to lead, coordinate and monitor the AML/CFT efforts of all financial sector agents and competent authorities. A new AML/CFT Standing Committee was set up, in which both SEPBLAC and the Banco de España are represented. Notable among the documents drawn up by the Committee this year is the opinion on the future of European AML/CFT regulation.

7.2.2 European Systemic Risk Board

The profound macroeconomic and financial impact arising from COVID-19 has been the most important challenge faced by the European Systemic Risk Board (ESRB) since its creation in 2010. The ESRB adapted its work programme, temporarily focusing its attention on five priority areas, under the coordination of its Advisory Technical Committee:[6] i) implications for the stability of the financial system of public guarantee schemes and other fiscal measures to protect the real economy; ii) market illiquidity and implications for asset managers and insurers; iii) procyclical impact of ratings downgrades for the financial system; iv) restraints on dividend payments, share buybacks and other pay-outs by financial institutions; and v) liquidity risks arising from margin calls.

The ESRB's work in 2020 in response to the pandemic led to a series of recommendations for authorities with supervisory and macroprudential policy responsibilities in EU Member States.[7] In particular, the Banco de España, in its dual capacity as designated authority and competent authority for the microprudential supervision of LSIs in Spain, adopted the recommendations relating to the banking system:

- Recommendations ESRB/2020/7 and ESRB/2020/15 on temporary restrictions of dividends and variable remuneration. The Banco de España issued its own recommendations, in coordination with the ECB and the SSM national authorities (see Section 2.2.4).

6 The ESRB Advisory Technical Committee has been chaired by the Governor of the Banco de España since July 2019.

7 For a broader summary, see Box 3.2 "The response of the European Systemic Risk Board to the COVID-19 crisis", *Financial Stability Report, Autumn*, Banco de España (2020).

— Recommendation ESRB/2020/6 on liquidity risks arising from margin calls, which seeks to: i) limit cliff effects in relation to the demand for collateral; ii) improve stress scenarios for the assessment of CCPs; iii) limit liquidity constraints related to margin collection; and iv) promote international standards on mitigating procyclicality. This recommendation affects the Banco de España, as supervisor of credit institutions that are CCP members.

— Recommendation ESRB/2020/8 on the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken in response to COVID-19. The Spanish authority to which this recommendation is addressed is AMCESFI. As a member institution of AMCESFI, the Banco de España participates actively in the development of an analytical framework for assessing the measures.

Aside from coronavirus-related work, in 2020 the ESRB issued a recommendation for promoting the use of the legal entity identifier (LEI) for regulated entities involved in financial transactions.

7.3 Other fora

In the area of conduct and consumer protection, the Banco de España is a member of the Governing Council of the International Financial Consumer Protection Organisation (FinCoNet). This organisation's activity in 2020 centred on tasks relating to the assessment of customer creditworthiness in responsible lending, financial products and services advertising, product governance, and the impact of COVID-19 on transparency and consumer protection. A report on the main SupTech tools developed by the authorities to oversee conduct was also published.

The Banco de España is also a member of the Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements (BIS). The bulk of the CPMI's work in 2020 was focused on monitoring the regulatory and supervisory measures taken as a result of the pandemic and on the ways to address the problems and challenges in financial market infrastructures posed by the crisis. It also continued to work on the strategy for reducing the risk of wholesale payment fraud at endpoints and monitored the degree of implementation of the PFMI across jurisdictions, publishing the assessment report for Brazil.

In the area of innovation, the CPMI continued to analyse large-value digital tokens. It monitored the matters described on global stablecoins in the 2019 report, having regard to the course and development of the projects (such as the Libra project) and examining the challenges, risks and benefits these initiatives could entail (in particular, their impact on financial stability). Based on the prior financial inclusion report, in 2020 the CPMI published a report analysing the opportunities and challenges of new technologies in the FinTech era, and another on the development of tools for helping national authorities undertake diagnostic studies to measure and track progress in financial inclusion from a payments perspective.

