

# REPORT ON BANKING SUPERVISION IN SPAIN 2002







# **REPORT ON BANKING SUPERVISION IN SPAIN**

**2002**



**BANCO DE ESPAÑA**

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## CONTENTS

	<i>Pages</i>
PREFACE .....	11
REPORT ENVISAGED IN THE LAW ON FINANCIAL SYSTEM REFORM MEASURES .....	13
I. STRUCTURE AND EVOLUTION OF THE INSTITUTIONS UNDER THE BANCO DE ESPAÑA'S SUPERVISION .....	17
I.1. Structure and composition of the banking system.....	19
I.1.1. Types of credit institution .....	19
I.1.2. Personnel, branch offices and other structural data of CIs and their consolidated groups .....	22
I.2. Activity of deposit institutions .....	23
I.2.1. Activity of individual DIs .....	25
I.2.2. Activity of consolidated groups of DIs.....	33
I.3. The results of DIs .....	35
I.3.1. The results of individual Dis .....	36
I.3.2. The results of consolidated groups of DIs .....	41
I.4. Solvency of CIs.....	43
I.4.1. Solvency of consolidated groups .....	45
I.4.2. Solvency of individual institutions.....	48
I.4.3. Solvency of mixed groups.....	48
I.5. Structure and evolution of the other institutions supervised by the Banco de España...	49
I.5.1. Specialised credit institutions.....	49
I.5.2. Appraisal companies.....	51
I.5.3. Mutual guarantee and re-guarantee companies.....	52
I.5.4. Currency exchange and transfer bureaux.....	53
APPENDIX.....	55

	<i>Pages</i>
II. BANKING SUPERVISION IN 2002.....	67
II.1. Recommendation and requirement letters sent to supervised institutions in 2002 .....	70
II.1.1. Summary of the subject-matter of the requirements and recommendations made .....	71
II.1.2. Compliance by the supervised institutions with the measures included in the letters sent by the Executive Commission .....	73
II.2. Proceedings and sanctions.....	73
II.3. Other supervisory activities of the Banco de España.....	76
II.3.1. Commission charges.....	77
II.3.2. Advertising.....	78
II.3.3. Reporting of interest rates on lending operations.....	80
II.3.4. Official registers of supervised institutions.....	80
II.3.5. Other information filed with the Banco de España: directors and senior executives, shareholders, agents and articles of association .....	82
II.3.6. Eligibility of hybrid capital instruments as own funds in the solvency ratio.....	85
II.4. Basic features of the own funds policies of credit institutions .....	87
II.4.1. The own funds policy: a crucial element in institutions' financial strategy .....	88
II.4.2. Institutions should run their business with a comfortable level of own funds .....	90
II.4.3. The composition of own funds as a solid basis for policies of sustained growth .....	90
II.4.4. An appropriate distribution of own funds across the group helps to strengthen the individual solvency of the various components and, as a result, that of the group as a whole .....	91
II.4.5. The definition of clear and prudent criteria for self-financing (the best quality funds) is an essential element of institutions' own funds policies .....	91
II.4.6. Conclusions.....	92
II.5. Development of the risk-based approach to banking supervision (SABER).....	92
II.5.1. Extension of the use of the methodology.....	94
II.5.2. The development of quantitative indicators of inherent risk.....	94
II.5.3. Integration of corporate governance into the risk-based approach.....	97
II.6. Risk-modelling techniques: analysis and application for supervisory purposes .....	98
II.6.1. Market risk .....	100
II.6.2. Credit risk .....	100
II.6.3. Operational risk.....	103
III. REGULATORY CHALLENGES IN PRUDENTIAL SUPERVISION.....	105
III.1. National provisions.....	107
III.1.1. Law 44/2002 of 22 November on financial system reform measures.....	107
III.1.1.1. Specific changes regarding credit institutions.....	107
III.1.1.2. Changes affecting other entities supervised by the Banco de España .....	115
III.1.1.3. Other matters.....	116
III.1.2. Contributions to deposit guarantee funds .....	117
III.1.3. Accounting and regular reporting of information .....	118

	<i>Pages</i>
III.2. Community provisions .....	118
III.2.1. Financial conglomerates .....	118
III.2.2. Financial collateral arrangements .....	121
III.2.3. Application of international accounting standards .....	122
III.2.4. Distance marketing of financial services .....	123
ANNEX 1. RECENT DEVELOPMENTS IN INTERNATIONAL REGULATION AND BANKING SUPERVISION FORA.....	125
ANNEX 2. CONSOLIDATED GROUPS OF SPANISH CREDIT INSTITUTIONS.....	137
ANNEX 3. DIRECTORATE GENERAL BANKING SUPERVISION: ORGANISATION CHART..	147
ANNEX 4. DIRECTORATE GENERAL BANKING REGULATION: ORGANISATION CHART..	151
ANNEX 5. DISCIPLINARY PROCEEDINGS INITIATED DURING THE PERIOD 1998-2002 ...	155
ANNEX 6. PROCEEDINGS BY TYPE OF INFRINGEMENT .....	159





## ABBREVIATIONS

€ m	Millions of euro
IBCD	First Banking Co-ordination Directive
2BCD	Second Banking Co-ordination Directive
ACs	Appraisal Companies
AIAF	Association of Securities Dealers
ATA	Average total assets
ATM	Automated teller machine
BAC	Banking Advisory Committee
BCBS	Basel Committee on Banking Supervision
BE	Banco de España
BIS	Bank for International Settlements
BOE	Official State Gazette
b.p.	Basis points
BSC	Banking Supervision Committee of the ESBC
CBE	Circular of the Banco de España
CCR	Central Credit Register of the Banco de España
CECA	Spanish confederation of savings banks
CERSA	Spanish state-owned reinsurance company
CGs	Consolidated groups of CIs, DIs, etc.
CIs	Credit Institutions (DIs, SCIs, and the ICO)
CNMV	National Securities Market Commission
DGF	Deposit Guarantee Fund
DGS	Directorate General of Insurance
DGTPF	Directorate General of the Treasury and Financial Policy
DIs	Deposit Institutions
EAR	Equivalent annual rate
EC	European Commission
ECB	European Central Bank
ECOFIN	EU Council of Ministers of Economy and Finance
EEA	European Economic Area
EFAs	Earning financial assets
EMU	Economic and Monetary Union
ESBC	European System of Central Banks
EU	European Union
FCs	Financial conglomerates

FESCO	Forum of European Securities Commissions
FMC	Financial Markets Committee
GdC	Groupe de Contact
GDP	Gross Domestic Product
GTIAD	Working Group on the Interpretation and Application of the Banking Directives
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBFLs	Interest-bearing financial liabilities
ICO	Official Credit Institute
IFAC	International Federation of Accountants
IOSCO	International Organisation of Securities Commissions
IPO	Initial public offering
LABE	Law on the Autonomy of the Banco de España (Law 13/1994)
LDI	Law of the discipline and intervention of credit institutions (Law 26/1988)
LSM	Law on the securities market (Law 24/1988)
MGCs	Mutual guarantee companies
MO	Ministerial Order
MTG	Mixed Technical Group
OCC	US Office of the Comptroller of the Currency
OECD	Organisation for Economic Co-operation and Development
OJ L	Official Journal of the European Communities - legislation series
ORS	Other resident sectors
PBT	Profit before tax
p.p.	Percentage points
RD	Royal Decree
RDL	Royal Decree Law
RGs	Regional (autonomous) governments
ROA	Return on assets (profit after tax as percentage of ATA)
ROE	Return on equity (profit after tax as percentage of own funds)
SABER	Risk-based approach to banking supervision
SCIs	Specialised credit institutions
SEPBLAC	Commission for the Prevention of Money Laundering and Monetary Offences
SLBE	Banco de España Settlement Service
SNCE	National Electronic Clearing System
TSG	Technical Sub-Group
US	United States

## PREFACE

At its sitting on 12 July 2002, the Governing Council of the Banco de España approved the Report on Banking Supervision in Spain

This issue adheres to the provisions of Law 44/2002 on Financial System Reform and includes an Internal Audit Report

At its sitting on 12.07.02, the Governing Council of the Banco de España approved and ordered the release of the first edition of the annual *Report on Banking Supervision in Spain*. As explained in the first issue, the primary aim of this publication was and still is to help interested parties understand the supervisory tasks carried out by the Banco de España. In turn, underlying this decision was a regard for the transparency of banking supervision as an intrinsic value that the financial sector is increasingly observing, even though the central bank's supervisory work has traditionally been a somewhat cloistered area.

At a later date, the second additional provision of Law 44/2002 of 22 November 2002 on Financial System Reform Measures established that the Banco de España, among others, *shall annually prepare a report on its supervisory functions in relation to the measures and procedures it has pursued in this area, from which information may be drawn as to the effectiveness and efficiency of such procedures and measures*. As this Law came into force on 22 November 2002, such a report might be interpreted as not being legally mandatory until the year 2003. Nevertheless, as there was no reason for deferring it, the Banco de España has decided to include it in this issue.

This second edition of the *Report on Banking Supervision in Spain* thus adheres to the general outline of the first issue and to its attendant legal tenet. Accordingly, it includes an Internal Audit Report of the Banco de España on how closely its governing bodies' decisions conform to the procedural rules applicable in each case.



REPORT ENVISAGED  
IN THE LAW ON FINANCIAL  
SYSTEM REFORM MEASURES





## I. INTRODUCTION

Additional Provision Two of Law 44/2002 of 22 November 2002 on financial system reform establishes, as its name suggests, certain measures to improve the efficiency, effectiveness and quality of supervision procedures. They include most notably the following:

1. The obligation of certain supervisory agencies, including the Banco de España, to establish “internal control bodies whose functional hierarchical relationships and reporting powers shall be governed by the principles of impartiality, objectivity and avoidance of conflicts of interest”.
2. The obligation of these agencies to prepare annually “a report on their supervisory function”. These reports shall include “a report by the respective internal control bodies on how closely the decisions taken by their governing bodies conform to the procedural rules applicable in each case”.

When Law 44/2002 came into force, the Banco de España had, pursuant to the Executive Commission resolution dated 28 November 2001, already set up an Internal Audit Department, endowing it with specific statutes in line with generally accepted international standards.

The 2003 Audit Plan, prepared in accordance with the mandate contained in these statutes and approved by the Deputy Governor on 23 December 2002, includes the drafting of the report envisaged in the above-mentioned Additional Provision Two, although its preparation is not yet legally obligatory.

## 2. PURPOSE, SCOPE AND METHODOLOGY OF THE REPORT

This report falls within the bounds of the legal mandate contained in Additional Provision Two of Law 44/2002. As mentioned above, this Additional Provision Two 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. Conformity of the decisions taken by their governing bodies to the “procedural rules applicable in each case”.

The period addressed by the report is the same as that covered by the Report on Banking Supervision in which it has to be included, i.e. 2002 in this case.



The subject matter of the report is the decisions taken by the Banco de España's governing bodies within the sphere of competence of the Directorate-General of Banking Supervision.

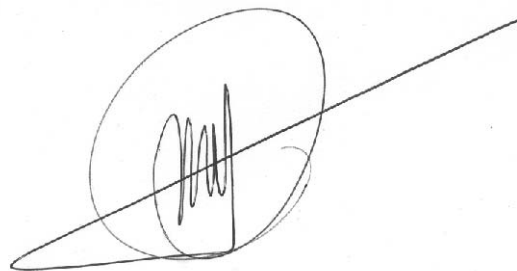
The examination was performed by stratified sampling, as this provides greater accuracy than simple random sampling. Nine strata or decision types were identified and different sampling fractions (100%, 10%, 5%) were applied to them depending on the materiality, numerical volume and internal homogeneity of each stratum.

### 3. OPINION

In our opinion, based on examination of the sample selected, the decisions taken by the Banco de España's governing bodies in 2002 in the sphere of competence of the Directorate-General of Banking Supervision conformed, in all material respects, to the existing procedural rules applicable in each case. The decisions were taken by bodies with sufficient own or delegated powers in accordance with the Banco de España's Internal Regulations.

Madrid, 24 April 2003.

DIRECTOR OF THE INTERNAL  
AUDIT DEPARTMENT,

A handwritten signature in dark ink, consisting of a large, loopy initial 'M' followed by several vertical strokes and a long horizontal line extending to the right.

Miguel Martín Fernández

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

STRUCTURE AND EVOLUTION  
OF THE INSTITUTIONS UNDER THE BANCO  
DE ESPAÑA'S SUPERVISION



This first chapter of the Report on Banking Supervision aims to analyse the main features and activities of the institutions under the Banco de España's supervision, among which the credit institutions play a fundamental role. This description cannot disregard the national and international economic background against which the credit institutions (and the other supervised institutions) conduct their activities, since it has had a significant impact on them. The impact has on the whole been negative, albeit neutralised by the partial use of the "spare capacity" in terms of responsiveness that the Spanish banking system has built up in prior years. Indeed, at the beginning of 2003, Spanish institutions continue to enjoy high levels of solvency and profitability.

## **I.1. STRUCTURE AND COMPOSITION OF THE BANKING SYSTEM**

This section deals with the institutional structure of *credit institutions (CIs)* and how it has evolved. An overview of this structure is presented before going on to describe, in the following two sections, the activity and results of *deposit institutions (DIs)*, a narrower concept than CIs.

Also included is structural information on CIs. This shows that, apart from the tendency towards concentration and reduction in the number of institutions and the restructuring undertaken in the last decade, Spanish CIs continue to expand their basic operating capacity in the domestic market in respect of their network, automated teller machines (ATMs), employees and agents. The expansion of financial groups to other activities and/or countries is not considered in this section.

### **I.1.1. Types of credit institution**

The consolidation of the Spanish banking system initiated in the 1980s has entailed a continuous and sustained reduction in the number of credit institutions (CIs) (Chart I.1). After a respite in 2001 (1), numbers again fell in 2002 and at year-end there were 361 CIs registered with the Banco de España, 8 fewer than a year earlier (Table I.1) (2).

(1) In 2001 the number of active institutions was unchanged, although the number of registered institutions decreased by 2.

(2) As at December 2002, there were 4 non-operational institutions pending de-registration (3 co-operatives and 1 SCI), all in the process of merger.

The number of CIs held on the downward trend initiated in the 1980s

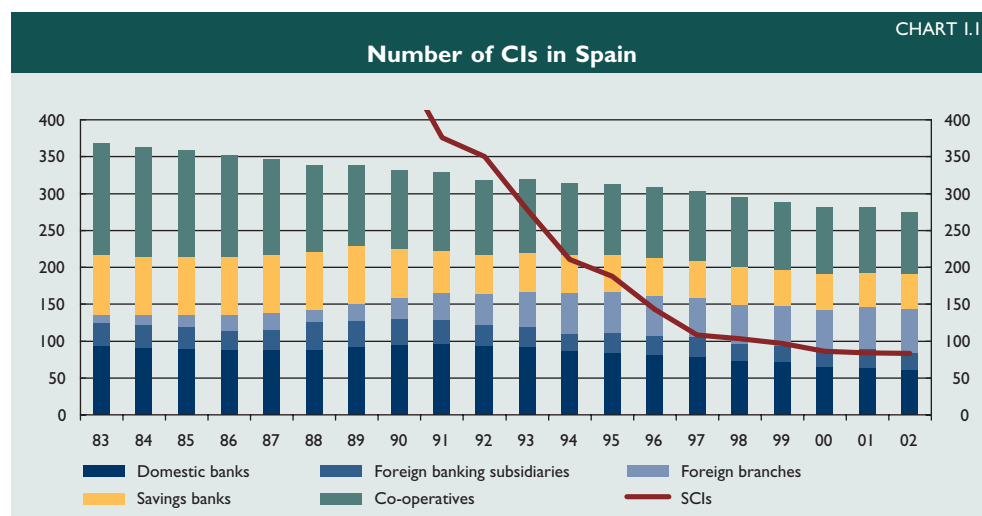
Number of CIs in Spain					TABLE I.1
	1999	2000	2001	2002	
<b>CREDIT INSTITUTIONS</b>	<b>391</b>	<b>371</b>	<b>369</b>	<b>361</b>	
<b>Deposit institutions</b>	<b>294</b>	<b>285</b>	<b>285</b>	<b>278</b>	
Banks	147	143	146	144	
Domestic	72	65	63	61	
Foreign	75	78	83	83	
of which: Foreign subsidiaries	22	25	27	24	
Savings banks	50	48	47	47	
Credit co-operatives	97	94	92	87	
<b>Specialised credit institutions</b>	<b>97</b>	<b>86</b>	<b>84</b>	<b>83</b>	
<b>CONSOLIDATED GROUPS</b>	<b>29</b>	<b>30</b>	<b>32</b>	<b>30</b>	
<b>Institutions belonging to consolidated groups</b>	<b>123</b>	<b>116</b>	<b>121</b>	<b>116</b>	
<b>Stand-alone institutions</b>	<b>268</b>	<b>255</b>	<b>248</b>	<b>245</b>	
MEMORANDUM ITEMS:					
Operational institutions	383	365	365	357	
Institutions operating in Spain without an establishment	201	248	276	292	

The branches of EU banks increased their presence in Spain...

... as did CIs operating in Spain without a permanent establishment

Although the number of foreign banks (subsidiaries plus branches) was unchanged on December 2001, there was a redistribution between subsidiaries and branches which raised the number of the latter to 59 (50 from the EU) as at December 2002. The scant presence of branches from non-Community countries is related to the ease of access to the domestic market from other EU locations, mainly London, which is an important international financial centre. The number of foreign CIs operating in Spain without a permanent establishment continued to increase, although at a lower rate than in past years.

The disappearance of two consolidated groups in which there were two or more Spanish CIs was due to mergers or absorptions in these groups between their member CIs. These processes also reduced the number of Spanish CIs in these consolidated groups from 121 to 116.



Mergers and acquisitions of DIs in the period 1999-2001 (a)

TABLE I.2

	1999	2000	2001	2002
<b>Mergers and acquisitions</b>	<b>10</b>	<b>11</b>	<b>8</b>	<b>7</b>
Between banks	5	5 (12)	4	5 (11)
Between savings banks	1	2	1	0
Between co-operatives	3 (7)	2	3 (8)	2 (5)
Acquisition of banks by savings banks	1	2	0	0

(a) The figures in brackets are the number of institutions involved where mergers/acquisitions include operations in which more than two credit institutions take part, i.e. when the number of credit institutions involved is not equal to twice the number of operations.

Mergers and acquisitions largely accounted for the fall in the number of CIs

The fall in the number of CIs was the result of 7 registrations and 15 de-registrations, which are discussed later in Section II.5.4 on the Official Registers kept by the Banco de España. As has habitually been the case, the de-registrations were due to internal restructurings of banking groups (in this case medium-sized domestic groups and foreign groups), to the merger of co-operatives operating in neighbouring geographical areas and to the discontinuation of business activity. In all, there were 7 mergers and acquisitions between CIs (5 in banks and 2 in co-operatives), involving 16 CIs (Table I.2).

The domestic banks continued to lose share of the balance sheet total to savings banks...

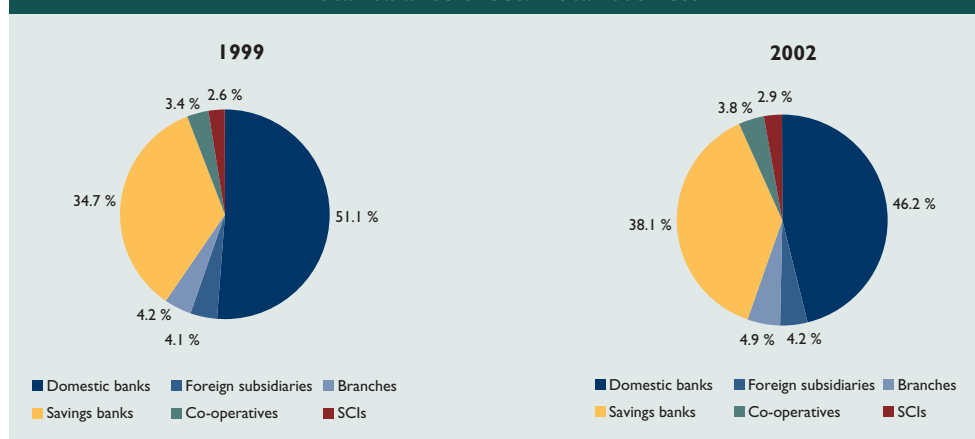
The mergers that gave rise to the large Spanish banking groups, the subsequent international expansion of these groups and the expansion of savings banks throughout Spain are reflected in the market shares of banks and savings banks. Taking as a reference the balance sheet total, in the last four years the market share of savings banks increased by 3.4 percentage points (p.p.) from 34.7% to 38.1%. In the same period the market share of domestic banks fell from 51.1 to 46.2% (Chart I.2). In terms of balance sheet captions, savings banks substantially raised their relative weight on the liability side (private-sector deposits), while banks improved their share of loans and credits despite the predominance of savings banks in the mortgage market.

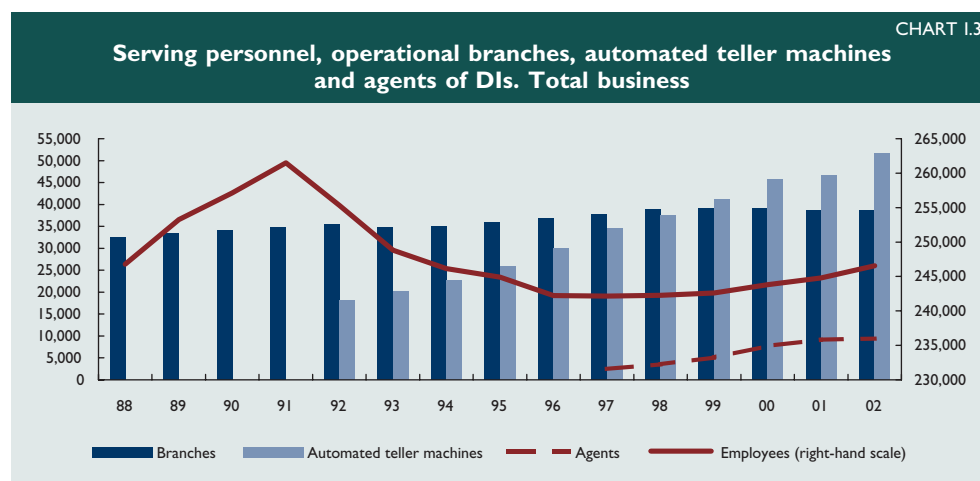
... and to the branches of EU CIs, which have doubled their activity in the last 4 years

Although their relative weight is low, the branches of EU banks notably gained more than 1 p.p. of market share. In the last four years they have doubled their business volume, with a particularly strong increase in deposits. The relative weight of credit co-operatives, especially rural credit co-operatives, has also increased.

Market share of CIs in Spain  
Total balance sheet. Total business

CHART I.2





### 1.1.2. Personnel, branch offices and other structural data of CIs and their consolidated groups

The number of staff employed by CIs continued on a mild upward trend

The staff cuts by DIs in the early 1990s as a result of the intense wave of mergers and acquisitions were more severe in the first few years, with staff numbers bottoming out in 1996. Since then, not only has the new trend of mild workforce growth been sustained, but in 2002 it became more pronounced (Chart I.3), which is all the more significant given the growing number of agents used by the institutions to outsource certain (basically commercial) activities.

... while domestic banks resorted increasingly to outside agents for commercial tasks

The fall in employee numbers has been most marked in domestic banks, which are precisely those mainly responsible for the expansion of external agents. The agents of these banks have approximately doubled in number in the last 4 years.

The branch network held steady, although the average staff per branch tended to rise slightly due to the strategy of giving priority to high-value-added services

The branch network grew at a very moderate and steady pace until 1999, when it stabilised at around 39,000 branches (see Table I.A.1), at which level it has since remained. This growth pattern, together with that of employees, resulted in an initial decline in employees per branch from 7.5 in December 1990 to 6.2 in 1998, when the trend reversed very slightly. Since then, the slight increase in the number of employees per branch has proceeded despite the growing automation of clerical processes and the general use of telephone and Internet banking. This trend is linked to the institutions' strategy of strengthening commercial functions by more personalised customer service and to their decision to provide high-value-added financial services, which calls for at least a certain minimum of staff at each branch and the reassignment of personnel from central services to the commercial network.

The average staff per branch (6 employees) is half the EU average

This strategy was also clearly apparent in 2002, particularly in the increase in staff numbers at branches. Even so, the average of 6 employees per branch at DIs in Spain is half the EU average of around 12, a circumstance which largely counteracts the higher number of branches in Spain.

The staff and branches of savings banks and co-operatives continued to grow

However, this process is not identical in all types of CI. Banks, which started with higher numbers of employees and branches, have systematically reduced both these resources since the beginning of the 1990s, whereas savings banks and, to a lesser extent, co-operatives have done the opposite, boosting both their workforce and their branch numbers, on occasions by direct acquisition from banks of the latter's excess capacity.

Expansion beyond their home regions has been responsible for the rise in the numbers of savings bank branches. Moreover, the additional branches have in the main been set up from scratch as completely new facilities and are thus operated by a smaller number of employees, which explains the lower staff ratio: 4 in savings banks compared with 7 in banks.

The expansion of the ATM network accelerated due to the boost given to those located at branches. Spain now has double the average number of ATMs per thousand inhabitants in the EU

The surge in the installation of automated teller machines (ATMs) in 2002 is related to the boost given by CIs to ATMs at branches. Many are located inside the branch and the latest versions have a broader range of self-service transactions available to customers. Also, CIs have continued to increase the number of ATMs at places heavily transited by the public (airports and other transport centres, leisure facilities, shopping centres, etc.), where they have replaced the traditional branch for handling day-to-day transactions. At year-end the number of ATMs was 33% higher than the number of branches and there was more than one ATM per thousand inhabitants, more than double the European average. This growth is common to all types of institution.

The number of bank cards per inhabitant aged 16 or more remained flat at 1.6

The growth of the number of bank cards has slowed after the significant increase seen in 2001, holding steady at 1.6 cards per inhabitant aged 16 or above. This is the result, however, of a significant rise at banks and a decrease at savings banks for the first time since this information has been available (1992).

## 1.2. ACTIVITY OF DEPOSIT INSTITUTIONS

Activity was affected by weak international economic growth

Deposit institutions (DIs) pursued their activities in 2002 against a background of weak international economic growth, or even recession in certain European countries, though the Spanish economy was affected to a lesser extent. Spanish GDP at constant prices grew by 2%, which, while less than in the previous three years, compared favourably with the pace of GDP growth of the euro area, which stood at 0.8%, down from 1.4% in 2001. This divergence in growth helped to boost banking activity in Spain relative to that abroad, both for DIs and, more particularly, for their consolidated groups.

Balance sheet growth centred on mortgage lending to the resident private sector, spurred by low interest rates

The balance sheet of DIs grew by 6.4% (Table I.3) in 2002, driven by the growth of credit to the resident private sector, which rose by 13%. This in turn found its primary stimulus in mortgage lending for house purchases, which held firm at a growth rate of 21%. The strong growth of credit to the private sector took place in a financial context of very low interest rates.

The low interest rates on new loans in Spain, together with a consumer price index whose growth rate stood at 4% in December, meant that the real financial cost of some new financing transactions was nearly zero, or even negative in variable-rate monthly-adjustable financing. This highly beneficial situation for borrowers contributed to the strength of lending to the private sector and helped to decouple it from the real GDP growth rate in 2002, in contrast to the parallel course followed by the two variables since 1996 (Chart I.4).

The strong demand for very-long-term mortgage loans and the downward course of interest rates has underpinned the high growth of variable-rate loans, which now account for 67% of total lending by Spanish DIs (including nearly all house purchase mortgage loans), against somewhat less than 50% in 1999.



TABLE I.3

**Year-on-year change in the activity of Spanish DIs (a)**  
**Total business (%)**

	1999	2000	2001	2002
<b>ASSETS:</b>				
<b>Cash and central banks</b>	<b>63.4</b>	<b>-27.8</b>	<b>47.5</b>	<b>-21.2</b>
<b>Financial intermediaries</b>	<b>-9.3</b>	<b>-3.9</b>	<b>-0.3</b>	<b>6.3</b>
<b>Loans and credits</b>	<b>12.7</b>	<b>16.5</b>	<b>11.2</b>	<b>10.5</b>
Of which:				
Resident private sector	14.8	17.5	11.3	13.0
Of which: Secured	20.4	20.5	18.0	19.2
Variable-rate credit	18.3	32.0	27.6	15.4
<b>Securities portfolio</b>	<b>15.9</b>	<b>12.6</b>	<b>12.2</b>	<b>0.9</b>
<b>Fixed assets</b>	<b>-1.6</b>	<b>-2.2</b>	<b>-1.3</b>	<b>-2.8</b>
<b>BALANCE SHEET TOTAL</b>	<b>8.9</b>	<b>11.2</b>	<b>9.3</b>	<b>6.4</b>
<b>LIABILITIES AND EQUITY:</b>				
<b>Credit institutions and Banco de España</b>	<b>-3.0</b>	<b>-1.6</b>	<b>-2.5</b>	<b>4.2</b>
<b>Creditors</b>	<b>7.9</b>	<b>14.3</b>	<b>12.6</b>	<b>6.8</b>
Of which:				
Resident private sector	4.3	11.7	11.1	7.8
Non-residents	57.7	30.6	9.3	-2.5
<b>Debt securities</b>	<b>147.4</b>	<b>-10.6</b>	<b>19.4</b>	<b>25.4</b>
<b>Subordinated debt</b>	<b>49.2</b>	<b>55.5</b>	<b>31.9</b>	<b>2.4</b>
<b>Provisions</b>	<b>7.9</b>	<b>36.0</b>	<b>17.5</b>	<b>12.7</b>
<b>Capital and reserves</b>	<b>6.2</b>	<b>31.5</b>	<b>7.7</b>	<b>7.3</b>

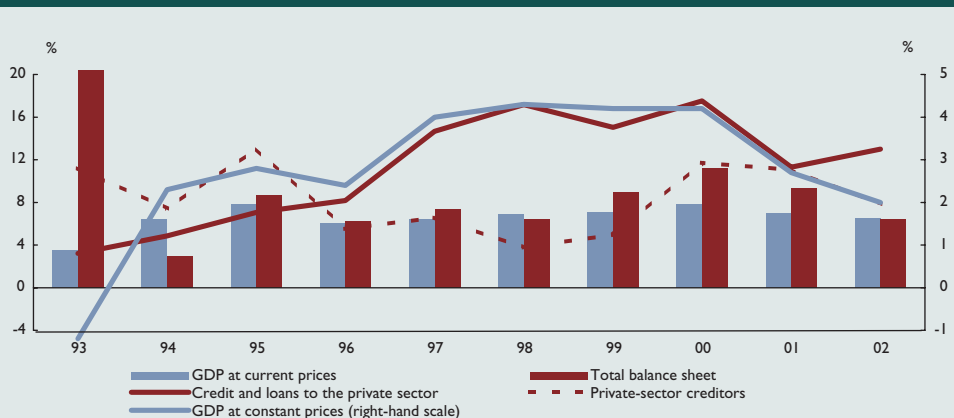
(a) Institutions existing at each date.

The growth of consolidated groups was much weaker (0.7%) due to the strong euro and the sluggish international economy

The aggregate balance sheet of consolidated groups and CIs not consolidated in any group (collectively referred to as CGs) grew much more slowly (0.7%) due to the 23% contraction in foreign business. This sharp fall in activity abroad was due to the depreciation of the US dollar against the euro and to the difficulties encountered by some of the main Latin American economies and their currencies (see Table I.A.6). In contrast, the activity of CGs in Spain increased by 8%, a higher growth rate than that of individual balance sheets.

CHART I.4

**Rates of change of GDP and of certain DI balance sheet items (a)**  
**Total business**



(a) DIs existing at each date.

### 1.2.1. Activity of individual DIs

#### *Changes in the balance sheet and in its main items*

The end-2002 balance sheet total of the DIs operating in Spain amounted to €1.3 trillion, with growth that year of €78 billion (6.4%), which represented a significant deceleration from the 9.3% growth of the previous year (Table I.3).

Apart from lending to the resident private sector, the balance sheet items grew weakly or negatively

74% of that growth (€58 billion) related to collateralised lending to the resident private sector (19.2%), and the remainder came from other lending to private-sector borrowers (€18 billion) and claims on financial intermediaries (€13 billion), which in both cases grew by 6.4%. The growth of lending to the private sector was in line with the strong demand for housing derived from the labour market developments of recent years and with the fresh rises in real estate prices despite the expectations in early 2002 that they would moderate.

Among the other items, only the securities portfolio recorded a modest increase of €2.4 billion (0.9%), while the other captions decreased in absolute terms. The most notable decline was the 15% fall in lending to non-residents (see Table I.A.2), more in line with the moderation in economic growth, stock market instability, the fall in bond yields and the appreciation of the euro.

The strong growth of resident private sector deposits was insufficient to finance the growth of lending to the sector, and the shortfall was made up by debt securities

The balance sheet growth in 2002 was basically financed by the increase of €48 billion (7.8%) in resident private-sector deposits. Nevertheless, it was insufficient to finance the expansion of lending to this sector, the net debit position of which increased. The other major source of financing was debt securities which, with growth of €10.2 billion (25.4%), were the most dynamic item. At the other extreme was the virtual stagnation of subordinated debt, contrasting with its vigour in the previous three years, when it had grown at rates of more than 30%.

The sectoral breakdown of the adjusted net balance sheet (Chart I.5) shows that the public sector is the main net recipient of funds, although a significant reduction in its net borrowing has been discernible since 1997. In contrast, own funds are the most important and stable source of financing in net sectoral terms.

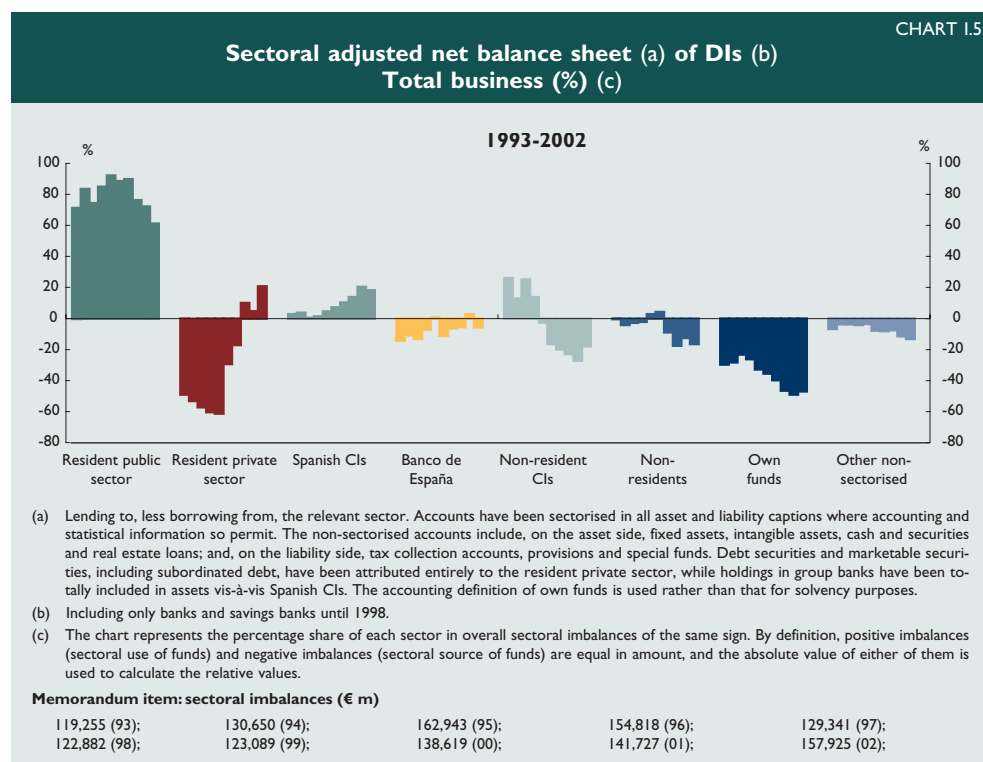
The private sector increased its net debit position vis-à-vis DIs in 2002

Mention should be made of the change in the resident private sector, which in the last 3 years has gone from being a net provider to a net recipient of funds, at the same time as the public sector reduced its borrowing requirement. The opposite is true of non-resident CIs, which since 1997-98 have been net providers of funds, although with a significant decrease in 2002.

#### *Concentration of activity*

The biggest gains in market share in the last 4 years have been made by the two largest institutions

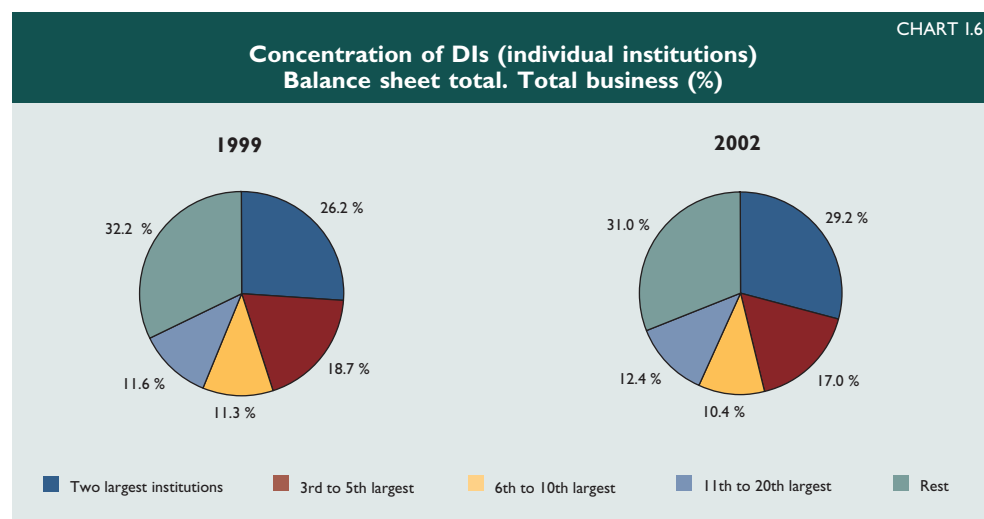
The two largest DIs account for 29.2% of activity as measured by the balance sheet total, with a gain of 3 p.p. in market share since 1999 (Chart I.6). This gain was basically at the expense of the 3rd to 10th largest institutions, which lost 2.6 p.p. This change was due to the BBVA-Argentaria merger and, to a lesser extent, to group restructurings in which the parent bank absorbed certain smaller



institutions (3). Mergers with smaller institutions also explain the gain in market share by the segment consisting of the 11th to 20th largest DIs.

### Interest rates on new business

The interest rates (4) applied by institutions to new transactions at end-2002 were lower than in 2001 (Table I.4). Following the downward trend in the second half of 2001, rates held relatively stable until August-September 2002 and



(3) Owing to these restructurings, it is more meaningful to analyse concentration at group level, as is done in Point I.2.2.

(4) Figures are equivalent annual rates (EAR), which take into account the periodicity of accrual and the commissions payable to the institution.

