Interview with the Deputy Governor Margarita Delgado Tejero

Two years into the pandemic, how would you assess the role of the banking sector in this crisis?

In this crisis, the role of banks has been fundamental in maintaining credit to the economy, as well as providing the rest of the financial services in exceptional circumstances. The banking sector has made a positive contribution to sustaining economic activity and maintaining stability, channelling the fiscal and monetary measures adopted by the authorities and ensuring continuity in the provision of banking services. The better starting position from which institutions dealt with this crisis after the major balance sheet repair efforts of recent years and the bolstering of solvency following the implementation of Basel III made it possible to maintain the flow of credit in the most difficult moments.

You say that the strengthening of solvency has enabled the banking sector to contribute to the recovery, but what is the current solvency situation of Spanish institutions?

Spanish institutions' solvency ratios have grown considerably, and the Common Equity Tier 1 ratio rose from 11.8 % in 2014 to 13.7 % in the third quarter of 2021. Not only has the ratio improved, but the basis of calculation is more solidly defined thanks to the Basel III regulatory reforms. But, as supervisors, we must be aware that we still have some way to go in this area. In this respect, the Basel III implementation process needs to be completed, which will lead to greater homogeneity in risk-weighted asset data thanks to the limits and floors imposed on capital requirements.

Although the solvency level of Spanish institutions is still below the average level of institutions in European countries, we should bear in mind that our institutions have a solid business model, generating recurring income, and that they have higher densities of risk-weighted assets due in part to a lower use of internal models.

Lastly, as shown in the European stress tests conducted in 2021, Spanish banking groups presented satisfactory capital levels in the adverse scenario. As I have said, the full implementation of the Basel III framework, with such relevant aspects as the output floor, can help mitigate these differences.

Certainly, government support measures have alleviated the adverse effects of the pandemic, but what are the uncertainties related to withdrawing these measures?

Indeed, financing conditions have been very favourable during the pandemic due to both monetary policy actions and the support made available to businesses and households. This has undoubtedly alleviated their liquidity needs, which has also helped to contain NPLs, while we wait until the economic situation recovers. However, we need to be cautious because not all sectors have fully recovered their activity. As you will recall, Royal Decree-Law 8/2020 allowed for the extension of grace periods for principal repayments and it will not be until the second half of this year that we will see the behaviour of transactions with extended grace periods. So it is important that institutions analyse risks properly and do not release provisions until the uncertainty has dissipated, especially in the sectors most affected by the crisis. In addition, we now have another source of uncertainty, which is geopolitical. In addition to the undesirable consequences of the conflict in terms of human lives, it will undoubtedly also impact on the economy and energy prices. Although the level of direct exposure of Spanish institutions to Russia or Ukraine is not significant, it will be necessary to monitor how this situation evolves and how it impacts on the scenario ahead.

At a time when inflation has reached levels we have not seen for decades, how could an interest rate rise affect banks' profitability?

Credit institutions must be prepared to properly manage all risks, and in this case they must also be prepared to properly manage interest rate fluctuations. Positive interest rates would be the most logical scenario in an environment of financial stability and growth in which resources are allocated in a balanced manner. Spanish institutions are, in general, favourably positioned for rate hikes.

However, in these times of huge geopolitical uncertainty, it is difficult to establish clear scenarios for the evolution of interest rates.

This is why, irrespective of the different scenarios, we must insist on the messages that we supervisors have been giving for years: institutions must improve their efficiency by containing costs, dealing with transformations in their business model —with a focus on digitalisation and financing the economy towards more sustainable models— and diversifying their income sources.

These income sources include fees. How do you think these will evolve?

For some years now, we have been seeing growth in fee income. The increase in the fees charged by institutions is always highly controversial. On the one hand, institutions incur costs for providing these services, so it is logical that they are passed on to their customers, as is the case in the other industries. On the other hand, the charging of these fees is subject to strict regulation and ongoing supervision, and it is based on the premise that fees can only be charged for services actually provided.

What is important is that past errors are avoided and banks comply with the strict rules of conduct to which they are subject. Having robust governance and a responsible banking model, with the commitment of the governing bodies and an organisation-wide approach, is the only way to ensure that customer relations are always responsible, ethical and transparent, thus avoiding reputational damage. This is where the focus must be for both supervised institutions and supervisors.