Lastly, the work carried out by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) was noteworthy. The purpose of this network of supervisors and central banks from across the world, including the Banco de España, is to contribute to the financial system's global response to achieving the goals of the 2015 Paris Agreement. In 2020, this organisation published a guide for banking and insurance supervisors on integrating environmental and climate-related risks into supervisory practices.

8

NEW REGULATORY DEVELOPMENTS IN SUPERVISORY MATTERS

8.1 Banco de España circulars and guidelines

8.1.1 Circular 1/2020

Circular 1/2020 of 28 January 2020 amending Circular 1/2013 of 24 May 2013 on the Central Credit Register.

The main aim of this Circular is to adapt the CCR to the changes introduced by Law 5/2019 of 15 March 2019 regulating real estate credit agreements to Law 44/2002 of 22 November 2002 on financial system reform measures.

The main change is that all real estate lenders are granted access to the CCR: first, the obligation to report to the CCR is extended to real estate lenders and credit institutions operating under the freedom to provide services. Second, real estate credit intermediaries are granted access, on an equal footing with reporting institutions, to the credit reports of legal entities and individuals registered in the CCR. These amendments increase the information available to institutions for assessing the exposures of their customers, enabling them to improve their decision-making process.

8.1.2 Circular 2/2020

Circular 2/2020 of 11 June 2020 amending Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial reporting standards and financial statement formats.

The main aim of the new Circular, in force since 17 June, is to adapt Circular 4/2017 to the changes in European law on reporting requirements for credit institutions made by Commission Implementing Regulation 2020/429 and Regulation 2020/605 of the European Central Bank. The amendment is aimed at: i) expanding the information to be submitted by institutions on non-performing and forborne exposures and foreclosed collateral; ii) supplementing information on operating and administrative expenses; and iii) incorporating minor changes to the data available on leases, as a result of the entry into force of International Financial Reporting Standard (IFRS-EU) 16 Leases.

The latest developments in IFRS-EU, including most notably the new definition of a business in IFRS-EU 3, are also incorporated. In addition, to comply with the ESRB Recommendation on closing real estate data gaps (ESRB/2016/14), it makes changes to the information required from credit institutions on (commercial and residential) real estate loans.

With a view to enhancing transparency, the Banco de España has been entrusted with the dissemination of the public financial statements of credit institutions, although they may also be released by associations as has been the case to date. The first information disseminated by the Banco de España was that referring to 2020 Q2.

8.1.3 Circular 3/2020

Circular 3/2020 of 11 June 2020 amending Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial reporting standards and financial statement formats.

In view of the economic crisis brought about by COVID-19, banking regulators and supervisors across the world recommended that appropriate use be made of the implicit flexibility of the regulatory framework, without detriment to the suitable identification and coverage of credit risk.

In this context, this Circular, which entered into force on 17 June, aims to change how forbearance is treated for the purposes of its classification by credit risk (to avoid the rule being applied automatically or mechanically) and to allow greater flexibility in the application of expert judgement. In particular, this amendment allows the rebuttal of the presumption that, in all forborne transactions, there is a significant increase in credit risk at the time they are granted. Henceforth, such transactions may be classified as performing provided that the institution can prove that it has not identified a significant increase in credit risk since their initial recognition (to date they could only be classified as non-performing exposures or Stage 2 exposures).

These amendments also affect SLIs, pursuant to the reference to the criteria of Circular 4/2017 made in Circular 4/2019 of 26 November 2019 to specialised lending institutions on public and confidential financial reporting standards and financial statement formats.

8.1.4 Circular 4/2020

Circular 4/2020 of 26 June 2020 on the advertising of banking products and services.

This Circular, which repeals Circular 6/2010 of 28 September 2010, amends some aspects of the previous regulation in order to adapt it to developments in the advertising sector –mainly as a result of the impact of digital technology– and to ensure more effective supervision.