TABLE I.4

**Average annual interest rates on new business (pesetas or euro)  
with the resident private sector (a)  
Business in Spain (%)**

	Banks and savings banks					Banks		Savings banks	
	1999	2000	2001	2002	Mem. item Dec. 2002	2001	2002	2001	2002
<b>LENDING:</b>									
Credit accounts									
Three months to one year	4.02	5.37	5.42	4.79	4.73	5.35	4.67	6.57	5.99
One year to three years	4.46	5.40	5.52	4.53	4.11	5.41	4.35	6.11	5.36
Personal loans for three years or more	6.31	7.27	7.43	6.86	6.07	7.11	6.58	8.01	7.31
Mortgage loans for three years or more (fixed or variable rate)	4.73	5.76	5.74	4.81	4.35	5.48	4.61	5.94	4.90
Variable-rate credit (non-housing)									
Adjustable monthly	3.14	4.44	4.71	3.55	3.32	4.69	3.52	4.75	3.74
Adjustable every three or more months	4.24	5.42	5.40	4.56	4.10	5.21	4.36	5.63	4.72
<b>BORROWING:</b>									
Current accounts	1.46	1.86	2.01	1.64	1.61	1.92	1.60	2.11	1.73
Savings accounts	0.60	0.61	0.63	0.46	0.42	1.62	1.32	0.54	0.41
Time deposits									
Up to three months	2.26	3.60	3.85	2.86	2.58	3.96	2.85	3.56	2.87
One year and up to two years	2.29	3.45	3.49	2.87	2.59	3.30	2.85	3.52	2.87
Repos up to three months	2.63	4.03	4.26	3.19	2.90	4.24	3.18	4.28	3.21

(a) The rates are annual weighted averages of the monthly rates. In turn, the monthly rates are averages weighted by the amounts of new operations reported by institutions, excluding operations with a deviation from the average of +/- twice the standard deviation.

then turned clearly downwards in the last quarter, in line with the expectations of cuts in the ECB's intervention rate, which were finally fulfilled (5).

The gap between the rates reported by banks and savings banks on new business widened, except for mortgage loan rates, which moved nearer together due to the strong competition

The reported rates on new business indicate certain differences between banks and savings banks. The latter reported higher rates than banks and this difference tended to increase in 2002. The exception to this divergence of interest rates was in house purchase mortgage loans. It is on this high-growth, highly competitive lending segment that DIs have focused their strategy to build domestic market share. The reasons for this strategy are that mortgage lending is low-risk, foments customer loyalty and generates additional business. It is thus natural that mortgage lending should be the segment in which interest rates have most fallen. Furthermore, these falls led to greater convergence between institutions, as is seen from the fact that savings banks cut their mortgage rates by 104 basis points (b.p.) and banks by 87 b.p., although the former are still 29 b.p. higher.

### **Lending to the resident private sector**

As in previous years, the changes in loan composition according to type were characterised by the greater weight of households, basically via house purchase loans, at the expense of productive activity, particularly goods production (see Table I.A.4).

(5) The intervention rate on main refinancing operations, unchanged since end-2001, was cut by 0.5 p.p. to 2.75% in December 2002.

The breakdown of lending by sector shows that the gains in relative weight were predominantly in all the financing segments linked to real estate activity

The most notable feature in 2002 was that these gains in weight were confined to loans relating to real estate activities, including house purchases by households (1.1 p.p.), property development (0.9 p.p.) and construction (0.7 p.p.). Another distinctive feature in 2002 was the slowdown, for the first time in the last four years, in overall lending to the service sector, which resulted in a slight loss in its relative weight.

### Mortgage lending

More than two-thirds of mortgage lending was to households for house purchases

In 2002 on-balance sheet mortgage lending grew by 19.4% and accounted for 53% of lending to the resident private sector (see Table I.A.2). More than two-thirds of its balance was loans to households for the purchase of housing. The growth of house purchase loans took the form of a higher number of transactions and a very substantial increase in average loan amounts due to the rise in the price per square metre (around 17%).

The variable known as *managed mortgage lending* is calculated by adding to on-balance sheet loans the amount of the others that were removed from the balance sheet but which continue to be managed by the institution. It therefore gives a more complete view of mortgage lending. The outstanding balance of DIs' *managed mortgage lending* at end-2002 amounted to €371 billion (against €350 billion on the balance sheet) and grew by 21% in the year (6).

A good part of securitised mortgage lending returns to bank balance sheets in the form of mortgage-backed securities

A portion of the mortgage loans securitised (and thus removed from the balance sheet) is automatically repurchased by the institutions in the form of mortgage-backed securities issued by the special purpose vehicle to which the loans were transferred. In these cases, the institutions are using the securitisation, and incurring the related costs, mainly to improve their liquidity management by means of the transformation of non-negotiable loans into negotiable securities.

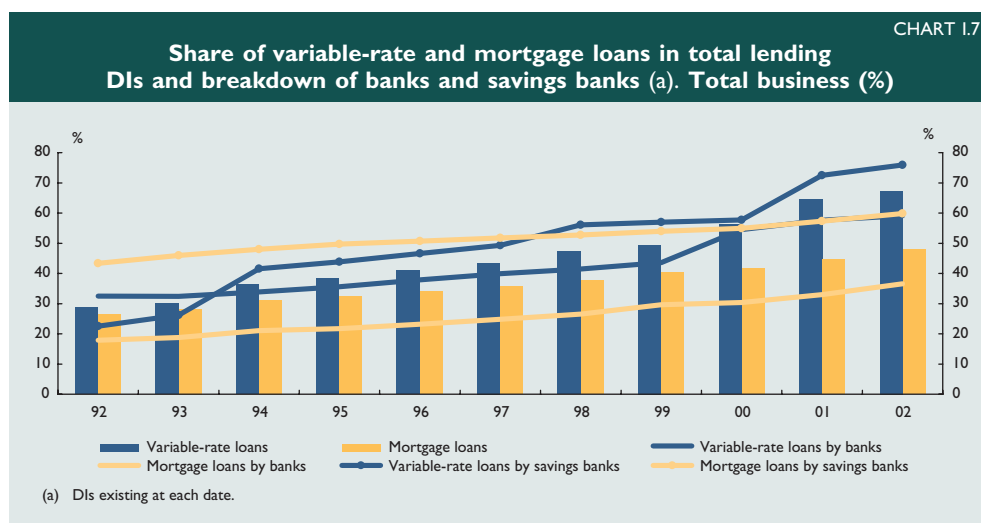
There was significant growth of the refinancing of mortgage loans via "cédulas"

To refinance on-balance sheet mortgage loans, the institutions can issue the securities envisaged in Law 2/81, namely "cédulas", bonds and collateralised mortgage bonds. The issuance of "cédulas" (the predominant instrument on this market) grew spectacularly in 2002 (76%), and they now account for 7.2% of on-balance sheet loans, up from 4%-5% in previous years but still far below the legal limit of 90%. This growth is attributable to the greater demand for these securities because of their improved treatment under solvency regulations (7) (which has raised the demand for them among Spanish and foreign CIs) and to their use in asset securitisation operations (8).

(6) Removal from the balance sheet arises as a result of transfer to mortgage securitisation funds. The flow of securitised mortgage loans amounted to €6.5 million in 2002, an increase of 26% in the period. However, this figure is an understatement because it refers only to mortgage loan securitisations that meet the requirements of Law 2/81, specifically the requirement placing an upper limit on the loan based on the appraisal value of the property. However, during the year considerable volumes of other mortgage loans were securitised, the amounts of which are included in other non-mortgage asset securitisations. Financial System Reform Law 42/2002 of November 22 expressly recognises the securitisation of these "other" loans through the issuance of collateralised mortgage bonds which, to distinguish them from those governed by Law 2/81, will be referred to as "mortgage transfer certificates".

(7) The Ministerial Order of 13 April 2000 reduced the weight of mortgage "cédulas" from 20% to 10%, as permitted by Article 45.2 of Directive 2000/12/EC for securities backed by assets of a certain minimum quality.

(8) This second-level securitisation enables "cédulas" to be transformed into securities more familiar to international investors (mortgage-backed securities), thereby increasing the size of the market for them. Moreover, given the low credit risk of mortgage "cédulas", the process requires few credit enhancements.



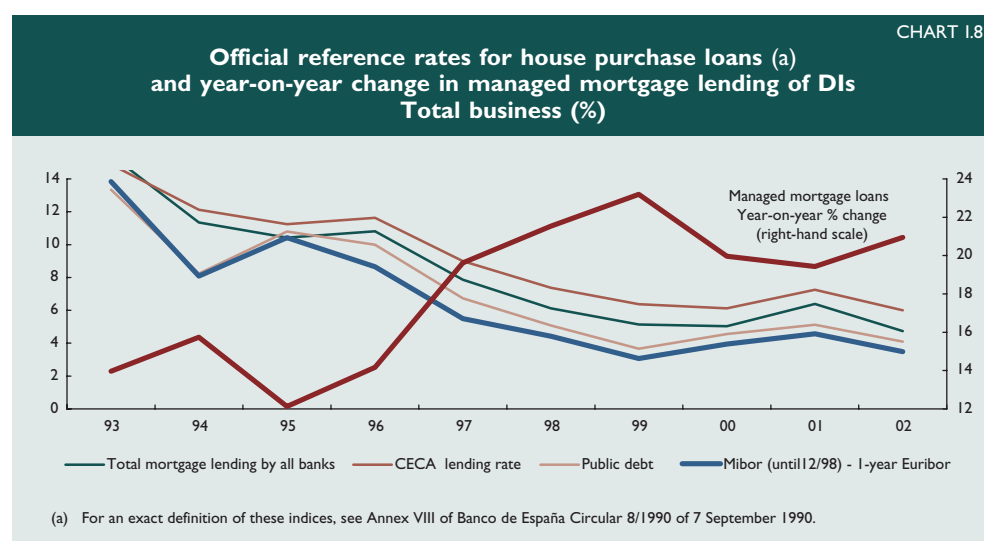
The fall in interest rates and the focus on long-term lending led to strong growth of variable-rate loans, which now account for two-thirds of the total

The strong growth of long-term mortgage loans and the downward movement of interest rates described above have led to considerable growth of variable-rate loans (Chart I.7). Variable-rate loans currently account for more than two-thirds (67.3%) of the balance sheet total of DIs, compared with somewhat less than 50% in 1999. Not all this growth is due to mortgage loans, since non-mortgage loans at variable rates have grown vigorously in the last few years, particularly at banks from 2000 onwards. Even so, variable-rate loans account for a higher proportion of lending at savings banks than at banks: 76% against 58%.

The high proportion of variable-rate loans tied to the money market makes mortgage loans more sensitive to interest rate fluctuations

The growth of managed mortgage loans is rather sensitive to changes in the interest rates used as the official reference in this segment for variable-rate loans, which make up the bulk of this financing. As might be expected, there is a certain negative correlation between them, which is extremely marked in the case of the main reference rate, i.e. Mibor/Euribor, where simultaneous shifts in trend are seen in the rates of change of credit growth and in the interest rate level (Chart I.8).

The official reference rates have fallen steadily and practically uninterruptedly since 1993, with 1-year Mibor/Euribor being the lowest rate throughout the



whole period and that most widely used. Last December this rate was 2.872%, which was very near the all-time low around mid-1999. The preference for this interest rate has to do with the speed with which it reflects changes in the institutions' financing costs, as well as its transparency.

### Securities portfolio

The securities portfolio was notably stable in 2002, with weak growth of permanent holdings...

The DIs' securities portfolio was practically unchanged in absolute terms, although there was moderate growth (4.3%) in the equity portfolio, which makes up less than one-third of total securities (see Table I.A.2). The growth centred on permanent holdings and related, on the one hand, to holdings in non-group non-financial corporations, acquired to benefit from low market prices and, on the other, to the relocation of holdings within consolidated groups.

... and a redistribution within the bond portfolio in which the available-for-sale portfolio lost weight to the other two portfolios

There was a redistribution within the bond portfolio in which the available-for-sale portfolio lost weight to the trading portfolio which, despite the low interest rates from 1999 to 2002, grew at a cumulative rate of 21% during that period. This movement seems to reflect an attempt by the institutions to benefit from price fluctuations at times of low returns and high uncertainty about future market trends. The redistribution also caused a shift towards the held-to-maturity portfolio, particularly Spanish government securities.

### Doubtful exposures and their coverage

Doubtful exposures grew at twice the rate of total credit exposure

The total credit exposure subject to provisions (9) grew at a rate of 9.6% last year, while the growth of doubtful assets and guarantees was 19.6% (28.5% in their past-due component). As a result, the doubtful exposures ratio worsened from 0.88% to 0.97%, although it continued to be low in historical terms (Table I.5). Despite this general deterioration, the ratio held steady in the case of the resident private sector, owing to the considerable buoyancy of lending to this sector and the natural time lag between the assumption of risk and the appearance of any impairment.

The coverage of doubtful exposures by provisions remained at the previous level of more than 200%

Provisions grew in the same proportion as doubtful exposures (19.6%), so coverage continued to be twice the minimum level required by current accounting regulations (203.6%) (10). The *specific provision* increased by 17%, compared with absolute decreases in previous years. The highest growth was in the *statistical provision* (11) (43%), reflecting the fact that the efforts made in provisioning for doubtful exposures are still well below the historical average. Moreover, the statistical provision still has leeway left, since it is considerably off its upper limit. By contrast, the lower growth of the *general provision* (12) reflected the slowdown in credit extension and the high proportion of house purchase mortgage loans subject to lower coverage requirements.

(9) Excluding General Government, the trading book and exposures with country-risk coverage when such coverage exceeds that required for credit risk purposes.

(10) The coverage of doubtful exposures is calculated as the sum of the provisions (specific, general and statistical) divided by the doubtful assets and contingent liabilities, excluding those covered by country-risk provisions and therefore exempt from coverage under Rule 11.4 of Banco de España Circular 4/1991.

(11) See Report on Banking Supervision in Spain 2001.

(12) Which covers risks for which a specific provision is not required.



**Deposit institutions (a): Doubtful exposures and their coverage (b)**  
**Total business (€ m and %)**

TABLE I.5

	1999	2000	2001	2002
Doubtful assets and guarantees	6,099	5,772	6,270	7,501
<i>Of which: Past-due</i>				
Mortgage	701	456	464	630
Non-mortgage	2,677	2,130	2,408	3,060
Provisions	8,859	10,233	12,768	15,273
Specific	4,471	3,624	3,588	4,182
General	4,388	5,425	6,064	6,625
Statistical	—	1,184	3,117	4,466
Total exposures (c)	535,320	629,194	708,601	776,843
Write-offs	20,919	21,098	21,157	20,391
<i>Of which: write-offs during the year</i>	2,381	2,082	1,601	1,783
RATIOS (%):				
Doubtful/total exposures	1.14	0.92	0.88	0.97
Doubtful exposures to ORS/lending to ORS	1.20	0.98	0.93	0.94
Provisions/doubtful exposures	145.25	177.29	203.64	203.61

(a) Institutions existing at each date.

(b) Except covered country-risk exposures when the coverage exceeds that for credit risk.

(c) All assets and guarantees, excluding those not requiring provisions: exposure to general government, trading portfolio and covered country-risk exposures.

### Financing of activity

The most notable changes in the financing of DIs (Table I.6) were the greater vigour of debt securities and the growth of provisions. In addition, there was a decline in the relative importance of subordinated debt and non-resident creditors. There was no change in the proportion of financing provided by the resident private sector – which furnishes nearly 60% of total bank liabilities – or in that represented by capital and reserves, which stands at 7.3%.

The recovery in residents' deposits and the growth of provisions and of debt securities alleviated the ongoing pressure on non-residents' savings as a source of financing

Aside from the above-mentioned growth of debt securities (via mortgage "cédulas") and of provisions, there are other liability components which merit comment. Subordinated debt issuance has slowed because the most active issuers are approaching the upper limit (50% of tier I capital). The fall of 1.1 p.p. in financing from non-resident creditors is attributable more to events in previous years than to those in 2002. The substantial balance sheet growth in the period 1998-2001 obliged institutions to seek financing abroad, whereas in 2002 the lower growth and the recovery in residents' deposits reduced recourse to external funds.

### Share of each type of institution in the balance sheet total

The banks' loss of aggregate balance sheet share to savings banks accelerated and the market share of branches of EU institutions grew significantly

Banks have a 55.3% market share, measured as a proportion of the CIs' balance sheet total (see Table I.A.3). This share has been declining, mostly in favour of savings banks. In 2002 this trend quickened, as banks lost 1.6 p.p., against 1.1 p.p. in 2001, and the share forgone was nearly all taken up by savings banks. The loss was in domestic banks, since foreign banks recorded a gain of 0.6 p.p., generated by EU branches owing to their increasing numbers and, more importantly, to their dynamism, which was particularly notable in those operating nearly exclusively via telephone and the Internet. Outside the DI segment, the market share of the SCIs also held steady.



DI liability structure (a) Total business (%)					TABLE I.6
	1999	2000	2001	2002	
<b>LIABILITIES</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	
<b>Financial intermediaries (net) (b)</b>	<b>7.1</b>	<b>7.1</b>	<b>5.1</b>	<b>5.1</b>	
<b>Creditors</b>	<b>74.6</b>	<b>73.3</b>	<b>74.3</b>	<b>73.7</b>	
Of which:					
Resident private sector	62.1	59.7	59.7	59.8	
Current accounts	15.7	14.7	15.4	15.5	
Savings accounts	14.4	12.7	12.7	12.6	
Time deposits	21.7	22.4	22.0	22.5	
Repos	10.4	10.0	9.5	9.2	
Non-residents	10.0	11.2	11.1	10.0	
<b>Debt securities</b>	<b>5.1</b>	<b>3.9</b>	<b>4.2</b>	<b>4.9</b>	
<b>Subordinated debt</b>	<b>3.0</b>	<b>4.0</b>	<b>4.7</b>	<b>4.5</b>	
<b>Provisions</b>	<b>3.5</b>	<b>4.1</b>	<b>4.4</b>	<b>4.6</b>	
<b>Capital and reserves</b>	<b>6.7</b>	<b>7.6</b>	<b>7.3</b>	<b>7.3</b>	

(a) Institutions existing at each date.  
(b) Including Banco de España.

### Banco de España Central Credit Register (CCR)

94% of borrowers reported to the CCR are resident individuals...

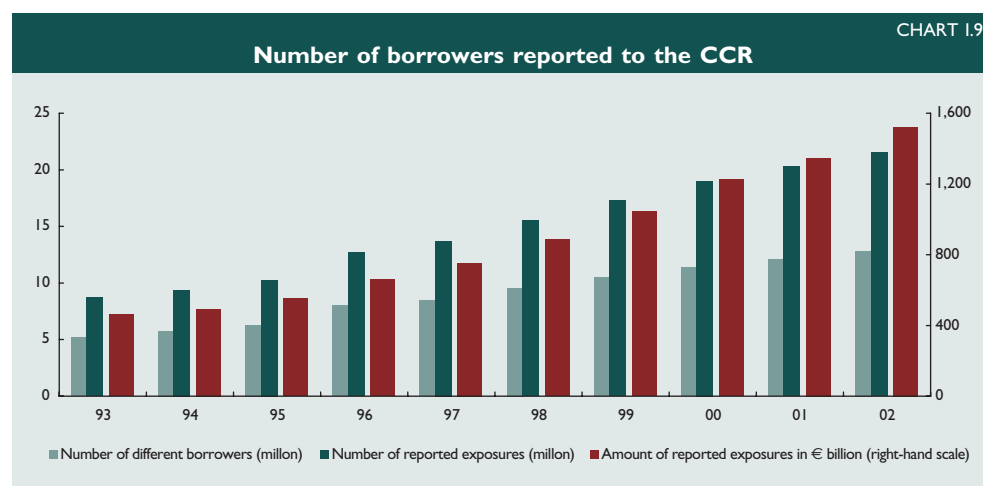
..., although the number of resident foreign individuals (2% of borrowers) has doubled in the last 4 years

The 12% growth of the amount of the exposures reported was twice that of borrowers

To supplement the foregoing review of DIs' activities, there follows a brief description of the exposures reported to the Banco de España Central Credit Register (CCR).

As at December 2002 more than 21 million exposures with a reported amount of €1.52 trillion and distributed among nearly 13 million borrowers, had been reported to the Banco de España CCR. 94% of the borrowers were individuals resident in Spain, the vast majority Spanish. However, foreigners resident in Spain, who barely account for 2% of the total borrowers reported, are exhibiting significant annual growth (20%) and their number has doubled in the last four years (see Table I.A.5).

The amount of the exposures reported (12%) grew at a higher rate than the number of different borrowers and exposures (6% each). Among the automatically requested reports, considerable growth is still being shown by those addressed to the reporting institutions, for which they constitute an important credit risk management instrument.



### 1.2.2. Activity of consolidated groups of DIs (13)

The consolidated balance sheet grew only slightly due to international economic weakness and, to a lesser extent, to the decrease in the number of consolidated institutions

As at the end of December 2002, the CGs' balance sheet total amounted to €1.46 trillion, 11.6% more than the DIs' balance sheet (See Table I.A.6). The consolidated balance sheet grew by €9.6 billion (0.7%) in 2002, which contrasted with the growth of €78 billion (6.4%) in the individual balance sheet. This weak growth is attributable to the reduction in the number of consolidated institutions, the depreciation of the US dollar against the euro and, more importantly, the general depreciation of the currencies of certain countries (14) in which large subsidiaries of the consolidated groups have a presence.

On-balance sheet activities are supplemented by mutual and pension fund management. The net asset value of managed funds amounted to €268 billion in December 2002, down 4% in the year.

82% of the aggregate balance sheet of CGs arose from business units based in Spain (€1.2 trillion), and practically all of this percentage related to DIs, since the other institutions in CGs are special-purpose entities, small securities brokers and dealers and fund managers which make a scant contribution to the balance sheet.

#### Foreign business and concentration

While groups' domestic business grew by 8.1%, their foreign business decreased by 23.5%

17.8% of the consolidated balance sheet and 22.5% of the assets of managed funds related to foreign business, compared with 2001 figures of 23.4% and 26.6%, respectively. This lesser relative weight of foreign business was due to the combined effect of the negative performance of exchange rates and the reduction in the number of subsidiaries, particularly in Latin America (see memorandum item in Table I.A.6). The foreign consolidated balance sheet decreased by 23.5% in 2002, and financial assets diminished by a very similar proportion, while financial liabilities fell by a smaller percentage (–16.2%).

Foreign financial activity has a higher volume on the liability side, since it represents a source of net financing via debt securities, subordinated debt and preference shares

The separation of activity into domestic and foreign business means that the consolidated assets and the consolidated liabilities of the respective areas do not match. At the end of 2002, foreign business was financing domestic activity for a net amount of €57.1 billion (see Table I.A.6), and this position had become more pronounced than in the previous year owing to growth of 8.8% against balance sheet growth of 0.7%.

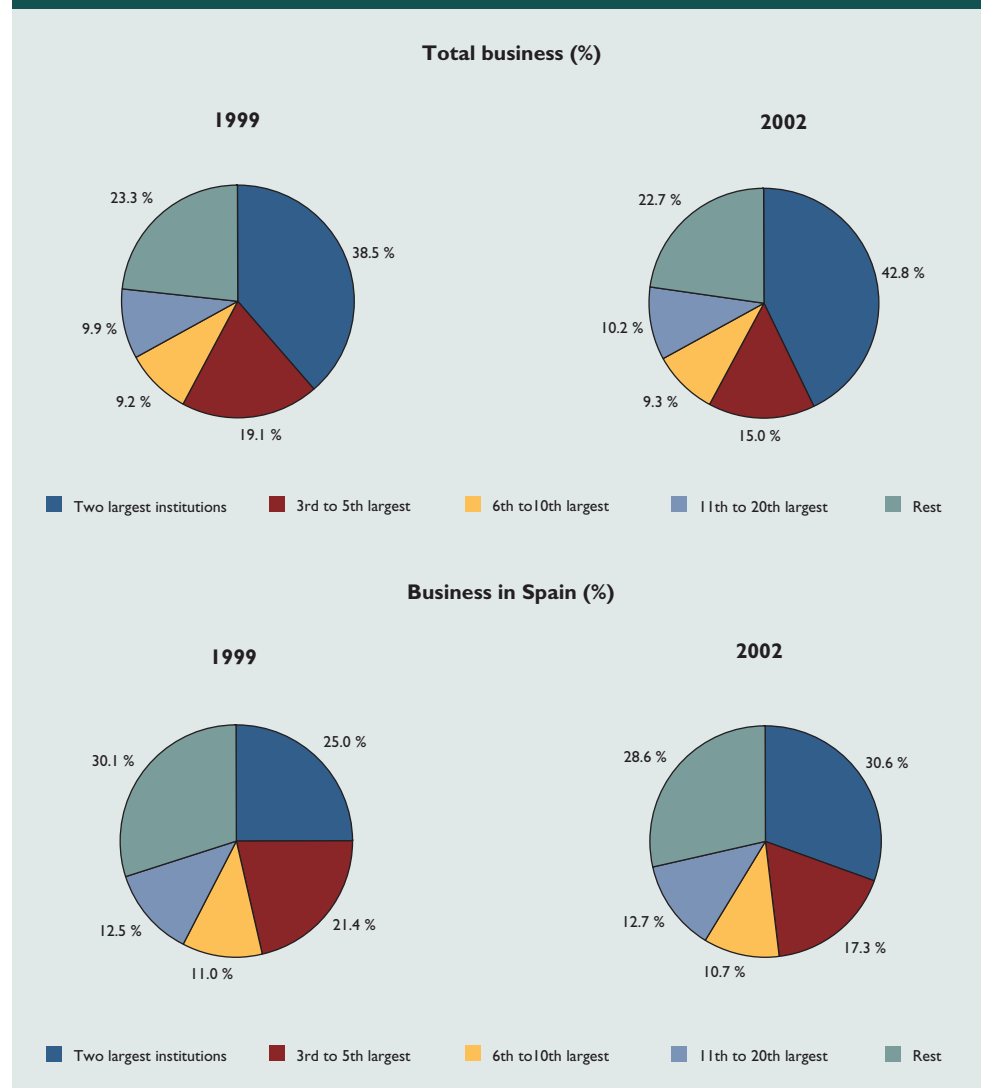
The greater importance of foreign business as a source of funds is concentrated mainly in debt securities, in subordinated debt and in preference shares (included in minority interests). Although foreign business accounts for 17.8% of total operations, these foreign liabilities make up 53% and 69% of their respective categories (see Table I.A.6).

(13) Consolidated groups of DIs also include individual DIs not forming part of any group. Consolidated groups are based on the definition contained in the accounting and solvency regulations. They include all the institutions and companies over which control is exercised or in which a significant ownership interest is held. Financial institutions (securities companies, investment companies, mutual and pension fund managers, holding companies and banking ancillary companies), except for insurance companies, are fully or proportionally consolidated, while non-financial and insurance companies are valued by the equity method.

(14) As at 31.12.2002 and relative to the end-2001 price, the Argentine peso had depreciated by 233%, the Brazilian real by 52% and the Mexican peso by 14%.

CHART 1.10

### Concentration of DIs and of their consolidated groups Balance sheet total



The asset operations of most importance in foreign business are the government bond portfolio, fixed assets and goodwill

On the asset side, the main difference between business in Spain and that abroad is the greater weight in the latter of the government bond portfolio, fixed assets and consolidated goodwill. The latter two arose from the recent acquisition of certain large institutions with extensive branch networks (15) (fixed assets). Since these purchases were made through companies abroad, the resulting goodwill pertains to the foreign business.

The importance of government bonds in foreign business is related to the larger budget deficits and other historical features of the countries where the banking subsidiaries are located, and to the relative paucity of sufficiently attractive financing alternatives available to the private sector. However, in 2002 the decrease in these government securities exceeded that of the balance sheet abroad (–32.5%), and there was a simultaneous deterioration in the credit standing of some of these issuers.

(15) Fixed assets can also be affected by valuation standards, which provide for application of the exchange rate prevailing on the acquisition date. Therefore, the value of this item would not be affected by the above-mentioned depreciations.

TABLE I.7

**Foreign business of consolidated groups  
and individual institutions (a) (€ m)**

	1999	2000	2001	2002 (p)
<b>Consolidated foreign balance sheet (assets)</b>	<b>211,523</b>	<b>372,428</b>	<b>338,932</b>	<b>259,380</b>
Financial assets	138,371	243,421	250,813	189,073
<i>EU</i>	31,232	47,563	54,154	47,169
<i>Latin America</i>	81,510	169,737	170,312	121,051
<i>Rest</i>	25,629	26,121	26,347	20,853
Financial liabilities	125,656	246,553	245,899	205,989
<i>EU</i>	20,478	40,421	34,743	30,696
<i>Latin America</i>	73,448	147,866	155,829	110,227
<i>Rest</i>	31,730	58,266	55,327	65,066
<b>MEMORANDUM ITEM:</b>				
Funds managed (net asset value)	24,668	50,972	74,490	60,544
<i>EU</i>	2,999	4,626	5,968	6,951
<i>Latin America</i>	21,209	44,673	63,285	48,889
<i>Rest</i>	460	1,673	5,237	4,704

(a) Institutions existing at each date.

Since two large groups account for the bulk of foreign business, their share of the balance sheet total is much greater than their share of business in Spain

The two largest CGs have a 42.8% share of the CGs' balance sheet total (Chart I.10). This is due to the dominant position of these two groups in foreign business, since their share of business in Spain is only 30.6%, a percentage which is closer to that of the parent banks.

In general, the degree of concentration of the CGs' activity in Spain is only slightly greater than that of the DIs' total banking activity (Chart I.10 and Chart I.6), with the exception of the smallest institutions, which generally do not form part of a group and in which the losses of market share are thus concentrated.

Foreign business and its contraction were largely concentrated in Latin America

The decrease in foreign financial assets and liabilities was concentrated in Latin America, with declines therein of between €45 billion and €49 billion. Also concentrated in this area was the reduction, albeit smaller, in the net assets of managed funds (€-14 billion, -19%). Even so, the foreign financial assets and liabilities and the net assets of the funds managed outside Spain are still strongly concentrated in this region, which accounts for 53%, 64% and 81% of their respective totals (Table I.7)

### I.3. THE RESULTS OF DIs

The extraordinary dividends received from affiliated undertakings in 2001 should be taken into account when assessing 2002 individual results

As noted above, the macroeconomic situation in which the DIs' results were obtained in 2002 was less favourable than that of the preceding years. Notable in this connection was the decrease in 2002 in profit before taxes expressed as a proportion of average total assets (ATA), both in individual institutions (Table I.8) and in consolidated groups (Table I.9), although in the case of individual institutions it was partly due to the extraordinary dividends paid by affiliated undertakings in 2001. These dividends hinder comparison between individual profit and loss account margins for 2002 and 2001, right from the net interest income level, making it necessary to take the effect of these dividends into account.

TABLE I.8

Individual profit and loss account of DIs (a) (€ m and %)												TABLE 1.8
	1999			2000			2001			2002		
	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ
Financial income	44,713	4.72	-11.5	54,442	5.25	21.8	64,575	5.58	18.6	57,910	4.64	-10.3
Financial costs	-23,873	-2.52	-20.4	-31,833	-3.07	33.3	-36,333	-3.14	14.1	-29,701	-2.38	-18.3
<b>Net interest income</b>	<b>20,841</b>	<b>2.20</b>	<b>1.4</b>	<b>22,609</b>	<b>2.18</b>	<b>8.5</b>	<b>28,242</b>	<b>2.44</b>	<b>24.9</b>	<b>28,209</b>	<b>2.26</b>	<b>-0.1</b>
Non-interest income	7,487	0.79	4.1	8,555	0.83	14.3	8,298	0.72	-3.0	8,560	0.69	3.2
<b>Gross income</b>	<b>28,328</b>	<b>2.99</b>	<b>2.1</b>	<b>31,164</b>	<b>3.01</b>	<b>10.0</b>	<b>36,540</b>	<b>3.16</b>	<b>17.3</b>	<b>36,768</b>	<b>2.95</b>	<b>0.6</b>
Operating expenses	-18,563	-1.96	3.2	-19,611	-1.89	5.6	-20,865	-1.80	6.4	-21,528	-1.73	3.2
Net operating income	9,766	1.03	0.1	11,553	1.11	18.3	15,675	1.35	35.7	15,240	1.22	-2.8
Provisions and write-downs (net)	-2264	-0.24	-36.7	-3,611	-0.35	59.5	-7,026	-0.61	94.6	-6,953	-0.56	-1.0
Extraordinary income (net)	1380	0.15	-29.5	2,033	0.20	47.3	1,239	0.11	-39.1	1,543	0.12	24.6
<b>Profit before tax</b>	<b>8,895</b>	<b>0.94</b>	<b>9.0</b>	<b>9,982</b>	<b>0.96</b>	<b>12.2</b>	<b>9,910</b>	<b>0.86</b>	<b>-0.7</b>	<b>9,875</b>	<b>0.79</b>	<b>-0.3</b>
<b>Net profit</b>	<b>6,986</b>	<b>0.74</b>	<b>6.5</b>	<b>8,408</b>	<b>0.81</b>	<b>20.3</b>	<b>8,689</b>	<b>0.75</b>	<b>3.3</b>	<b>8,928</b>	<b>0.72</b>	<b>2.8</b>
MEMORANDUM ITEM:												
Average total assets	947,233		5.8	1,036,619		9.4	1,157,856		11.7	1,246,956		7.7
Average own funds	53,862		4.3	63,194		17.3	73,818		16.8	78,251		6.0
Efficiency ratio	65.5			62.9			57.1			58.5		
Return on average own funds	13.0			13.3			11.8			11.4		

(a) The figures in this table refer to the institutions existing as at December 2002.

(a) The figures in this table refer to the institutions existing as at December 2002.

### I.3.1. The results of individual DIs

Individual net profit grew by 2.8% (more slowly than business volume), although the return on equity held up strongly

The falls in interest rates and in the main stock market indices, along with the growing competitive pressure and the substantial provisions recorded, meant that the net income of individual institutions grew modestly (2.8%), at a slower pace than business volume. The growth rates of intermediation activity and of financial services also slowed, although they remained high. In this highly complex and competitive setting, the return on equity was surprisingly resilient, falling only 36 b.p. to 11.4%.

All the margins expressed as a proportion of ATA, except for PBT, broke structurally with their downward trend, although the effect of dividends from affiliated undertakings meant that they decreased with respect to 2001

The net interest, gross and net operating margins of the DIs, expressed in terms of ATA, broke structurally in 2002 with the gentle downward trend prevailing before 2001, although by then they had already formally diverged from it owing to the effect of the extraordinary dividends paid by affiliated undertakings (Chart I.11) (16). However, until 2002 that long-term downward trend did not feed through to profit before tax (PBT) because of the progressive reduction in the impact of the transfers to provisions and the write-downs of exposures included in the final items at the bottom of the profit and loss account. This decrease in provisions and write-downs halted in 2001 due to the impact of the statistical provision introduced in mid-2000, which reopened the gap between net operating income and PBT.

(16) Disregarding the effect of dividends received from affiliated undertakings, the net interest and gross margins (as a proportion of ATA) held steady in 2002, while the net operating margin increased in the year.

TABLE I.9

**Consolidated profit and loss account of DIs (a)**  
(€ m and %)

	1999			2000			2001			2002 (b)		
	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ
Financial income	60,122	5.82	-3.7	80,819	6.76	34.4	88,808	6.37	9.9	77,843	5.43	-12.3
Financial costs	-33,533	-3.25	-10.0	-50,134	-4.19	49.5	-51,901	-3.73	3.5	-41,430	-2.89	-20.2
<b>Net interest income</b>	<b>26,588</b>	<b>2.57</b>	<b>5.6</b>	<b>30,685</b>	<b>2.57</b>	<b>15.4</b>	<b>36,907</b>	<b>2.65</b>	<b>20.3</b>	<b>36,413</b>	<b>2.54</b>	<b>-1.3</b>
Non-interest income	11,656	1.13	9.1	14,575	1.22	25.0	15,945	1.14	9.4	15,068	1.05	-5.5
<b>Gross income</b>	<b>38,245</b>	<b>3.70</b>	<b>6.6</b>	<b>45,260</b>	<b>3.79</b>	<b>18.3</b>	<b>52,852</b>	<b>3.79</b>	<b>16.8</b>	<b>51,482</b>	<b>3.59</b>	<b>-2.6</b>
Operating expenses	-25,226	-2.44	5.6	-28,897	-2.42	14.5	-32,428	-2.33	12.2	-31,040	-2.17	-4.3
<b>Net operating income</b>	<b>13,018</b>	<b>1.26</b>	<b>8.7</b>	<b>16,363</b>	<b>1.37</b>	<b>25.7</b>	<b>20,424</b>	<b>1.47</b>	<b>24.8</b>	<b>20,441</b>	<b>1.43</b>	<b>0.1</b>
Provisions and write-downs (net)	-3,131	-0.30	-13.6	-4,964	-0.42	58.5	-9,659	-0.69	94.6	-7,439	-0.52	-23.0
Amortisation of goodwill	-1,644	-0.16	19.8	-1,765	-0.15	7.4	-3,004	-0.22	70.2	-2,645	-0.18	-12.0
Extraordinary income (net)	898	0.09	-27.0	618	0.05	-31.2	3,141	0.23	407.8	370	0.03	-88.2
<b>Profit before tax</b>	<b>12,618</b>	<b>1.22</b>	<b>14.7</b>	<b>15,295</b>	<b>1.28</b>	<b>21.2</b>	<b>15,826</b>	<b>1.14</b>	<b>3.5</b>	<b>13,956</b>	<b>0.97</b>	<b>-11.8</b>
<b>Net profit</b>	<b>9,497</b>	<b>0.92</b>	<b>14.7</b>	<b>11,922</b>	<b>1.00</b>	<b>25.5</b>	<b>12,692</b>	<b>0.91</b>	<b>6.5</b>	<b>11,659</b>	<b>0.81</b>	<b>-8.1</b>
Of which: attributable to the group	8,258	0.80	13.0	10,045	0.84	21.6	10,721	0.77	6.7	9,857	0.69	-8.1
MEMORANDUM ITEMS:												
Average total assets (ATA)	1,033,298		5.0	1,195,304		15.7	1,393,168		16.6	1,433,308		2.9
Average own funds of the group	54,882		8.2	66,599		21.4	80,405		20.7	82,884		3.1
Efficiency ratio	66.0			63.9			61.4			60.3		
Return on average own funds of the group (b)	15.0			15.1			13.3			11.9		

(a) The data in this table refer to the institutions existing as at December 2002.

(b) Net profit attributable to the group as a proportion of: capital (net of own shares and uncalled capital), reserves of the controlling company and of consolidated companies (net of prior year's losses and losses of consolidated companies), net profit attributable to the group and fund for general banking risks.

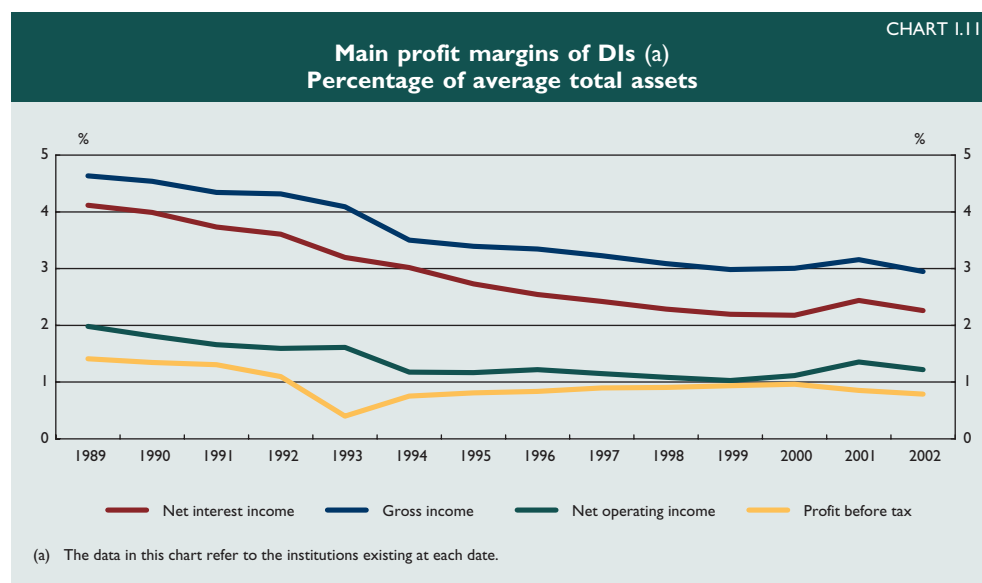
The fall in total spread and the lower return on own funds placed in earning financial assets were responsible for the fall in net interest income

The decrease in *net interest income* in 2002 was caused by: (i) the narrowing of the total spread with which DIs operate (difference between the average return on earning financial assets, EFAs, overstated in 2001, and the average cost of interest-bearing financial liabilities, IBFLs); and (ii) the direct effect that the fall in interest rates has been exerting on the return on institutions' own funds invested in earning financial assets (17) (Table I.A.7). Acting in the opposite direction to cushion the fall in the return on the traditional financial intermediation business were non-interest income (commissions for financial services and securities and derivatives trading) and, more importantly, the efforts to contain operating expenses.