In recent years there has been growing concern about the effects of climate change, but how does this issue impact the banking sector and how do supervisors expect institutions to include climate risks in their internal management?

Concern about climate change is an issue from which no economic sector, least of all the financial sector, is left untouched. Its effects on the traditional banking risks (credit, market, operational) and on financial stability need to be carefully assessed.

Some analyses carried out under certain scenarios indicate that a significant number of companies would be exposed to climate catastrophes and subject to energy transition risk as a result of the shift towards more sustainable production models. Credit institutions, which are the main channelers of financing in Spain, cannot ignore this fact.

Quantification of the environmental impact is rather difficult because obstacles such as the absence of a global taxonomy and the lack of reliable data still persist. However, there are recent initiatives to improve data availability. I would highlight the European Commission's recent proposal for a corporate sustainability reporting directive, which will increase the availability and accessibility of reliable and comparable data.

Although information is still scarce and not very comparable, we believe that banks need to make the effort to identify the necessary data and collect it from customers. As for the need to integrate data into management, both the Banco de España and the European Central Bank (ECB) have issued expectations setting out the way in which this risk should be included in business models, in strategies and in the internal capital adequacy assessment processes.

Lastly, also at the European level, I would like to point out the commitment of the ECB and the European Systemic Risk Board to raising awareness of climate change issues, in connection with supervisory and financial stability functions. In this respect, it is worth noting that this year the ECB will subject institutions to a stress test on climate risks, which will incorporate profitability metrics and exposures to sectors affected by these risks. This test is intended as a learning exercise, one of the main objectives of which is to improve the capacity of institutions and the supervisor to assess climate risk. Moreover, through the Spanish macroprudential authority (AMCESFI), the Banco de España participates, together with the other authorities, in the coordination and preparation of what will be the first biennial report on the assessment of the risk to the Spanish financial system stemming from climate change, as provided for in the recent law on climate change and energy transition.

However, I would like to stress that, while the importance of the financial sector in guiding the transformation of the economic model towards a more sustainable one is undeniable, I believe that the ultimate responsibility lies with both governments and the individual actions of us all.

On the other hand, you have also emphasised the need for Spanish banks to continue gaining efficiency. Is there the capacity for more mergers in Spain?

As I pointed out earlier, one of the ways to gain efficiency is to reduce operating costs. The Spanish financial sector has made significant efforts to adjust its structures with mergers, staff reductions and branch closures. After the recent bank concentration processes, it seems that the scope for bank concentration is more limited, although we still do not have high concentration rates compared to other European countries. At the international level, there is a growing trend towards international business acquisitions and, at the European level, there is an increasing possibility of further cross-border mergers. A potential risk of a very large resulting entity would be the so-called Too Big To Fail. However, this risk is mitigated, since we have tools and mechanisms to manage it, such as buffers for systemically important institutions.

In any case, it is up to the institutions to take the initiative. Our role as supervisors is to ensure that the resulting institutions are soundly and sufficiently capitalised, and have a sustainable business plan and adequate risk management and governance systems.

When we talk about mergers and profitability, we cannot fail to mention the entry of new technology sector competitors into the financial sector. How do you think banks should respond to this new threat?

For the banking sector, digitalisation is not an option, but an integral part of its core business. Institutions that lag behind in this area will not be sustainable in the medium term. Investment in digitalisation not only generates efficiency, as I mentioned earlier, but it also provides the potential to improve income and business. Only then will they be able to contend with competition driven by technology giants where innovation provides a competitive edge. In this respect, banks are implementing technological improvements at all stages of the commercial relationship, from customer acquisition to the management of their unforeseen financing needs. A notable feature of the new competitors is that, in general, they have specialised in the sections of the value chain that bring them the highest returns, such as means of payment, rather than covering the entire banking business.

Supervisors are aware of this new reality and we are therefore supporting the digitalisation of institutions through new projects. In this respect, I would highlight the participation of the Banco de España, together with the National Securities Market Commission and the Directorate General Insurance and Pension Funds, in a controlled testing environment, known internationally as Sandbox, created by the law for the digital transformation of the financial system. It is a safe space in which to test projects involving technology-based financial innovation applicable to the financial system. In it, risks to the financial system and to participants have been mitigated or minimised.