In particular, the scope is extended to lenders and real estate credit intermediaries and includes both Spanish financial institutions and foreign institutions that advertise banking products and services in Spain through a branch or agent or under the freedom to provide services.

In addition, the principles and general criteria on the content and format of advertising messages are more accurately defined. A new specific regime is introduced for advertising broadcast via audiovisual media or on the radio and for advertising through digital channels and on social media, and the procedures and internal controls required of institutions are detailed with a view to ensuring more effective preventive control of the risks of advertising activity.

Lastly, the new Circular includes additional improvements and guarantees in the administrative procedure through which the Banco de España may request removal or rectification of bank advertising that does not comply with the provisions of the Circular.

8.1.5 Circular 5/2020

Circular 5/2020 of 25 November 2020 to payment institutions and electronic money institutions on public and confidential financial reporting standards and financial statement formats and amending Circular 6/2001 of 29 October 2001 on owners of currency-exchange bureaux and Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial reporting standards and financial statement formats.

The main aim of this new Circular, which entered into force on 1 January 2021, is to establish the accounting regime – including the reporting regime – of PIs and ELMIs.

In this Circular, the Banco de España continues its strategy of adapting the accounting standards of financial institutions to the European accounting framework set out in IFRS-EU, subject to the general principles of the Spanish Commercial Code. This Circular to PIs and ELMIs draws on the accounting circular to credit institutions (Circular 4/2017), either by setting similar criteria or by referring directly to its rules.

Pursuant to the principle of proportionality, it establishes a simplified reporting regime compared with that in force for credit institutions. New financial statement formats have been designed, which include the provision of payment services and the issuance of electronic money.

In addition, the Circular includes improvements and clarifications to Circular 4/2017 on accounting of credit institutions and to Circular 6/2001 on owners of currency-exchange bureaux.

8.1.6 Circular 1/2021

Circular 1/2021 of 28 January 2021 amending Circular 1/2013 of 24 May 2013 on the Central Credit Register and Circular 5/2012 of 27 June 2012 to credit institutions and payment service providers on the transparency of banking services and responsible lending.

The main aim of this Circular is to adapt Circulars 1/2013 and 5/2012 to the changes introduced in the regulation on the CCR and on official reference interest rates by Ministerial Order ETD/699/2020 of 24 July 2020 on the regulation of revolving credit and amending Ministerial Order ECO/697/2004 of 11 March 2004 on the Central Credit Register, Ministerial Order EHA/1718/2010 of 11 June 2010 on regulation and control of the advertising of banking services and products and Ministerial Order EHA/2899/2011 of 28 October 2011 on transparency and customer protection in banking services (hereinafter, Revolving Credit Ministerial Order).

This Revolving Credit Ministerial Order adjusts the functioning of the CCR to provide more comprehensive information to the reporting parties and improve the information available, thereby enabling an increasingly accurate solvency analysis. To this end, the range of institutions that must report their data to the CCR has been extended, the threshold of the data provided by the Banco de España to the reporting institutions and to real estate intermediaries in the exercise of their activity has been lowered, the amount of information that institutions must report to the Banco de España has been increased and the reporting dates have been brought forward. The Ministerial Order sets out a gradual process for adapting the CCR to these changes.

The Revolving Credit Ministerial Order increases the alternative official reference interest rates available to institutions when granting loans and for inclusion as replacement rates in the loan agreements. To this end, the list of interest rates deemed official reference interest rates has been revised, some of the names of the existing rates have been changed and their number has been increased.

8.1.7 Circular 2/2021

Circular 2/2021 of 28 January 2021 amending Circular 8/2015 of 18 December 2015 to institutions and branches belonging to the Deposit Guarantee Scheme

for Credit Institutions (DGSCI) on information for determining the basis of calculation of contributions to the DGSCI.

In the event of insolvency of a credit institution, Article 30 quater of Royal Decree 217/2008 provides for coverage by the DGSCI of balances held by investment firms in instrumental and cash suspense accounts open in their name on behalf of their clients at the institution for which an insolvency order has been made. Article 43(3) of this Royal Decree adds that, when an investment firm deposits cash on behalf of clients at a credit institution, the balances should be on a client-by-client basis and it should periodically inform the credit institution of the client-by-client balances.