The decrease in the total spread in 2002 was accompanied by an increase in the deposit spread, which, however, was well below that a decade earlier because of the greater downward stickiness of deposit interest rates

The downward trend of the *total spread* and its components (Chart I.12) was in turn caused by an increasingly competitive financial market. But it should also be noted that the EFA and IBFL average return and cost ratios did not fall in parallel; rather, the former fell more sharply because there was less leeway in the interest borne on financial liabilities given the sharp declines in interest rates and the growing predominance of variable-rate loans. However, this trend was broken in 2002 since, disregarding the effect of the extraordinary dividends in 2001, the total spread stabilised.

(17) This component of net interest income is always positive because the earning financial assets (EFAs) are financed at no cost. The assumed return on this subset of EFAs is taken to be that on total EFAs, which entails a distribution of the financing from own funds throughout the whole of the EFAs.



An analytical breakdown of the total euro-denominated spread into the lending and the deposit spreads calculated using a neutral market reference rate (18) shows a certain cyclical pattern that highlights the different lags with which the interest rate variations are reflected in the average return and cost ratios (Chart I.12, bottom panel). The changes in these components of the total euro-denominated spread in 2002 included a sharp increase in the weight of the deposit spread, although its level was far below that a decade earlier.

Non-interest income posted a moderately positive performance thanks to commissions for collection and payment services

*Non-interest income* recovered moderately (3.2%) in 2002, in contrast to the fall in 2001. This pick-up was due to the growth in commission revenue, particularly that for collection and payment services, which amply makes up for the fall in commission revenue from currency and note exchange (–45%), relating to the placement in circulation of euro notes and coins since the beginning of 2002. In contrast, the return on financial transactions performed negatively due to the situation of the capital markets, with the exception of futures operations, which fared favourably as they were the ones most used as a financial hedging instrument (see Table I.A.7).

2002 saw further progress in the reduction of operating expenses, particularly personnel expenses,...

... which enabled the net operating margin to recover to the level of 1996

In 2002 *operating expenses* as a percentage of ATA continued the downward trend initiated in 1992, driven by the sharp decreases in personnel expenses and in other operating expenses (Chart I.13). The decline in personnel expenses at a time of increasing bank employee numbers (see Table I.2) reflects institutions' ongoing efforts to improve the efficiency of their human resources by means of workforce adjustments (early retirement), outsourcing of activities and progressive adoption of new information technologies. This cost containment effort made possible a net operating margin relative to ATA of 1.2%, similar to that in 1996 (19). Also, the efficiency ratio, defined as operating expenses divided by

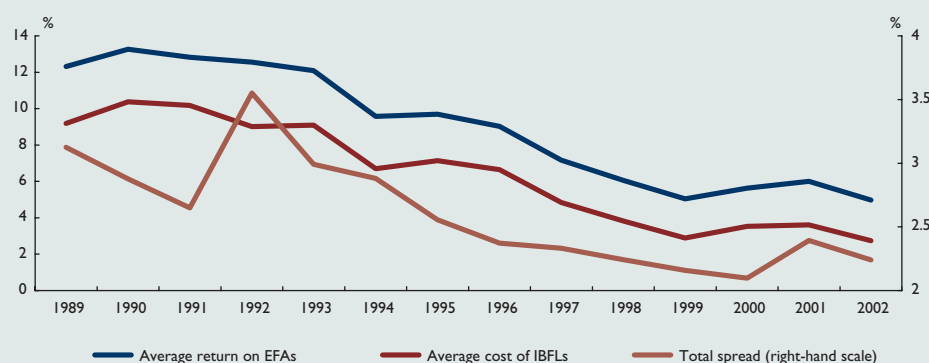
(18) Both calculated with respect to the average annual internal rate of return (IRR) on Spanish public debt for a term equal to that of euro-denominated EFAs. The term of the public debt used as a reference is different each year, as it follows the trend towards longer average terms in the institutions' investments. Thus, the euro-denominated lending spread is obtained as the difference between the average return on euro-denominated EFAs and the return on the euro-denominated debt used as a reference. The deposit spread is obtained by taking the difference up to the total spread.

(19) In 2001 this margin was 13 b.p. higher than in 2002, but it was due to carry-over of the impact of the substantial dividends paid by affiliated undertakings.

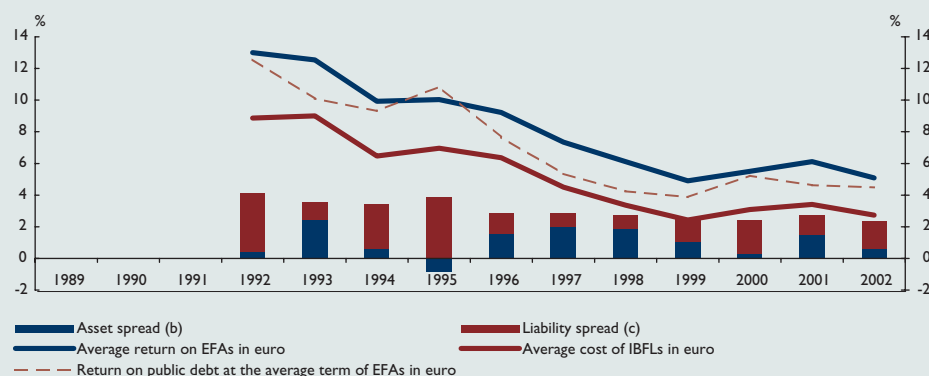


CHART I.12

**Return on earning financial assets (EFAs),  
cost of interest-bearing financial liabilities (IBFLs) and total spread  
Total DIs (a). Total activity**



**Comparison of return on EFAs and average cost of IBFLs with public debt.  
Activity in euro**



- (a) The data in this chart refer to the institutions existing at each date.  
 (b) Difference between average return on EFAs in euro and public debt.  
 (c) Difference between return on public debt and average cost of IBFLs in euro.

gross income, reached its lowest level since 1990 (adjusted for 2001 dividends), which reflects the long-term trend towards improved efficiency (i.e. lower ratios) in the Spanish banking system (20) (Table I.18).

The counter-cyclical behaviour of the statistical provision helped to stabilise profit and loss accounts,...

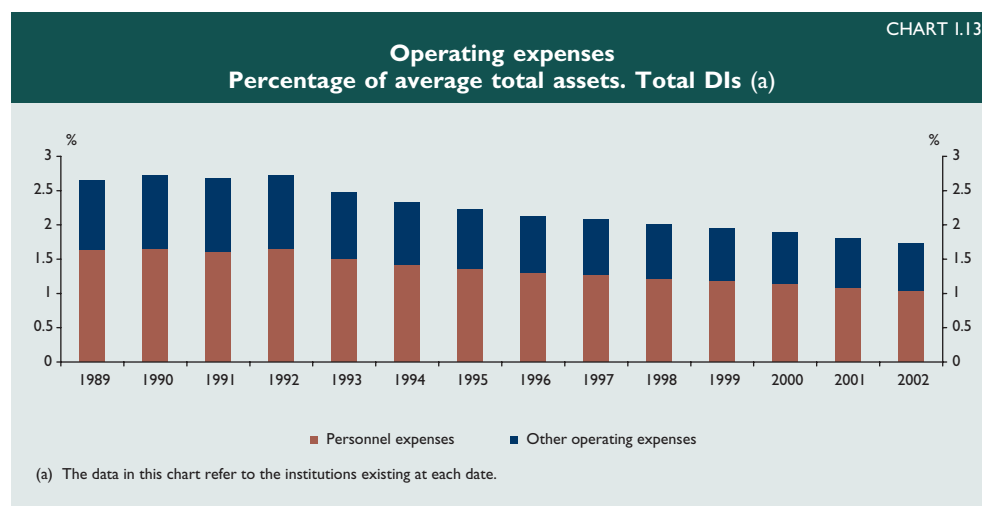
The total *net provisioning for bad debts* grew by 8.1% in 2002, which was a relatively moderate rise. This was possible because the higher specific provisioning in line with the economic slowdown was partially offset by the lower statistical provisioning (see Table I.A.7), which functioned in its intended fashion as a counter-cyclical provision. General provisioning was also lower as a result of slower lending in 2002 and of the higher proportion of mortgage loans, which have a lower weighting. In these circumstances, the doubtful exposure coverage ratio stood at 203.6%.

... but this did not prevent the final items from performing negatively, which resulted in a slight decline in PBT

The negative contribution to 2002 earnings of the net provisioning for bad debts, security price fluctuation and country-risk was only partially offset by the net recoveries of the funds for general banking risks and other specific funds and by the increase in extraordinary profit. All these resulted in the above-mentioned

(20) This long-term trend is clearer in the consolidated figures because they are free from the effect of the dividends paid by group companies (Chart I-3.7).





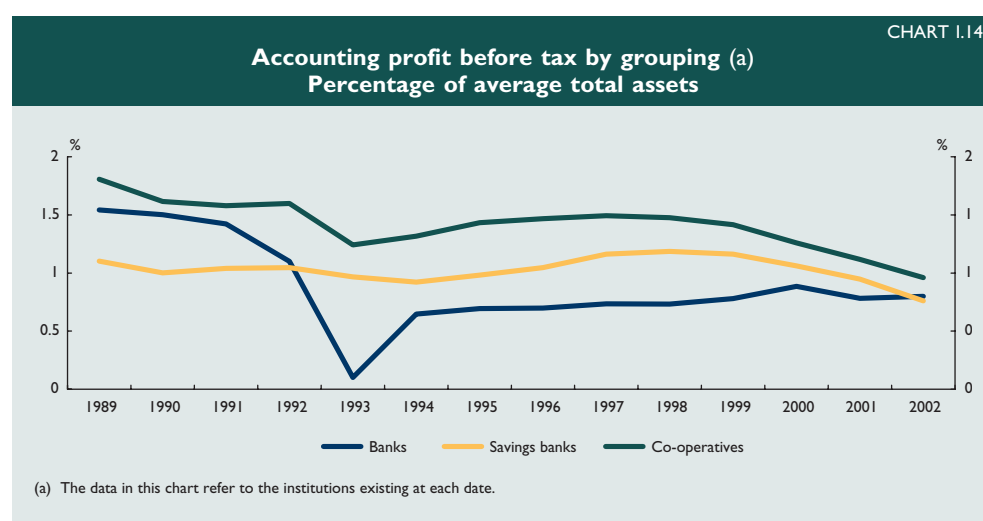
slight decrease in *book profit before tax*, both in absolute terms and as a percentage of ATA (Table I.8).

### Results by grouping

Banks made notable efforts to reduce personnel expenses in order to counteract their lower net interest and gross income

Certain differentiating features in the performance of the different DI groupings (see Table I.A.8) can be identified by comparing their margins relative to ATA. Only the bank grouping increased its profit before tax in absolute terms in 2002. As a result, for the first time since 1993 (21), bank PBT was slightly higher than that of savings banks (Chart I.14). This was achieved despite banks' lower net interest and gross margins, which are however offset by lower personnel expenses (22).

Performance was also uneven in the items below the net operating margin. At banks the net provisioning and write-downs decreased by 12.9% – compared with growth of 190% in 2001 –, while at savings banks they rose by 32.2%, driven by the specific provisioning for bad debts, and at co-operatives they were up by



(21) The sharp fall in 1993 in the PBT of the bank grouping was due to the intervention in respect of Banesto.

(22) Personnel expenses as a percentage of ATA in 2002 were 0.9% in the bank grouping, compared with 1.2% in savings banks and 1.3% in co-operatives.

16.9%. The basic reason for this asymmetry was the net recoveries of other specific funds, which were much more significant in banks.

### 1.3.2. Results of consolidated groups of DIs

The internationalisation of Spanish groups exposes them to the international economic background, which was unfavourable in 2002

The decrease in interest rates in Spain, along with the above-mentioned difficulties besetting certain Latin American countries and the resulting depreciation of their currencies, to which must be added that of the US dollar, were behind the decline in group attributable net profit (–8.1%) and the fall in consolidated return on equity to 11.9% (–1.4 p.p.), the lowest level since 1998.

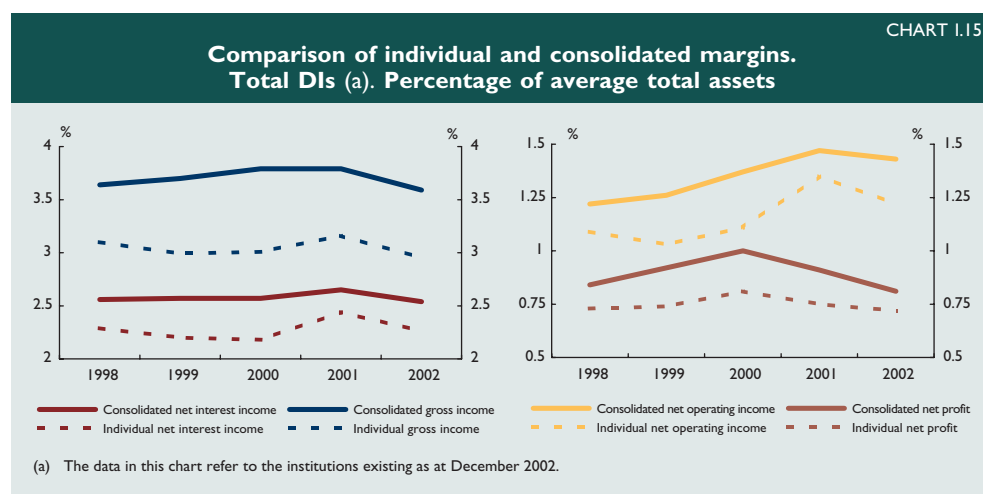
There are significant differences between the consolidated and individual margins relative to ATA (23) (Chart I-3.5). The former are always higher. This is a reflection of numerous factors such as the inclusion of entities ranging from those that are purely providers of financial services without any intermediation element (fund managers) to those completely focused on traditional financial intermediation operating in a context of high margins, operating costs, credit risk and write-downs (Latin American subsidiaries), not to mention the inclusion of the profit or loss of non-financial corporations accounted for by the equity method.

The results of CGs and DIs, which differ most in gross income, converge to a greater degree in net income

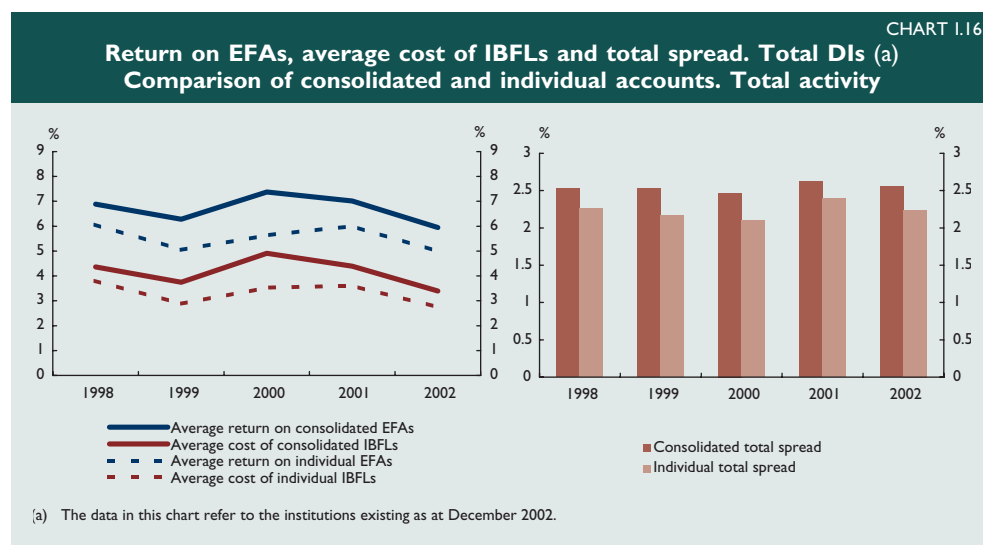
This wide range of differentiating factors means that the gap observed in the net interest margin reaches a maximum in the gross margin, is partially absorbed by the higher relative operating expenses and finally closes further in the final net result. The consolidated net profit is more variable than its individual counterpart, reflecting both the variation in the composition of consolidated groups and the greater volatility of results from business abroad.

The higher interest rates and spreads with which the foreign subsidiaries operate raise the net interest and gross income of CGs with respect to those of DIs

The return on earning financial assets (EFAs), the cost of interest-bearing financial liabilities (IBFLs) and the *total spread* are all higher in CGs than in DIs (Chart I.16), which reflects the higher risk (credit and otherwise) and hence the higher premia on foreign business, particularly in Latin America. However, the total spread narrowed in 2002 and was largely responsible for the moderate fall in the consolidated net interest margin. This decrease passed through, being magnified in the process, to the consolidated *gross margin* (Chart I-3.5), basically because



(23) Because of the process by which consolidation is performed, the 2001 margins do not include the effect of the dividends received from affiliated undertakings mentioned in the analysis at individual level.



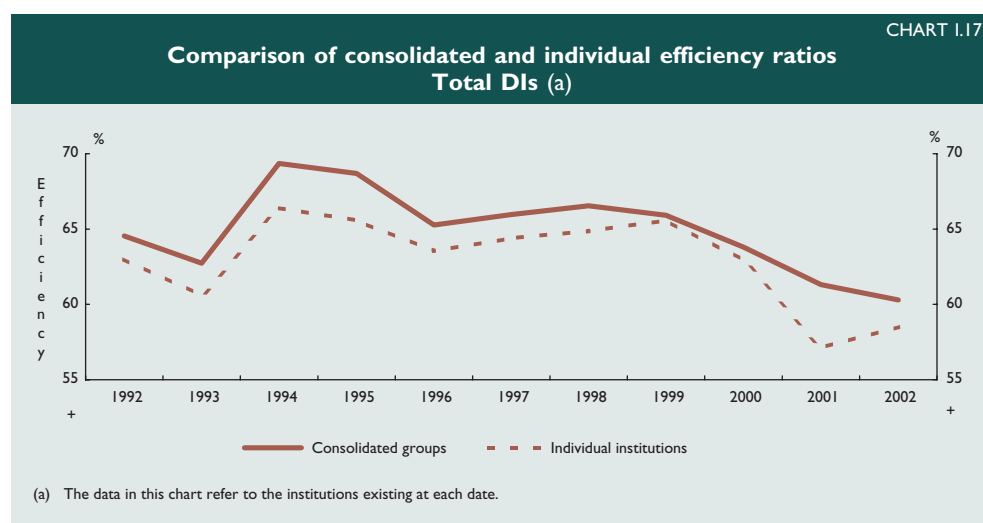
of the sharp fall in net income on financial transactions (–21%) arising from the increase in the loss on the trading book (see Table I.A.10).

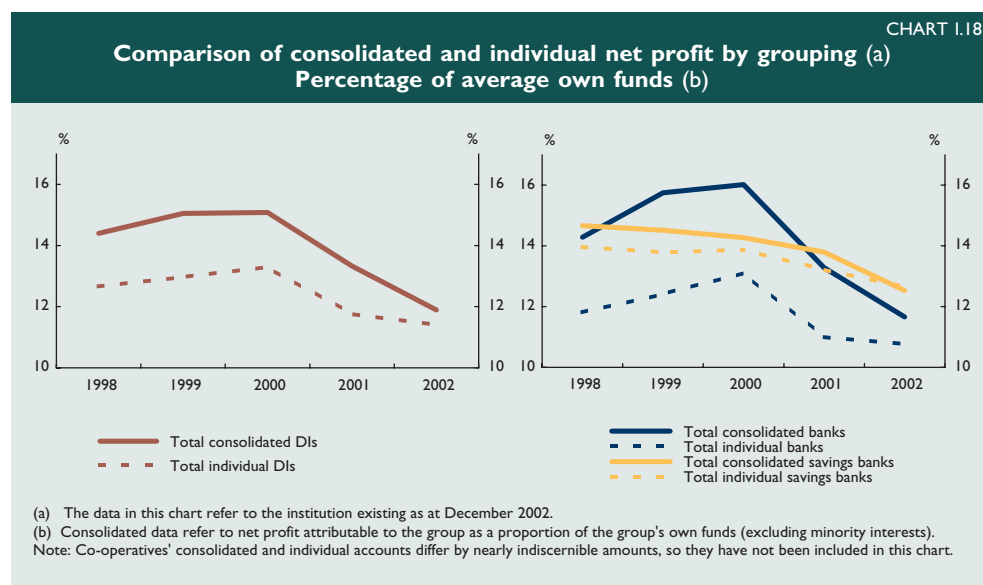
Comparison of the consolidated and individual efficiency ratios shows that consolidated groups have considerable room for improvement by reducing their operating expenses

The stability of consolidated net operating income gave way to a fall of 12% in PBT due to the sizeable write-downs made...

The higher *operating expenses* of CGs reflect a potential means of improving future earnings through the implementation of efficiency policies already in place at DIs in Spain. Notable in this connection is the effort made since 1999, with a reduction of 0.3 p.p. in the operating expenses/ATA ratio based on reduction of the weight of personnel expenses. This containment drive was stepped up in 2002, the year which accounted for 60% of the cumulative reduction in the operating expenses/ATA ratio since 1999. Nevertheless, there is still room for improvement, as the efficiency ratio shows (Chart I.17).

Contrasting with the stagnation of the net operating margin relative to ATA (Table I.9) was the fall in profit before tax (–11.8%) due to the growth in provisioning and securities write-downs and the virtual disappearance of extraordinary income, which diminished by 88%. This decrease was caused by the rise in losses from previous years and by extraordinary pension provisioning. Also worthy of mention is the negative performance of net income on group transactions (–84.1%), where the income from companies valued by the equity method declined (–16.6%) and the





losses on disposals of holdings rose. By contrast, amortisation of goodwill and provisions for bad debts decreased with respect to 2001, although remaining high.

Given the differing size and composition of the consolidated groups, the step from the earnings of individual DLs to those of CGs is insignificant in co-operatives, moderately significant in savings banks and significant in the banks with larger and more complex consolidated groups. Of importance in this step is the contribution from foreign business, which in banks was 19.9% of 2002 net profit, against 1% in savings banks.

As noted in Section 2 of this chapter, foreign business largely centres on Latin America via subsidiaries and, as a result, all the aforementioned specific operational factors in these markets are reflected more intensely in the consolidated financial accounts of banks.

Significantly, unlike in the individual profit and loss accounts, the banks' consolidated gross margin was substantially higher than that of savings banks during the period 1999-2002 (see Table I.A.9), which reflects the differences in business structure and in the financial margins applied in foreign business in line with the higher risks taken. It is precisely because of the greater weight of this foreign business that banks' consolidated ROE declined more than that of savings banks in 2001 and 2002 (Chart I.18).

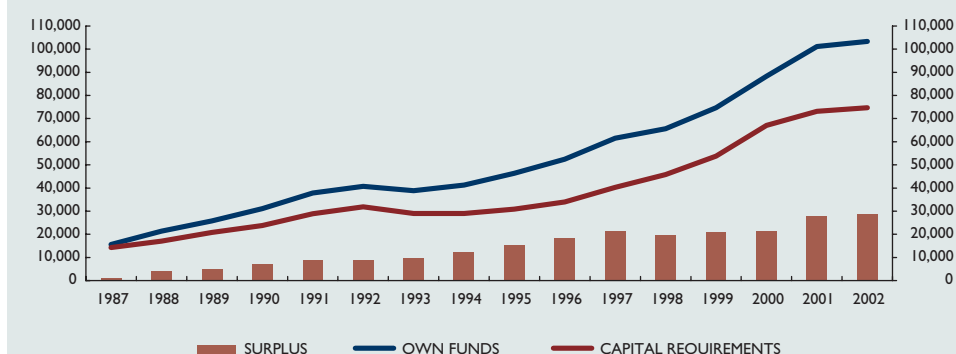
#### I.4. SOLVENCY OF CIs

The solvency ratio of the consolidated groups and individual institutions not forming part of any consolidated group (collectively referred to as CGs) held steady in 2002, although the growth rate of their own funds and capital requirements slowed sharply (24). Their surplus capital over the requirements at individ-

(24) All the solvency data given in this chapter are taken from the reports on own funds submitted by the reporting institutions on the relevant date. The December 2002 data are still provisional, but no substantial changes are expected in the picture they portray, which bears out the strength of the Spanish banking system even in such complicated times for financial activity.

CHART I.19

## Own funds and capital requirements of consolidated groups (€ m)



ual level continued to be very high, as was that of the non-consolidable mixed groups under the Banco de España's supervision.

... breaking with the trend in prior years of growth in the numerator and denominator

The solvency ratio of CGs in 2002 broke with the pattern of high growth rates of both the numerator (capital) and the denominator (risk weighted assets) of the ratio which characterised it from 1996 to 2001 (Chart I.19 and Table I.10). During that period the growth of capital was based on the issuance of subordinated debt and preference shares, while the strong growth of activity and of exposure drove up the volume of risk weighted assets and, consequently, the capital requirements (8% of the risk weighted assets).

TABLE I.10

## Solvency ratio of consolidated groups of CIs (€ m and %)

	1999			2000			2001			2002 (b)		
	Amount	% composition	% annual Δ	Amount	% composition	% annual Δ	Amount	% composition	% annual Δ	Amount	% composition	% annual Δ
<b>Own funds</b>	<b>74,682</b>	<b>100.0</b>	<b>13.8</b>	<b>88,274</b>	<b>100.0</b>	<b>18.2</b>	<b>101,141</b>	<b>100.0</b>	<b>14.6</b>	<b>103,344</b>	<b>100.0</b>	<b>2.2</b>
Tier 1 capital	61,212	82.0	14.3	73,432	83.2	20.0	80,045	79.1	9.0	79,995	77.4	-0.1
Capital Stock, Reserves and assimilated items (a)	49,459	66.2	5.3	57,545	65.2	16.3	62,670	62.0	8.9	63,442	61.4	1.2
Preference Shares	11,753	15.7	79.6	15,887	18.0	35.2	17,375	17.2	9.4	16,553	16.0	-4.7
Tier 2 capital	16,655	22.0	21.5	20,724	23.5	24.4	27,104	26.8	30.8	27,265	26.4	0.6
Deductions	-3,185	-4.0	99.8	-5,882	-6.7	84.7	-6,007	-5.9	2.1	-3,914	-3.8	-34.8
<b>Requirements</b>	<b>53,831</b>	<b>100.0</b>	<b>17.5</b>	<b>67,015</b>	<b>100.0</b>	<b>24.5</b>	<b>73,116</b>	<b>100.0</b>	<b>9.1</b>	<b>74,745</b>	<b>100.0</b>	<b>2.2</b>
Credit risk	50,443	94.0	16.8	63,079	94.1	25.1	68,838	94.1	9.1	70,897	94.9	3.0
Market risk	1,628	3.0	21.7	1,680	2.5	3.2	2,052	2.8	22.1	2,249	3.0	9.6
Foreign-exchange risk	1,053	2.0	53.9	1,357	2.0	28.9	1,444	2.0	6.4	849	1.1	-41.2
Additional	706	1.0	17.1	900	1.3	27.5	782	1.1	-13.1	750	1.0	-4.1
<b>Solvency ratio (%)</b>	<b>11.1</b>			<b>10.5</b>			<b>11.1</b>			<b>11.1</b>		
Of which: Tier 1 (%)	9.1			8.8			8.8			8.6		
Core Capital Ratio (%) (b)	7.4			6.9			6.9			6.8		
MEMORANDUM ITEM: SOLVENCY RATIO:												
1988 Basel Capital Accord (%)	12.6			12.5			12.9			12.6		
Of which: Tier 1 (%)	9.5			9.1			9.1			8.7		
EU regulation (%)	12.1			11.6			12.3			12.3		
Of which: Tier 1 (%)	9.3			8.9			8.8			8.6		

(a) Specific deductions of Tier 1 capital are included (negative results, intangible assets, losses of consolidated companies, etc.) as it is obtained as the difference between Tier 1 capital and preference shares.

(b) Ratio obtained using as the numerator capital stock and assimilated items.

### 1.4.1. Solvency of consolidated groups

The solvency ratio of 11.1% represented surplus capital of €28.6 billion

Direct application of the 1988 Basel Capital Accord would raise the solvency ratio to 12.6%. This reflects the greater strictness of the Spanish rules

The solvency ratio stood at 11.1% in 2002, the same level as at the end of the previous year. It was thus again 3.1 p.p. in excess of the minimum requirement (8%). The surplus capital amounted to €28.6 billion, up €0.6 billion on 2001 (Chart I.19).

The Tier I capital ratio, the numerator of which only includes Tier I capital, was 8.6%, which means that Tier I capital was sufficient to cover, with some surplus, the minimum capital requirements under Spanish regulations.

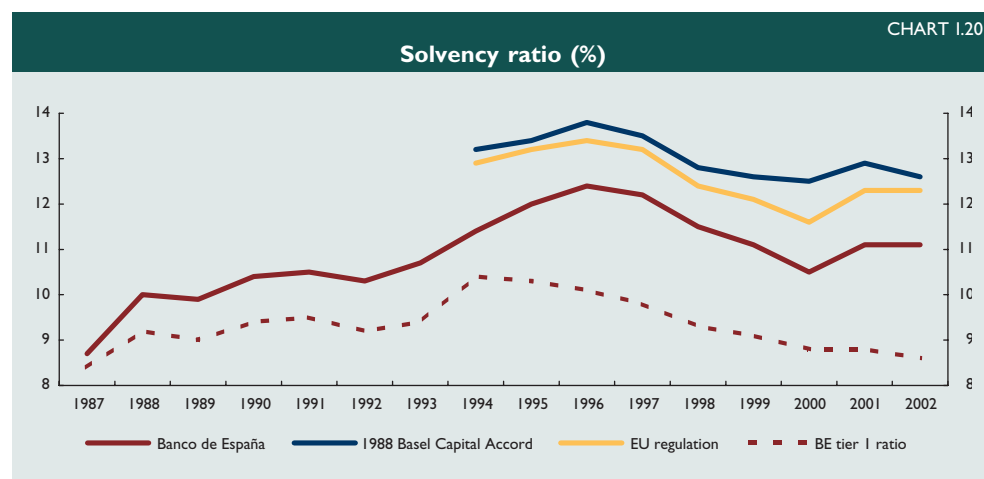
If, instead of the stricter Spanish regulations, the 1988 Basel Capital Accord rules currently in force had been applied, the solvency ratio would have been 12.6%, basically because a part of the general and statistical provisions is recognised as Tier 2 capital. An alternative calculation of the solvency ratio under the EU Solvency Directive would result in a ratio of 12.3% in 2002, which clearly shows that the Spanish solvency regulations are stricter, particularly regarding the eligibility of certain capital components (Table I.10 and Chart I.20).

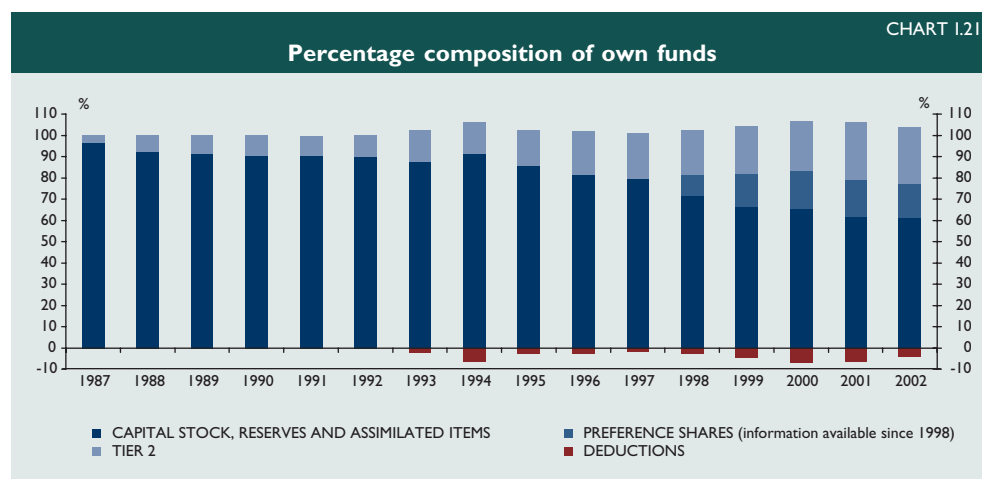
As can be seen in Chart I.20, the stability of the solvency ratio in 2002 did not pass through to the Tier I ratio, which continued on the same gentle downward trend prevailing since 1996, although now for different reasons. Until 2001 this trend was such because the growth of capital requirements was covered to a large extent by capital other than Tier I capital. However, in 2002 there was a direct negative impact on the Tier I capital existing at the beginning of the year, linked to the situation in Latin America, the depreciation of the Latin American currencies and the appreciation of the euro (see Section I-2).

The breakdown of solvency by brackets (Table I.A.11) shows that the slight decrease in the Tier I ratio reflects a widespread situation among institutions, characterised by a sustained decline since 1999 in the number of CGs with a Tier I ratio higher than 10%.

### Changes in capital and capital requirements

In 2002 Tier I capital accounted for 77.4% of total capital and Tier 2 capital and deductions from total capital amounted to 26.4% and –3.8%, respectively (Chart I.21).





The year saw a reversal of the behaviour shown by two of the components that had previously been most dynamic: preference shares and subordinated debt.

Sharp slowdown in the growth of the most dynamic capital components: subordinated debt and preference shares

The eligible amount of preference shares and their contribution to Tier I capital decreased in line with the position adopted by the Banco de España in 2001 that it was inadvisable for the Tier I capital components other than capital stock and reserves to exceed 30% of total Tier I capital. Table III.10 shows how the number and amount of the issues decreased in 2002.

Eligible subordinated debt, including that of no specified maturity date, represented 95.3% of Tier 2 capital. In 2002 it was practically flat, with growth of less than 4% against 34% in 2001, due to the fact that the most active issuers were near the eligibility limit (25).

Also noteworthy was the increase of €3.6 billion in the negative components of Tier I capital, nearly all due to the increase in foreign exchange losses at consolidated companies as a result of the adverse performance of the exchange rates of the Latin American currencies and the US dollar in 2002. Meanwhile, the negative contribution from goodwill decreased as a result of its accelerated amortisation.

In 2002 there was a sharp decrease in the deductions applied to overall eligible capital, due to the fall of 31% in the deductions applied for exceeding the limits set in the solvency rules on holdings in non-consolidated financial institutions (Chart I.21).

Capital requirements also showed a sharp deceleration, largely associated with the fall in foreign business as indicated in Section 2

The capital requirements for covering risk exposures increased modestly (2.2%) in 2002 owing to the fall in foreign business mentioned in Section 2 of this chapter. Also, capital requirements decelerated owing to the shift in the institutions' exposure profile towards more conservative positions in the trading book and in those portfolios subject to exchange risk. Credit risk accounted for 95% of total capital requirements at end-2002, while those arising from trading book risk (3%), exchange risk (1%) and additional risk (26) (1%) continued to be largely marginal and stable over time (Table I.10).

(25) The eligibility of subordinated debt is limited to 50% of eligible tier I capital.

(26) The capital requirements of a consolidated group of credit institutions are the higher of the following two figures: the result of applying to the whole group the requirements contained in Banco de España Circular 5/1993, or the sum of applying to each category of institutions its specific requirements. If the latter were higher, they would result in additional requirements equal to the value of the difference.

Credit risk accounted for 95% of overall requirements and its most dynamic component was that associated with mortgage lending, which has a 50% risk weight

The 95% of capital requirements that relate to credit risk arose from on-balance sheet exposures (83%), from contingent risks and liabilities (11%) and finally from other off-balance sheet items relating to exchange and interest rates (1%, due to counterparty risk). The distribution of the credit risk weights assigned to on-balance sheet exposures indicates that the trend for exposures to shift away from the public sector (0% weight) towards the private sector has been maintained. This shift, for average weighting purposes, was offset almost in full by an increase in the proportion of mortgage credit (50% weight) in the overall private sector (normal weight of 100%).

Next in quantitative order of significance after credit risk is that arising from the trading book, which in turn can be subdivided into market risk arising from exposure to adverse movements in the price of instruments included in this portfolio, and other risks, the most important of which is counterparty risk on derivatives. Market risk accounts for 90% of the exposure on the trading book and derives mainly from positions taken in fixed-income instruments.

Exchange risk decreased to 1% in 2002, reflecting the efforts made by institutions to hedge this risk.

### Limits on concentration

The concentration of exposures is subject to a double limit under Spanish regulations enacted to implement European directives. First, the overall exposure to a single client or group of mutually related clients shall not exceed 25% of the group's own funds. This limit is reduced to 20% in the case of non-consolidated companies belonging to the economic group in question. Second, total large exposures (27) may not exceed eight times the group's own funds. If either of these limits is exceeded, all the excess must be deducted from the eligible capital.

The concentration of exposures to major clients decreased in 2002, while total large exposures remained well below the regulatory limit

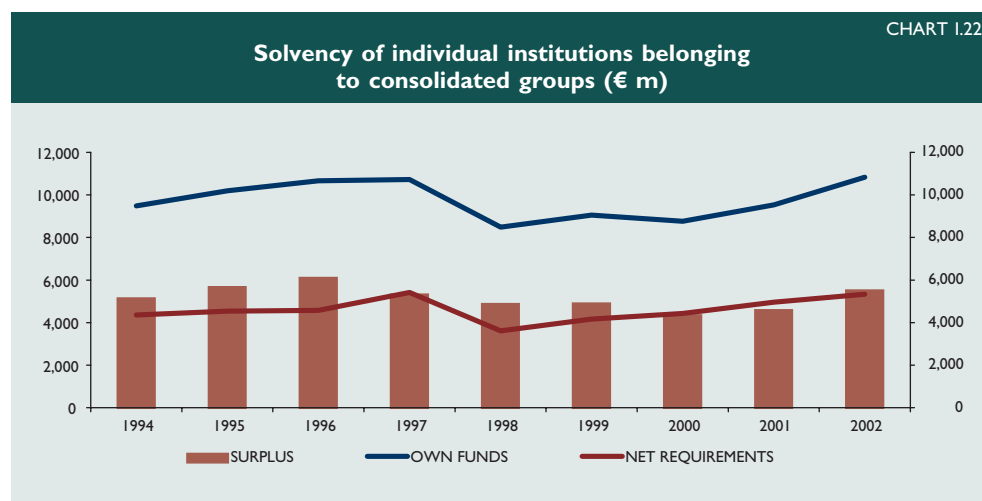
For CGs as a whole, the most important large exposure (28) decreased by €1.2 billion to 18% of overall CG own funds. The three most important large exposures and total large exposures similarly decreased. The relative weight of the latter in own funds fell to 77.4%, far below the limit of 800% set in the regulations (Table I.11).

Concentration of risks of consolidated groups of CIs (%)				TABLE I.11
	1999	2000	2001	2002 (p)
<b>Concentration with single customer:</b>				
Most important large exposure/own funds	20.9	20.9	19.3	18.0
Three most important large exposures/own funds	52.5	51.2	48.6	46.3
<b>Aggregate large exposures/own funds</b>	<b>82.6</b>	<b>86.8</b>	<b>79.5</b>	<b>77.4</b>

(27) Large exposures are defined as those of an amount greater than or equal to 10% of the group's own funds.

(28) The most important large exposure for CGs as a whole is obtained by taking the weighted average of the exposures nearest to the limit or, where applicable, the largest in excess of the limit for each of the CGs considered individually.





### I.4.2. Solvency of individual institutions

The minimum solvency requirements at individual level are very comfortably met

In addition to compliance at consolidated level with the minimum solvency requirements, the regulations call for compliance at individual level by the subsidiaries belonging to consolidated groups and by entities belonging to “horizontal” consolidation groups, in order to ensure that the own funds and exposures are adequately distributed within CGs. For these purposes, eligible capital is defined as that per the subsidiaries’ individual balance sheets, while the capital requirements are adjusted by a factor that is inversely proportional to the parent’s percentage of ownership of the subsidiary. Thus the gross requirements are converted into the net requirements by applying this coefficient between 0.5 and 1.