I see digitalisation as a major transformation affecting many sectors, and the financial sector is no exception. In this adaptation process, there are major transition costs that banks will have to take into account in their decisions, and analyse how they affect the various customer segments. In particular, the elderly and groups of people less familiar with digitalisation must receive priority attention. This was embodied in the protocol recently signed by the main banking associations.

You say that the Sandbox allows the risks of innovative projects to be assessed, but what other risks associated with technological innovation would you highlight?

There is no denying the great benefits associated with a more intense use of technology in the banking business. However, this comes with risks that must not be ignored.

The main risks I see are, on the one hand, those associated with cyber risk and, on the other hand, those linked to the outsourcing of processes to third-party providers.

In relation to cyber risk, there has been an increase in the number of cyberattacks directed at financial institutions, their customers and their suppliers. As regards the outsourcing of processes, the main risk is the loss of control over them and, on the other hand, the potential concentration of these services in a small number of providers.

Therefore, this risk is of concern to the authorities. In this respect, the European Commission has a legislative proposal (DORA) on how to improve cybersecurity and operational resilience in the financial sector. This regulation will address measures to mitigate risks associated with technology and the outsourcing of processes and services.

In addition, with the aim of mitigating management risks and boosting the cyber resilience of the financial sector as a whole, in 2018 the ECB published the advanced cybersecurity testing framework called TIBER-EU, which has been adopted in a large number of European jurisdictions, including Spain.

Lastly, technological innovations are also permitting the development of new products, for example, those based on distributed ledger technology, such as crypto-assets. There is currently a proposal for a European regulation on the issuance and provision of services relating to these products (MiCA), as their growth is becoming systemically relevant and poses a potential risk to financial stability.

For our part, supervisors must distinguish between the activities that involve a way of gaining efficiency, profitability and sustainability and those that might be a source of instability or that are not in line with a responsible banking model.

When we talk about the risks of crypto-assets, their relationship with money laundering comes to mind. What is the Banco de España doing in this respect?

The Banco de España is aware of the money laundering risks involved in the use of crypto-assets and that they should therefore be subject to anti-money laundering and counter-terrorist financing (AML/CTF) supervision. In fact, following international and EU standards, Spanish legislation includes certain categories of crypto-asset service providers that are obliged to comply with AML/CTF rules.

Unfortunately, the activities that require close monitoring to prevent money laundering and terrorist financing are not limited to crypto-assets. Credit institutions are highly exposed to money laundering risk which has a direct impact on their reputation and would be evidence of poor governance and internal control; hence the prudential supervisor's interest in money laundering and terrorist financing issues. It is therefore increasingly important that the AML/CTF authorities and the Banco de España work together. To this end, a new agreement was signed this year between the Commission for the Prevention of Money Laundering and Monetary Offences and the Banco de España, which deepens supervisory cooperation and coordination.

To conclude, almost ten years after the creation of the Banking Union, what is your assessment of how it has evolved? What aspects do you think have improved and what challenges remain?

The creation in 2013 of the Single Supervisory Mechanism and in 2014 of the Single Resolution Mechanism has meant that, within the Banking Union, the same risks and the same type of business model can be treated homogeneously, not only in terms of regulation, but also in terms of enforcement. What would be needed to deepen the current institutional framework? The Banking Union would undoubtedly be strengthened by the creation of a common deposit guarantee fund. With such a fund, in the event of a bank crisis, there would be the backing of a European fund that would mutualise the risks. The completion of this pillar of the Banking Union would play a key role in boosting cross-border mergers within the Monetary Union. However, no political agreement has yet been reached in the European Union (EU) to have this common deposit guarantee fund.

In addition, we need a more developed and integrated capital market for the EU as a whole, allowing public and private resources to be channelled into projects that promote the transition towards a more sustainable economy. In this respect, among the most recent achievements, I would like to highlight the European harmonisation of covered bond regulations, which was transposed into Spanish law in 2021, and the adaptation of the EU securitisation framework. We are firmly committed to continuing to work towards the achievement of this project, which aims to connect EU companies more closely with investors, improve access to finance for EU companies and increase investment opportunities for retail clients.