Circular 8/2015 is amended to clarify how the new information should be reported in the return entitled "Information for determining the basis of calculation of contributions to the DGSCI" and the "Breakdown of deposits received".

8.2 Other draft circulars and guidelines in progress

The *Guidelines on the organisational and operational criteria of the CSDs of institutions supervised by the Banco de España* are the result of the supervisory experience acquired in this field.[1]

The guidelines are aimed at institutions supervised by the Banco de España and subject to Ministerial Order ECO/734/2004 of 11 March 2004 on the customer service department and ombudsman of financial institutions. They identify basic supervision criteria and include general principles that are applicable to the organisation and functioning of CSDs and considered appropriate for compliance with supervisory regulations.

The principles and criteria of these guidelines take into account the applicable national regulations and draw on the supervisory guidelines adopted by the Banco de España on this matter, in particular the ESAs Joint Committee's Guidelines on complaints-handling for the securities and banking sectors (JC 2018 35) and the EBA Guidelines on internal governance (EBA/GL/2017/11).

Also in progress is a circular on the macroprudential tools provided for in Articles 45(1), 69 bis and 69 ter of Law 10/2014 (as per the wording of Royal Decree-Law 22/2018 of 14 December 2018 establishing macroprudential tools) and in Article 15 of Royal Decree 102/2019 of 1 March 2019 creating AMCESFI, establishing its legal

1 These draft supervisory guidelines were published for public consultation in December 2020.

regime and implementing certain aspects on macroprudential tools.[2] The future circular, which amends Circular 2/2016, will include provisions on:

– The CCyB requirements applicable to exposures of credit institutions or groups thereof to a specific sector.

– Limits on the concentration of exposures of credit institutions or of a subset thereof to a specific economic sector.

– Conditions on lending and purchase of debt securities and derivatives by credit institutions, for operations with the private sector in Spain.

Another circular in progress is that addressed to payment service providers on operational and security risk management relating to payment services, reporting of serious operational and security incidents and communication of data on fraud relating to means of payment. This circular will implement the obligations of payment service providers deriving from Articles 66 and 67 of Royal Decree-Law 19/2018 of 23 November 2018 on payment services and other urgent financial measures, specifically the requirements to:

– Establish sufficient palliative measures and control mechanisms to manage operational and security risks relating to payment services provided by payment service providers.

– Provide, at least once a year, an assessment of these risks and of the sufficiency of the above-mentioned palliative measures and control mechanisms.

– Immediately report to the Banco de España any serious operational and security incidents.

– Submit to the Banco de España, at least once a year, statistical data on fraud related to means of payment.

A circular to SLIs on liquidity, prudential regulations and reporting requirements is also under preparation.[3] This circular completes the regulatory framework for these institutions. It implements provisions of Law 5/2015 of 27 April 2015 on the promotion of business financing and of Royal Decree 309/2020 of 11 February 2020 on the legal regime of SLIs.

2 The draft circular aimed at including the rules on macroprudential tools was published for public consultation in February 2021.

3 The public consultation of the draft circular to SLIs was published in February 2021.

Specifically, the circular aims to regulate the liquidity buffer and the funding source and maturity structure of SLIs and their solvency reporting requirements. To this end, the circular will be based on the requirements applicable to credit institutions, with appropriate adaptations. The circular also aims to establish: i) the guarantees that the Banco de España may require when control of an SLI is to be exercised by persons residing or authorised in a non-EU country; ii) the reporting requirements as regards the shareholder structure; and iii) the specific cases in which SLIs must draw up the internal capital adequacy assessment report and the Banco de España must conduct the SREP.