The degree of compliance with these requirements was very high (Chart I.22), since the own funds amounted to twice the net requirements (in fact they were even higher than the gross requirements), with a surplus of €5.5 billion (20.3% higher than in 2001). This increase in the surplus took place despite a rise in the percentage applied to the gross requirements to obtain the net requirements: it rose to 63% as a result of the decrease in the average ownership interest of groups in their subsidiaries.

### I.4.3. Solvency of mixed groups

The weight of insurance companies in the mixed groups under the Banco de España’s supervision is marginal and does not alter the situation of the CGs included in them. Therefore the mixed groups comfortably meet their capital requirements

The non-consolidated groups of financial institutions under the Banco de España’s supervision consist of CGs per se and of their subsidiary insurance companies. Spanish regulations establish specific minimum solvency requirements for these mixed groups. Their capital is basically calculated as the sum of that of the CGs and the uncommitted assets of the insurance companies, net of any cross-holdings. The minimum requirements are obtained by adding the capital requirements of the CG to the solvency margin of the insurance companies, excluding cross-exposures.

The number of mixed groups decreased from 34 to 33 in 2002. Table I.12 shows that the importance of CGs in mixed groups is much greater than that of insurance companies as regards both capital and capital requirements. The slight decrease in both eligible capital (–1.3%) and capital requirements (–1.5%) clearly

TABLE I.12

**Solvency margin of non-consolidated mixed groups of financial institutions subject to supervision by the Banco de España (€ m)**

	1999			2000			2001			2002 (p)		
	Amount	% composition	% annual Δ	Amount	% composition	% annual Δ	Amount	% composition	% annual Δ	Amount	% composition	% annual Δ
<b>Effective own funds</b>	<b>63,205</b>	<b>100.0</b>	<b>15.7</b>	<b>68,653</b>	<b>100.0</b>	<b>8.6</b>	<b>76,113</b>	<b>100.0</b>	<b>10.9</b>	<b>75,136</b>	<b>100.0</b>	<b>-1.3</b>
Credit institutions or groups	62,129	98.3	15.6	67,578	98.4	8.8	74,737	98.2	10.6	73,706	98.1	-1.4
Insurance undertakings or groups	3,246	5.1	31.2	3,733	5.4	15.0	3,744	4.9	0.3	3,857	5.1	3.0
Deductions	-2,169	-3.4	36.1	-2,657	-3.9	22.5	-2,367	-3.1	-10.9	-2,427	-3.2	2.5
<b>Capital requirements</b>	<b>47,153</b>	<b>100.0</b>	<b>19.4</b>	<b>54,028</b>	<b>100.0</b>	<b>14.6</b>	<b>56,900</b>	<b>100.0</b>	<b>5.3</b>	<b>56,055</b>	<b>100.0</b>	<b>-1.5</b>
Credit institutions or groups	45,769	97.1	19.3	52,683	97.5	15.1	55,349	97.3	5.1	54,505	97.2	-1.5
Insurance undertakings or groups	1,609	3.4	23.4	1,633	3.0	1.5	1,845	3.2	13.0	1,879	3.4	1.8
Deductions	-224	-0.5	44.5	-288	-0.5	28.6	-294	-0.5	2.1	-330	-0.6	12.2
<b>Surplus or deficit of mixed groups</b>	<b>16,052</b>		<b>6.3</b>	<b>14,625</b>		<b>-8.9</b>	<b>19,214</b>		<b>31.4</b>	<b>19,081</b>		<b>-0.7</b>
<b>Surplus or deficit of CGs</b>	<b>16,360</b>		<b>6.4</b>	<b>14,895</b>		<b>-9.0</b>	<b>19,388</b>		<b>30.2</b>	<b>19,200</b>		<b>-1.0</b>
MEMORANDUM ITEM:												
Number of non-consolidated mixed groups	37			35			34			33		

reflects the change in the solvency trend noted in the previous section for CGs as a whole. In any event, the surplus in mixed groups (€19 billion) represents 34% of requirements, which is a very comfortable level of compliance.

## I.5. STRUCTURE AND EVOLUTION OF THE OTHER INSTITUTIONS SUPERVISED BY THE BANCO DE ESPAÑA

### I.5.1. Specialised credit institutions

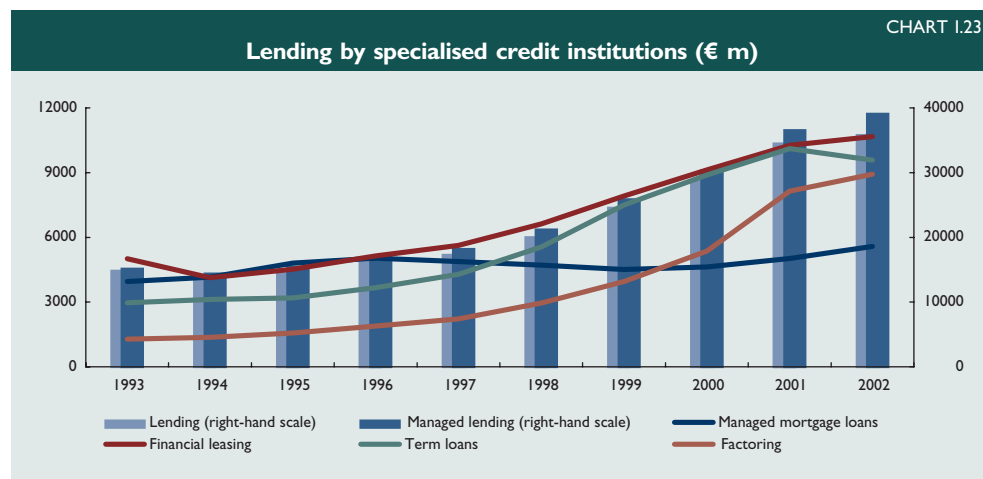
SCIs are CIs specialised in credit extension that cannot raise deposits from the public

Specialised credit institutions (SCIs) are a distinctive type of CI that may not finance itself by taking deposits from the public but that is otherwise subject to a regulatory regime similar to that of other CIs. On many occasions SCIs are used by DIs, of which they are subsidiaries and with which they are consolidated, as specialised financing vehicles. On other occasions, those known as brand finance companies operate in and around industrial and retail groups to support their commercial policies.

#### Activity

SCIs account for 3% of the activity but more than 5% of the lending of CIs as a whole

The SCIs' balance sheet has grown at an annual rate of 16% over the last four years, although decelerating last year to 4.5%, after which it stood at €38.4 billion, or 3% of total CI activity (Chart I.2). These institutions focus on lending, which, including doubtful loans, accounts for more than 93% of their bal-



ance sheet and for practically all their earning assets. The share of SCIs in total lending to the private sector is higher (5.3%), given their greater specialisation in these instruments.

They are specialised in certain segments of business in which they have a highly significant market share

The basic instruments in which SCIs specialise are financing of instalment sales, financial leasing and factoring, which together have for many years accounted for 75% of their total lending. The extent of their specialisation can be appreciated by looking at their weight in the financial lease markets (49%) and factoring markets (79%) (29). Mortgage lending, another of their specialities, has diminished in significance, even taking into account the securitised loan portfolio managed by them; that said, at €5.6 billion it still represents somewhat more than 15% of their total managed loans (Chart I.23). The difference between the on-balance sheet loan portfolio and that managed has been increasing slowly but continuously owing to the securitisation of mortgage assets up to 2001 and of other assets since 2002 (see Table I.A.12).

The figures are affected by the restructuring of a financial group which transferred 1.5% of the SCI balance sheet total to a DI

In 2002 the restructuring of a foreign industrial group's financial institutions in Spain led to the transfer of business from a SCI to a DI. The amount of this transfer was around 1.5% of the SCI balance sheet total, which reduced lending growth in this sector by 1 p.p. and led to a fall of 13% in doubtful assets, which would otherwise have risen by 9%.

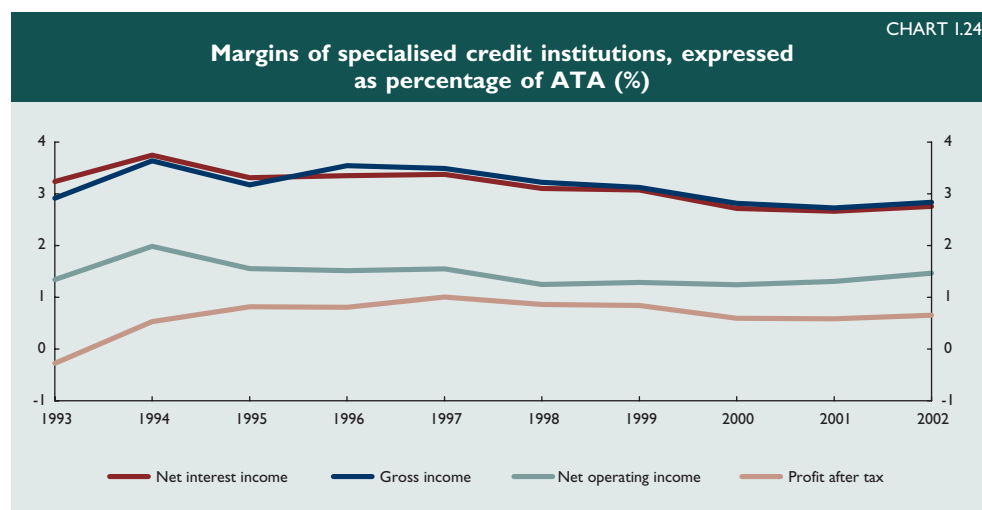
The most important and stable CSI financing is from DIs, generally in their financial groups

The bulk of SCI financing is from CIs and accounts for 74% of their balance sheet or €29 billion. This financing comes particularly from the CIs of the financial groups to which many SCIs belong. Of far less importance is the financing from debt securities and other similar sources, which accounts for barely 10%, with half of this also from intra-group financing, from parent companies and from other industrial or commercial retailing affiliates.

Own funds are relatively low owing to the weight of the subsidiaries of DIs

Own funds, i.e. capital and reserves, do not reach 6% of the balance sheet because the numerous subsidiaries of DIs that represent 67% of the balance sheet consolidate in their respective groups and are subject to low individual solvency ratios.

(29) This information and that in the chart on factoring include a large part of the on-balance sheet transactions with general government carried out using this instrument.



## Results

Given that SCIs use bank financing, the interest rate decreases have led to an improvement in their net interest margin

The continuing positive performance of general expenses made for an efficiency ratio of 48%, a new historical low

Most of the improvement in net operating income flowed through to profit before tax

Most of the improvement in net operating income flowed through to PBT and also to ROE

Appraisers engage only in real estate appraisal and their number is continually decreasing

The considerable dependence on bank financing has meant that lower interest rates have fed through to the financial costs of SCIs (-9%), while their financial income has remained at similar levels to that of the previous year. This has improved their net interest margin, which stands at 2.75% of ATA, up 10 b.p. or 14% (see Table I.A.12).

Apart from the small contribution from other operating income, which was similar to that in previous years, 2002 was notable because general expenses continued to perform positively relative to gross income, with the efficiency ratio standing at 48%, a new historical low. This allowed the upward trend of net operating income seen since 1998 to continue, with a rise of 23% taking it to 1.47% of ATA (Chart I.24).

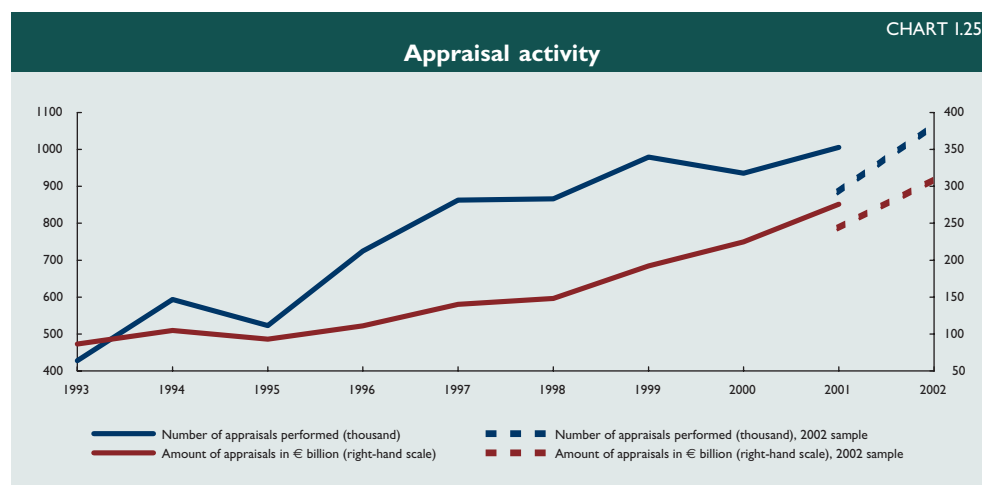
The fall in doubtful assets as a result of the above-mentioned group restructuring was conducive to the maintenance of net provisioning for bad debts at the same level and the consequent fall in their impact in terms of ATA. However, this improvement in bad debt provisioning was neutralised by the deterioration of the other factors included in the last part of the profit and loss account (income on financial transactions, extraordinary income, etc.). Therefore, most of the improvement in net operating income flowed through to profit before tax.

Thus profit before and after tax improved both in absolute terms (27% and 22%) and in relative terms (8 b.p. and 7 b.p. of ATA), amounting to 0.98% and 0.65% of ATA, respectively. This meant that the return on equity improved to 11.4%.

### I.5.2. Appraisal companies

Appraisal companies are specialised institutions with the sole corporate purpose of property assessment (30). The 69 operational appraisal companies and services at end-2002 numbered five fewer than a year earlier, as a result of six deregistrations and one new registration. These progressive deregistrations, which

(30) Three CIs have operational appraisal services. These services can only appraise real estate provided as collateral for mortgage operations performed by companies in the financial group to which they belong and must meet the same requirements regarding certification and professional qualifications as apply to companies.



are normally at the request of the appraisal companies themselves, have had little effect on the concentration of the sector (see Table I.A.13).

... in contrast to the expanding trend of appraisals in terms of numbers and amounts

DIs are the main recipients of appraisals because of their role in residential mortgage financing

The available information (31) shows that the number of appraisals grew by 21% in 2002 and the amount of the appraisals by 28%, accentuating the trend of previous years (Chart I.25).

The main recipients of appraisals continue to be savings banks (44%) and banks (37%), although it is the end customer that bears the cost of the service. The basic purpose of appraisals is to obtain financing via residential and property mortgages (92% of the number and 86% of the amount) (32).

### 1.5.3. Mutual guarantee and reguarantee companies

MGCs are mutual companies conceived to improve the access of SMEs to financing

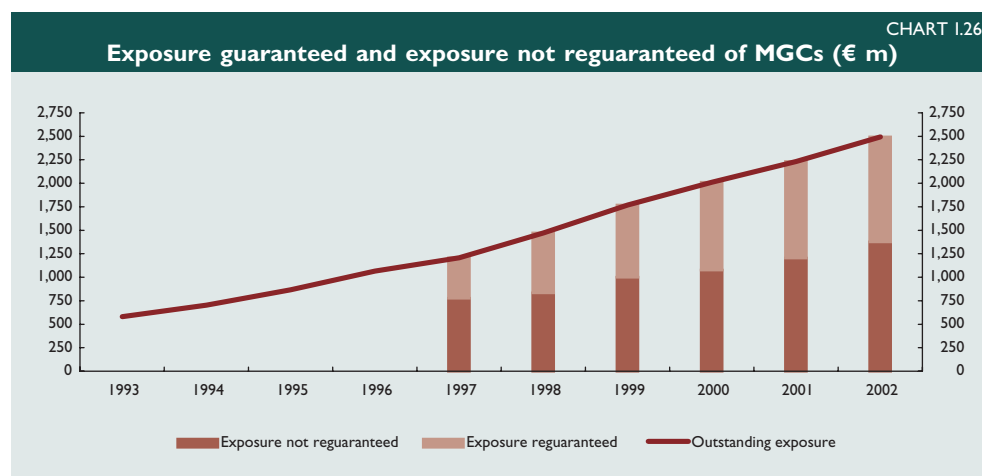
Mutual guarantee companies (MGCs) specialise in providing their members with the guarantees, through avals or any other lawful means except suretyship insurance, required for their ordinary business activity. The basic purpose of these institutions, which date from 1978, is to furnish small and medium-sized enterprises (SMEs) with the best possible access to financing, generally within the geographical bounds of the regions to which they are usually linked or within a specific economic sector. MGCs have been subject to prudential supervision by the Banco de España since 1988.

The weight of patron members has progressively diminished in favour of participating members, which now account for 57% of ownership

MGCs are sponsored by their patron members, which fall within a variety of categories: governments and public institutions, savings banks, financial institutions, territorially-based sectoral and trade organisations, etc. Although these patron members represent only 1% of all members and this proportion is decreasing, their contributions represented more than 43% at end-2002. By contrast, the participating members, which contribute 57% of the paid-in capital of MGCs, have been growing constantly in number, up to 63,793.

(31) At the date of preparation of this report, only partially edited information was available on the 2002 appraisal activity of a (albeit highly representative) portion of all appraisal companies.

(32) Appraisals carried out to support loans in accordance with Royal Decree 685/1982 on the implementation of mortgage market regulations and with the Ministerial Order of 30/11/ 1994 on real estate appraisal rules for certain financial institutions.



MGCs continue to be highly dependent on the aid received from their patron members, particularly regional governments

CERSA guarantees 55% of the exposure on financial guarantee operations of MGCs, and this percentage may rise to 75%

In 2002 the outstanding exposure amounted to €2.5 billion (45% reguaranteed) and the guarantees exceeded €1 billion. Commissions averaged 1%

Despite the growing role of the participating members, MGCs are strongly dependent on the public patron members, particularly the regional governments, which in many cases founded them. The support received includes most notably the reguarantee of their operations (up to 40% in certain cases), special contributions to technical provisions or to capital, and subsidisation of their operating expenses and of the commissions charged for their services. Also notable in this connection is the reguarantee of the MGCs' guarantee operations by the State via the Spanish Reguarantee Company (Compañía Española de Reafianzamiento-CERSA), which normally guarantees 55% of the exposure arising from financial guarantees, although this percentage may rise to 75% in certain programmes to support investment in technological innovation. In no operation is the MGC in question allowed to retain less than 25% of the arranged exposure uncovered by reguarantee (Chart I.26).

The outstanding exposure guaranteed by MGCs amounted to €2.5 billion at end-2002, with annual growth of 12% and a reguarantee ratio of 45%. Last year they granted and formally arranged somewhat more than €1 billion in new operations with SMEs. The income from guarantee commissions is very low, at around 1% of the outstanding exposure, and barely covers operating expenses. Any profits earned are added to the technical provisions to strengthen the MGCs' solvency (See Table I.A.14).

#### I.5.4. Currency exchange and transfer bureaux

The implementation of the legal regime governing currency exchange and transfer bureaux was completed at the beginning of 2002

The regulatory implementation of the legal system for the licensing of and engagement in currency exchange and foreign transfer processing activities was completed at the beginning of 2002 with the entry into force of Banco de España Circular 6/2001. This Circular set forth the rules on the transparency of transactions, customer protection and disclosure to customers of exchange rates and commissions. It also stipulated the disclosures to be made periodically by these bureaux to the Banco de España on their activity and, if applicable, on their financial position, all based on the activity engaged in by each bureau according to the authorisation received: (i) purchase of foreign exchange and traveller's cheques for euros, which can be performed on an ancillary and complementary basis by companies in certain business sectors (hotels, travel agencies, etc); and (ii) purchase and sale and/or processing of transfers by public limited companies having this sole corporate purpose and with capital resources growing in proportion to the volume of their activity.

TABLE I.13

Currency exchange bureaux and money transfer agencies Key data				
	1999	2000	2001	2002
<b>Licensed proprietors (number)</b>	<b>1,862</b>	<b>2,981</b>	<b>2,974</b>	<b>2,756</b>
Currency purchasing	1,850	2,939	2,928	2,702
Currency buying and selling (FX trading)	6	15	14	15
FX trading and transfers by immigrants				
or for living expenses	3	24	28	34
FX trading and transfers of all types	3	3	4	5
<b>Currency transactions (€ m)</b>				
Purchases from customers	4,045	4,595	4,609	2,488
Sales to customers	228	37	0	272
Purchases from other currency exchange bureaux or from CIs	114	106	147	195
Sales to other currency exchange bureaux or to CIs	3,925	4,661	4,752	2,429
Transfers dispatched	n.a.	n.a.	n.a.	2,369
Transfers received	n.a.	n.a.	n.a.	244
<b>Balance sheet and profit and loss account (€ m)</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>	
Capital and reserves (June)	n.a.	n.a.	n.a.	51
Income from main activity (annual estimate)	n.a.	n.a.	n.a.	134

The decrease in the number of licensed proprietors by more than two hundred in 2002 was because of the greater requirements of the new regulatory and supervisory framework and also because there may have been a certain saturation in segments of this market due to the replacement of national currencies by the euro in the euro area countries (Table I.13).

The introduction of the euro and competition from CIs seem to have prompted a reduction in the number of establishments and business volume of this sector

The 54 proprietors authorised to buy and sell foreign currencies and/or process transfers have €51 million of capital and reserves, nearly 1,200 employees and more than 3,000 agents, half of which are legal entities providing services in 178 offices and 4,900 premises. 2002 income is estimated at approximately €134 million based on the information available as at June 2002. The annualised volumes of foreign exchange transactions as at September 2002 reveal that the volume of foreign exchange purchases fell by a little more than half, which seems to be associated with the above-mentioned placement in circulation of the euro and with a greater participation of CIs in this activity.

The sales of foreign exchange (€2.4 billion) to other currency-exchange bureaux or to CIs arose because the establishments that are only authorised to purchase foreign exchange from individuals sell it almost automatically to institutions authorised to engage in a wider range of operations. Of the currencies purchased, that with the highest euro-equivalent was the pound sterling (more than €500 million), followed by the US dollar (€283 million).

Transfers are in euro and in US dollars and more than half are to Ecuador and Colombia

The volume of transfers issued in 2002, the first year for which information is available, is practically equal to the amount of foreign exchange purchased from customers (€2.4 billion). The bulk of the transfers issued is denominated in euro (€1.5 billion) and in US dollars (€0.8 billion). The main countries of destination are Ecuador (27%) and Colombia (27%). The transfers received are much less significant, with the United States of America being the main country of origin (19% of the total).



## APPENDIX

TABLE I.A.I

**Serving employees, operational branches, ATMs and agents of DIs**  
**Units and %**

	Number of active institutions	Serving employees				Operational offices				ATMs	Number of cards (thousands)	Agents	Employees at branches as % of operational offices (5/7)
		Total	Of which:			Thousands of hours worked	Total	Owned or under financial lease					
			Part-time	At central services	At branches								
	1	2	3	4	5	6	7	8	9	10	11	12	
TOTAL DIs													
1999	286	242,591	2,243	55,756	186,836	413,299	39,058	19,587	41,129	41,427	5,090	4.8	
2000	278	243,794	1,719	55,802	187,992	415,885	39,046	19,453	45,772	44,620	7,753	4.8	
2001	280	244,786	1,274	55,686	189,100	412,608	38,757	19,533	46,623	55,311	9,173	4.9	
2002	274	246,546	1,300	53,264	193,282	413,196	38,754	19,600	51,762	55,925	9,420	5.0	
MEMORANDUM ITEMS:		Per 10,000 inhabitants > 16 years						Per inhabitant > 16 years					
1999		73.4					11.8		12.4	1.2			
2000		72.8					11.7		13.7	1.3			
2001		72.4					11.5		13.8	1.6			
2002		72.4					11.4		15.2	1.6			
Banks													
1999	144	131,460	1,222	31,024	100,436	228,786	16,963	7,473	16,193	16,723	4,401	5.9	
2000	140	127,583	892	31,042	96,540	217,111	15,873	6,953	18,470	17,770	7,148	6.1	
2001	145	123,613	481	30,812	92,801	210,472	14,817	6,685	17,590	23,175	8,477	6.3	
2002	143	122,373	495	27,960	94,413	207,504	14,129	6,432	20,087	24,171	8,652	6.7	
Domestic													
1999	71	116,325	1,156	23,878	92,447	202,604	15,609	7,047	15,200	14,463	4,082	5.9	
2000	63	112,236	796	23,472	88,764	191,346	14,541	6,542	17,437	15,671	6,484	6.1	
2001	62	107,749	323	22,700	85,049	183,289	13,452	6,272	16,461	20,835	7,775	6.3	
2002	60	106,609	315	20,059	86,550	180,897	12,788	6,022	18,933	21,667	7,972	6.8	
Foreign													
1999	73	15,135	66	7,146	7,989	26,181	1,354	426	993	2,260	319	5.9	
2000	77	15,347	96	7,570	7,776	25,765	1,332	411	1,033	2,099	664	5.8	
2001	83	15,864	158	8,112	7,752	27,184	1,365	413	1,129	2,340	702	5.7	
2002	83	15,764	180	7,901	7,863	26,606	1,341	410	1,154	2,504	680	5.9	
Of which: Subsidiaries													
1999	21	11,733	15	4,479	7,254	20,302	1,229	402	977	2,254	273	5.9	
2000	25	11,902	28	4,872	7,030	19,905	1,208	392	1,017	2,092	616	5.8	
2001	27	12,169	57	5,272	6,897	20,801	1,227	399	1,114	2,332	651	5.6	
2002	24	11,899	69	4,905	6,994	19,940	1,202	399	1,139	2,480	613	5.8	
Savings banks													
1999	50	97,276	805	21,199	76,077	161,084	18,355	12,114	22,300	22,746	547	4.1	
2000	48	101,718	643	21,137	80,581	165,903	19,285	12,500	24,331	24,570	461	4.2	
2001	47	105,593	608	21,078	84,515	175,069	19,848	12,848	25,625	29,399	561	4.3	
2002	47	107,745	616	21,495	86,250	178,448	20,349	13,168	27,972	28,218	624	4.2	
Credit co-operatives													
1999	92	13,855	216	3,533	10,323	23,429	3,740	—	2,636	1,959	142	2.8	
2000	90	14,493	184	3,623	10,871	32,870	3,888	—	2,971	2,280	144	2.8	
2001	88	15,580	185	3,796	11,784	27,066	4,092	—	3,408	2,737	135	2.9	
2002	84	16,428	189	3,809	12,619	27,244	4,277	—	3,703	3,536	144	3.0	



TABLE I.A.2

**Breakdown of activity of DIs (a)**  
**Total business (€ m)**

	1999	2000	2001	2002	Memorandum items: 2002		
					Structure		% annual Δ
					%	p.p. change	
ASSETS:							
Cash and central banks	19,689	14,221	20,975	16,522	1.3	-0.4	-21.2
Financial intermediaries	211,065	202,861	202,273	215,103	16.5	-0.0	6.3
Loans and credit	509,969	593,862	660,236	729,640	55.9	2.1	10.5
Government bonds	28,730	28,814	31,269	30,910	2.4	-0.2	-1.1
Resident private sector	448,278	526,761	586,281	662,460	50.8	3.0	13.0
Of which: Secured	212,445	256,065	302,145	360,127	27.6	3.0	19.2
Of which: Mortgage guarantee	206,209	247,436	293,484	350,523	26.9	2.9	19.4
Non-residents	32,961	38,287	42,686	36,270	2.8	-0.7	-15.0
Of which: Variable rate	252,453	333,351	425,390	490,856	37.6	2.9	15.4
Securities portfolio	204,259	230,008	257,992	260,365	19.9	-1.1	0.9
Bond trading book	13,565	16,536	19,164	24,302	1.9	0.3	26.8
Equity trading book	3,146	3,336	3,725	3,395	0.3	-0.0	-8.9
Available-for-sale bond portfolio	113,611	108,266	130,006	120,295	9.2	-1.4	-7.5
Available-for-sale equity portfolio	11,528	10,030	10,245	11,000	0.8	0.0	7.4
Permanent bond portfolio	26,853	29,649	28,029	31,501	2.4	0.1	12.4
Permanent equity portfolio	35,556	62,191	66,823	69,872	5.4	-0.1	4.6
Fixed assets	19,287	18,859	18,605	18,081	1.4	-0.1	-2.8
Other assets	45,768	63,046	67,128	65,530	5.0	-0.5	-2.4
BALANCE SHEET TOTAL	1,010,037	1,122,857	1,227,209	1,305,241	100.0	0.0	6.4
LIABILITIES AND EQUITY:							
Credit institutions and Banco de España	275,668	271,281	264,618	275,722	21.1	-0.4	4.2
Creditors	544,931	622,772	700,949	748,579	57.4	0.2	6.8
Of which:							
Resident private sector	453,938	507,164	563,249	607,405	46.5	0.6	7.8
Current accounts	114,452	124,490	144,890	157,506	12.1	0.3	8.7
Savings accounts	104,953	107,473	120,149	128,069	9.8	0.0	6.6
Time deposits	158,507	190,365	208,030	228,276	17.5	0.5	9.7
Repos	76,009	84,549	89,762	93,449	7.2	-0.2	4.1
Non-residents	73,132	95,510	104,398	101,816	7.8	-0.7	-2.5
Debt securities	37,509	33,519	40,026	50,193	3.8	0.6	25.4
Of which: mortgage securities	12,461	12,304	14,328	25,266	1.9	0.8	76.3
Subordinated debt	21,609	33,612	44,322	45,401	3.5	-0.1	2.4
Provisions	25,778	35,062	41,181	46,399	3.6	0.2	12.7
Capital and reserves	48,875	64,267	69,187	74,205	5.7	0.0	7.3
Other liabilities	55,667	62,344	66,926	64,742	5.0	-0.5	-3.3
MEMORANDUM ITEM:							
Transferred assets	11,663	17,473	21,952	35,012			
Of which: Securitised (b)	9,348	15,207	20,207	33,491			
Of which: Mortgage-backed (Law 2/1981) (b)	8,121	9,689	13,612	20,900			

(a) Institutions existing at each date.

(b) In certain securitisations, these assets return to the institution's balance sheet in the form of mortgage-backed bonds (issued by the vehicle company that acquired the original loans) and are included in the accounts along with the rest of the institution's bond portfolio.

TABLE I.A.3

**Breakdown of CI activity by institutional group. Total business  
December 2002 (€ m and %)**

	Amount	Breakdown											
		Total DIs	Banks								Savings Banks	Co-ops	SCIs
			Total	Domes- tic	Foreign								
					Total	Subsid- iaries	Branches						
							Total	EU	Non-EU				
ASSETS:													
Cash and central banks	16,551	99.8	39.6	32.4	7.2	4.0	3.1	2.9	0.2	55.4	4.9	0.2	
Financial intermediaries	216,717	99.3	70.2	51.4	18.8	7.6	11.2	10.8	0.4	26.0	3.1	0.7	
Loans and credit	765,431	95.3	48.4	41.0	7.4	4.2	3.2	2.8	0.4	42.2	4.7	4.7	
Government bonds	32,166	96.1	58.5	52.9	5.6	4.6	1.0	0.9	0.1	36.0	1.6	3.9	
Resident private sector	696,057	95.2	46.3	39.1	7.2	4.1	3.1	2.7	0.3	43.7	5.1	4.8	
Of which: Secured	363,910	99.0	39.1	34.9	4.2	3.6	0.6	0.5	0.1	53.9	6.0	1.0	
Non-resident	37,208	97.5	78.0	66.6	11.4	4.2	7.3	6.2	1.0	19.2	0.3	2.5	
Securities portfolio	260,422	100.0	61.5	54.5	7.1	1.7	5.3	5.2	0.1	36.6	1.8	0.0	
Bond trading book	24,301	100.0	78.3	75.5	2.8	2.2	0.6	0.6	0.0	21.6	0.1	0.0	
Equity trading book	3,395	100.0	86.9	64.8	22.0	3.0	19.1	19.1	0.0	11.0	2.1	0.0	
Available-for-sale bond portfolio	120,315	100.0	59.1	47.1	11.9	2.5	9.5	9.3	0.2	38.3	2.6	0.0	
Available-for-sale equity portfolio	11,039	99.7	54.5	44.9	9.6	1.3	8.4	8.1	0.2	42.2	3.0	0.3	
Permanent bond portfolio	31,500	100.0	36.8	33.5	3.3	1.3	2.0	1.9	0.1	60.3	2.8	0.0	
Permanent equity portfolio	69,872	100.0	70.9	70.3	0.6	0.5	0.1	0.1	0.1	28.5	0.5	0.0	
Fixed assets	18,276	98.9	44.2	38.5	5.7	3.4	2.2	2.1	0.1	48.7	6.0	1.1	
Other assets	57,580	98.9	68.5	61.8	6.7	2.5	4.2	3.8	0.4	28.9	1.5	1.1	
BALANCE SHEET TOTAL	1,343,680	97.1	55.3	46.2	9.1	4.2	4.9	4.6	0.3	38.1	3.8	2.9	
LIABILITIES AND EQUITY:													
Credit institutions and Banco de España	304,318	90.6	70.3	46.4	23.9	6.9	17.0	16.2	0.8	19.5	0.7	9.4	
Creditors	751,668	99.6	47.2	42.3	4.9	3.7	1.3	1.2	0.1	46.9	5.5	0.4	
Of which:													
Resident private sector	607,665	100.0	41.6	36.5	5.1	3.8	1.4	1.3	0.0	51.8	6.5	0.0	
Current accounts	157,506	100.0	56.2	47.2	9.0	5.0	3.9	3.8	0.1	39.4	4.4	0.0	
Savings accounts	128,069	100.0	31.2	30.4	0.8	0.8	0.0	0.0	0.0	59.2	9.5	0.0	
Time deposits	228,536	99.9	31.1	28.7	2.4	1.9	0.5	0.5	0.0	60.4	8.4	0.1	
Repos	93,448	100.0	57.2	45.9	11.3	10.2	1.1	1.1	0.0	41.4	1.4	0.0	
Non-residents	104,644	97.3	74.8	69.7	5.1	4.1	1.0	0.8	0.2	21.9	0.6	2.7	
Debt securities	50,820	98.8	53.4	52.8	0.6	0.6	0.0	0.0	0.0	45.1	0.3	1.2	
Subordinated debt	45,769	99.2	63.5	62.1	1.4	1.4	0.0	0.0	0.0	35.3	0.3	0.8	
Provisions	47,419	97.8	67.0	63.3	3.8	2.2	1.5	1.2	0.3	28.0	2.9	2.2	
Capital and reserves	76,496	97.0	56.8	50.7	6.1	4.1	2.0	0.7	1.4	34.8	5.3	3.0	
Other liabilities	67,190	96.4	63.1	56.0	7.0	2.9	4.1	3.7	0.4	31.2	2.2	3.6	
MEMORANDUM ITEM:													
Variable-rate credit, DIs only	490,856	100.0	44.6	36.5	8.1	4.2	3.9	3.3	0.5	49.9	5.5	n.a.	

TABLE I.A.4

**Structure of lending to resident private sector (a)**  
**Business in Spain (%)**

	1999	2000	2001	2002
<b>Lending to businesses</b>	<b>53.5</b>	<b>53.3</b>	<b>52.0</b>	<b>51.3</b>
Goods	24.7	23.8	22.4	22.1
Agriculture, fishing and extractive industries	3.3	3.0	2.7	2.8
Manufacturing	11.6	10.8	10.0	9.0
Energy and electricity	2.4	2.3	2.2	2.2
Construction	7.4	7.6	7.4	8.1
Services	28.7	29.5	29.6	29.2
Commerce, repair and hotels and restaurants	8.6	8.4	8.2	7.9
Transport and communications	3.2	3.4	3.2	3.3
Real estate development	5.3	6.2	6.9	7.8
Financial intermediation	2.7	3.1	2.2	1.9
Other services	8.9	8.5	9.1	8.3
<b>Lending to households</b>	<b>44.1</b>	<b>44.3</b>	<b>45.9</b>	<b>46.8</b>
Housing (purchase and refurbishing)	31.7	33.0	34.6	35.7
Consumer credit	4.0	3.9	4.4	4.1
Other purposes	8.3	7.3	6.9	7.0
<b>Other</b>	<b>2.5</b>	<b>2.4</b>	<b>2.0</b>	<b>1.9</b>

(a) Deposit institutions existing at each date.

TABLE I.A.5

**Key data of the BE Central Credit Register**

	1999	2000	2001	2002
Reporting institutions (number)	420	400	397	361
Exposures admitted (number)	17,270,767	19,006,985	20,265,305	21,538,342
Of which:				
Banks	7,165,923	7,740,929	8,114,700	8,384,623
Savings banks	7,832,475	8,743,234	9,402,126	10,211,426
Credit co-operatives	1,176,068	1,320,935	1,448,149	1,525,728
Amount (€ m)	1,045,264	1,224,434	1,354,570	1,522,023
Of which:				
Banks	563,236	659,958	673,076	677,946
Savings banks	370,830	457,289	530,501	618,785
Credit co-operatives	44,381	53,033	62,002	70,619
Different borrowers (number)	10,493,103	11,396,892	12,066,861	12,816,049
Of which:				
Resident Spanish individuals	9,718,478	10,548,269	11,142,630	11,801,966
Resident foreign individuals	126,754	154,700	187,850	248,518
Resident legal entities	640,285	684,523	725,310	755,308
Non-resident individuals	3,206	4,395	5,297	5,975
Non-resident legal entities	4,380	5,005	5,774	4,282
Ineligible borrowers (number)	13,412	10,782	9,697	8,441
Suspended exposures (€ m)	938	485	435	463
Borrowers: additions (number)	5,559,930	6,571,506	5,211,644	5,428,575
Borrowers: deletions (number)	4,299,281	5,356,474	4,264,817	4,398,190
Access and rectification rights exercised (number)	16,870	18,677	19,932	21,811
<b>REPORTS ISSUED:</b>				
Automatically	157,271,115	173,217,385	185,632,065	197,186,241
Requested by reporting institutions	1,155,769	1,321,546	1,647,409	2,156,369
For debtors	35,877	39,588	45,015	55,296
Data Protection Agency	9	77	132	53
Courts	896	695	443	317
Other central credit registers	8	3	9	37

TABLE I.A.6

**Activity of DIs and of their consolidated groups**  
(Period-end data) (€ m and %)

	1999	2000	2001	2002 (p)	Breakdown (%)			
					Business in Spain		Business abroad	
					2001	2002	2001	2002
ASSETS:								
Cash and central bank	26,076	25,117	34,768	27,719	59.7	58.5	40.3	41.5
Financial intermediaries	174,696	181,219	178,862	181,113	78.7	83.8	21.3	16.2
Loans and credit	582,959	721,126	794,258	836,845	82.0	86.6	18.0	13.4
Securities portfolio	224,469	287,377	301,133	281,237	68.5	77.3	31.5	22.7
Government bonds	143,726	187,228	185,260	165,161	62.2	73.1	37.8	26.9
Corporate bonds	38,603	47,111	60,108	62,805	75.9	80.7	24.1	19.3
Equities	42,140	53,038	55,765	53,271	81.7	86.3	18.3	13.7
Fixed assets	32,550	36,447	37,492	39,846	62.2	64.9	37.8	35.1
Other assets	56,561	97,431	100,145	89,534	64.7	68.4	35.3	31.6
Of which: Consolidated goodwill	6,146	19,825	19,375	18,577	37.3	36.6	62.8	63.4
BALANCE SHEET TOTAL	1,097,311	1,348,717	1,446,657	1,456,295	76.6	82.2	23.4	17.8
LIABILITIES AND EQUITY:								
Financial intermediaries	255,578	283,849	263,373	269,596	81.9	86.8	18.1	13.2
Deposits	586,743	712,553	807,271	813,798	75.4	80.9	24.6	19.1
Debt securities	77,352	105,226	106,925	110,285	36.8	47.3	63.2	52.7
Subordinated debt	16,391	22,613	30,324	31,238	40.1	43.8	59.9	56.2
Provisions	29,560	54,382	56,404	52,671	65.8	74.3	34.2	25.8
Capital and reserves	69,863	94,930	101,789	106,516	78.2	78.2	21.8	21.8
Of which: Minority interests	15,850	21,803	22,078	20,536	26.5	30.8	73.5	69.2
Other liabilities	61,823	75,165	80,570	72,191	77.5	82.5	22.5	17.5
Mismatches between business areas (€ m)							-52,539	-57,112
Net asset value of managed funds	229,872	249,881	279,641	268,507	73.4	77.5	26.6	22.5
MEMORANDUM ITEM: NUMBER OF BANKS INCLUDED IN GROUPS.								
TOTAL	475	470	470	458				
Spain (b)	294	285	285	278				
Abroad	181	185	185	180				
Subsidiaries	78	95	95	88				
Branches	103	90	90	92				
Rest of European Union	83	79	82	85				
Subsidiaries	11	15	15	14				
Branches	72	64	67	71				
Latin America	32	35	35	30				
Subsidiaries	28	31	32	27				
Branches	4	4	3	3				
Other	66	71	68	65				
Subsidiaries	39	49	48	47				
Branches	27	22	20	18				

(a) Institutions existing at each date.