In addition, a circular is being prepared on confidential conduct-related information.[4] The circular will include both the formats for the financial statements to be prepared by the supervised institutions and the information to be made available to the Banco de España. The information will refer to financial activity with individuals (residents and non-residents) and microfirms conducted in Spain on an individual basis by institutions within the scope of the circular.

Specifically, it envisages requesting a series of statements, divided into three distinct blocks by: i) type of banking products and services, including payment services, marketed by institutions; ii) sources of interest and fee income; and iii) claims filed with the institution. The circular will also require institutions to keep a claims register with predefined content, at the disposal of the Banco de España. Pursuant to the principle of proportionality, it will recognise a simplified reporting requirements regime, depending on the type and size of the institution and the type of customers to whom they provide services.

8.3 Other new regulatory developments

Although this was not regulation issued by the Banco de España, of particular importance is Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic, known as the "quick fix". The changes stemming from this Regulation aim chiefly to maximise the capacity of credit institutions to lend and to absorb losses related to the pandemic, while still ensuring the continued resilience of such institutions. The main changes introduced in the regulations are listed below (for further details, see Figure 8.1):

- The prudential transitional arrangements for expected loss provisions have been extended.

4 The public consultation of the draft circular on confidential conduct-related information was published in July 2020.

– A prudential filter has been introduced for changes in the value of sovereign debt instruments at fair value through other comprehensive income.

– The prudential backstop has been adjusted for exposures with State guarantees granted in the context of the COVID-19 crisis.

– Central bank reserves may be temporarily excluded from the leverage ratio denominator.

– Supervisors have been granted some discretion to adjust capital requirements for market risk, so as not to take into account potential deviations occurred during the pandemic.

– The date of entry into force of certain measures already included in European regulations has been changed.

Of particular note is Law 7/2020 of 13 November 2020 on the digital transformation of the financial system, which includes a raft of measures to promote the digital transformation of the sector and has fed expectations among many financial sector players.

The main part of the law regulates the so-called “regulatory sandbox” and provides for projects which may result in a technology-based innovation applicable to the financial system to be tested in a closed and controlled environment.

Applications will be submitted to the virtual office of the General Secretariat of the Treasury and International Financing, which will be tasked with forwarding them to the supervisors (the Banco de España, the CNMV or the DGSFP), depending on the nature of the application. The law provides for calls for applications to be published every six months.

After the submission deadline has expired, the applications will be assessed by the supervisors, which will draw up a reasoned report on their acceptance or rejection. When a project qualifies for admission to the sandbox, the applicant and the supervisor will have a period of three months to sign a protocol defining the rules and conditions for conducting the tests, which will be monitored by one or more supervisors.

The law also provides for the creation of specific channels for communicating directly with the supervisory authorities and a channel for written queries on the regime, classification or application of the sectoral financial regulations relating to the use of technology in the financial sector.

Also published was Royal Decree 309/2020 of 11 February 2020 on the legal regime of specialised lending institutions and amending the Mercantile

Registry Regulation, approved by Royal Decree 1784/1996 of 19 July 1996, and Royal Decree 84/2015 of 13 February 2015 implementing Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions. This Royal Decree, which repeals the previous regulation on SLIs, implements Title II of Law 5/2015 of 27 April 2015 on the promotion of business financing. Consequently, it details the legal regime of SLIs and of consolidated groups or sub-groups of SLIs whose parent is in Spain, in terms of access to activity, solvency requirements and supervisory arrangements.

Also noteworthy for its importance in endeavouring to mitigate the increase in litigation associated with certain financial products is Ministerial Order ETD/699/2020 of 24 July 2020 on the regulation of revolving credit, mentioned in the previous section. The main aims of this regulation are to reduce the risk of debt overhang and excessive loan duration and to strengthen pre-contractual and contractual information requirements, so that the borrower adequately understands the economic burden of the service to be taken out and has accurate information at all times on the debt owed to the institution.

Lastly, the Technical Auditing Standard on the preparation of the new report complementing the audit report on the annual accounts of credit institutions and specialised lending institutions was approved by the ICAC Resolution of 27 October 2020 and published. This report is one of the systems established by law for coordinating public institutions, such as the Banco de España, that are legally entrusted with control and supervisory powers over institutions that submit their annual accounts for statutory audit, and the statutory auditors of these institutions. Since the latest version of this complementary report was approved in 2007, relevant changes have been made to the accounting policies of credit institutions and SLIs (such as the transition to an expected loss impairment model) and the International Standards of Auditing have been adopted in Spain. Consequently, it was deemed advisable to draw up a new technical standard on this matter to improve the information that auditors provide to the Banco de España in this report.

Figure 8.1
MAIN ADAPTATIONS TO BANKING REGULATIONS MADE IN RESPONSE TO THE COVID-19 PANDEMIC (QUICK FIX)

ADAPTATIONS	DESCRIPTION	TIME FRAME
Transitional prudential treatment applicable to accounting impairment arising from expected losses	The transitional period is extended and the CET1 add-back percentage in the dynamic component of the transitional prudential treatment of expected loss provisions is raised	The term and percentages of the phase-in schedule for these provisions are increased to 2024 and the reference date for the calculation is changed to 1 January 2020
Prudential filter	Institutions are allowed to apply a prudential filter that would temporarily neutralise the impact on CET1 of changes in the value of sovereign debt instruments at fair value through other comprehensive income	The filter will be applied for three years to cumulative unrealised gains and losses from 31 December 2019. 100% of the impact is neutralised in 2020, 70% in 2021 and 40% in 2022
Prudential backstop	The prudential backstop for NPLs is adjusted by introducing a favourable treatment for exposures with State guarantees granted in the context of the COVID-19 crisis	This treatment is applicable for the first seven years from the classification of the exposure as non-performing
Adjustments to the leverage ratio	Central bank reserves may be temporarily excluded from the leverage ratio denominator when the NCA, in consultation with the relevant central bank, determines that exceptional circumstances so warrant, to facilitate implementation of monetary policy. This was determined by the ECB and the Banco de España in their decisions of 27 September 2020 (a) and 2 October 2020 (b), respectively	From 28 June 2021 for requirement purposes. From 28 June 2020 for reporting purposes
Adjustments to the capital requirements for market risk	Supervisors are granted some discretion to adjust capital requirements for market risk, so as not to take into account potential deviations occurred during the period from 1 January 2020 to 31 December 2021	Up to 31 December 2021
Changes in the entry into force of measures scheduled for 2021	The date of entry into force of certain measures already included in European regulations is changed. This includes bringing forward the entry into force of the SME and infrastructure supporting factors and the new prudential treatment of software assets and postponing the date of entry into force of the new leverage ratio buffer requirement for G-SIIs	The entry into force of the SME and infrastructure supporting factors was 28 June 2020 The new prudential treatment of software assets will apply from the entry into force of the EBA's RTS implementing it The leverage ratio buffer requirement for G-SIIs will enter into force on 1 January 2023

SOURCE: Banco de España.

a See press release "ECB's Governing Council says that exceptional circumstances justify leverage ratio relief", of 17 September 2020.
b See press release "El Banco de España determina que se dan circunstancias excepcionales para la exclusión temporal de determinadas exposiciones en la ratio de apalancamiento", of 5 October 2020.

9

INTERNAL AUDIT REPORT
REPORT PROVIDED FOR IN THE CONSOLIDATED TEXT OF THE SECURITIES MARKET LAW APPROVED BY ROYAL LEGISLATIVE DECREE 4/2015 OF 23 OCTOBER 2015
2020 REPORT

1. Introduction

The tenth additional provision of the consolidated text of the Securities Market Law (LMV, by its Spanish initials) approved by Royal Legislative Decree 4/2015 of 23 October 2015 establishes that the Banco de España shall prepare an annual report on its supervisory function, describing the supervisory actions undertaken and procedures followed, permitting information to be gained on the effectiveness and efficiency of these procedures and actions. It also provides that such annual report shall include a report by the internal control body on the conformity of the decisions taken by the governing bodies of the Banco de España with the procedural regulations applicable in each case. This annual report shall be approved by the Governing Council of the Banco de España and sent to the Spanish Parliament and Government.