(b) Including individual institutions.

TABLE I.A.7

**Breakdown of DI individual profit and loss account (a)**  
(€ m and %)

	1999			2000			2001			2002		
	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ
<b>Financial income</b>	<b>44,713</b>	<b>4.72</b>	<b>-11.5</b>	<b>54,442</b>	<b>5.25</b>	<b>21.8</b>	<b>64,575</b>	<b>5.58</b>	<b>18.6</b>	<b>57,910</b>	<b>4.64</b>	<b>-10.3</b>
Interest income	42,332	4.47	-12.0	50,603	4.88	19.5	57,346	4.95	13.3	52,321	4.20	-8.8
Income from equity portfolio	2,382	0.25	-2.1	3,839	0.37	61.2	7,228	0.62	88.3	5,589	0.45	-22.7
<b>Financial costs</b>	<b>-23,873</b>	<b>-2.52</b>	<b>-20.4</b>	<b>-31,833</b>	<b>-3.07</b>	<b>33.3</b>	<b>-36,333</b>	<b>-3.14</b>	<b>14.1</b>	<b>-29,701</b>	<b>-2.38</b>	<b>-18.3</b>
<b>NET INTEREST INCOME</b>	<b>20,841</b>	<b>2.20</b>	<b>1.4</b>	<b>22,609</b>	<b>2.18</b>	<b>8.5</b>	<b>28,242</b>	<b>2.44</b>	<b>24.9</b>	<b>28,209</b>	<b>2.26</b>	<b>-0.1</b>
<i>Of which: Investment of own funds</i>	2,892	0.30	2.2	3,701	0.36	28.0	4,182	0.36	13.0	3,902	0.31	-6.7
<b>Non-interest income</b>	<b>7,487</b>	<b>0.79</b>	<b>4.1</b>	<b>8,555</b>	<b>0.83</b>	<b>14.3</b>	<b>8,298</b>	<b>0.72</b>	<b>-3.0</b>	<b>8,560</b>	<b>0.69</b>	<b>3.2</b>
Commissions (net)	6,641	0.70	11.0	7,355	0.71	10.7	7,604	0.66	3.4	8,076	0.65	6.2
<i>Of which:</i>												
Collection and payment service	3,390	0.36	9.5	3,889	0.38	14.7	4,267	0.37	9.7	4,719	0.38	10.6
Securities service	994	0.10	3.6	1,201	0.12	20.8	1,179	0.10	-1.8	1,097	0.09	-7.0
Marketing of non-banking products	2,074	0.22	10.0	2,068	0.20	-0.3	1,952	0.17	-5.6	2,084	0.17	6.8
Contingent liabilities	554	0.06	8.0	654	0.06	18.0	733	0.06	12.1	799	0.06	8.9
Exchange of foreign currency												
and banknotes	134	0.01	64.5	139	0.01	3.1	136	0.01	-1.6	75	0.01	-45.3
Other commissions	792	0.08	17.4	908	0.09	14.6	1,000	0.09	10.1	1,141	0.09	14.1
Result on financial transactions	846	0.09	-30.1	1,200	0.12	41.8	694	0.06	-42.1	483	0.04	-30.4
Trading book	-216	-0.02	—	-300	-0.03	39.2	-273	-0.02	-9.2	-490	-0.04	80.0
Available-for-sale bond portfolio	329	0.03	-42.9	-72	-0.01	—	238	0.02	—	457	0.04	91.9
Exchange differences	386	0.04	-24.7	782	0.08	102.8	281	0.02	-64.1	141	0.01	-49.8
Other futures transactions	-214	-0.02	-66.2	904	0.09	—	327	0.03	-63.8	470	0.04	43.7
Other	561	0.06	—	-114	-0.01	—	121	0.01	—	-94	-0.01	—
<b>GROSS INCOME</b>	<b>28,328</b>	<b>2.99</b>	<b>2.1</b>	<b>31,164</b>	<b>3.01</b>	<b>10.0</b>	<b>36,540</b>	<b>3.16</b>	<b>17.3</b>	<b>36,768</b>	<b>2.95</b>	<b>0.6</b>
<b>Operating expenses</b>	<b>-18,563</b>	<b>-1.96</b>	<b>3.2</b>	<b>-19,611</b>	<b>-1.89</b>	<b>5.6</b>	<b>-20,865</b>	<b>-1.80</b>	<b>6.4</b>	<b>-21,528</b>	<b>-1.73</b>	<b>3.2</b>
Personnel	-11,235	-1.19	3.3	-11,756	-1.13	4.6	-12,471	-1.08	6.1	-12,825	-1.03	2.8
General and levies	-5,604	-0.59	3.0	-5,992	-0.58	6.9	-6,388	-0.55	6.6	-6,616	-0.53	3.6
Depreciation and amortisation	-1,724	-0.18	3.5	-1,862	-0.18	8.0	-2,006	-0.17	7.7	-2,088	-0.17	4.1
<b>NET OPERATING INCOME</b>	<b>9,766</b>	<b>1.03</b>	<b>0.1</b>	<b>11,553</b>	<b>1.11</b>	<b>18.3</b>	<b>15,675</b>	<b>1.35</b>	<b>35.7</b>	<b>15,240</b>	<b>1.22</b>	<b>-2.8</b>
<b>Provisions and write-downs (net)</b>	<b>-2264</b>	<b>-0.24</b>	<b>-36.7</b>	<b>-3,611</b>	<b>-0.35</b>	<b>59.5</b>	<b>-7,026</b>	<b>-0.61</b>	<b>94.6</b>	<b>-6,953</b>	<b>-0.56</b>	<b>-1.0</b>
Bad debts	-1,250	-0.13	3.4	-2,264	-0.22	81.1	-3,409	-0.29	50.6	-3,684	-0.30	8.1
<i>Of which:</i>												
Specific coverage	—	—	—	-977	-0.09	—	-1,321	-0.11	35.2	-2,265	-0.18	71.6
General coverage	—	—	—	-960	-0.09	—	-564	-0.05	-41.2	-494	-0.04	-12.4
Statistical coverage	—	—	—	-1,036	-0.10	—	-1,932	-0.17	86.6	-1,347	-0.11	-30.3
Country risk	-8	0.00	-96.0	121	0.01	—	146	0.01	20.8	-78	-0.01	—
Security price fluctuation fund	-788	-0.08	-39.8	-519	-0.05	-34.1	-3,319	-0.29	539.2	-3,374	-0.27	1.7
Fund for general banking risks	-9	0.00	-83.7	-153	-0.01	1578.0	-11	0.00	-92.8	79	0.01	—
Other specific funds	-209	-0.02	-73.7	-795	-0.08	281.0	-433	-0.04	-45.6	103	0.01	—
<b>Extraordinary income (net)</b>	<b>1380</b>	<b>0.15</b>	<b>-29.5</b>	<b>2,033</b>	<b>0.20</b>	<b>47.3</b>	<b>1,239</b>	<b>0.11</b>	<b>-39.1</b>	<b>1,543</b>	<b>0.12</b>	<b>24.6</b>
<b>PROFIT BEFORE TAX</b>	<b>8,895</b>	<b>0.94</b>	<b>9.0</b>	<b>9,982</b>	<b>0.96</b>	<b>12.2</b>	<b>9,910</b>	<b>0.86</b>	<b>-0.7</b>	<b>9,875</b>	<b>0.79</b>	<b>-0.3</b>
Corporate income tax	-1,824	-0.19	17.5	-1,319	-0.13	-27.7	-1,087	-0.09	-17.6	-826	-0.07	-24.0
Other taxes	-84	-0.01	80.7	-255	-0.02	204.7	-134	-0.01	-47.5	-121	-0.01	-9.7
<b>NET INCOME</b>	<b>6,986</b>	<b>0.74</b>	<b>6.5</b>	<b>8,408</b>	<b>0.81</b>	<b>20.3</b>	<b>8,689</b>	<b>0.75</b>	<b>3.3</b>	<b>8,928</b>	<b>0.72</b>	<b>2.8</b>

(a) The data in this table refer to the institutions existing as of December 2002.

TABLE I.A.8

**Main margins of the individual profit and loss account. Breakdown by grouping (a) (€ m and %)**

	1999			2000			2001			2002		
	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ
<b>NET INTEREST MARGIN:</b>												
Banks	10,432	1.80	-1.4	11,326	1.82	8.6	15,488	2.26	36.7	14,737	2.06	-4.8
Savings banks	9,270	2.76	4.3	10,031	2.66	8.2	11,317	2.63	12.8	11,929	2.46	5.4
Co-operatives	1,139	3.51	4.8	1,252	3.41	9.9	1,437	3.42	14.8	1,542	3.24	7.3
<b>GROSS MARGIN:</b>												
Banks	15,202	2.63	0.3	17,058	2.74	12.2	20,687	3.02	21.3	20,043	2.81	-3.1
Savings banks	11,751	3.50	4.1	12,621	3.34	7.4	14,161	3.29	12.2	14,916	3.07	5.3
Co-operatives	1,375	4.23	6.0	1,484	4.04	7.9	1,691	4.02	14.0	1,809	3.80	7.0
<b>NET OPERATING INCOME:</b>												
Banks	5,077	0.88	-2.8	6,447	1.04	27.0	9,620	1.40	49.2	9,020	1.26	-6.2
Savings banks	4,146	1.24	2.9	4,516	1.20	8.9	5,370	1.25	18.9	5,519	1.14	2.8
Co-operatives	543	1.67	7.0	591	1.61	8.8	686	1.63	16.1	702	1.47	2.4
<b>PROFIT BEFORE TAX:</b>												
Banks	4,599	0.79	9.9	5,515	0.89	19.9	5,362	0.78	-2.8	5,733	0.80	6.9
Savings banks	3,836	1.14	8.3	4,005	1.06	4.4	4,078	0.95	1.8	3,682	0.76	-9.7
Co-operatives	460	1.42	6.1	462	1.26	0.6	469	1.12	1.5	460	0.96	-2.0
<b>NET INCOME:</b>												
Banks	3,616	0.62	4.9	4,716	0.76	30.4	4,787	0.70	1.5	4,852	0.68	1.4
Savings banks	2,985	0.89	8.5	3,298	0.87	10.5	3,497	0.81	6.1	3,667	0.76	4.9
Co-operatives	386	1.19	6.7	394	1.07	2.2	405	0.96	2.7	409	0.86	1.2

(a) The data in this table refer to the institutions existing as of December 2002.

TABLE I.A.9

**Main margins of the individual profit and loss account. Breakdown by grouping (a) (€ m and %)**

	1999			2000			2001			2002		
	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ
<b>NET INTEREST MARGIN:</b>												
Banks	15,962	2.46	6.5	19,143	2.52	19.9	23,823	2.65	24.4	22,308	2.53	-6.4
Savings banks	9,484	2.69	4.2	10,288	2.58	8.5	11,645	2.58	13.2	12,549	2.50	7.8
Co-operatives	1,143	3.51	4.6	1,255	3.41	9.8	1,440	3.39	14.7	1,542	3.22	7.1
<b>GROSS MARGIN:</b>												
Banks	24,374	3.76	8.2	30,354	3.99	24.5	36,091	4.01	18.9	33,668	3.81	-6.7
Savings banks	12,490	3.55	3.9	13,415	3.37	7.4	15,062	3.34	12.3	15,986	3.18	6.1
Co-operatives	1,381	4.24	5.7	1,491	4.05	8.0	1,698	4.00	13.9	1,813	3.79	6.7
<b>NET OPERATING INCOME:</b>												
Banks	8,163	1.26	13.6	11,032	1.45	35.1	14,067	1.56	27.5	13,795	1.56	-1.9
Savings banks	4,316	1.23	0.7	4,747	1.19	10.0	5,685	1.26	19.8	5,962	1.19	4.9
Co-operatives	540	1.66	6.6	585	1.59	8.4	672	1.58	14.8	670	1.40	-0.3
<b>PROFIT BEFORE TAX:</b>												
Banks	7,448	1.15	18.4	9,743	1.28	30.8	10,065	1.12	3.3	9,014	1.02	-10.4
Savings banks	4,705	1.34	10.2	5,086	1.28	8.1	5,287	1.17	3.9	4,477	0.89	-15.3
Co-operatives	465	1.43	5.7	466	1.27	0.3	475	1.12	1.9	465	0.97	-2.2
<b>NET INCOME:</b>												
Banks	5,570	0.86	18.4	7,463	0.98	34.0	7,849	0.87	5.2	6,890	0.78	-12.2
Savings banks	3,537	1.00	10.2	4,062	1.02	14.8	4,434	0.98	9.2	4,357	0.87	-1.7
Co-operatives	390	1.20	6.0	396	1.08	1.8	408	0.96	2.9	412	0.86	1.0

(a) The data in this table refer to the institutions existing as of December 2002.

TABLE I.A.10

**Breakdown of DI consolidated profit and loss account (a)**  
(€ m and %)

	1999			2000			2001			2002		
	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ	Amount	% of ATA	% annual Δ
<b>Financial income</b>	<b>60,122</b>	<b>5.82</b>	<b>-3.7</b>	<b>80,819</b>	<b>6.76</b>	<b>34.4</b>	<b>88,808</b>	<b>6.37</b>	<b>9.9</b>	<b>77,843</b>	<b>5.43</b>	<b>-12.3</b>
Interest income	58,757	5.69	-4.1	79,045	6.61	34.5	86,761	6.23	9.8	75,934	5.30	-12.5
Income from equity portfolio	1,365	0.13	14.4	1,774	0.15	30.0	2,047	0.15	15.4	1,909	0.13	-6.8
<b>Financial costs</b>	<b>-33,533</b>	<b>-3.25</b>	<b>-10.0</b>	<b>-50,134</b>	<b>-4.19</b>	<b>49.5</b>	<b>-51,901</b>	<b>-3.73</b>	<b>3.5</b>	<b>-41,430</b>	<b>-2.89</b>	<b>-20.2</b>
<b>NET INTEREST INCOME</b>	<b>26,588</b>	<b>2.57</b>	<b>5.6</b>	<b>30,685</b>	<b>2.57</b>	<b>15.4</b>	<b>36,907</b>	<b>2.65</b>	<b>20.3</b>	<b>36,413</b>	<b>2.54</b>	<b>-1.3</b>
<i>Of which: Investment of own funds</i>	3,939	0.38	12.5	5,238	0.44	33.0	5,698	0.41	8.8	4,927	0.34	-13.5
<b>Non-interest income</b>	<b>11,656</b>	<b>1.13</b>	<b>9.1</b>	<b>14,575</b>	<b>1.22</b>	<b>25.0</b>	<b>15,945</b>	<b>1.14</b>	<b>9.4</b>	<b>15,069</b>	<b>1.05</b>	<b>-5.5</b>
Commissions (net)	10,529	1.02	13.0	12,684	1.06	20.5	14,117	1.01	11.3	13,625	0.95	-3.5
<i>Of which:</i>												
Collection and payment service	4,396	0.43	11.5	5,545	0.46	26.1	6,944	0.50	25.2	7,197	0.50	3.6
Securities service	2,796	0.27	-1.7	3,938	0.33	40.8	3,879	0.28	-1.5	3,364	0.23	-13.3
Marketing of non-banking products	2,880	0.28	24.7	2,962	0.25	2.8	3,116	0.22	5.2	2,886	0.20	-7.4
Contingent liabilities	642	0.06	12.3	726	0.06	13.0	817	0.06	12.5	863	0.06	5.7
Exchange of foreign currency and banknotes	162	0.02	17.3	188	0.02	16.5	232	0.02	23.1	131	0.01	-43.6
Other commissions	1,640	0.16	40.6	1,738	0.15	6.0	1,975	0.14	13.6	1,970	0.14	-0.2
Result on financial transactions	1,127	0.11	-17.5	1,891	0.16	67.8	1,827	0.13	-3.4	1,444	0.10	-21.0
Trading book	-255	-0.02	—	-928	-0.08	263.7	-137	-0.01	-85.2	-639	-0.04	364.7
Available-for-sale bond portfolio	832	0.08	11.8	721	0.06	-13.4	235	0.02	-67.4	379	0.03	61.5
Exchange differences	436	0.04	-40.9	856	0.07	96.3	390	0.03	-54.5	1,076	0.08	176.0
Other futures transactions	-426	-0.04	-39.6	1,392	0.12	—	1,201	0.09	-13.7	705	0.05	-41.4
Other	540	0.05	—	-150	-0.01	—	139	0.01	—	-77	-0.01	—
<b>GROSS INCOME</b>	<b>38,245</b>	<b>3.70</b>	<b>6.6</b>	<b>45,260</b>	<b>3.79</b>	<b>18.3</b>	<b>52,852</b>	<b>3.79</b>	<b>16.8</b>	<b>51,482</b>	<b>3.59</b>	<b>-2.6</b>
<b>Operating expenses</b>	<b>-25,226</b>	<b>-2.44</b>	<b>5.6</b>	<b>-28,897</b>	<b>-2.42</b>	<b>14.5</b>	<b>-32,428</b>	<b>-2.33</b>	<b>12.2</b>	<b>-31,040</b>	<b>-2.17</b>	<b>-4.3</b>
Personnel	-14,589	-1.41	5.6	-16,334	-1.37	12.0	-18,352	-1.32	12.4	-17,577	-1.23	-4.2
General and levies	-8,095	-0.78	4.2	-9,610	-0.80	18.7	-10,870	-0.78	13.1	-10,370	-0.72	-4.6
Depreciation and amortisation	-2,543	-0.25	11.1	-2,953	-0.25	16.1	-3,206	-0.23	8.6	-3,093	-0.22	-3.5
<b>NET OPERATING INCOME</b>	<b>13,018</b>	<b>1.26</b>	<b>8.7</b>	<b>16,363</b>	<b>1.37</b>	<b>25.7</b>	<b>20,424</b>	<b>1.47</b>	<b>24.8</b>	<b>20,441</b>	<b>1.43</b>	<b>0.1</b>
<b>Provisions and write-downs (net)</b>	<b>-3,131</b>	<b>-0.30</b>	<b>-13.6</b>	<b>-4,964</b>	<b>-0.42</b>	<b>58.5</b>	<b>-9,659</b>	<b>-0.69</b>	<b>94.6</b>	<b>-7,439</b>	<b>-0.52</b>	<b>-23.0</b>
Bad debts	-2,589	-0.25	19.9	-3,827	-0.32	47.8	-5,964	-0.43	55.8	-5,937	-0.41	-0.4
<i>Of which:</i>												
Specific coverage	—	—	—	-1,680	-0.14	—	-3,459	-0.25	105.9	-4,053	-0.28	17.2
General coverage	—	—	—	-1,058	-0.09	—	-587	-0.04	-44.5	-597	-0.04	1.6
Statistical coverage	—	—	—	-1,109	-0.09	—	-1,930	-0.14	73.9	-1,302	-0.09	-32.5
Country risk	15	0.00	—	148	0.01	863.5	92	0.01	-38.1	-156	-0.01	—
Security price fluctuation fund	-199	-0.02	747.4	-113	-0.01	-43.2	-116	-0.01	2.1	-431	-0.03	272.4
Fund for general banking risks	-9	0.00	-83.3	-154	-0.01	1551.9	-13	0.00	-91.8	80	0.01	—
Other specific funds	-347	-0.03	-66.4	-1,017	-0.09	193.4	-3,658	-0.26	259.8	-994	-0.07	-72.8
<b>Income on group transactions (net)</b>	<b>1,586</b>	<b>0.15</b>	<b>40.5</b>	<b>2,998</b>	<b>0.25</b>	<b>89.0</b>	<b>1,663</b>	<b>0.12</b>	<b>-44.5</b>	<b>267</b>	<b>0.02</b>	<b>-84.0</b>
Gains on group transactions	4,451	0.43	21.8	6,325	0.53	42.1	6,736	0.48	6.5	6,047	0.42	-10.2
Losses on group transactions	-2,865	-0.28	13.5	-3,327	-0.28	16.1	-5,073	-0.36	52.5	-5,781	-0.40	14.0
<i>Of which: Amortisation of goodwill</i>	-1,644	-0.16	19.8	-1,765	-0.15	7.4	-3,004	-0.22	70.2	-2,645	-0.18	-12.0
<b>Extraordinary income (net)</b>	<b>898</b>	<b>0.09</b>	<b>-27.0</b>	<b>618</b>	<b>0.05</b>	<b>-31.2</b>	<b>3,141</b>	<b>0.23</b>	<b>407.8</b>	<b>370</b>	<b>0.03</b>	<b>-88.2</b>
<b>Sundry income (net)</b>	<b>219</b>	<b>0.02</b>	<b>-13.7</b>	<b>257</b>	<b>0.02</b>	<b>17.1</b>	<b>226</b>	<b>0.02</b>	<b>-11.8</b>	<b>295</b>	<b>0.02</b>	<b>30.6</b>
<b>PROFIT BEFORE TAX</b>	<b>12,618</b>	<b>1.22</b>	<b>14.7</b>	<b>15,295</b>	<b>1.28</b>	<b>21.2</b>	<b>15,826</b>	<b>1.14</b>	<b>3.5</b>	<b>13,956</b>	<b>0.97</b>	<b>-11.8</b>
Corporate income tax	-2,872	-0.28	15.1	-2,476	-0.21	-13.8	-2,381	-0.17	-3.8	-1,387	-0.10	-41.7
Other taxes	-249	-0.02	10.0	-898	-0.08	260.8	-754	-0.05	-16.0	-909	-0.06	20.7
<b>NET INCOME</b>	<b>9,497</b>	<b>0.92</b>	<b>14.7</b>	<b>11,922</b>	<b>1.00</b>	<b>25.5</b>	<b>12,692</b>	<b>0.91</b>	<b>6.5</b>	<b>11,659</b>	<b>0.81</b>	<b>-8.1</b>
<i>Of which:</i>												
Group	8,258	0.80	13.0	10,045	0.84	21.6	10,721	0.77	6.7	9,857	0.69	-8.1
Minority interests	1,239	0.12	27.1	1,877	0.16	51.6	1,971	0.14	5.0	1,802	0.13	-8.6

(a) The data in this table refer to the institutions existing as of December 2002.

TABLE I.A.11

**Distribution of consolidated groups and their assets according to solvency (a)**

	1999		2000		2001		2002 (p)	
	No. of CGs	% of assets	No. of CGs	% of assets	No. of CGs	% of assets	No. of CGs	% of assets
<b>OVERALL SOLVENCY RATIO:</b>								
< 8%	0	0.0	2	0.2	3	0.1	0	0.0
≥ 8 and < 9%	19	4.9	21	3.1	23	3.3	10	1.8
≥ 9% and < 10%	24	17.9	36	58.5	24	7.6	38	29.6
≥ 10% and < 11%	32	39.7	23	10.1	38	63.5	31	38.8
≥ 11% and < 12%	23	15.5	27	8.4	21	5.6	20	6.5
> 12%	142	18.6	122	16.7	115	16.4	119	19.1
Institutions not subject (a)	48	3.4	47	3.0	51	3.5	53	4.2
<b>TIER I SOLVENCY RATIO:</b>								
< 5%	0	0.0	0	0.0	0	0.0	0	0.0
≥ 5 and < 6%	2	0.2	0	0.0	2	0.3	2	0.2
≥ 6% and < 8%	16	45.0	31	63.3	29	61.6	24	57.5
≥ 8% and < 10%	51	30.7	46	12.4	48	17.3	56	28.1
≥ 10% and < 11%	24	8.5	19	6.1	17	7.3	17	1.7
> 11%	147	12.2	135	15.0	128	9.7	119	8.1
Institutions not subject (a)	48	3.4	47	3.0	51	3.5	53	4.2
<b>MEMORANDUM ITEM:</b>								
Number of reports (b)	240		231		224		218	
(a) The CIs not subject to compliance with the solvency ratio in Spain are branches of Community institutions and branches of institutions of third countries with equivalent regulations.								



TABLE I.A.12

**Accounting information on specialised credit institutions (a)**  
(€ m and %)

	1999	2000	2001	2002	Memorandum items: 2002		
					Structure		Δ annual %
					%	p.p. change	
BALANCE SHEET OF TOTAL BUSINESS							
ASSETS:							
Cash and central banks	40	28	40	28	0.1	0.0	-29.9
Financial intermediaries	781	1,108	1,301	1,617	4.2	0.7	24.4
Loans and credit	23,915	27,962	33,594	35,051	91.2	-0.1	4.3
Government	857	974	1,228	1,256	3.3	-0.1	2.3
Resident private sector	22,757	26,472	31,731	32,861	85.5	-0.7	3.6
Factoring	3,215	4,434	7,004	7,918	20.6	1.6	13.0
Secured loans	3,440	3,291	3,492	3,782	9.8	0.3	8.3
Term loans	7,496	8,888	10,110	9,580	24.9	-2.5	-5.2
Financial leases	7,911	9,124	10,269	10,676	27.8	-0.1	4.0
Other	694	734	856	905	2.4	0.0	5.7
Non-residents	300	516	635	934	2.4	0.7	47.1
Doubtful assets	596	686	847	736	1.9	-0.4	-13.1
Securities portfolio	50	26	51	58	0.2	0.0	13.4
Fixed assets	256	260	299	217	0.6	-0.2	-27.6
Other assets	507	690	670	733	1.9	0.1	9.4
BALANCE SHEET TOTAL	26,145	30,760	36,801	38,439	100.0	0.0	4.5
LIABILITIES AND EQUITY:							
Credit institutions and Banco de España	20,057	23,623	26,799	28,599	74.4	1.6	6.7
Creditors and debt securities	2,072	2,460	4,213	3,716	9.7	-1.8	-11.8
Of which:							
Deposits of the group or shareholders	1,440	2,010	2,602	1,956	5.1	-2.0	-24.8
Resident private sector	201	277	408	260	0.7	-0.4	-36.3
Non-residents	1,280	1,773	3,182	2,828	7.4	-1.3	-11.1
Subordinated debt	181	273	356	367	1.0	0.0	3.2
Provisions	595	714	880	1,027	2.7	0.3	16.8
Capital and reserves	1,526	1,769	2,066	2,290	6.0	0.3	10.9
Other liabilities	1,714	1,922	2,487	2,440	6.3	-0.4	-1.9
OFF-BALANCE SHEET ACCOUNTS:							
Transferred credit	1,329	1,714	2,076	3,276	8.5	2.9	57.8
Of which: Mortgage securitisation	1,072	1,335	1,527	1,802	4.7	0.5	18.0
					In terms of ATA		
					%	p.p. change	
PROFIT AND LOSS ACCOUNT							
Financial income	1,441	1,791	2,236	2,239	6.04	-0.58	0.2
Financial costs	-710	-1,032	-1,337	-1,218	-3.29	0.67	-8.9
Net interest income	732	760	899	1,022	2.76	0.09	13.7
Non-interest income	12	28	22	29	0.08	0.01	33.7
Gross income	744	787	921	1,051	2.84	0.11	14.1
Operating expenses	-437	-441	-479	-507	-1.37	0.05	5.8
Of which: Personnel	-185	-193	-197	-207	-0.56	0.02	5.5
Net operating income	307	347	442	544	1.47	0.16	23.1
Write-downs and bad debts	-98	-167	-249	-247	-0.67	0.07	-0.6
Other	101	67	94	68	0.18	-0.10	-27.7
Profit before tax	309	246	287	364	0.98	0.13	27.1
Profit after tax	201	167	197	242	0.65	0.07	23.1
MEMORANDUM ITEMS:							
Average total assets (ATA)	23,815	27,940	33,745	37,051			
Average own funds	1,458	1,594	1,832	2,117			
Number of employees	4,876	4,855	5,057	5,210			
Efficiency ratio	-58.73	-55.98	-52.05	-48.26			
Return on equity	13.76	10.45	10.74	11.44			
Return on ATA	0.84	0.60	0.58	0.65			

(a) Grouping calculated as sum of institutions existing at the latest date.

TABLE I.A.13

## Appraisal companies and services: Key data (a)

	1999	2000	2001	2002	
Operational appraisal companies (number)	86	75	71	66	
DI appraisal services (number)	4	3	3	3	
				2002 sample	
				2001	2002
				54	54
<b>Number of appraisers</b>	<b>7,013</b>	<b>7,275</b>	<b>7,503</b>	<b>6,395</b>	<b>7,065</b>
Of which: Associate appraisers	666	588	560	449	369
<b>Number of appraisals performed (thousands)</b>	<b>979</b>	<b>935</b>	<b>1,005</b>	<b>884</b>	<b>1,068</b>
Of which:					
Complete buildings (b)	61	62	67	61	68
Dwellings (c)	757	719	788	690	840
Commercial premises	65	60	60	54	59
Commissioned by banks	389	346	354	336	394
Commissioned by savings banks	438	438	478	391	469
For extension of mortgage guarantee	877	849	921	812	979
<b>Amount of appraisals performed (€ m)</b>	<b>192,339</b>	<b>224,821</b>	<b>275,792</b>	<b>243,187</b>	<b>310,240</b>
Of which:					
Complete buildings (b)	76,380	91,369	107,800	95,662	118,327
Housing units (c)	75,919	82,791	100,626	88,377	122,368
Commercial premises	11,059	11,194	12,215	10,929	14,472
Commissioned by banks	69,597	74,215	83,786	80,188	108,191
Commissioned by savings banks	85,176	102,413	126,071	104,866	122,440
For extension of mortgage guarantee	164,963	191,927	231,834	205,561	264,794
<b>Appraisal companies</b>					
Total assets (€ m)	86.1	87.2	100.0		
Of which: Results (€ m)	10.2	9.1	15.0		
ROE (%)	29.3	23.5	35.9		

(a) Data refer to the institutions existing as at the end of December each year. The 2002 sample includes the institutions on which information was available when this table was prepared.

(b) Including residential, tertiary and industrial buildings either finished or under construction for the expected completion value.

(c) The term "dwelling" is used to refer to individual elements of buildings, including single-family buildings.

TABLE I.A.14

**Mutual guarantee companies: key data (a)**

	1999	2000	2001	2002 (p)
Operational entities (number) (a)	21	21	21	21
Patron and participating members (number)	55,244	58,598	61,341	64,491
Of which: Participating members	54,566	57,913	60,648	63,793
<b>BALANCE SHEET AND RESULTS (€ m)</b>				
Balance sheet total	305	338	362	404
Outstanding risk on guarantees	1,770	2,012	2,231	2,493
Non-reguaranteed risk	1,001	1,077	1,206	1,375
Reguaranteed risk	769	935	1,025	1,118
Doubtful assets and guarantees (b)	77	91	101	124
Of which: Net of reguarantees	20	35	40	49
Own funds	115	126	136	146
Net fund for technical provisions	93	107	130	150
Fund for bad debts	33	27	27	29
<b>GUARANTEE TRANSACTIONS AMOUNT IN THE YEAR (€ m)</b>				
Applied	1,148	1,157	1,208	1,406
Extended	893	913	959	1,066
Formalised	825	855	950	1,027
<b>RATIOS (%)</b>				
Weight of members participating in capital	52.0	52.8	55.5	57.2
Doubtful assets and guarantees/risk	4.4	4.5	4.5	5.0
Guarantee commissions/risk	1.2	1.1	1.0	1.0

(a) There are 22 mutual guarantee companies in the Register, but one is inactive and in the process of being liquidated.

(b) Doubtful assets and guarantees are presented net of commissions received not included in profit and loss, of capital disbursed by the holder and of monetary contributions received specifically for covering risk.

II

## BANKING SUPERVISION IN 2002



Article 43 bis of the LDI grants the Banco de España powers to “oversee and inspect credit institutions”. Likewise, article 7(6) of the LBE provides that “The Banco de España shall supervise, in accordance with existing regulations, the solvency, activities and compliance with specific regulations of credit institutions, and any other financial institution or market it has been called on to oversee...”.

Basic features of the Spanish model of banking supervision

In order to perform the legal task conferred upon it by Spanish law, the BE has designed a model of banking supervision, in conformity with the Basic Principles of Effective Banking Supervision of the Basel Committee on Banking Supervision, Community law and Spanish regulations. The most notable features of this model (set out in detail in the *Report on Banking Supervision in Spain 2001*) are:

Emphasis on prevention

1. That it is essentially preventive. The requirement for sufficient own funds to cover the risks arising from transactions, the requirements for regular information and the verification carried out by the BE itself contribute to an up-to-date knowledge of the financial and risk situation of banking groups.
2. A continuous supervision cycle.
3. Notwithstanding its preventive nature, the BE also has sanctioning powers, conferred upon it by law, to remedy and prevent the repetition of actions defined as offences (very serious, serious and minor).

Dual microeconomic/ macroeconomic approach

4. The performance of supervisory tasks that combine both microeconomic and macroeconomic aspects. Consequently, there are two related objectives: the stability and solvency of the individual institutions, and systemic financial stability.
5. The notion that financial regulation (both prudential and strictly accounting) is important to safeguard the solvency of credit institutions.
6. An increasingly risk-oriented supervisory approach (“SABER”, which stands for “risk-based approach to banking supervision”), but without abandoning the reviewing of financial statements and the valuation of bank assets and contingencies.
7. A combination of on-site techniques and remote monitoring.

8. A policy of communicating with institutions, not only during inspection visits, but also through diverse contacts and meetings with the directors and other representatives of such institutions.
9. Relations with other supervisors, both domestic and foreign, as well as international financial bodies with supervisory powers.

In 2002, in order to comply effectively with its legal mandate, the BE performed a wide range of supervisory activities, as described below.

## Chapter structure

Section II.1 includes an analysis of the recommendations and requirements made during the year. Section II.2 reports on the various disciplinary proceedings conducted during 2002, and section II.3 details other procedures and control mechanisms that contribute to the proper performance of supervisory tasks. Although Spanish regulations envisage other instruments of supervisory control, in particular intervention measures, the replacement of directors and the approval of extraordinary restructuring plans for institutions, no specific section in this Report is devoted to them, since there was no instance in 2002 in which it was necessary to apply such provisions.

Given the great topicality of the subject, owing to the revised Basel Capital Accord, section 4 reflects on institutions' own-funds policy. Section 5 is a descriptive account of developments in the SABER system of assessment, which aim to include an analysis of the corporate governance of institutions and their groups in such model. Finally, section II.6 describes the analysis and review methodology that the BE is developing in response to the increased use by credit institutions of internal models for risk measurement and management, in areas as diverse as credit risk, market risk and operational risk.

### II.1. RECOMMENDATION AND REQUIREMENT LETTERS SENT TO SUPERVISED INSTITUTIONS IN 2002

The Banco de España has legal powers to formulate recommendations and requirements for supervised institutions

Under article 23 of the LBE, the Executive Commission of the BE has, among other powers, that of *"Formulating necessary recommendations and requirements for credit institutions and, with regard to the latter, their board of directors and management, agreeing to initiate sanctioning proceedings and intervention measures, replacing directors, or taking any other precautionary measures set out in legal regulations and entrusted to the BE"*. Consequently, the sending of recommendation and requirement letters is a legally established procedure, and a privileged means, which enables the BE to approach the supervised institutions directly in order to require or recommend modifications in different aspects of their activities.

The Banco de España sent 101 requirement and recommendation letters to supervised institutions

In 2002, 101 requirement and recommendation letters were sent to supervised institutions, mostly as a consequence of on-site inspections. On five occasions the letter referred to more than one institution in a group. The addressees, classified by the type of supervised institution were as follows:

- 35 banks
- 11 savings banks
- 3 Community branches

- 2 non-Community branches
- 22 credit co-operatives
- 13 specialised credit institutions
- 5 mutual guarantee companies
- 6 currency-exchange bureaux
- 9 appraisal companies

### II.1.1. Summary of the subject-matter of the requirements and recommendations made

The 101 letters included 464 different requirements and recommendations. Of those, 167 related to credit risk

In all, 466 separate requirements and recommendations were made, of which 167 related to credit risk, the most traditional area of banking activity. The latter can be broken down as follows:

1. 39 related to the *reclassification of ordinary investment as doubtful investment*.
2. On 42 occasions the BE required *increases in provisions*.
3. In 50 cases a *need for extra monitoring of certain risks (special vigilance)* was identified.
4. 36 letters required the institution addressed to *improve its systems for granting, monitoring and, in general, managing credit risk, as these were considered inappropriate or insufficient*, and, where applicable, to document its transactions properly.

In the area of price, interest-rate and liquidity risks there were a total of 50 requirements and recommendations were made

The second most important area addressed by the letters sent related to price, interest-rate and liquidity risks and operations and activities closely related to treasury and asset management. In total, 50 requirements were made in this area, with the following breakdown:

1. On 14 occasions institutions were required to *improve their systems for the management and control of overall interest and liquidity risks*, since these were considered inadequate for the institution's level of activity.
2. In 7 cases adjustments were required to *securities safekeeping and administration activity*.
3. In 12 cases the requirements were made as a consequence of *specific shortcomings in treasury management and capital market activities, owing to the absence or inadequacy of liquidity contingency plans, or else to the inappropriateness of market risk management systems*.
4. In 17 cases different institutions were required to resolve *specific shortcomings in internal control in the treasury and capital markets area*, owing in particular to the insufficient involvement of internal audit, the absence of rules manuals or the inappropriateness of risk control and measurement systems.



On 70 occasions modifications with effects on balance sheets were required, in addition to those already mentioned in relation to credit risk

Third, from the viewpoint of the balance sheet and own funds, besides the requirements to increase provisions mentioned in relation to credit risk, 70 requirements were made which can be broken down as follows:

1. In 32 cases *additional provisions* were required; in particular *provisions for securities price fluctuations, country risk and employee pension commitments*.
2. In 15 cases adjustments of a different nature and amount were required, which made it necessary to *recognise expenses or to reduce inappropriately recorded income*.
3. 23 letters required adjustments to own funds or pointed out the *insufficiency or weakness of the institution's level of solvency*.

22 requirements and recommendations were made in the area of consumer protection

The fourth area of importance relates to on-site inspection work to review compliance with the law for the protection of consumers and users of bank services and products. As a consequence of the analysis and review of customer transactions, 22 requirements and recommendations were formulated, urging the modification of different aspects of the institutions' policies and procedures, owing to *failures to comply with the aforementioned law for the protection of consumers/users or with transaction transparency obligations*.

61 requirements related to internal control

Fifth, in terms of importance, are letters in which the Banco de España made requirements relating to different aspects of the quality of internal control. On 61 occasions improvements were required, to a differing extent, in the three following areas:

1. *Internal control systems, considered overall to be inappropriate or inadequate*.
2. *Inadequacy of the accounting, administrative and technical support systems*.
3. *Inadequacy of the powers conferred upon and/or the resources assigned to internal audit*.