The Banco de España's 2021 Annual Internal Audit Plan includes the drafting of the report provided for in the LMV, so that it may be included in the Banco de España's Annual Report on its supervisory function, referred to above.

2. Purpose, scope and methodology of the report

This report falls within the bounds of the legal mandate contained in the tenth additional provision of the LMV, which, as indicated above, defines the scope of the report, by reference to three basic elements:

1. The supervisory function of the Banco de España.
2. The decisions taken by the governing bodies in exercise of the supervisory function.
3. The conformity of the foregoing decisions with the procedural regulations applicable.

As regards the reporting period, the report refers to the decisions taken by the Executive Commission in 2020, and the decisions adopted by delegation and notified to the Executive Commission in 2020.

The subject matter of the report relates to the decisions taken by the Banco de España's governing bodies within the spheres of competence of the Directorate General Banking Supervision; the Directorate General Financial Stability, Regulation and Resolution; the Directorate General Operations, Markets and Payment Systems; and the General Secretariat.

Regarding applicable regulations, the supervisory powers and procedures set out in Law 13/1994 of 1 June 1994 on the Autonomy of the Banco de España and in the Internal Rules of the Banco de España were taken into account, together with those established by the Single Supervisory Mechanism regulations (primarily Council Regulation (EU) No 1024/2013 of 15 October 2013 and Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014). In addition, the Executive Commission of the Banco de España has established the procedural rules applicable to proposals on matters within the competence of the various Directorates General.

On 2 November 2012, rules were laid down on the reporting of matters to the Executive Commission by all the Banco de España's Directorates General. These rules complement those specific to the aforementioned Directorates General.

Likewise, by means of a Resolution of 10 December 2019, the Executive Commission approved the regime governing the delegation of powers, published in the Official

State Gazette No. 311 of 27 December 2019,[1] and which provides for the delegation of signature and callback of delegated powers.

To review the decisions adopted by the Executive Commission and the decisions adopted by delegation, random sampling was performed by Directorate General.[2]

The work was conducted in accordance with the Internal Audit Manual, which includes the International Standards for the Professional Practice of Internal Auditing, approved by the Institute of Internal Auditors, including those relating to the Code of Ethics.

3. Opinion

In our opinion, the decisions taken by the governing bodies of the Banco de España in 2020 in the exercise of its supervisory function were taken by bodies with sufficient own or delegated powers in accordance with the Internal Rules of the Banco de España and with the provisions laid down by its Executive Commission, and conformed, in all material respects, with the procedural rules applicable in each case.

Madrid, 23 February 2021
Director of the internal Audit Department

[Digital signature]
Luis E. Pardo Merino

GOVERNOR OF THE BANCO DE ESPAÑA
DEPUTY GOVERNOR OF THE BANCO DE ESPAÑA

1 In force since 28 September 2019. The Executive Commission Resolution of 22 May 2015 (Official State Gazette of 2 June 2015) was in force until that date, and was amended by the Executive Commission Resolutions of 11 January 2017 (Official State Gazette No. 15 of 18 January 2017), of 23 March 2018 (Official State Gazette No. 88 of 11 April 2018), of 20 November 2018 (Official State Gazette No. 291 of 3 December 2018) and of 13 September 2019 (Official State Gazette No. 221 of 14 September 2019).

2 The random sampling was performed by establishing two groups for each Directorate General: one for resolutions adopted directly by the Executive Commission and another for the decisions adopted by delegation of powers.

INDEX OF PHOTOGRAPHS

The Banco de España publishes various types of documents providing information on its activity (economic reports, statistics, research papers, etc.). The full list of Banco de España publications can be found on its website at https://www.bde.es/f/webbde/Secciones/Publicaciones/Relacionados/Fic/Catalogopublicaciones.pdf.