13 requirements related to the cost and business structure

Sixth, 13 requirements were formulated directly relating to the need to *adjust cost structures or to improve margins and profitability*, owing to the existence of large differences with respect to the sector average. In one letter, moreover, an institution was required to make changes to its growth policy; its *strong geographical expansion was considered to have been carried out without a rigorous study of the advantages and without monitoring the profitability of the new branches*.

83 other requirements were also made

Another 83 requirements were made, with the following breakdown:

1. In 17 letters the institutions were required to remedy *diverse shortcomings in their reports to the Banco de España Central Credit Register*.
2. In 11 cases the requirements related to transactions between the institution and its directors or senior executives or related persons that were either not reported at all or were not correctly reported.
3. In 2 letters changes relating to the *welfare fund or the education and promotion fund* were required.

4. In 9 cases the requirement related to *breach by the institution of the limit on the concentration of risks with its own group*.
5. In 12 cases the requirement related to *breach of the limits on the concentration of risk with other groups, on tangible fixed assets or on holdings of shares/other equity*.
6. In 9 cases the reason was *breach of the requirements which appraisal companies must satisfy to obtain approval or for some other purpose*.
7. In 6 cases the reason was *breach of the requirements which currency-exchange bureaux must satisfy to obtain approval or for some other purpose*.
8. 3 letters included demands for the institution to change its accounting policy in relation to consolidation, owing to the *inappropriateness of its scope*.
9. Finally, there were another 14 requirements of various kinds including, for example, in relation to the concealment of information of relevance for supervisory purposes, reputation and legal risks and risks of inappropriate management.

### II.1.2. Compliance by the supervised institutions with the measures included in the letters sent by the Executive Commission

Remedy by the supervised institutions of the shortcomings indicated

In general, the institutions to whom the various letters were addressed proceeded to remedy the shortcomings indicated in the letters. The procedure followed has two basic stages:

1. Once the chairman, or a director or senior executive, has received the letter from the BE, the board of directors, or similar governing body, includes on the agenda of its next meeting the reading and discussion of the document. As a rule, the secretary to the board of directors certifies that this has been done.
2. Subsequently, and sometimes simultaneously, in accordance with the timetable for application of the remedies, the institution contacts the BE to notify it of compliance with the various requirements or recommendations made.
3. For its part, the BE, through its inspection department, reviews and checks, both by remote means and on site, effective implementation of the remedies required by the letters in question.

## II.2. PROCEEDINGS AND SANCTIONS

Exercise by the BE of its sanctioning power completes the supervision function assigned to the BE under Spanish law. Its basic purpose is to correct, by disciplinary means, the conduct and actions of institutions subject to supervision, and also of their directors and executives, which amount to significant infringements of organisational and disciplinary rules.

Article 18 of the LDI determines the administrative bodies to which the sanctioning power over credit institutions is assigned. It provides that the BE shall

be responsible for conducting proceedings, as well as for imposing sanctions for serious and minor infringements, while the power to impose sanctions for very serious infringements is conferred upon the Ministry of Economy, on a proposal from the BE, except in the case of revocation of authorisation to operate as a credit institution, a sanction that may only be imposed by the government, on a proposal from the BE.

It should be noted that the scope of the sanctioning power under Spanish sectoral law extends beyond credit institutions and their directors (banks, savings banks, credit co-operatives and specialised credit institutions) to other types of institution, and their directors too (including mutual guarantee companies, appraisal companies and currency-exchange bureaux), as well as to any natural or legal person who, without having obtained the necessary authorisation and without being registered in the relevant registers, engages in activities restricted by law to credit institutions or uses a name whose use is restricted to credit institutions.

The year 2002 saw the resolution of 7 sanctioning proceedings conducted against supervised institutions and 43 proceedings against their directors or executives, all of which were initiated in 2001. In addition, during the year 16 proceedings against supervised institutions and 69 against their directors and executives were commenced and are pending resolution.

The subject matter of the proceedings resolved in 2002 is classified below in accordance with the gravity and nature of the infringement sanctioned.

One *very serious infringement* was found to have been committed in a sanctioning proceeding last year. This involved the *use of nominees (natural or legal persons) in an attempt to obtain a result contrary to organisational and disciplinary rules*. As a result, the institution, its chairman, general manager, members of its executive committee and other members of its board of directors were all sanctioned.

Most of the sanctions imposed for *serious infringements* arose, basically, from the performance of transactions prohibited by organisational and disciplinary rules (with the status of law or regulations) and the performance of transactions directly affecting the institution's solvency. Sanctions were also imposed for the infringement of accounting rules for the recording of transactions and for the reporting of inaccurate data to the BE.

Among the first large group of infringements, in two cases *serious infringements* were found to have been committed on account of *merely occasional or isolated performance of acts or transactions prohibited by organisational and disciplinary rules with the status of law*. In one case, in which the institution, its chairman, its ex-general manager and the members of its board of directors were all sanctioned, the infringement involved the existence of capital contributions with a nominal value of less than the amount of ESP 10,000 (equivalent to EUR 60.10) required by law, while in another case, a guarantee was found to have been granted to the chairman of the institution, without the necessary authorisation having been obtained from the BE.

In this same group, sanctions were imposed in four of the proceedings concluded in 2002 for *serious infringements* involving the *performance of acts or transactions prohibited by organisational and disciplinary rules with the status of regulations or*

*infringing requirements laid down in such rules.* This category includes a varied group of infringements that were sanctioned in a number of proceedings concluded in 2002. Specifically, this category served as the basis for sanctioning two institutions and their respective chairmen, general managers and board members, owing to infringement of regulations which lay down a number of precautions for the adoption of resolutions relating to transactions, in which there may be a conflict of interest, with directors, family members or related entities. Also under this legal category, an institution, its chairman and its ex-general manager and its board members were sanctioned, owing to a number of instances of irregular behaviour deriving from serious shortcomings in the institution's administrative and accounting organisation and internal control. Finally under this category, an institution was sanctioned for irregularities in its register of special guarantees.

Regarding the second large group of infringements referred to above, relating to sanctions for inappropriate practices of institutions directly affecting their solvency, three proceedings were resolved in 2002, in which there was found to be a *serious infringement involving insufficient provisions for bad debts*. In the first one, a credit institution was sanctioned for shortfalls in its provisions for bad debts, for securities price fluctuations and for non-disposable earnings. In the second one, an institution, its chairman, its general manager and its board of directors were sanctioned for failing to classify as doubtful, for reasons of non-performance, and thus failing to make the necessary provision, for loans granted to a member of the board of directors which had not been paid owing to their restructuring. Finally, an institution, its chairman, its general manager and the members of its board of directors were sanctioned for a shortfall in the provision for bad debts. This arose from a number of transactions that were persistently non-performing, the counterparties having been declared bankrupt or the amounts in question being the subject of judicial claims.

A serious infringement involving breach of rules on risk concentration

Likewise in the area of the supervision of institutions' solvency, two institutions were sanctioned in 2002, along with the chairman, general manager and board of directors of one of them, for a *serious infringement involving the infringement of the rules in force that place limits on risks*. It was duly established in the proceeding that the risks of such institutions vis-à-vis certain unrelated individuals or financial groups exceeded the limit of 25% of eligible capital set in regulations.

A serious infringement involving insufficiency of own funds

Also in relation to the protection of solvency, an institution was sanctioned for a *serious infringement involving its failure to meet capital ratio requirements during a period of at least six months*.

Serious infringement involving breach of accounting rules

Finally, in relation to serious infringements, an institution was sanctioned, in the same proceedings, for a *serious infringement involving the infringement of accounting rules for booking transactions*, owing to the defective recording of certain transactions, with understatement of their economic essence, and also for a *serious infringement involving the reporting of inaccurate data to the Banco de España*, as it had concealed, in the answer to a request for information from the BE, the existence of a proceeding in which it was alleged to be secondarily liable as well as a guarantor.

Reporting of inaccurate data

Two minor infringements involving breach of regulatory and disciplinary rules

As regards the commission of *minor infringements*, two institutions were sanctioned in 2002 as a consequence of the performance of transactions which, although in contravention of organisational and disciplinary rules, were insufficiently important to amount to very serious or serious infringements. In the first case, an

overall balanced consideration of the circumstances present in the proceeding led to the action of the institution, which involved inaccurate information in the reporting of credits to the CCR, being classified as a minor infringement. In different circumstances this might have been classified as the serious infringement of reporting inaccurate data to the BE referred to above. In the second case, the sanctioned conduct related to certain shortcomings observed in the compliance with the regulatory rules relating to the CCR, which, either because of their occasional nature, or because of their insignificant or ancillary nature, could not be classified as serious infringements arising from the performance of acts or transactions prohibited by organisational and disciplinary rules with the status of regulations.

Two companies were sanctioned by the Banco de España

In 2002, two companies were sanctioned for the unauthorised use of generic names whose use is restricted to credit institutions. The proceedings established that they had used the names “BANK” and “BANCO”, in contravention of the provisions of article 28 of the LDI.

The Banco de España conducted 10 proceedings for breach of the reserve ratio

Also in 2002, a total of 10 proceedings were conducted against credit institutions owing to their failure to hold the level of minimum reserves required by the Governing Council of the ECB, in accordance with article 19 of the Statute of the ESCB and of the ECB. This type of proceeding is conducted by the Banco de España, while the ECB is responsible for commencing and determining them, as specified in Annex 6 hereto.

Extension of liability to directors and senior executives

Finally, it is worth highlighting the importance, within the scope of supervision under this sectoral law, of the correction of conduct contrary to organisational and disciplinary rules committed both by credit institutions and their directors and executives.

It is well known that article 1 of the LDI establishes the institutional liability of credit institutions and that it widens such concept (in conjunction with article 15 of the same law) to those persons holding administrative or management posts therein. Accordingly, these individuals may also be held liable for the very serious or serious infringements for which the institutions themselves are held liable, when they are attributable to the wilful misconduct or negligence of the former.

In this respect, the need to correct, by disciplinary means, the conduct of directors and managers of institutions subject to supervision should be reaffirmed. This is because, persons performing the function of a director or manager of a commercial company or similar entity and, especially, the directors of institutions that raise funds from third parties, with an obligation to repay them, should be required to exercise special diligence and responsibility.

### II.3. OTHER SUPERVISORY ACTIVITIES OF THE BANCO DE ESPAÑA

In addition to the powers and activities of the BE relating mainly to the prudential supervision of CIs, the BE is also entrusted with overseeing other aspects of the activity of such institutions.

A brief review of these functions is set out below, with comments on certain aspects of their performance in 2002.

### II.3.1. Commission charges

Brochures of charges may be viewed on the BE's website

Freedom – practically without exceptions – in setting the prices of bank services also entails the obligation of drawing up a brochure of charges, valuation conditions and chargeable expenses detailing the maximum amounts applicable, the item to which they relate and the terms of their application to the operations and services in which banks habitually engage. This brochure should be available at all times to customers and, at present, access to it may also be had through the BE website. The inclusion of charges in the brochure is, in the case of habitual services, a condition for their applicability to the product or operation concerned.

The BE is responsible for verifying and registering the brochure that includes these charges and changes thereto. Such verification does not, however, include securities operations, as these are the preserve of the CNMV (National Securities Market Commission), unless they refer to securities traded on the Public Debt Book-Entry Market.

Verification is restricted, by legal imperative, to monitoring the transparency of the brochure, i.e. to checking that it reflects maximum prices and the conditions governing their application in an orderly, clear and comprehensible fashion. The BE has also been rejecting those charges which either do not relate to the actual provision of a service requested by the customer, or which, owing to the manifest distance between the amount involved and that habitually applied in the industry, may not be generally applicable and, therefore, not reflect the commercial practice applied by the bank, distorting the basis for the publication of the charges.

The main activity performed in this area in 2002 involved the adaptation of brochures to the provisions on cross-border credit transfers incorporated into Circular 8/1990 by Circular 3/2001. The latter circular implemented the Order of 16 November 2000 which, in turn, implemented Law 9/1999 of 12 April regulating the legal system for credit transfers between EU Member States, as well as other provisions relating to credit transfers.

Adaptation of brochures to the provisions on transfers

As a result, all institutions performing this activity have had to include in a single section the general conditions applicable to these transactions, incorporating the other information required by the provisions cited above. The purpose of this is to ensure that customers of institutions wishing to carry out transactions of this nature know in advance all the requirements of the institution for accepting the transaction, the commission fees and charges payable, the options as to who will bear such costs (the originator, the beneficiary or both) and, in the case of transfers between EU Member States, the time needed for execution of the transfer. In this respect, it should be noted that, until the entry into force of this new provision, the brochure of charges, following the usual international practice whereby the charges are either shared or else borne by the beneficiary (SHA and BEN conditions), only showed the costs charged by the Spanish institutions for their involvement in initiating or receiving a cross-border credit transfer, so that it was not possible to know in advance the charges that each of the other institutions participating in the process was going to deduct from the amount of the transfer.



TABLE II.1

Commission charges (number)												
	Total				Banks				Savings banks			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
<b>Cases examined</b>	<b>1,314</b>	<b>1,068</b>	<b>855</b>	<b>860</b>	<b>541</b>	<b>522</b>	<b>396</b>	<b>371</b>	<b>333</b>	<b>227</b>	<b>234</b>	<b>243</b>
Decisions (a)	891	779	659	790	359	373	281	349	223	181	193	233
Approvals	511	420	307	201	204	194	122	98	131	100	79	53
With objections	380	359	352	589	155	179	159	251	92	81	114	180
Objections formulated	2,126	2,184	1,857	2,294	740	1,282	823	937	557	306	692	708
	Credit co-operatives				Specialised credit institutions				Securities-dealer companies and CEB			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
<b>Cases examined</b>	<b>299</b>	<b>247</b>	<b>149</b>	<b>128</b>	<b>136</b>	<b>55</b>	<b>57</b>	<b>67</b>	<b>5</b>	<b>17</b>	<b>19</b>	<b>51</b>
Decisions (a)	203	167	121	103	103	46	48	54	3	12	16	51
Approvals	112	93	71	21	64	27	26	14	—	6	9	15
With objections	91	74	50	82	39	19	22	40	3	6	7	36
Objections formulated	671	527	247	371	155	61	78	88	3	8	17	190

(a) A single decision may correspond to several cases.

Special system of protection for transfers to EU countries for less than €50,000 with execution for the whole amount unless originator instructs otherwise

Under the new legislation, credit transfers with EU countries of amounts of up to EUR 50,000, besides being subject to a special system of protection, shall be executed for the whole amount, unless the originator has expressly indicated that the charges are wholly or partially payable by the beneficiary. This means that the charges for these transfers are shown in the brochures, at least on the condition that the originator agrees to bear all the charges (OUR condition).

The adaptation work referred to above explains the significant increase (Table II.1) in decisions with objections (67%), although the number of objections increased by less (24%). Most of the objections in relation to transfers related to the lack of information on the charges applicable when the OUR condition applies.

Impact of adaptation of charges to the provisions regulating cross-border credit transfers

Over the period as a whole, the weight of brochures submitted by banks and credit co-operatives fell slightly (that of the former standing at 43%), while that of savings banks increased to 28% in 2002.

Another aspect that should be highlighted relates to the inclusion of brochures of charges on the BE website, which took place during 2003 Q1. This change has been favourably received, as can be seen in Table II.4, since the number of website visits has risen to 53,193.

### II.3.2. Advertising

The function assigned to the BE in this area is the authorisation, prior to diffusion, of CIs' advertising projects referring to costs or returns for the general public.

Said authorisation, which is unique among our peer countries (where self-regulation usually plays a greater role), is intended to ensure that advertising reflects clearly, accurately and in a manner respectful of competition the essential features of financial offers, and that the calculation of the cost or return offered has been made in keeping with the rules regulating the equivalent annual rate

TABLE II.2

Advertising projects (number)																				
	Total				Banks				Savings banks				Credit co-operatives				Specialised credit institutions			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
Cases processed	1,676	2,032	2,784	3,185	965	1,197	1,555	1,805	336	367	566	462	109	170	220	180	266	298	443	738
BY TYPE OF DECISION:																				
Authorised	1,311	1,540	2,225	2,555	744	866	1,220	1,395	269	287	474	400	85	130	188	157	213	257	343	603
Rejected	38	27	26	33	14	21	20	22	16	5	4	4	1	—	—	7	1	2	7	—
Modified (a)	154	248	354	383	102	180	206	258	19	33	63	32	5	7	14	12	28	28	71	81
Returned (b)	173	217	179	214	105	130	109	130	32	42	25	26	18	33	18	11	18	12	27	47
BY TYPE OF TRANSACTION:																				
Lending transactions	957	930	1,107	1,382	468	464	468	577	205	132	219	162	46	68	78	54	238	266	343	603
Deposit transactions	460	685	970	932	315	454	639	623	93	156	246	217	52	75	85	92	—	—	—	—
Other	105	169	148	241	80	99	113	195	19	46	9	21	6	20	25	11	—	4	—	—
BY ADVERTISING MEDIUM (c):																				
Press	419	548	870	789	231	328	545	442	40	43	58	53	13	17	23	24	135	160	244	270
Radio	59	26	60	100	37	13	35	54	8	2	—	—	—	—	1	—	14	11	24	46
Television	63	101	94	112	26	79	56	62	5	4	4	—	2	4	3	—	30	14	31	50
Other	981	1,109	1,201	1,554	569	597	584	837	264	285	412	347	89	142	161	133	59	85	44	237

(a) Modifications, normally in prices, in projects authorised in the same or in previous years

(b) Relate to projects whose content does not require authorisation, or which have been withdrawn by the applicant.

(c) Up to 2000, this includes projects authorised, rejected and returned. From 2001, only projects authorised feature.

(EAR) formula. This measure seeks to harmonise calculations to ensure the comparability of the different offers.

The number of advertising projects submitted for authorisation continued to increase

As in previous years the number of advertising projects submitted for authorisation continued to increase. In 2002, 3,185 projects were submitted, a 14% rise on the previous year (Table II.2).

The increases stemmed mainly from lending transactions

Unlike in 2000 and 2001, when the increases were primarily due to deposit transaction offers, essentially high-yield deposits at very short terms with banks via internet and telephone, as well as so-called double deposits (mixed deposits, consisting of a short-term deposit with a fixed interest rate and a structured deposit, at a substantially longer term), in 2002 the increases stemmed from lending transactions and, more specifically, from offers made by SCIs, which significantly increased their offers of vehicle financing and conducted numerous campaigns offering small loans at high interest rates. There were 67% more projects submitted by SCIs than in the previous year, which meant that they overtook the savings banks to move into second place behind the banks, in terms of the number of cases processed and authorisations. The number of rejections, as in previous years, is still a very small percentage of all applications (1.04%).

Increase in the number of projects for the Internet

As regards the media used, it should be noted that there was a decrease in the weight of projects for the press, down from 39% in 2001 to 31% this year (although it is still the most popular medium), while the number of projects for the Internet and radio increased significantly.

In terms of numbers of institutions, 57% of the cases processed are concentrated in banks, followed by SCIs with 23%, savings banks with 14% and, at an even greater distance, credit co-operatives with 6%. The preponderance of banks over savings banks can be explained first, in terms of their larger number, and further, because advertising by the latter is, like that of credit co-operatives, subject to the control of the regional governments. Only campaigns of a wider than regional scope are submitted to the BE's scrutiny.



Reporting of interest rates on lending transactions (number filed)					TABLE II.3
	1999	2000	2001	2002	
<b>Reports processed</b>	<b>619</b>	<b>531</b>	<b>505</b>	<b>405</b>	
Banks	346	302	282	237	
Savings banks	143	118	115	91	
Credit co-operatives	130	111	108	77	

### II.3.3. Reporting of interest rates on lending operations

The BE publishes reported interest rates on its website

Banks, savings banks, Spanish credit co-operatives and the branches of foreign CIs are obliged to disclose a series of interest rates on their lending operations: their prime rate, the respective rates on current-account and credit-account overdrafts (both are applicable at the maximum rate unless lower rates are contractually envisaged), and the indicative reference rates relating to other financial facilities deemed most habitual or representative. In turn, institutions should report such rates, and changes therein, to the BE, indicating the dates from which they are applicable. The BE has been publishing these rates on its website so that they may be freely consulted by analysts and customers.

To gauge the public usefulness of these data, Table II.4 draws together the replies made in writing to CIs and to individuals to information requests, essentially in relation to the interest rates obligatorily reported (these consultations also relate occasionally to the commissions reflected in the charges brochures approved by the BE). The table also includes consultations by the courts channelled through the BE Legal Services. It further shows hits on the interest rate database on the BE's website where, as stated, the information contained in the reports is included.

### II.3.4. Official registers of supervised institutions

Registers of institutions kept by the BE

So as to give legal force to and publicise the “vetted access” principle (on which licences to operate are conditional) governing the presence of various insti-

Consultations on interest rates and commissions (number)					TABLE II.4
	1999	2000	2001	2002	
<b>Consultations</b>	<b>757</b>	<b>545</b>	<b>403</b>	<b>355</b>	
By institution	471	383	319	312	
Banks	324	238	193	179	
Savings banks	81	92	82	84	
Credit co-operatives	14	13	9	13	
Other	52	40	35	36	
By individuals	42	24	24	13	
By corporations	52	28	11	11	
By the courts	192	110	49	19	
<b>Internet consultations</b>	<b>20,318</b>	<b>14,642</b>	<b>15,830</b>	<b>67,749</b>	
Interest rates (a)	20,318	14,642	15,839	14,556	
Commission charges				53,193	

(a) Number of hits on the related BE website with information on the interest rates reported for institutions' lending transactions.

Official registers of institutions as at 31 December (a)				TABLE II.5
	1999	2000	2001	2002
<b>Institutions with an establishment</b>	<b>585</b>	<b>579</b>	<b>576</b>	<b>566</b>
Credit institutions	391	371	369	361
Representative office	67	62	60	62
Mutual guarantee companies	23	23	23	22
Reguarantee companies	1	1	1	1
Currency-exchange bureaux and money-transfer agencies	10	42	49	53
Appraisal companies	93	80	74	67
<b>Credit institutions operating without an establishment</b>	<b>201</b>	<b>248</b>	<b>276</b>	<b>292</b>
Of which:				
EU credit institutions operating without an establishment	199	246	274	290
Of which: financial subsidiaries of EU credit institutions	2	2	2	2
(a) The number of institutions also includes those that are not-operational and in the process of deregistering.				
(b) Does not include foreign currency purchasing establishments.				

tutions operating on our financial markets, and in order to publicise the fact that institutions are subject to supervision by the Spanish central bank, the BE is also responsible for keeping the public records in which, prior to engaging in their activity, the following institutions must be registered:

- All CIs licensed to provide banking services in Spain (banks, savings banks, credit co-operatives, specialised credit institutions, foreign branches of CIs and foreign CIs providing services without an establishment), and the representative offices of foreign CIs whose functions in Spain are of a merely commercial or market prospection nature.
- The owners of currency-exchange bureaux and/or money transfer agencies, the only establishments other than banks licensed to buy and sell foreign bank-notes or make transfers abroad.
- Appraisal companies, to which this activity is confined when what are involved are movable goods or rights in the mortgage market or goods and rights suitable for setting up the assets of real estate investment funds or insurance companies.
- Mutual guarantee and reguarantee companies.

The existence of these Registers does not encroach on those (if any) the regional governments may have set up for the purpose of certification of the institutions over which they have certain supervisory powers. Such institutions are essentially savings banks whose registered offices are in the region and credit co-operatives whose operating scope does not extend beyond the region in question. Nor do the Registers have any bearing on the more general powers of the Mercantile Registers.

Table II.5 lists the number of institutions subject to BE supervision and entered in the relevant registers, as well as the number of institutions that operate

in Spain under the freedom to provide services, in accordance with the provisions of Directive 2000/12/EC of the European Parliament and of the Council, and of article 11 of Royal Decree 1245/1995 of 14 July 1995.

Of the 20 additions in 2002, 7 correspond to the owners of currency-exchange bureaux and/or money transfer agencies; six to branches of foreign CIs, 5 of them being Community ones; four to representative offices; two to SCIs; and one to an AC.

In the same period 26 institutions were removed from the register, 16 of which were CIs (5 banks, 5 credit co-operatives, 3 branches of Community CIs and 3 SCIs), mostly as a consequence of merger.

In 2002, 24 new EU CIs have notified their intention of providing services in Spain, without a permanent establishment, and eight have notified cessation of activities.

### **II.3.5. Other information filed with the Banco de España: directors and senior executives, shareholders, agents and articles of association**

The BE keeps the register of directors and senior executives

The BE receives information on the directors and senior executives of supervised institutions for inclusion in the Registers of Directors and Senior Executives, which it is responsible for keeping. In the case of savings banks, this information is passed to the Ministry of Economy. The term “directors and senior executives” covers members of the Board of Directors of the company in question and its senior managers. Throughout the EU, and as provided for under harmonised Community regulations, those in senior positions of responsibility at CIs must have a recognised commercial and professional standing and reputation, in keeping with the factors envisaged to this end in the law.

At present, the most important function of these registers, which are confidential, is to make available updated personal and professional data on those chiefly responsible for the activity of supervised institutions. This provides a further auxiliary instrument for the exercise of the supervisory and sanctioning powers assigned to the BE.

However, in the case of directors and senior executives of banks and credit co-operatives, the register is also a specific element for monitoring the restrictions and incompatibilities to which such individuals are subject in respect of holding posts at other companies. The BE is responsible for such monitoring in this latter instance, while the regional governments monitor the analogous rules applicable to the directors and senior managers of savings banks. In these cases, inscription in the BE Register shall precede that required in the Mercantile Register, reflecting the need for prior vetting of incompatibilities as a prerequisite for effectively taking up a senior post.

Fall in the number of registered directors and senior executives and increase in persons included for the first time

In 2002 the total number of directors and senior executives of supervised institutions in the registers fell slightly. There was a considerable increase in persons included for the first time vis-à-vis those who, having been included previously on account of positions held in the past, are considered reinstated.

Register of directors and senior executives (number)				TABLE II.6
	1999	2000	2001	2002
<b>Directors and senior executives registered</b>	<b>5,187</b>	<b>5,030</b>	<b>4,946</b>	<b>4,866</b>
Additions or deletions in supervised institutions	3,211	3,513	2,832	3,283
Of which:				
First-time additions	644	767	570	702
Reinstatements	255	296	260	109
Inquiries as to integrity of directors and senior executives	580	904	757	504
Average number of people listed per document	6	6	5	5

Of the total, 7.3% were legal persons, mostly belonging to the boards of directors of MGCs. Women represented 7% of all the individuals included in the registers (of the 300 women in the registers, 208 hold positions in credit institutions, 26 of them in banks). Savings banks have the highest percentage of women on their governing bodies.

Also noted in the registers are the administrative penalties which the officials listed may have incurred in connection with the disciplinary rules applicable to them. This explains why other supervisory authorities direct numerous reputation-related inquiries to the register. The BE also receives confidential information about the shareholders of banks and SCIs, and about the members of credit co-operatives, further to the obligation to report data quarterly on all shareholders or holders of contributions that are deemed to be financial institutions, and on those which, while not considered as such, have in their name shares or contributions representing a percentage of the share capital of the institution equal to or exceeding 0.25% for banks, 1% for credit co-operatives and 2.5% for SCIs.

This information is intended for the basic supervisory tasks of the BE, it being essential for it to know the share ownership structure of the institutions under its supervision. Further, and most particularly, it makes for the readier exercise of the provisions which bring under BE control the ownership share of the biggest of these institutions, once this exceeds certain thresholds.

Reduction in the number of shareholders of banks, in particular individual shareholders

The number of shareholders included in banks' reports continued to decline in relation to previous years. Of particular importance was the 15% reduction in the number of individual shareholders. The presence of foreigners in reported ownership interests also displayed a downward trend, as did the number of members of credit co-operatives, given that individual members of the latter fell by 32%. By contrast, the shareholders of SCIs showed greater stability.

Obligation on currency-exchange bureaux licensed to process cross-border money transfers to notify their agents

CIs operating in Spain (and the currency-exchange bureaux licensed to process cross-border money transfers since early 2002) are also obliged to report to the BE their agents, i.e. the resident and non-resident individuals and corporations which they have authorised to operate habitually with their customers, in the name and on behalf of the principal, in the trading and execution of operations typical of their activity.

In turn, Spanish CIs must, with the same periodicity and criteria mentioned above, report to the BE the list of foreign CIs with which they have en-

Register of shareholders (number)												TABLE II.7
	Banks				Credit co-operatives				Specialised credit institutions			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
Individuals	270	209	166	141	222	218	200	137	51	45	37	37
Legal persons	606	547	521	499	216	204	217	199	172	154	144	144
Credit institutions	135	123	113	115	100	91	75	67	69	63	67	66
Other	471	424	408	384	116	113	142	132	103	91	77	78
MEMORANDUM ITEM:												
Spanish	649	554	483	440	435	421	416	335	201	179	162	161
Foreign	227	202	204	200	3	1	1	1	22	20	19	20

tered into agency agreements or agreements to provide financial services to customers (I).

CBE 6/2001 specifies the public nature of the information received on agents

With the entry into force on 1 January 2002 of CBE 6/2001 of 29 October 2001 on the owners of currency-exchange bureaux, owners authorised to process cross-border money transfers have notified the BE of the list of their agents for inclusion in a public register. The law regulating this activity requires that all agents hired shall be exclusive agents and that the powers granted be executed before a public authenticating official and entered in the Mercantile Register.

As at 31 December 2002, there were 3,169 agents in the register with powers to process money transfers, notified by 24 owners out of the total of 38 authorised to process cross-border money transfers.

As regards the agents of CIs and agreements entered into by them with foreign CIs for the regular provision of financial services to their customers, CBE 6/2002, which is due to enter into force in April 2003 to replace CBE 5/1995, seeks to establish a more precise definition of what, for reporting purposes, should be understood by "agent" and "agreement". It also seeks to make explicit the public nature of the information received, following the criterion laid down in the aforementioned CBE 6/2001, given the importance of this new channel for the provision of services and the interest in increasing the protection of customers, who should at all times be able to know if the agents serving them are authorised

Credit institutions' agreements as at 31 December				TABLE II.8
	Agreements			
	2000	2001	2002	
<b>TOTAL</b>	<b>551</b>	<b>465</b>	<b>544</b>	
Banks	160	160	169	
Savings banks	37	34	35	
Credit co-operatives	—	—	—	
Specialised credit institutions	354	269	337	
Branches of EU credit institutions	—	2	2	
Branches of non-EU credit institutions	—	—	1	

(I) Article 22 of Royal Decree (RD) 245/1995 of 14 July 1995, and CBE 5/1995 of 31 October 1995.

Register of articles of association (number)				TABLE II.9
	1999	2000	2001	2002
Amendments registered	204	328	290	275
Cases processed	56	42	39	57
BY TYPE OF INSTITUTION:				
Banks	26	21	13	14
Savings banks	—	—	—	—
Credit co-operatives	18	17	12	38
SCIs	8	4	6	5
MGCs	4	4	8	
PROCESSING CHANNEL:				
Reported to Directorate General of the Treasury and Financial Policy	45	40	36	44
Reported to regional governments	11	2	3	13

to do so. This supplements the publicity that these data already have in the annual report of the institutions, and the situation of credit institutions is brought more into line with that of securities-dealer companies and securities agencies, whose agents must be entered in the Mercantile Register.

Around 9,500 agents are registered

As at mid-March 2003, 85 CIs had about 9,500 agency agreements (see Table I.A.I in the annex to Chapter I) for the negotiation or execution of their transactions with customers. Of these, some 76% were accounted for by four banks.

Finally, as an auxiliary means of control for the BE in respect of the amendment of supervised institutions' articles of association (which are usually subject to authorisation by the Ministry of Economy, further to a report by the BE) (2) and, generally, as an additional supervisory instrument, the special register of articles of association is also kept by the BE, reflecting as they do employer/union pacts that are usually of significance from a prudential and operational perspective. This register was created further to the obligation for CIs and other supervised entities to report the successive amendments made to their public deed of incorporation.

Adaptation of articles of association to State and regional law

As regards the entries made in the special register of articles of association of supervised institutions, those corresponding to banks and to SCIs mostly refer to changes in the amount of share capital, its redenomination and other adaptations to legal provisions, as well as to amendments in the regulation of their boards of directors; and those corresponding to savings banks and credit co-operatives, to adaptations to State (general credit co-operatives law) and regional law.

### II.3.6. Eligibility of hybrid capital instruments as own funds in the solvency ratio

Included among the elements of capital eligible as own funds are some that, albeit to a lesser degree than ordinary capital, meet certain requirements, so that

(2) Banks, savings banks, credit co-operatives, SCIs and MGCs, although the licensing body varies (the related powers are the preserve of regional governments as far as savings banks and co-operatives within their sphere are concerned).

they partially resemble ordinary capital. These requirements are the capacity to offset losses, long-term or indefinite permanence in the institution and returns that depend, in certain cases, on the existence of sufficient profits. Such characteristics have led these elements to become known as hybrid capital instruments.

The instruments in question are subordinated debt, the main particularity of which is that, as regards the ranking of claims, it comes behind all common creditors, and preference shares, which are issued as a capital-like instrument by special-purpose entities that are subsidiaries of Spanish CIs, and which have fewer voting rights in exchange for certain dividend privileges.

There are no restrictions on the issuance of such instruments, although when they are in the form of a series of securities they are subject to the regulations of the securities market on which they are to be traded. The BE, however, must verify that these instruments meet the conditions envisaged in bank solvency rules as a requisite for their eligibility as own funds of the individual institution or of its consolidated group (3).

Most of these instruments are traded on organised markets. However, some issues are still often distributed to customers through institutions' branch networks. In this latter case in particular, the BE insists on the need for customers to be informed about the nature of such securities, which constitute venture capital in the true sense of the term. And, when the interest rates applied do not realistically reflect this fact, the BE warns issuers of the reputational risk they may be incurring.

In 2002, the amount of funds raised by the institutions through these instruments diminished, falling by 34% from the previous year (subordinated debt by 37.5% and preference shares by 18%). 56 debt issues were classified as eligible, most of which corresponded to savings banks. The latter continued to make numerous issues of subordinated debt, which were generally small in amount.

For the desirable purpose of enhancing the quality of own funds, the BE considers that capital and reserves must predominate in tier-I capital and, therefore, that preference shares should not account for more than 30% of such funds. Accordingly, the BE has been indicating to institutions with preference shares close to or exceeding this percentage, that it considers they should not make any new issues.

Most of these instruments have come to be demoninated in euro in recent years, and all of them were so denominated last year.

Offerings of preference shares to end-1998 were targeted almost exclusively at the US market. Their distribution on the Spanish market began in that period (under the trade name of *participaciones preferentes*), the point being reached where all issues of this nature were placed in Spain in 1999 and 2002.

(3) Article 8 of CBE 5/1993 of 23 March 1993 on the determination and monitoring of minimum own funds.

Reduction in the amount of funds raised through these instruments

TABLE II.10

Issuance of eligible instruments by Spanish credit institutions (€ millions)								
	1999		2000		2001		2002	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
<b>TOTAL</b>	<b>63</b>	<b>8,202.7</b>	<b>71</b>	<b>9,497.5</b>	<b>72</b>	<b>8,947.9</b>	<b>56</b>	<b>5,945.0</b>
<b>Subordinated Debt</b>	<b>52</b>	<b>2,552.7</b>	<b>65</b>	<b>5,771.8</b>	<b>60</b>	<b>7,178.8</b>	<b>50</b>	<b>4,487.0</b>
Traditional	32	2,500.1	48	5,721.0	58	6,853.6	50	4,487.0
Banks	9	801.7	18	4,403.2	22	4,287.3	12	1,720.0
Savings banks	13	1,591.2	17	1,175.5	17	2,382.6	29	2,737.0
Credit co-operatives	2	12.1	5	87.0	2	72.0	—	—
SCIs	8	95.1	8	55.2	17	111.7	9	30.0
Of which								
In pesetas/ECUs/euro	32	2,500.1	44	3,535.0	58	6,853.6	50	4,487.0
In US dollars	2	1,758.7	—	—	—	—	—	—
Of foreign subsidiaries	2	620.0	11	4,151.0	12	2,626.0	9	2,375.0
Loans	11	140.7	14	202.4	24	161.0	12	180.0
Undated	20	52.6	17	50.8	2	325.3	—	—
Banks	1	50.0	—	—	1	322.6	—	—
Credit co-operatives	19	2.6	15	1.7	0.0	—	—	—
SCIs	—	—	2	49.1	1	2.7	—	—
Of which: in pesetas/ECUs/euro	20	52.6	17	50.8	1	2.7	—	—
<b>Preference shares</b>	<b>11</b>	<b>5,650.0</b>	<b>6</b>	<b>3,725.7</b>	<b>12</b>	<b>1,769.1</b>	<b>6</b>	<b>1,458.0</b>
Banks	6	3,050.0	3	1,325.7	3	729.1	3	1,138.0
Savings banks	5	2,600.0	3	2,400.0	9	1,040.0	3	320.0
Of which:								
In US dollars	—	—	1	324.7	1	269.1	—	—
In pesetas/ECUs/euro	11	5,650.0	4	2,580.0	11	1,500.0	5	1,298.0

## II.4. BASIC FEATURES OF THE OWN FUNDS POLICIES OF CREDIT INSTITUTIONS

Rapid changes in the banking environment

Credit institutions, in the early years of the 21st century, are facing a series of profound and rapid changes in their technological environment, competitive situation, transparency requirements and in the external expectations regarding their actions.

Changes in the regulatory environment: New Basel Capital Accord

Significant changes have also been made to their regulatory environment. In fact, probably in no period in history have credit institutions had to adapt to so many new rules at once as they are having to now, and will have to in the coming months, as a consequence of the initiatives of the Basel Committee on Banking Supervision (the most influential forum of international supervisors). Spain has been a member of the BCBS, along with twelve other countries, for two years now and the governor of the Banco de España is due to take up the post of chairman in July. Similarly significant is the change arising from the EU's New Accounting Strategy, and the resulting adoption of the International Accounting Standards, which it will be compulsory for most credit institutions to apply to their consolidated accounts from 2005/2007 (see Box II.1).

The New Capital Accord (Basel II) sponsored by the Basel Committee is structured as follows:

- Pillar I: aims to bring the own funds requirements into line with necessary economic capital, by introducing calculation systems that are more sensitive to the actual risk assumed by institutions. This means that regulatory capital will be



determined in a way that more closely reflects the risk management techniques applied in practice.

- Pillar 2: aims to ensure that the emphasis on the risk profile of institutions is incorporated into the supervisory procedures of the various authorities, thereby recognising the progress made in recent years in supervisory methods, which are increasingly focused on risk.
- Pillar 3: aims to promote greater transparency on the part of institutions as regards the risks of their activity, so that the market can properly perform its disciplinary function.

An appropriate understanding of the purpose of Basel II should lead institutions to concentrate their efforts on improving the identification, measurement, administration and control of their risks, thereby enhancing their overall management, rather than merely modifying the exercise of calculating the consumption of own funds.

#### Importance of solvency ratio denominator

Basel II, as is well known, deals rigorously and in detail with the denominator of the solvency ratio, that is to say the weighted quantification of the risks assumed. It is natural, therefore, that the current discussions and proposals should be focused mainly on this issue. However, the other decisive element involved in assessing solvency, the numerator of the ratio, should not be forgotten. The following points are therefore devoted to an analysis of the basic features of credit institutions' own funds policies.

### II.4.1. The own funds policy: a crucial element in institutions' financial strategy

#### Strategic nature of own funds policy

In the financial strategy of any company, the own funds policy set by its most senior governing bodies plays an important role, as it has a direct bearing on the company's effective solvency situation and on its capacity to assume risks and undertake strategies to expand or develop its activities. In the case of credit institutions this policy is even more significant, on account of the variety and complexity of banking risks, the characteristic dynamism of the financial sector, the high leverage with which it operates and, especially, the fact that banking is a confidence-based business, and that such confidence is only attained and retained by effective, sound and prudent management. Accordingly a well-defined, well-established and well-communicated own funds policy, taking into account the characteristics of the sector, the business strategies and regulatory requirements, is closely linked to good governance and will effectively contribute to improving institutions' economic and financial situation, the strength of their balance sheets and their stability.

#### Essential elements of own funds policies

When defining their policies it is essential that institutions focus on the following four basic elements:

- One: the need to operate with a comfortable level of own funds for complying with legal requirements, carrying out their business strategies and to be able to take advantage of market opportunities.

### The application of international accounting standards

The adoption on 1 January 1999 of the euro as the single currency and the need to establish an internal market in financial services highlighted the need for progress towards a basic level of harmonisation in relation to European financial information. As the European accounting legislation in force did not provide a sufficient degree of comparability for firms with securities listed on European markets, it was considered necessary to adopt an approach which, given the increasing internationalisation of financial transactions, assures accurate financial information for investors, creditors and other users, with competitors being subject to the same conditions and rules.

The idea was favourably received and the European Parliament, on a proposal from the Commission, approved Regulation No 1606/2002. As a result, the consolidated accounts of companies with securities admitted to trading on a regulated market of any Member State shall be prepared, from 1 January 2005, in conformity with the international Accounting Standards (IAS) drawn up by the International Accounting Standards Board (IASB). The application of these standards within the EU is not automatic, however. In order to be adopted the international standards must comply with the basic requirement of Directives Four and Seven ensuring their usefulness to financial decision-taking, i.e. their application must give rise to a true and fair view of the company.

As regards annual accounts, and the consolidated accounts of groups without securities admitted to trading on regulated European markets, these shall continue to be subject to the national authorities, although the latter may permit or require application of the IAS adopted by the EU. In this case, in order to ensure that the IAS are applied consistently and to reduce the risk of divergent national accounting treatment, Spanish standards should be brought into line with the international ones, generally selecting the most appropriate options given the characteristics of the firms and the Spanish commercial environment and completing the accounting criteria with others not included therein.

The effect of introducing the IAS should not be underestimated and all European institutions required to adopt them will have to carry out a far-reaching reorganisation of their accounts preparation systems, all the more so in view of the fact that the transition period is very short; consolidated accounts for 2005 must include comparative data for 2004 compiled on the same basis. In the specific case of credit institutions, the impact may be considerable, given the characteristics of their main assets and liabilities. Indeed, both the current IAS 39 and the draft for its reform, relating to financial instruments, already point to a significant effect on such questions as application of fair value accounting to financial instruments (and the problems that arise when there is no reliable market price to refer to), the limitations on recognition of accounting hedges (in particular, macrohedges as opposed to instrument-by-instrument hedges), the rules on writing down financial assets and the recognition of the methodology for the creation of dynamic provisions. At the same time, the criteria for preparing consolidated accounts will be altered; it will not be possible to exclude from the consolidated group any institutions by reason of its activity, and the threshold for accounting by the equity method will change (from the current 3% to 20%), etc. Accordingly, credit institutions will have to carry out a programme of analysis and adaptation, in view of the profound impact that these issues may have not only on their balance sheets and profit and loss accounts, but also on information reporting requirements. All in all, in view of the limited time available, institutions should not wait for the proposals to become definitive before undertaking the necessary reorganisation and adaptation of their information systems.

Against this background, the BE considers the accounting regulations governing the public financial information on credit institutions to be a basic instrument for exercising the prudential supervision entrusted to it by law, as well as a mechanism to contribute to transparency and market discipline, a key element in the future prudential regulation of capital. For all these reasons, given the nature of the IAS as general principles, as well as the current gaps and those that may appear in future, and since accounting standards undoubtedly have an effect on the financial stability of institutions subject to prudential supervision (and, in consequence, on the country in which they operate), the BE will continue to play an active role in shaping the accounting regime applicable to credit institutions.

- *Two*: an appropriate composition of funds, to ensure their stability and quality.
- *Three*: an appropriate distribution of own funds across the group, reflecting the actual location of risks.
- *Four*: self-financing, to permit sustained growth of funds based on independent and stable sources. The capacity to generate own funds internally on an ongoing basis strengthens the institution's balance sheet and increases its possibilities of gaining access to markets to raise funds at a reasonable cost.

#### **II.4.2. Institutions should run their business with a comfortable level of own funds**

The own funds requirements established by prudential regulation are minimum levels

The first of the above elements is a quantitative one. Institutions should always run their business with a comfortable level of own funds. Solvency regulations establish minimum requirements and not a target. The latter shall be set, with the appropriate time horizon, basically taking into account the risk profile of the institution itself or its group, as well as the economic capital needs arising from the prudent management of such risks and from the orderly execution of business policies.

Role of the risk profile

When defining the own funds policy, the board of directors must particularly take into account the risk profile of the institution and its economic capital requirements on the assumption that risk is managed prudently. Operating with a sufficient buffer of own funds is desirable from the viewpoint of the individual institution, since it enables it to assess the opportunities offered by the market calmly and from a position of strength, and also from the viewpoint of the financial system as a whole, since it helps to enhance its stability and solvency.

#### **II.4.3. The composition of own funds as a solid basis for policies of sustained growth**

Quality of own funds

Attention must also be given to the quality of funds. Thus, internationally it is considered good practice for institutions to maintain an appropriate composition of own funds, to provide a solid base for their policies of sustained growth. The quality of the funds is a qualitative factor which has a significant bearing on an institution's effective solvency situation. This is recognised by the regulations themselves, which have established two categories of eligible own funds, classifying them as either tier 1 (core capital) or tier 2 (supplementary capital).

Differences between tier 1 and tier 2 funds

This distinction should be taken into account when defining policies for two reasons. First, tier 1 funds are of greater intrinsic quality and, second, tier 2 funds are legally limited by the amount of tier 1 funds. Consequently, the fact that institutions operate with high levels of tier 1 funds and with an available capacity of tier 2 funds should be considered very positive, not only because of the greater intrinsic quality of tier 1 funds, but also because they can draw on the second category of funds if the market situation or the situation of their own business makes this advisable.

Preference shares and their role in own funds

Also, the BE considers that preference shares, given their cost, lower degree of stability and lower market estimation, should not be used to finance strategies for sustained developments and that, under no circumstances, should they

account for more than 30% of all tier I funds. The issuance of preference shares, given the nature of this instrument, is more appropriate when the increase in own funds requirements can be absorbed over time, so avoiding the risk of structural reliance on this instrument by the institution.

#### **II.4.4. An appropriate distribution of own funds across the group helps to strengthen the individual solvency of the various components and, as a result, that of the group as a whole**

Role of own funds and their internal distribution

The third factor which should be incorporated into sound own funds policies is the appropriate distribution of such funds within the group. If the geographic and corporate location of the consolidated own funds reflects that of risk, the individual solvency of each component of the group is strengthened and, as result, so is that of the group as a whole.

In crisis situations, the possibility of transferring surplus own funds from one company to cover the risks of another is difficult and limited, especially when there are minority shareholders, geographic frontiers and differing national interests involved.

The adoption of balanced criteria for the distribution of own funds thus enables the various banks in the group to implement sound strategies of autonomy and financial independence, which strengthens the position of the consolidated group as a whole. These criteria should also consider the need for the group's parent company to be adequately capitalised on an individual basis.

#### **II.4.5. The definition of clear and prudent criteria for self-financing (the best quality funds) is an essential element of institutions' own funds policies**

Prudent self-financing criteria

Fourth, and last, there are advantages to be had from incorporating sound and prudent self-financing criteria into own funds policies.

Role of disclosed reserves

Disclosed reserves, arising from the capitalisation of profits, may be considered the source of own funds that most enhance the quality, independence and stability of the institution's balance sheet.

Their quality

Their quality derives from their permanence, their full availability to absorb losses, without being subject to the legal risks that sometimes affect other instruments, and the absence of any explicit cost for their use as a source of financing.

Their independence: the only category of eligible own funds depending solely on internal factors

Their independence derives from the fact that they are the only category of eligible own funds whose accumulation depends solely on internal factors, i.e. upon the good management of the institution (profits) and on the decisions of its governing bodies (distribution of profits). Accordingly, they help improve solvency without any exposure to the risks of possible adverse market situations (as regards liquidity or cost).

They facilitate market access

The recurrence of profits and a high level of capitalisation are factors that stabilise the growth of own funds and which should be promoted by the relevant

management bodies. The capacity to generate own funds internally in excess of the minimum regulatory requirements continuously and sustainably is not only a good indicator of the strength of the institution's balance sheet, but also helps to facilitate its access to the markets to obtain new funds at a reasonable cost.

#### Dividend policy

The decision whether to distribute a dividend, in the case of institutions with corporate status, or net profit, in that of other CIs, is the responsibility of the institutions' governing bodies. However it is advisable to maintain a sustained and consistent dividend, or surplus, distribution policy, on the premise that, by its nature, the amount set should not be based on the distribution made in the previous year or on other factors such as, for example, the performance of the stock market, etc, but on the current year's earnings and their recurrent nature. As a good rule of thumb, the portion of the profit for the year allocated to reserves should, on average, represent around half the published recurrent profit (recurrent profit attributed to the group in the case of consolidated groups). Decisions on the percentage dividend each year should not depart from this frame of reference, which should constitute the institution's policy, any departure therefrom being exceptional and compatible with growth strategies and risk assumption, avoiding sporadic and unsustainable remuneration, so that a return to the normal situation represented by the general policy is envisaged.

#### Transparency and dividend policy

It is important that the principle of transparency – the third pillar of Basel II – should also be applied to these policies. The necessary transparency is achieved through a clear and precise communication strategy, and also through systematic application of these policies over time, so that the market has confidence in their solidity and consistency. Shareholders must perceive the advantages for their investment of having a profit distribution policy based on moderation and stability. The directors must ensure that these policies are sufficiently well known and valued by the shareholders, potential investors and other interested parties.

### II.4.6. Conclusions

#### Conclusions

In sum, when defining their own funds policies, credit institutions should bear in mind the need to carry on their activity with a comfortable level of funds, with a predominance of higher quality funds, to have such funds where the risk is located and for the capitalisation of profits to make a continuous and steady contribution.

The application of an appropriate own funds policy is undoubtedly a strategic factor, but also a matter of good governance, which management bodies should promote at all times. That said, more important still, if that is possible, is knowing, identifying, measuring and controlling the risks of the business, a factor which it is intended shall be significantly boosted by Basel II.

## II.5. DEVELOPMENT OF THE RISK-BASED APPROACH TO BANKING SUPERVISION (S.A.B.E.R.)

#### Reasons for the risk-based approach to supervision

The risk-based approach to supervision continued to be developed in 2002. The reasons that led the BE to take this path remain fully valid today, and can be summarised under four headings:

## Definitions of risk included in the “SABER” methodology

TYPE OF RISK	DEFINITION
CREDIT RISK	Possibility of incurring losses arising from the failure of counterparties to perform their obligations under contracts executed with the institution
MARKET RISK	Possibility of incurring losses due to adverse movements in the market prices of negotiable financial instruments held by the institution
INTEREST-RATE RISK	Possibility of incurring losses due to the negative impact of interest rate changes on the institution's financial margins
FOREIGN-EXCHANGE RISK	Possibility of incurring losses due to adverse fluctuations in the exchange rates of currencies in which the assets, liabilities or off-balance-sheet transactions of the institution are denominated
LIQUIDITY RISK	Possibility of incurring losses due to not having liquid funds available to meet payment obligations
BUSINESS RISK	Possibility of incurring losses due to loss of the current position of the institution in the markets in which it operates
OPERATIONAL RISK	Possibility of incurring losses as a consequence of inadequate processes, systems, technical equipment and staff, or of failures in the aforesaid, as well as of external events
LEGAL RISK	Possibility of incurring losses arising from infringements of the law or from defectively defined contractual relations

- Risk factors are inherent in the business of banking.
- Reviewing the mechanisms to measure and control risk is an effective means of detecting potential problems in CIs early.
- The preventive measures proposed when weaknesses are detected in the risk-management process are more effective than corrective measures taken after the event.
- It is easier to improve the planning and management of supervision resources, adapting them to the situation of each institution, when risk is taken as the guiding principle.

Increasing use of internal risk management systems for regulatory purposes

Internationally, increasing use is being made for regulatory purposes of the internal systems used by the institutions themselves to measure, control and manage risk (e.g. to calculate the statistical fund or the level of own funds needed to cover market risk according to the Value at Risk methodology). As a result, what used to be a supervision strategy has become a necessary step to check regulatory compliance.

International extension of the methodology known in Spain as “SABER”

This working philosophy is shared, internationally, by the supervisors of the countries with the most developed banking systems, although important differences exist as regards its implementation, which arise from the supervision model adopted by each of them. In the BE this methodology is known as “SABER” (see definition of risks in Box II.2) and it is intended to act as a unifying element for the various phases of the supervisory process. These stages are: continuous monitor-

ing of the institution, planning and scope of supervisory activities, on-site inspection, and the proposal, where applicable, of corrective measures.

#### First steps

In an initial phase, the efforts of the BE to develop this methodology focused on the definition of a solid conceptual framework to enable the foundations of the system to be laid. Also, the key phases of the process were identified: quantification of the inherent risk, analysis of the control systems, assessment of the residual risk, analysis of solvency and determination of the supervision risk (see the 2001 Report), and the tools began to be developed to enable it to be efficiently implemented

#### Developments in 2002

Three areas of development stand out in 2002: the extension of use of the new methodology to all the various phases of supervisory plans and strategies, the development of quantitative indicators of inherent risk and last, but not least, the integration of corporate governance into the risk-based approach.

### II.5.1. Extension of the use of the new methodology

#### Risk matrix

The so-called risk matrix, which summarises by type of risk the various elements that make up the process of supervision based on the SABER approach, is a key part of this model (see Box II.3).

#### Planning and the risk matrix

In the planning phase, the risk matrix is the common language that enables institutions to be compared and priorities established in accordance with the supervision risk profile of each. The basic aim of the annual inspection plan is to devote more resources to and focus more attention on those institutions that display a comparatively high level of risk. The degree of detail of the matrix also enables the inspection objectives to be oriented towards the weaknesses of the institution. Thus, the reasons for the high level of the institution's supervision risk profile (e.g. weaknesses in credit risk controls) become the targets of the inspection. This means that both the selection of the institution to visit and the scope of the inspection are based on risk parameters.

#### Supervision cycle

The supervision process involves the continuous collection of relevant information on the situation of the institution. The new information is incorporated into the risk matrix, changing the profile of the institution from the supervisory viewpoint. In the planning phase, the starting point is the assessment obtained on the basis of the knowledge accumulated in previous supervision cycles. The conclusions of the inspection visit are a key moment in this feedback process, since direct, up-to-date and verified information is then available on the most significant aspects of the CI. Comparison of the initial risk matrix with the one prepared when the visit has been concluded should enable changes in the institution to be analysed, the strategy for its supervision to be redefined and any recommendations or corrective measures to be proposed.

### II.5.2. The development of quantitative indicators of inherent risk

#### Quantitative and qualitative aspects of risks

The risk management process has aspects of a qualitative and quantitative nature, both being relevant to the assessment of the inherent risk. The definition



### The risk matrix

The risk matrix is what the BE uses to summarise the process of determining the *Supervision risk profile*. Each box is given a value on a five-category scale: *very high, high, medium, low, very low*, for risks and solvency, and *deficient, improvable, acceptable, good and very good*, for controls and corporate governance. When this table is completed, the different areas of business into which the CI is organised will have been analysed already. In each area of business three elements are identified for each *type of risk*: *inherent risk, control and residual risk*. The *residual risk* is based on a subjective and reasoned opinion, considering both the magnitude of the risk and the quality of the control systems. The effect of the control systems and the inherent risk on the residual risk are very different. The controls reduce, but do not eliminate, the inherent risk, which is the component with the strongest bearing on the residual risk.

TYPE OF RISK	INHERENT RISK	CONTROL	RESIDUAL RISK
CREDIT			
MARKET			
BUSINESS			
LIQUIDITY			
INTEREST-RATE			
FOREIGN-EXCHANGE			
OPERATIONAL			
LEGAL			
THE INSTITUTION'S RISK PROFILE			
CROSS-SECTIONAL ASSESSMENT OF CORPORATE GOVERNANCE			
ASSESSMENT OF SOLVENCY			
SUPERVISION RISK PROFILE			

When the elements of the first part of the table have been assessed, the *Institution's Risk Profile* is obtained. The weight of each risk will differ according to the institution's type of business, so that it is necessary to weight the effect that each one has on the total risk. In the event that it is significant, an indication of the trend (*Increasing or Decreasing*) can be added to the assessment of the *Inherent risk*.

The adjective *cross-sectional* applied to the assessment of corporate governance, indicates that such assessment has already been included in other sections of the risk matrix. Owing to its importance, it is shown specifically in a special section, but this does not imply any double counting in the assessment of the supervision risk profile.

Solvency should reflect the risks assumed by the CIs; the greater the risk assumed the greater the cover that the own funds of the institution should provide. Dynamic aspects of solvency shall be assessed, including the capacity to generate future profits.

Finally, taking into account the *institution's risk profile*, its solvency and certain aspects of its corporate governance, the *supervision risk profile* is obtained. The inclusion of solvency in this assessment should not lead to a mistaken diagnosis of the situation of the institution. It is considered that, although a larger surplus of own funds gives the institution greater scope for reaction to address its risks or to strengthen its controls, good controls are no substitute for an adequate level of own funds, and vice versa. Thus, the solution to a deficient control system in a CI should not come from a strengthening of its capital, but from the adaptation of its control systems to the risks assumed.



of each of the eight risks contemplated in the SABER approach, explained in Box II.2 above, starts with the expression “possibility of incurring losses arising from ...” or some equivalent, and continues with the description of the risk factor that gives rise to these losses. This definition can be transferred to the numerical field, at least in theory, simply by indicating the size of the potential loss and its associated probability.

#### Methodological difficulties

The introduction of quantitative measures into this methodology involves certain difficulties which are illustrated by two extreme examples. On one hand, the abuse of algorithms and measures that, by mechanically applying certain pre-set rules, enable a conclusion to be reached on the risk profile of a CI would be to the detriment of the information that the inspector’s experience can contribute. On the other hand, this methodology is intended to introduce larger doses of reflection on the basic aspects that characterise the management of the risk. Moreover, the nature and complexity of the ultimate variable to be measured, the supervision risk profile, and the lack of sufficient statistical data in the CIs would greatly reduce the significance of the measures obtained. At the other extreme, the lack of quantitative measures, especially in this stage of the process, would eliminate the necessary references that enable the situation of institutions to be meaningfully classified in comparative terms, leading to excessive discretionality based on very subjective opinions.

It has been decided, in view of the above problems, to provide for each type of risk a number of indicators which, without claiming to measure it statistically, are directly related to the level of risk assumed. For example, in the case of the most significant risk of a CI – credit risk – the measures used are:

#### Measures of credit risk

- Sectoral concentration
- Borrower concentration
- Term of lending
- Consumption of own funds according to the amount and characteristics of lending
- Level of the statistical fund relative to the amount of lending
- Non-performing loans and cover rate

#### Levels of inherent risk

These measures are calculated for all CIs and the data arranged according to the level of each indicator. This means that when the inherent risk is graded on a five-category scale (*very high, high, medium, low and very low*), the relative position that such institution occupies in the system as a whole is known in advance.

#### Future developments

This line of work, which is still being pursued, will be enriched by the experience of the reviews performed during inspection visits, the work carried out by the specialist groups of the BE’s Directorate General of Banking Supervision and by the new information requirements, soon to enter into force, that will permit an improvement in the measurement and control of risk by the supervisor.

### II.5.3. Integration of corporate governance into the risk-based approach

#### Responsibility for good governance

Recognition that responsibility for the sound functioning of the CI rests with the company itself is the reason why BE supervision is paying increasing attention to good governance practices. This attention coincides with the growing interest in this area in national and international circles (in Spain, for example, the recent *Aldama* report), and with the active participation of supervisory authorities and international bodies concerned with banking supervision and financial stability in the current debate. It need only be recalled that in 1999 the Basel Committee on Banking Supervision published its report *Enhancing Corporate Governance for Banking Organisations* and that recently the Financial Stability Forum has requested the OECD to reconsider its *Principles of Corporate Governance*, also published in 1999, in view of recent events.

Good governance is naturally of interest to financial market participants. Indeed, a fair number of the recent initiatives in this area focus on promoting adequate investor protection. However, the application by firms of sound good governance criteria benefits not only the transparency and security of markets; its positive effects also extend to the field of management and administration.

In the case of credit institutions, the role of governance is even more important, owing to the complexity of banking risks, the dynamism of the sector, the high leverage with which it operates, the fact that banking business is based on confidence and the systemic importance of the sector.

The above reasons also explain why the application of appropriate good governance criteria is relevant to all credit institutions, irrespective of their legal status and of whether they issue securities. In fact, corporate governance affects the sound management of institutions, their reputation, their stability and their risk profile. Moreover, there is a class of creditors (depositors) whose interests merit special protection, since their savings are channelled through a specially regulated and supervised sector, i.e. the banking industry.

#### Special relevance of knowledge of the quality of governance of credit institutions

At the same time, and since the financial sector merits special regulation, the good governance criteria applied by the institutions should respect the spirit as well as the letter of such regulation. Accordingly, CIs should take as the yardstick for their behaviour the protection of savers through prudence, since that way they strengthen their own solvency. Finally, CIs should also bear in mind the special function performed by the financial system, which has social consequences and implications for the stability of the system itself.

Knowledge of the power structure in a CI is important for supervisors from several viewpoints. The approach taken by their review can be analysed from two angles:

#### Downward review

- Downward: from the board to senior management and the rest of the organisation.

#### Upward review

- Upward: from the board to persons with interests in the company, starting with its shareholders.

**Supervision strategy**

Both viewpoints are relevant to the establishment of a supervisory strategy, but they are reflected in different parts of the risk matrix. The first one is fundamental to the assessment of a CI's risk management system, since the latter rests on the board's definition of the risk-assumption policies and the mechanisms to ensure compliance therewith. This system is reviewed in each area of business and the goodness of the corporate governance is classified in accordance with the risk policies followed in practice, the degree of compliance with the guidelines issued by the governing bodies and the appropriateness of the controls established to monitor them. The assessment appears in the risk matrix in the inherent risk and controls columns.

**Components of upward assessment**

The upward viewpoint of corporate governance should assess aspects such as:

- The composition of the shareholders, the board of directors and the committees reporting thereto.
- The content of the articles of association.
- The training, experience and dedication of the directors.
- The rules for the functioning of the board of directors and its committees and their actual functioning, checking whether their minutes properly reflect the discussions and positions of their members.
- The attitude of the institution towards the supervisor, its transparency towards the markets and the role of other groups (customers, workers, etc.) with interests in the CI.

**Corporate governance, management of credit institutions and supervision risk profile**

These factors affect the management of the CI as a whole and are therefore the subject of a specific review, which supplements the examination of the various areas of business. They form part of the institutional profile of the CI and are assessed, either as part of the subjective aspects of solvency, or else within the *supervision risk profile*. For example, two CIs that are similar in terms of the risk assumed and objective solvency will have a different supervision risk profile if the shareholders in one of them have conflicting interests, while in the other they act in co-ordination with one another. Likewise, an institution that supplies relevant quality information to the market beyond the minimum required shall be assessed more favourably than another that does not act so transparently.

**Inclusion of corporate governance assessment in the risk matrix**

Given the importance of the assessment of corporate governance, a specific element has been included for evaluation in the SABER approach, to avoid its dilution among the different components of the risk matrix.

## **II.6. RISK-MODELLING TECHNIQUES: ANALYSIS AND APPLICATION FOR SUPERVISORY PURPOSES**

The BE has for many years set great store in its continuous supervision of institutions by the verification and evaluation of risk control and management. As mentioned above, the introduction of the SABER methodology makes the importance of this area explicit, owing to its role in determining the institutions' *risk profile*.

Traditional qualitative and quantitative requirements in relation to risk management

For some years now institutions have been developing and improving their own models to assess, manage and control risk. The latter includes overall risks affecting the whole balance sheet, such as interest-rate, liquidity and foreign-exchange risks; risks specific to operations, such as credit and market risk; and risks of a more general nature, such as operational risk. These are the types of risk that were discussed above when describing the SABER approach. Institutions have developed internal models, and will continue to do so in future, for their own management requirements, irrespective of the regulatory requirements that may exist from time to time in this area.

Until now, these requirements have referred mainly to qualitative aspects and have been of a general type, although they have given sufficient support to the supervisory function. The legislation has sought to underscore the significance of such requirements up to the point that one of the requirements to be able to engage in banking activity, according to Royal Decree 1245/1995 of 14 July 1995 on the formation of banks, cross-border activity and other issues relating to the legal regime for credit institutions, is to “have sound administrative and accounting procedures, as well as adequate internal control procedures to ensure sound and prudent management of the institution”.

Recently, a new direction has been observed in the prudential regulation of credit institutions, whereby the use of well-founded and verified internal risk management models has or will have effects both on the accounting valuation of assets and commitments subject to credit risk (calculation of provisions) and on the determination of the own funds needed to cover certain banking risks (credit, market and operational). This trend is embodied in three initiatives:

- Directive 93/6/EEC of 15.03.1993 on the capital adequacy of investments firms and credit institutions provided for the possibility of institutions’ using internal models to calculate the capital needed to cover market risk. Spanish institutions will be able to make use of this possibility very soon, when this directive is fully incorporated into Spanish law.
- CBE 9/1999 of 17 December 1999 regulated the so-called statistical fund, and provided that, in addition to the standard model, the institutions could also use calculation methods based on their own experience of default, provided that they form part of an appropriate system to measure and manage credit risk.
- The New Capital Accord (Basel II) provides, in relation to the so-called *Pillar I*, that institutions may even use their own internal advanced calculation methods to measure their own funds requirements, not only for market risk, as is currently envisaged, but also for credit risk (until now only the standard system could be used) and for operational risk (a type of risk that will be subject to capital requirements for the first time under the New Accord).

As mentioned above, the BE is aware of the importance of risk-management models in the organisation of institutions’ administration, and of their increasing use not only in management itself, but also for the purposes of valuing assets and calculating own funds. Accordingly, in 1996 it set up, within its Directorate General Banking Supervision, a specialised *Treasury and Models* group, which has been progressively assigned advanced technical resources and staff with the

appropriate financial/mathematical profile. Its purpose is to gain an in-depth knowledge of the systems used by institutions and their constant advances, so as to be able to establish appropriate inspection procedures and to facilitate their dissemination among the BE's supervisory staff.

### II.6.1. Market risk

Traditional qualitative and quantitative requirements in relation to risk management

The management and control of market risk by means of different sensitivity measures, *duration* or other techniques is being done by practically all institutions. Those with more active treasury departments have been using so-called value at risk (VaR) techniques for some years now. In fact, the institutions that use advanced models to manage this risk, while not a majority of those registered, account for about 90% of the system's market risk.

The BE has been analysing these models for some time, paying special attention to the integrity of the data used and to the design and results of so-called back testing and stress testing. In some institutions these internal models are already potentially suitable for acceptance by the BE for the purposes of determining the minimum own funds for market risk, when the incorporation of the aforementioned Directive 93/6/EEC into Spanish law has been completed.

Institutions with value at risk (VaR) models

Basel II is not going to entail any change in the methodology for calculating the minimum own funds for market risk. However, it will probably modify its scope of application, by widening the definition of *trading book*, bringing the regulatory definition more into line with that used by the institutions for management purposes.

### II.6.2. Credit risk

Models and credit risk

A large number of institutions have for some years now had internal credit risk models, based on rating or scoring systems, integrated into their management processes. More common are the scoring-type systems, which have traditionally been used to authorise or reject transactions. The larger institutions and, of course, internationally active ones have introduced, or are in the process of introducing, internal credit risk models into the main homogenous segments of their lending, with a view to their results being used in future to calculate own funds requirements. For this to be possible these models will have to comply with the Basel II requirements for foundation or advanced approach internal rating based (IRB) systems. The number of institutions either developing their own internal credit risk models or participating in joint projects to develop such models is difficult to estimate, but they account for around 70% of the lending of the Spanish financial system.

Scoring models

Internal rating based (IRB) models

The statistical fund

The BE has already attempted to promote the development by institutions of internal models for credit risk management, through CBE 9/1999 of 17 December 1999, which introduced the so-called statistical fund, with effect from July 2000.

This new provision for bad debts supplements the specific provision (for non-performing and other problem loans) and the general provision. The aim is to

ensure appropriate provisioning for latent losses on loans for which specific weaknesses have still not been identified. These are capital losses that cannot be attributed to individual borrowers, but which can be estimated overall by statistical methods.

#### Estimation of average annual losses

The calculations may be based on a standard system, whereby each of the six risk categories, defined in accordance with their objective characteristics, is assigned a percentage representing the average expected loss. However, it is also envisaged that institutions may estimate their provisions using methods of calculation based on their own experience of default and on the expected losses for homogenous risk categories. These methods of calculation must be part of an adequate system for measuring and managing credit risk, must use an historic database spanning a complete business cycle and must be verified by the BE.

The introduction of the statistical fund has three advantages:

- It provides incentives for the adoption of better credit risk management techniques, stimulating institutions to develop as soon as possible internal models that may be used for different purposes: management of credit risk, setting transaction prices, calculating provisions, calculating economic capital, introducing return on risk adjusted capital (RORAC) approaches and, in future, calculating minimum own funds requirements for credit risk (Basel II).
- It addresses a constant concern of international supervisors: that institutions should apply realistic and prudent accounting standards in their valuation of assets. The application of standards of this type increases confidence as to the quality of the assets in the balance sheet and thus the efficacy of rules to calculate own funds based on such valuations, thereby reconciling the objectives of good risk management and sound and prudent accounting practices.
- Finally, the statistical fund is counter-cyclical, since the provisioning requirements are conceived in relation to a complete cycle. This means that the rate of provisioning is adjusted to the stage of the cycle (simplifying, statistical fund provisioning is higher when provisioning to the specific provision is lower, and vice-versa).

The use of internal models to calculate statistical fund provisioning requires prior verification by the Banco de España, in accordance with CBE 9/1999 (referred to above). In order to specify the scope of the new provisions and the criteria to be used in the verification procedure, the Banco de España notified the institutions, by means of a letter dated 14 December 2000, of the quantitative and qualitative requirements that should be taken into account in the design and introduction of internal models. Notable among them are:

#### The role of senior management

- Responsibility for the choice of model is the institutions'.
- Senior management should actively participate in the review and approval of credit risk strategies and policies.

#### Separation of functions

- There should be an appropriate structure for the control of credit risk based on a correct separation of functions.

### Integration of management and control

- The system should be integrated into the general structure for the control of credit risk and be used, at least, in the transaction selection process.
- Procedures for granting loans and the measurement system should be adequately documented in manuals.
- Institutions should have appropriate data-processing and management information systems to identify, measure, control and monitor credit risk.
- Institutions shall have an internal audit report on the model, containing a positive opinion with regard to the coherence and integrity of the databases from which the information used in its design was drawn.

Provisioning to the statistical fund began in 2000. Two and a half years on an initial assessment can be made with regard to its efficacy and acceptance by institutions. First, its relative importance has been increasing: as at 31.12.2002 it accounted for 25% of all the provisions in the Spanish banking system (22% as at 31.12.2001). As for the role it may have had in boosting the introduction and improvement of credit-risk management systems, its influence seems to have been limited so far. However, as will be seen below, this statement may be qualified.

As at 31.12.2002 the BE had received nine formal applications for the authorisation of internal methods to calculate statistical provisions, with the following results:

- In five cases, its compliance having been verified, the model was approved by the BE. One of the authorisations has recently been revoked as the institution was found not to be using the approved method.
- In four cases the model is still under consideration.

There are basically three reasons why there have been relatively few applications:

First, in many cases the savings on provisions that may be generated by using internal calculation methods instead of the standard system may not be very significant since the BE, when setting the average expected loss percentages for the various categories of risk defined in the standard system, avoided making them very demanding, in view of the fact that the new fund was additional to and not a substitute for existing provisions. As a result, given the difficulty some institutions have had introducing an integral credit-risk management model, they have preferred to direct their efforts towards compliance with Basel II, for which they have a somewhat longer time horizon.

Second, although two and a half years have already elapsed since the entry into force of the new fund, as pointed out above, this is still a very limited time period in which to fine-tune all the mechanisms that an adequate credit risk management model requires. In fact, as at the aforementioned date of 31.12.2002, the BE was aware of twenty institutions, accounting for 50% of the system's credit risk, in which internal models were being developed. In most cases the intention was to apply to the BE for authorisation to use them to calculate statistical provisions. All this confirms a very broad interest on the part of institutions, not just the larger and in-



ternationally active ones, although their current degree of participation in specific projects depends on the priorities of each institution and the costs involved.

Third, the development of projects for the introduction of internal models for credit risk management that may be considered suitable by the BE for the purposes of calculating provisions and, in future, calculating own funds, is a very complex process in which, as was to be expected, institutions are encountering difficulties. Among these, the most significant, according to the evidence obtained by the *Treasury and Models* Group of the Directorate General Banking Supervision of the BE, are:

- The scoring and rating systems used by the institutions are not properly integrated into their risk management and, in some cases, are only used to supply information to risk analysts.
- There is a lack of sufficiently long data series, spanning a complete business cycle, for default and loss given default (LGD, the percentage of final loss to the institution, once default has occurred). Institutions usually have four to five years of data at most, which means that assumptions and estimations have to be made to have information on a complete cycle, with the consequent risk of loss of reliability.
- The LGD data are moreover, incomplete, since they do not incorporate all the costs and recoveries in relation to non-performing transactions.
- Some scoring systems introduced in the past have not been calibrated, i.e. the different scores are not correlated with the probability of default (PD).
- In certain homogeneous lending segments the base data on default are not sufficiently extensive to allow their statistical treatment. This makes it necessary to resort to links with external systems in order to be able to calculate PDs and LGD percentages. This is very frequent in the investment banking and promoters segments.
- Institutions have used different definitions of default, so that the available data must be homogenised in order to adjust them to the definition currently used (any payment obligation 90 days past due).

Non-homogeneous definitions

In sum, the development and introduction of internal models for the management of credit risk is a complicated process requiring the commitment of time and resources by institutions. Validation by the BE of such models is equally complex and time-consuming, as an initial superficial review is not sufficient. Involvement of the institutions in the validation process is essential, as they must propose suitable solutions to the deficiencies and problems that emerge. The significance of this process will be multiplied with the entry into force of the New Capital Accord (Basel II).

### II.6.3. Operational risk

Difficulties of modelling operational risk

Although institutions and supervisors have long been well aware of the existence and importance of operational risk, in recent years greater attention has



begun to be given to the need to design methods that enable it to be adequately measured and managed. This risk has usually been addressed using measures of a qualitative and management kind, but the recent original contribution has been the attempt to measure the exposure of institutions to this kind of risk, as well as the capital that needs to be assigned to it.

In fact, under the New Capital Accord (Basel II) operational risk will be included, together with the traditional types of market and credit risk, in the category of risks that need to be specifically covered by own funds. As in the case of market and credit risk, it is also envisaged that, along with the standard system for calculating capital, institutions may design their own internal models for the management of operational risk, which may be used to infer the amount of own funds necessary for this type of risk. However, this process is at an even earlier stage than in the case of other risks.

The design of internal models for the measurement and control of operational risk is still at the stage of consideration, analysis and progressive introduction by institutions, especially the larger ones, who are aware that no methodology has yet been unreservedly accepted internationally. The BE, within the process of continuous supervision of institutions, is currently concentrating on analysing and evaluating the systems that have begun to be introduced by the institutions or that are being developed by consultants for identifying, mitigating and controlling operational risk.

### III

## REGULATORY CHANGES IN PRUDENTIAL SUPERVISION



### III.1. NATIONAL PROVISIONS

#### III.1.1. Law 44/2002 of 22 November 2002 on financial system reform measures (1)

It amends the regulations not only on banking but also on securities and insurance

It would be advisable to set out the changes in prudential supervision starting with those laid down in this legislation, as it contains by far the most significant and far-reaching aspects for the Spanish financial system as a whole.

The considerably complex content of the Law affects all financial sectors (banking, securities and insurance). However, the following description will confine itself to the aspects therein deemed most significant in respect of the prudential supervision of credit institutions and other financial intermediaries overseen by the Banco de España.

##### III.1.1.1. Specific changes regarding credit institutions

###### *Savings banks*

Amends the basic State regime: representation of the different stakeholder sectors, duration of mandate, irrevocability of appointments, age limit

*Governing bodies:* Article 8 of the Law addresses a partial reform of Law 31/1985 of 2 August 1985 on the Basic Rules on the Governing Bodies of Savings Banks (LORCA by its Spanish name), accompanied by the related transitional arrangements. In this connection the following changes may be highlighted:

- With regard to the various groups participating in these Bodies (General Meeting, Board of Directors and Steering Committee), these are now set out as an open list, and the former fixed ownership interests are eliminated, provision being made for a system of thresholds whereunder general government representation (including the founding entity if its status is such) is limited to 50% of the voting rights on the aforementioned Bodies; the representation percentage for depositors shall vary from a minimum of 25% to a maximum of 50%, and that for employees from a minimum of 5% to a maximum of 15%.
- The term of office of Delegates and of Directors of the Board of Directors is extended from four to six years. Statutory re-election may be provided for, if so stipulated in the procedure for the application of the Law's rules; notwith-

(1) BOE (Official State Gazette) of 23 November 2002.

standing, Directors of the Board may not hold the post either continuously or intermittently for more than 12 years (formerly 8 years).

- The arrangements for the irrevocability of appointments of Delegates and Directors of the Board are reinforced, with effect for those appointed after 1 June 2003. The case whereby board membership status could be lost on losing in turn the representation by virtue of which appointment had come about has ceased to apply.
- Directors of the Board shall not be older than 70 years of age on taking up their post, although the procedure for the application of the Law's rules may provide otherwise.
- Measures are included providing for the possibility of establishing strategic agreements between savings banks, and greater clarity has been given to the competence-related arrangements for authorisation and the manner in which the composition of governing bodies is to be established in the event of mergers between savings banks domiciled in different Regional (Autonomous) Communities.
- As regards savings banks founded by the Catholic Church, it is foreseen they will be subject to the provisions laid down in the current memorandum and articles of association and, if they so wish, they may be subject to the control of the Ministry of Economy in certain institutional aspects (approval of memorandum and articles of association, regulations, budget for welfare projects).

Possibility of the Ministry of Economy controlling savings banks founded by the Catholic Church

The Law further provides for the necessary adaptation to the legislative precepts for savings banks laid down by the Regional (Autonomous) Governments. This adaptation has already been carried out in Catalonia by means of Article 77 of Catalonia Regional Government Law 31/2002 of 31 December 2002 on fiscal and administrative measures and on savings banks (2), which introduces additional changes to the legal regime governing savings banks in Catalonia. As regards changes pertaining to the Financial Law (44/2002), regional government regulations include the restriction on public-sector voting rights on the governing bodies; the limitation on the age of members of the Board and members of the Steering Committee to what is laid down in the memorandum and articles of association and, subsidiarily, to 70 years of age (although those affected by this may, temporarily, continue in their post to complete their current term of office), and the limitation of the maximum mandate of members of all governing bodies to four years (a stricter criterion than that contained in the LORCA, as it is not provided for that the memorandum and articles of association may establish another limit).

A non-voting equity instrument which is a potential means for increasing capital

*“Cuotas participativas” (non-voting equity units):* with a view to updating and improving the regulatory framework hitherto governing this instrument, Article 14 of the Law defines more accurately and fully the basic legal regime for non-voting equity units to be issued by savings banks, via the amendment of Article 7 of Law 13/1985 of 25 May 1985 on investment ratios, capital and reporting obligations of financial intermediaries.

(2) The amendment of specific precepts of Royal Legislative Decree 1/1994 of 6 April 1994, approving the Consolidation of Laws 15/1995 of 25 May 1995 and 13/1993 of 25 November 1993 on Catalanian Savings Banks.