Most of these documents are available in PDF format and can be downloaded free of charge from the Banco de España website at https://www.bde.es/webbde/en/secciones/informes/. Requests for others should be addressed to edicionpublicaciones@bde.es.

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ACRONYMS AND ABBREVIATIONS

AMCESFI	Spanish Macroprudential Authority
AML/CTF	Anti-money laundering and counter terrorist financing
ASPSP	Account servicing payment service provider
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CCR	Central Credit Register
CCP	Central counterparty
CCyB	Countercyclical capital buffer
CGP	Code of Good Practice
CET1	Common equity tier 1
CNMV	Spanish National Securities Market Commission
CPMI	Committee on Payments and Market Infrastructures
CPMLMO	Commission for the Prevention of Money Laundering and Monetary Offences
CRD	Capital Requirements Directive
CRD-V	Capital Requirements Directive V
CROE	Cyber resilience oversight expectations
CRR	Capital Requirements Regulation
CSD	Customer service department
CSDR	Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories
CVA	Credit valuation adjustment
DGBS	Directorate General Banking Supervision
DGFSRR	Directorate General Financial Stability, Regulation and Resolution
DGOMPS	Directorate General Operations, Markets and Payment Systems
DGSCI	Deposit Guarantee Scheme for Credit Institutions
DGSFP	Directorate General of Insurance and Pension Funds *(Dirección General de Seguros y Fondos de Pensiones)*
DORA	Digital Operational Resilience Act
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
ELMI	Electronic money institution
ESA	European Supervisory Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
EURO1	Large-value payments
EUCLID	European Centralised Infrastructure for Supervisory Data
Fintech	Financial technology
FIU	Financial Intelligence Unit
FRTB	Fundamental review of the trading book
FSB	Financial Stability Board
FSC	Financial Stability Committee
FSTC	Financial Stability Technical Committee
GDP	Gross domestic product
G-SII	Global systemically important institution
GHOS	Group of Central Bank Governors and Heads of Supervision
Iberpay	Sociedad Española de Sistemas de Pago, SA
ICAC	Spanish Accounting and Audit Institute *(Instituto de Contabilidad y Auditoría de Cuentas)*
ICO	Official Credit Institute (Instituto de Crédito Oficial)
IFRS-EU	International Financial Reporting Standards as adopted by the European Union
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IT	Information technology
JST	Joint Supervisory Team
LCR	Liquidity coverage ratio
LMV	Royal Legislative Decree 4/2015 of 23 October 2015 approving the consolidated text of the Securities Market Law
LSI	Less significant institution
MGS	Mutual guarantee society
ML/TF	Money laundering and terrorist financing
MPF	Macroprudential Forum
NBB	Central Bank of Belgium
NCA	National competent authority
NPL	Non-performing loan
O-SII	Other systemically important institution
PI	Payment institution
PFMI	CPMI-IOSCO Principles for financial market infrastructures
PPS	Post Program Surveillance
PSD2	Payment Services Directive 2
P2G	Pillar 2 guidance
P2R	Pillar 2 requirement
Regtech	Regulatory technology
RT1	Instant payment system
SAREB	Asset management company for assets arising from bank restructuring *(Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria)*
SB	Supervisory Board
SEPA	Single Euro Payment Area
SEPBLAC	Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences
SI	Significant institution
SIPS	Systemically important payment system
SLI	Specialised lending institution
SNCE	National Electronic Clearing System *(Sistema Nacional de Compensación Electrónica)*
SQA	Supervisory Quality Assurance
SREP	Supervisory Review and Examination Process
SRI	Systemic risk indicator
SSM	Single Supervisory Mechanism
STEP2	Retail payment system
Suptech	Supervisory technology
TARGET2	Trans-European Automated Real-time Gross Settlement Express Transfer System
TPP	Third party payment service provider
€m	Million euro
€bn	Billion euro
pp	Percentage points