This instrument is part of tier I funds (or core capital) for the purposes of the issuing savings bank's (or its consolidable group's) compliance with the solvency ratio, as it shares the same end-uses, and is proportionate to, the initial capital and reserves of the savings bank (inter alia, the offsetting of the institution's losses).

In addition, the maximum volume of units in circulation may not exceed 50% of the savings bank's capital (with a transitory period of two years as from the entry into force of the Law during which this ceiling is set at 25%).

The equity units are negotiable securities, in book-entry form, of indefinite term and, with no voting rights, they confer on their holders benefits solely of a financial nature, such as a variable remuneration via a share in the distribution of the freely disposable surplus (although this entitlement is subject to certain conditions if the savings bank has a shortfall in own funds); pre-emptive equity-unit subscription rights in the event of new issues; the obtaining of their realisable value in the event of a winding-up; and, in the case of a merger, the obtaining of market value should their assignment to the savings bank be sought.

Although the equity units will be listed on organised secondary markets, the maximum holding per person or economic group is restricted to 5% of the equity units outstanding.

### **Credit co-operatives**

Article 5 contains two measures affecting credit co-operatives, with distinct aims.

First, various amendments are made to Law 20/1990 of 19 December 1990 on the tax regime for co-operatives. Their aim is to allow these institutions to invest with greater flexibility in non-co-operative entities without thereby forgoing the tax benefits attributed to them under this Law. Until the reform, holdings exceeding 10% of the investee company, or 40% if said company engaged in auxiliary or accessory activities, required prior authorisation from the Ministry of Economy. For credit co-operatives, the Ministry would request a prior report from the Banco de España and, in practice, authorisation would not usually be denied except in extreme circumstances where the investment might jeopardise the solvency or stability of the acquirer. Henceforth, such authorisation will not be needed in those cases which, on the basis of experience, have been detected as most commonplace in the mercantile life of these entities: namely, when the holding is in auxiliary companies, or, if such auxiliaries are not involved, the holding does not exceed 25% of the investee's capital. In turn, although the overall ceiling for these holdings remains at 50% of the co-operatives' capital, the fact the reference now is to holdings in excess of 25% (as opposed to 10%) is indicative of the significant flexibility added in this area.

The Law also has a bearing on the flexibility of the regime governing subordinated debt issues by credit (and insurance) co-operatives subject to Law 27/1999 of 16 July 1999. It is clarified that, as opposed to the ordinary regime where under the decision to issue was the remit of the General Meeting, at the co-operatives in question the issuance decision may be taken by the Governing Council if so provided for in the memorandum and articles of association.

Fewer formalities for participating in other companies, and more flexible legal arrangements governing subordinated debt issues

### Operations of credit institutions

New instrument to mobilise institutions' portfolio of loans to the public sector

*"Cédulas territoriales"* (Territorial bonds). The creation of this new instrument is regulated in Article 14 of the Law and is intended to enable credit institutions, via the issuance of such liabilities, to refinance the loans and credit extended to the State, to Regional Governments, to Local Governments, and to the entities and bodies reporting to the latter, and to such similar agencies as may be operating in the European Economic Area.

In line with the arrangements for mortgage-backed bonds (for which the treatment in respect of the capital ratio and of the regulations governing collective investment institutions is the same), territorial bonds are fixed-income securities, in book-entry form, whose principal and interest are backed by the aforementioned credits, with holders enjoying priority in respect of collection rights in the event of the issuer facing insolvency proceedings.

It is stipulated that the total amount of these bonds issued by an institution shall not exceed 70% of its outstanding loans and credits to the above-mentioned general government tiers.

The special regime applicable to these agreements is extensive to their guarantees

*Contractual netting agreements.* Article 16 of the Law addresses in depth the special regime in place since 1998 that has been governing a large portion of the financial operations transacted under contractual netting agreements. This regime, which derives from the application of Community regulations, involves the recognition as a single debt of the resulting net balances of the aforementioned operations, even if one of the parties thereto is subject to insolvency proceedings. From the prudential standpoint, this regime amounts to a credit and counterparty risk mitigation mechanism, entailing a subsequent reduction in financial institutions' capital requirements.

So that the effects of this regime may be confined to where they are strictly necessary, the limitations already in force are retained in respect of the intervening parties (at least one shall be a credit institution or an investment services company) and of the content of the agreement (the mechanism for calculating the net balance shall be included). The changes introduced by the Law consist of its extension to guarantees bound up with the agreement and to financial operations relating to securities lending and repos (previously they would benefit only from the special treatment accorded to operations with derivatives and foreign exchange). The changes also provide greater flexibility as regards the formal requirements the agreement must meet so it may be effective vis-à-vis third parties (private legalisation of the agreement suffices, as does the actual transfer of the securities and the delivery or transfer of the cash).

Greater legal security for factoring operations relating to rights against the public sector

*Assignment of collection rights against the public sector.* As a means of making it easier for companies to raise financing via factoring and of reinforcing the legal security of these operations, Article 17 of the Law amends the regulations on general government contracts. First, it clarifies the possibility of making second and successive assignments of contractors' claims on general government. And further, it protects assignment activity and, consequently, the normal enforceability of such loans, from potentially becoming null and void as a result of the insolvency of the assigning contractor and back-dating of said event, provided that the assignment were made in conformity with the requirements stipulated in this connection.

Mortgage participation certificates:  
participations in loans not complying with mortgage market regulations

*Mortgage participation certificates:* to allow for readier mobilisation of institutions' mortgage portfolios, the possibility of mortgage participations grouped in asset securitisation funds corresponding to loans not fulfilling mortgage market regulations is confirmed. A specific trade name ("mortgage participation certificates") is given to these instruments so they may be distinguished from other participations of greater credit quality (article 18).

Restriction of electronic money issuing activity to credit institutions

*Issue of electronic money:* article 21 of the Law, drawing on Community regulations on the issue of this instrument and the parties authorised to this end (see further details on this matter), includes as one of the activities whose exercise is confined to credit institutions (among which electronic money entities are now also included) that involving the issue of means of payment in the form of electronic money.

Electronic money is understood as monetary value represented by a claim on the issuer, stored on an electronic device, which is issued on receipt of funds of an amount not less in value than the monetary value issued and is accepted as a means of payment by undertakings other than the issuer. Among other products conforming to this definition is what is commonly known as the "electronic purse" or pre-paid cards.

Completing the legal regulations on this instrument is the introduction of an across-the-board rule applicable to all electronic money issuers. This rule, in line with Community stipulations, provides for the obligatory redeemability of funds advanced to the issuer on the request of the bearer of the instrument, in cash or by transfer to an account, with no expenses other than those strictly needed to conduct the transaction. It is further provided that the receipt of funds in the form of electronic money will have the same coverage as deposits for the purposes of coverage by the Deposit Guarantee Funds if the device into which the funds are incorporated is non-transferable or linked to an account representing a deposit set up by the holder.

### ***Transparency of operations and protection of bank customers***

Commissioners created for the protection of financial services customers

The Law (articles 22 et seq.) provides for the creation of new bodies to oversee and safeguard the interests of financial services users: the commissioners for the protection of financial services customers (respectively, for the protection of banking services customers, of investors, of insurance policy holders and of pension scheme participants). Acting on an independent and autonomous basis, their function will be to attend to complaints and claims by customers, and to advise users of financial services as to their rights in respect of transparency and protection.

The commissioners, whose mandate will be for five years, shall be appointed by the Ministry of Economy, once the opinion of the respective supervisory authorities (the Banco de España in the case of the commissioner for the protection of banking services customers) has been heard. In turn, it is established that the respective complaints services or equivalent administrative units in place at present within the supervisory authorities' organisations, and which have been entrusted to date with functions of a similar scope to those attributed to the new bodies, shall be organically assigned to said new bodies.



The obligatory presence at financial institutions of a customer care service or department is also envisaged (most of the system's credit institutions have already voluntarily set in place such a department). The possibility of creating a customer ombudsman, on an individual or group basis, is likewise provided for. Ombudsman decisions, if favourable to customers, would be binding on the institution. The processing of complaints to the respective commissioner is conditional upon their prior submission to the above-mentioned services or Ombudsman (if any).

Rounding arrangements are established for secured variable interest rate loan transactions

In this same consumer-protection regulatory framework, the Law empowers the Ministry of Economy to regulate the specialised segments of electronic trading in investment and banking services (article 20). It further provides for specific arrangements for rounding in loans and credits backed by mortgages, sureties, pledges or other equivalent guarantees executed at a variable interest rate. If such rounding is agreed, it must be to the limit of the closest interval, without this exceeding one-eighth of a point (twelfth additional provision).

### ***Penalties applicable to credit institutions***

The Law also addresses the updating and streamlining of penalties (3), amending to this end Law 26/1988 of 29 July 1988 on the disciplining and intervention of credit institutions (LDI by its Spanish abbreviation).

New infringements defined

First, and regarding infringements, the main aim of the changes introduced is to include, with sufficient clarity and legal soundness, the possibility of correcting certain shortcomings in respect of compliance with substantive obligations already foreseen in the law by means of the application of the corresponding disciplinary measures. Thus, and in addition to providing for some minor technical improvements, certain punishable actions are expressly defined, including most notably those relating to organisation or internal control shortcomings; the transfer or reduction of a significant shareholding without adhering to the arrangements envisaged to this end in the LDI; the de facto administration or management of institutions by persons not entitled de jure to perform such duties; and others pertaining to the new legal regulation of the Central Credit Register, which will be discussed elsewhere in this Report.

Updating of amounts of penalties

Further, the regime for penalties is also updated. Among other measures, the amounts of fines are raised tenfold to correct how evidently out of date figures set 14 years back have become; aspects such as the possibility of imposing several penalties for a single infringement or of penalising administrators without having to penalise the institution are clarified and improved; and, in the case of very serious infringements, a public reprimand to be published in the Official State Gazette is included as one of the penalties applicable.

### ***Central Credit Register***

A legal regime is established in a single regulation enacted as a law

Chapter V of the Law (articles 59 to 69) is dedicated in full to the regulation of the Banco de España Central Credit Register (CCR). Although the new provisions do not generally imply any break with the current operating regime of the CCR, they are a substantive improvement on the regulatory framework ap-

(3) Articles 35 (1), 43, 69 and seventeenth additional provision of Law 44/2002.

plicable to date (4). This is because they cover, in the form of a consistent set of rules of an appropriate range, all the relevant aspects of the CCR's legal regime, combining the important public interests the CCR serves with the protection of the data of those concerned, particularly of individuals.

Public service, in which a balance is struck between the general interests it serves and the protection of personal data

The CCR is conceived as a public service. Its mission is to obtain data and information from reporting institutions (generally credit institutions and other regulated entities) on credit risks. This is done to meet specific ends, all related to the public interest of promoting a sound and solvent credit system. That includes providing reporting institutions with the information they need to engage in their activity (giving them an instrument for the proper evaluation of the risks they incur), and allowing the authorities properly to exercise their powers, especially as far as the prudential supervision of credit institutions is concerned.

It is this public vocation which underlies the provision made by the legal text for the absence of any right of the party concerned to oppose the treatment of the data; the absence of any need for consent from the data-holder for the mandatory communication of such data by institutions to the CCR (without prejudice to the fact that they should inform data-holders accordingly); the universalisation of reportable risks, including – along with standard loan transactions – other legal business that may prompt losses at the institution; or the inclusion among the reportable data of situations of non-compliance with obligations. In turn, the necessary protection of individuals' privacy underpins other provisions in the text, such as those by means of which access to individuals' data by institutions is conditional upon the existence of a legitimate interest, in accordance with the conditions expressly provided for in the legal text; the procedures to ensure that the data are sufficiently updated and to guarantee their accuracy; the shorter period over which individuals' data may be retained, and during which they may be transferred to the reporting institutions, or the impossibility of transferring to institutions data relating to non-compliance that are not attributable to objective circumstances. Further, the protection to which individuals' data are subject is lessened in part if said individuals are sole proprietors or fee-earning professionals pursuing their business activity, since the nature of their activity (which is closer to that of legal persons engaged in business operations) requires less protection of privacy than that of individuals.

Along the broad lines indicated above, the CCR acts as a derivative register in that it only reflects the information periodically provided by the reporting institutions. The data broadly comprise those necessary to identify persons with which the institutions hold credit risks, and the characteristics thereof, without in any circumstances including specially protected data (race, religion, etc.).

Access to reported data differs according to the intended end-use, and to the nature of the agent to which the data relate

As to access to the reported data, and apart from the fact that they will be available to the Spanish Data Protection Agency so that it may perform its functions, the following has been envisaged.

First, institutions may obtain reports on the exposures of natural and legal persons registered in the CCR, provided that such persons represent some form

(4) Article 16 of Decree-Law 18/1962 of 7 June 1962 on the nationalisation and reorganisation of the Banco de España, and Banco de España Circular 3/1995 of 25 September 1995 (this latter regulation will remain in force, insofar as it does not run counter to the Law, until the implementing provisions foreseen in the law are rendered).

of exposure to the institution, that they have applied to enter into some risk-based transaction with the institution (in which case the institutions must inform the person concerned that they will be consulting the risk) or that they feature as bound to pay or as guarantors in bills of exchange or credit instruments held by the institution. The information it is wished to obtain on natural persons other than sole proprietors or fee-earning professionals is restricted to the five years prior to the date on which it is requested. Further, these reports shall omit the name of the institutions with which the parties concerned have incurred the exposures and, regarding data that reflect some adverse criterion, only those relating to actual non-compliance of obligations or bankruptcy situations shall be included. The information obtained from the CCR by institutions should be treated with due confidentiality, and its use and transfer to other institutions in the group restricted to aspects relating to the extension and management of credit or to compliance with prudential supervision regulations, with the data on natural persons having to be cancelled once they have ceased to be pertinent in this connection.

The data reported to the CCR shall be reserved for the Banco de España and they shall be subject, like the rest of the information in their hands in the exercise of the functions legally attributed to them, to the professional secrecy arrangements envisaged to this end (5). Provision is made for the possible transfer of the data, under reciprocal arrangements, to foreign public agencies or entities performing similar functions to those of the CCR; however, if such agencies or entities do not belong to a European Union Member State, they may not provide data on natural persons that are not sole proprietors or on fee-earning professionals.

The data recorded in the CCR shall, generally, be maintained for ten years. That said, they may be maintained indefinitely, in such a way that the party concerned cannot be identified, depending on their historical, statistical or scientific value. Nonetheless, this general rule should be mixed with two others. First, regarding legal persons, data may also be maintained indefinitely, although access to data over ten years old is restricted to such access being made in the exercise of institutions' prudential supervision powers or as part of other legal functions of the BE (6). Second, the reporting institutions, as indicated earlier, cannot gain access to data older than five years on legal persons; accordingly, use and access in this case is restricted to exercise of the aforementioned public functions. Further, the Law contains a detailed and rigorous system of safeguards for the borrowers to whom the reported data pertain, envisaging various possible cases: data access, rectification and potential cancellation, and suspension of data transfer if the appropriate procedures and claims are substantiated.

Following a reminder of the sanctioning powers of the Data Protection Agency, the legal text adds further forms of conduct relating to the CCR that are punishable in the sanctioning regime applicable to credit institutions in the LDI. These expressly define the failure to comply with the duty of confidentiality in re-

(5) Article 6 of Royal Legislative Decree 1298/1986 of 28 June 1986 on the adaptation of legislation on credit institutions to EU law.

(6) In accordance with the amendment of article 64 (1) of Law 44/2002 of 22 November 2002, implemented via the twelfth additional provision of Law 53/2002 of 30 December 2002 on fiscal, administrative and social measures.

spect of the data received from the CCR, their use for unauthorised ends or the request for information outside the legally permitted bounds as a serious or very serious infringement (according to the circumstances).

New infringements defined for non-compliance with obligations, particularly regarding the use of the CCR by reporting institutions

Finally, the possibility is foreseen in the future of private institutions tendering to provide the information service rendered by the CCR on the capital solvency of households and firms. Such activity shall be in conformity, in any event, with the regulations applicable to the protection of personal data.

### ***Electronic money institutions***

New type of financial institution with credit institution-like articles of association

As indicated above, article 21 of the Law addresses the first phase of the transposition to Spanish law of European Parliament and Council Directives 2000/28/EC and 2000/46/EC, both dated 18 September 2000, on electronic money institutions and on electronic money. The legal regulation of this area (which has to be completed by the related implementing regulations) foresees the creation of a new type of financial figure, namely electronic money issuing institutions, which will be considered as credit institutions and whose main activity will consist of the issuance of means of payment in the form of electronic money, an instrument described elsewhere in this Report. Such institutions will be acknowledged as operators with a Community passport in other European Union Member States.

Admittedly, the requirements for the creation and activity of the new type of institution will be detailed in the regulations implementing the Law. But necessary prior authorisation is stipulated here for access to the activity (to be granted by the Ministry of Economy following a report by the Banco de España), as is subjection to the monitoring and examination of the Spanish central bank and the application, with the adaptations so determined, of the sanctioning regime for credit institutions.

Using the possibilities granted to Member States by Community regulations, the legal text now states that when the electronic money issued by an institution circulates solely among companies of the group it belongs to, it may be exempt from specific periodic reporting obligations. Institutions that have obtained an exception, in Spain or in another European Union country, will not be entitled to the Community passport.

### ***III.1.1.2. Changes affecting other entities supervised by the Banco de España***

#### ***Currency-exchange bureaux***

Tighter requirements for setting up and operating bureaux authorised to conduct cross-border transfers

Article 36 of the Law reforms the legal regime applicable to currency-exchange bureaux, to update that currently in force (7) in the light of the experience and practice of supervision in recent years.

As regards the bureaux that conduct the broadest range of transactions (those authorised to conduct cross-border transfers) – these being the ones

(7) Article 178 of Law 13/1996 of 30 December 1996 on fiscal, administrative and social measures.

whose activity is of most significance for our financial system – the requirements for taking up and pursuing their business have been tightened, bringing them more into line with those established for other supervised financial institutions. Accordingly, from the viewpoint of prudential supervision, first, the checking of the suitability of the shareholders is incorporated into the initial conditions that must be satisfied to obtain authorisation, and second, the possibility is envisaged of stricter operating conditions being laid down by the government in the relevant regulations, including controls over shareholder changes, minimum capital and own funds requirements and other appropriate measures to strengthen their solvency and liquidity. As regards the prevention of money laundering, the Ministry of Economy was authorised to establish certain conditions in relation to the operations of this type of bureaux (upper limits to the amounts of transactions, information requirements and forms relating to the customers involved in their transactions, etc.), to ensure better compliance with their obligations in this area. Finally, compulsory annual auditing of the accounts of these bureaux is provided for.

Consumer authorities have sole responsibility for ensuring transparency and customer protection in the case of bureaux authorised only to purchase currency

A second change made by the Law is to place the powers of supervision and oversight of transparency and customer protection in relation to bureaux authorised to conduct purchase transactions only, with the authorities responsible for the protection of consumers and users. The rationale for this change is that, since the aforementioned business is carried out basically by non-specialist entities as a complement to some other principal business (hotels, travel agencies, car hire companies, etc.), the supervision and oversight of these areas can be carried out more rapidly, closely and flexibly by these authorities. This change is without prejudice to the BE's powers of supervision and oversight in relation to the requirements to obtain and maintain authorisation, as well as to conduct proceedings and impose sanctions.

Measures to protect against unauthorised operators

Finally, the possibility is expressly provided for, by reference to the regulations applicable to credit institutions, of sanctioning persons who infringe the rules restricting access to the currency-exchange business provided for in the Law.

### III.1.1.3. *Other matters*

Supervisors given possibility of gaining access to auditor's working papers

- The Law envisages the possibility, as a further instrument of prudential supervision, that the BE and other authorities (the CNMV and Directorate General of the Treasury) may, in the exercise of their powers over the entities they supervise, have access to audit documentation (including the auditor's working papers). This possibility only applies in particularly serious cases, when they have been unable to obtain the specific information sought directly from the entities themselves (article 53, one) (8).

(8) As regards the provision of services by auditors to regional governments, article 98 of Law 53/2002 of 30 December 2002 has introduced a fifteenth additional provision into Law 26/1988 of 29 July 1988 (LDI) prohibiting auditors who provide services to the competent bodies of regional governments and agencies or entities reporting to them, in relation to the exercise of their powers over savings banks and other entities, from performing, simultaneously or during the five previous or five subsequent years, any audit work for such savings banks or other entities.

Supervisors' internal control bodies; annual report on supervision; and co-operation among authorities

- To improve the efficiency, effectiveness and quality of supervision procedures, the second final provision of the law provides that the BE and the CNMV (among other institutions) shall have internal control bodies whose hierarchical relationships and reporting powers shall be governed by the principles of impartiality, objectivity and avoidance of conflicts of interest.

A report on the supervisory functions of these institutions shall be prepared annually, for submission to Parliament and the Government, and shall include a report of the relevant internal control bodies. This publication satisfies this requirement. Indeed, the BE anticipated these provisions when it published the first edition of this report last year.

Finally, it should be noted that the authorities charged with prudential supervision have a duty to co-operate with one another, in accordance with the general principle of co-operation between general government bodies. They may enter into specific agreements for the purpose of establishing regular information exchanges, standardising their specific procedures and practices and, where applicable, designing instruments that enable the above-mentioned objectives to be monitored.

Banks' duty to keep customer data confidential

- The seventeenth additional provision of the Law expressly describes the duty of credit institutions and other persons subject to the same disciplinary rules to keep information on their customers confidential. The only exceptions to this duty of confidentiality are for data which the customer or the law allows to be revealed, data that are requested by or should be transmitted to the supervisory authorities and data exchanged between credit institutions belonging to the same consolidated group. Although this duty is not new to our legal system (being derived from the area of protection of the right to privacy and professional secrecy, with extensive support in case law) its infringement is now considered a very serious offence and sanctioned in accordance with the disciplinary rules applicable to such entities

### III.1.2. Contributions to deposit guarantee funds

Changes in the percentage of annual contributions and in the technical base for their calculation

Contributions to the Savings Bank Deposit Guarantee Fund, which had been suspended since 1996, were set by Order ECO 136/2002 of 24 January 2002 (9) at 0.04% of deposits as at December 2002.

Orders ECO 316/2002, 317/2002 and 318/2002 (10) establish that:

1. In accordance with the provisions of Royal Decree 948/2001 of 3 August 2001 on investor compensation schemes (see page 147 of the Report on Banking Supervision in Spain 2001), the base for calculating the contributions shall be made up of both the deposits and the securities guaranteed, the latter being weighted by their conversion value.
2. The volume of contributions for savings banks according to the Order discussed in the previous paragraph (now calculated using the new base) is held

(9) BOE of 30 January 2002.

(10) All in the BOE. of 14 February 2002.



unchanged, as is the level set for credit co-operatives (0.1%), while that for banks is set at 0.06% (previously 0.1%).

### III.1.3. Accounting and regular reporting of information

#### *Circular of the Banco de España 4/2002 of 25 June 2002* (11)

New information  
required by the  
European Central Bank

In order to obtain the information required by the European Central Bank (12), this Circular requires credit institutions to report to the Banco de España, on a monthly basis, new statistical information on interest rates applied to deposits and loans vis-à-vis households and non-financial corporations, distinguishing between that relating to outstanding amounts and that on new business. However, in order to minimise the cost of obtaining such data, it has been decided to make use of the possibility established in the Regulation of requesting this information only from a sample of institutions whose data are considered representative of those of the population. Accordingly, these new obligations shall only apply to Spanish institutions and the branches of EU institutions whose turnover in Spain of deposits and loans vis-à-vis households and non-financial corporations resident in Spain or in the EU is greater than or equal to € 500 million.

#### *Circular of the Banco de España 5/2002 of 24 September 2002* (13)

Also in relation to the information to be reported to the European Central Bank (14), the above Circular (which amends Circular 4/1991 of 14 June 1991 on accounting and financial statement formats) introduces, as its major changes, a requirement for monthly (instead of quarterly) information and also a requirement for more information on the rest of the world sector and other sectors of the euro area countries.

At the same time, the opportunity provided by this piece of legislation was taken, inter alia, to require a new statement from credit institutions, with greater details of the fixed-income and equity securities deposited by third parties, to unify the way in which the equity portfolios of individual entities and of the economic group are reported and to require, as a general rule, electronic transmission of the various confidential statements.

## III.2. COMMUNITY PROVISIONS

### III.2.1. Financial conglomerates

Text agreed during the  
six-month Spanish  
presidency

The most significant change at the European level in the prudential supervision of financial institutions was the approval in 2002 of Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplemen-

(11) BOE of 2 July 2002.

(12) Regulation (EC) No 63/2002 of the ECB of 20 December 2001 concerning statistics on interest rates applied by monetary financial institutions to deposits and loans vis-à-vis households and non-financial corporations.

(13) BOE of 4 October 2002.

(14) Regulation (EC) No 2423/2001 of the ECB of 22 November 2001 concerning the consolidated balance sheet of the monetary financial institutions sector.

tary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending other sectoral directives (15). It should be pointed out that the finally approved version of the text of this directive coincides, save for translation improvements and slight technical corrections, with the one prepared during the Spanish presidency of the first half of 2002 on which broad consensus was reached in the Council Working Group on Economic Questions (16).

Objective:  
supplementary  
supervision of  
multi-sector financial  
groups

The main objective of the Directive is to subject financial groups that include credit institutions, investment firms and insurance and reinsurance undertakings authorised in the European Union, to supplementary supervision, without prejudice to the traditional supervision at the sectoral level.

As regards the conceptual definition of a financial conglomerate (FC), in addition to the specifications to identify the regulated and non-regulated categories of entities that may make up the group, the Directive defines as such those groups whose financial activity represents more than 40% of their total business, provided that the smallest financial sector (banking and investment services, taken together, or insurance) represents more than 10% of overall financial activity, or has a balance sheet total exceeding € 6 billion. In this latter case, when the 10% threshold is not satisfied, the group may be excluded from supplementary supervision in the event of common agreement by the relevant competent authorities.

The scope of the supplementary supervision of FCs covers:

Conglomerates'  
adjusted solvency  
calculated

a) The calculation of their adjusted solvency, it being provided in general terms that the adjusted own funds of FCs must be at least equal to the sum of the solvency requirements of each of the financial sectors of the group, calculated in accordance with one of the various methods of calculation set out in Annex I of the Directive, which shall be selected in accordance with the criteria laid down for the purpose.

Supervision of risk  
concentration and  
intra-group transactions

b) The supervision of transactions entailing risk concentration for the conglomerate vis-à-vis third parties (based on the minimum amounts set for the purpose), as well as of significant intra-group transactions between the firms of the conglomerate or with respect to the natural or legal persons with which they have close links. As regards the latter, it is provided in the alternative that persons having more than 5% of the own funds of the FC shall be considered to have close links, as well as the possibility of the Member States being able to establish quantitative or qualitative limits.

Adequate risk  
management and internal  
control mechanisms

c) The obligation on regulated entities to have in place, at the level of the FC, adequate risk management processes and internal control mechanisms, with at least the scope specified in the Directive.

The co-ordinator is  
responsible for  
prudential supervision

As regards exercise of the new supplementary supervision, the Directive establishes that, for FCs in which there are entities regulated in more than one Member State, a co-ordinator shall be appointed on the basis of specific criteria,

(15) OJ L 35, of 11 February 2003. The sectoral directives it amends are: Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

(16) ECOFIN of 7 May 2002.



which essentially assign this role to the authority competent to supervise the group's parent undertaking or, in the absence thereof, to the authority with competence to supervise its most important financial institution. Notwithstanding the foregoing, the possibility is provided for some other co-ordinator being appointed by agreement between the competent authorities involved.

#### Functions of the co-ordinator and of the other authorities affected

The co-ordinator is assigned three types of task:

1. Assessment of the FC's financial and solvency situation, as well as of its structure and internal controls.
2. The taking of certain technical decisions necessary for application of the new prudential requirements.
3. Certain instrumental functions, such as the distribution of information among the competent authorities and the channelling of communication with the FC.

The most important of the technical tasks mentioned shall be carried out after consultation with the group's other relevant competent authorities (those, if different from the co-ordinator, responsible for supervising the sectoral groups included in the FC, as well as those, appointed by the latter, responsible for significant individual entities within the FC). By contrast, the adoption of measures to enforce the directive, e.g. those whose object is to correct possible deficiencies in compliance therewith, is generally assigned to the relevant competent authorities. To complement the above distribution of functions, the Directive provides, in greater detail than in those of a sectoral nature, a very precise system of co-operation and information exchange.

#### Rules for conglomerates with parent undertaking outside the EU

The Directive, within the scope of the supplementary supervision of FCs, finishes with the rules applicable to those whose parent undertaking is outside the Community. In this case it must be verified whether the supplementary supervision applicable in the third country in question is equivalent to that provided for by the Directive. Only in the absence of equivalent supervision shall the provisions of the Directive be applied to the European entities of the FC, the possibility being provided for of requiring a holding company to be set up, with its head office in the Community, as the parent undertaking of these entities.

Finally, a procedure is included to enable the Commission, assisted by the Member States, to adapt certain technical aspects of the Directive to market developments and to encourage its uniform application.

#### Amendments to sectoral directives

Notable, owing to its importance, among the amendments to the sectoral directives (banking, investment services and insurance), which are also included in this Directive, is that which aims to avoid the double counting of own funds arising from cross-sectoral cross-holdings in individual entities or groups not considered to be FCs. For this purpose, the Directive provides for the deduction from eligible own funds of those relating to the holdings that credit institutions and investment services companies have in insurance or reinsurance undertakings that exceed 20% of the investee (banking and investment services cross-sectoral holdings are already deducted), and vice versa in relation to the solvency margin of insurance undertakings. As an alternative to this deduction, Member States may authorise the application, *mutatis mutandi*, of the calculation methods included in

Annex I of the Directive. Certain provisions parallel to those described above are also incorporated into the sectoral Directives, such as that requiring verification of the equivalence of sectoral supervision in the case of groups with parent undertakings outside the Community and that relating to the need to subject intra-group transactions to supervisory overview.

Spain already has legislation on “mixed groups”

Regarding the transposition of the Directive into national law (the Member States having until August 2004 for this purpose), it should be noted that there is a body of rules in Spain (applied since 1996) that anticipated many of the Community provisions to which it must now be fully adapted. These rules relate to so-called “non-consolidated mixed groups of financial institutions” and are included in the legislation on the own funds requirements for financial institutions (17).

According to these rules, all national groups made up of financial institutions (including insurance undertakings) which constitute a decision unit (there are no absolute or relative thresholds), are subject to prudential supervision. As a general rule, this supervision shall be carried out by the Spanish body responsible for supervising the controlling entity or group of financial institutions or, if deemed more appropriate in the circumstances, such body as may be designated for the purpose by the Economy Minister. The functions of this supervision authority are similar to those provided for in the Directive in relation to the coordinator (assessment and monitoring of the situation of the conglomerate, the execution of decisions adopted by common agreement being left to the sectoral authorities within the scope of their respective powers). This prudential supervision of mixed groups basically involves net aggregation of the own funds and solvency requirements of the entities or groups that make them up, in accordance with the criteria envisaged in the sectoral legislation, albeit with certain adjustments established for the purpose (this method would be equivalent to one of the combination ones provided for in the Directive); Spanish legislation also envisages (although this aspect has not been developed) the control of risk concentration in a mixed group, extending the application of the rules provided for in the sectoral legislation to mixed groups (this option is also included in the Directive).

### III.2.2. Financial collateral arrangements

Uniform basic regime for the collateral provided in transactions between entities

Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (18) was also approved during the six-month Spanish presidency, the period for its transposition into the national legal systems expiring in December 2003. The main objective of this directive is to establish a uniform basic regime in the European market for financial services for the collateral provided to reduce credit risk in financial transactions between entities, resolving certain problems that affect the use of such collateral, especially at the cross-border level.

The financial collateral arrangements to which the instrument refers include both those involving transfer of title (repurchase agreements) and those involving

(17) Title V of Law 13/1992 of 1 June 1992; chapter V of Royal Decree 1343/1992 of 6 November 1992, incorporated by RD 2024/1995 of 22 December 1995; Order of 4 December 1996 and section eight of CBE 5/1993 of 26 March 1993, incorporated by CBE 3/1997 of 29 April 1997.

(18) OJ L 168 of 27 June 2002.

the creation of a security interest (basically pledges), potential collateral including both financial instruments and cash. As regards the parties covered, both the collateral taker and the collateral provider must be financial institutions subject to prudential supervision, the ECB or some other official banking institution or public authorities. The possibility is also included whereby one of the parties may be any person other than a natural person (although this latter case can be excluded by the Member States)

The measures approved in relation to these arrangements relate to:

- a) The removal of burdensome formalities for the creation and enforcement of collateral (including, among the possible forms of enforcement, both the appropriation of the collateral by the collateral taker and setting off its value against, or applying its value in discharge of, the relevant financial obligations).
- b) The right of use of the security provided as collateral by the collateral taker, even in cases, such as pledges, in which there is no transfer of title.
- c) The protection of such agreements from rules of insolvency law that may obstruct the effective enforcement of the collateral.
- d) The clarification for cross-border transactions of the legal system applicable to collateral arrangements involving book-entry securities (which shall generally be governed by the law of the country in which the relevant account is maintained).

### III.2.3. Application of international accounting standards

Future accounting regime for the consolidated accounts of companies with listed securities

Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (19) makes it compulsory for groups that have issued securities admitted to trading on a regulated market of any Member State to prepare their consolidated accounts, for each financial year starting on or after 1 January 2005, in conformity with such standards (20). The reform aims to harmonise the financial information supplied in EU capital markets.

In addition, each Member State may also permit or require the above-mentioned companies to prepare their annual accounts, and groups that have not issued securities traded on any EU regulated market to prepare their consolidated accounts, in conformity with the international accounting standards adopted by the EU.

No firm decision has yet been taken in Spain as to whether to use this possibility. However, it is very likely that annual accounts will continue to be prepared in accordance with Spanish accounting standards, which should converge with international ones, and also that non-publicly traded groups will be permitted to

(19) OJ L 243 of 11 September 2002.

(20) The international standards whose future application has been established are the International Accounting Standards (IAS), the International Financial Reporting Standards (IFRS) and related interpretations that may be made or approved by the International Accounting Standards Board (IASB), as well as future IFRS.

prepare their consolidated accounts in conformity with international standards, notwithstanding the existence of Spanish consolidated accounting rules compatible with the international ones.

### III.2.4. Distance marketing of financial services

Rules on pre-contractual information when financial services are provided to consumers without a physical presence

Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of financial services (21), which must be transposed into national law by 9 October 2004, aims to harmonise, as far as possible, measures relating to the marketing and provision to consumers of financial services, when this is carried out without the physical presence of the supplier (e.g. through channels of communication such as the postal service, the telephone system and electronic means). Following the example set by the Electronic Commerce Directive (22), this Directive establishes the general principle that the competent authorities of the service provider's home country shall be the ones responsible for ensuring compliance with its provisions.

Notable among its provisions are the determination of the information that financial institutions providing financial services at a distance are required to supply to the consumer in the pre-contractual phase, which extends from advertising to the contractual phase, and the grant to such consumer of a right to withdraw without giving any reason during a period of 14 calendar days from conclusion of the contract, although certain limited exceptions are recognised (e.g. in the case of mortgage loans).

(21) OJ L 271 of 9 October 2002.

(22) Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2002 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market.



ANNEX I

RECENT DEVELOPMENTS  
IN INTERNATIONAL REGULATION  
AND BANKING SUPERVISION FORA



## A.1. INTRODUCTION

There are three main areas in which international banking supervision and regulation activity is conducted. The first is an international forum, the Basel Committee on Banking Supervision (known as the Basel Committee or by its English abbreviation, BCBS). The other two areas relate to the structure of the European Union's institutions, with two committees connected to the European Commission – the Banking Advisory Committee (BAC) and the “Groupe de Contact” (GdC) – and another that is part of the structure of the European Central Bank – the Banking Supervision Committee (BSC).

In participating in these three fora, the Banco de España combines its functions as the supervisor of credit institutions, the Government's adviser on banking policy and the body responsible for the stability of the financial system.

The *Basel Committee* was created in 1974 by the central bank governors of the G-10 countries to lay down guidelines for sound supervisory practices. Although their recommendations do not formally have legal force, in practice they have a major impact and ultimately take the form of applicable rules. It receives material and organisational support from the Bank for International Settlements, but is independent from this latter institution. At present 13 countries sit on the Committee [the G-10 countries plus Switzerland, Luxembourg and Spain, which is the most recent member of the BCBS (1)].

As regards the first two fora within the European Commission's field, the *Banking Advisory Committee* (BAC) was set up in 1977. Its main aim was to advise the Commission on the preparation of prudential legislation for credit institutions. It is made up of representatives drawn from finance ministries, banking supervision authorities and central banks. The BAC is empowered to amend technical aspects of banking directives via the so-called *comitology* procedure, a power which will foreseeably be of greater relevance in the future if the *Lamfalussy* framework envisaged for the regulation of the securities industry is developed (a development which, moreover, may entail a far-reaching change with the BAC being transformed into another or other committees, as will be seen later).

The *Groupe de Contact* is the oldest of the supervisory groups. It was created in 1972 and is intended to be the forum in which supervisors may exchange their experiences and approaches in respect of the application of supervision and of prudential rules, and the discussion of individual cases. Its representatives are from the banking supervisory agencies of the 15 Member States, and there are also observers from the other three countries of the European Economic Area. Its composition and nature (a small number of high-level experts) provide for and promote fluid exchange among its members.

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(1) Spain joined the BCBS in February 2001.



Finally, the ECB set up the *Banking Supervision Committee* (BSC) in October 1998, though this was previously a sub-committee of the EMI. Its essential aims relate to the stability of the European financial system and the macroprudential analysis of credit institutions. It also assists in the preparation of the opinions delivered by the ECB on draft national or EU banking rules. It is made up of representatives from the central banks and supervisory authorities of the 15 EU members.

In addition, there are other groups in which the Banco de España participates in connection with the discussion of supervisory matters, such as the OECD Financial Markets Committee and the BIS Central Bank Statistics Group. Further, the Banco de España holds the chair of the Joint Forum of Financial Conglomerates, representing the Basel Committee.

The figures for the number of groups and sub-groups (2) of the three principal structures mentioned are very significant: 17 groups in Basle, 13 in the field of the European Commission, and 5 headed by the ECB Banking Supervision Committee (in addition to numerous task forces), making for a round total of 170 meetings in 2002.

Since late 2001, highly relevant events have occurred on the international scene: the terrorist attacks on the United States, failures at multinational companies, the questioning of accounting rules, and of auditing companies and rating agencies, crises in certain countries, etc. The consequences of these events have, from the standpoint of prudential regulations, supervision and financial stability, been widely analysed in these supervisory committees and groups during 2002.

There are also important areas in the banking supervision and regulation field on which work is under way in the related fora, such as the treatment of bank crises, the aggregation of inter-sectoral risks, the transfer of risks between different financial sectors, or the application of international accounting standards to credit institutions.

Nonetheless, when it comes to selecting the key issues in 2002 regarding international activity in the banking supervision and regulation area, this annex will focus on two very different matters, but ones which have significantly impacted banks, supervisors and institutions.

The first of these matters is the undertaking of work on the new Basel and European Union solvency regulations. Section A1 very briefly summarises first, the latest developments in and status of the new Basel Capital Accord, subsequently describing developments in the European Union in connection with this same Accord. This section closes with a description of the quantitative impact exercise performed by Basel to assess whether the accord, in its current draft phase, meets the objectives set by the Committee. Unsurprisingly, this impact study also affects the work of the European Union on this issue.

The second matter relates to the changes in the structure of European supervisory agencies. These are addressed in section A3.

Finally, section A4 analyses bilateral relations with other supervisors.

## **A.2. THE REVISION OF CAPITAL ADEQUACY REGULATIONS**

It is well known that the Basel Committee has, over the last four years, been immersed in a task of enormous importance for the international banking system. This will mark a milestone for banks' risk man-

(2) For further information on these groups and sub-groups, see the *Report on Banking Supervision in Spain 2001*.

agement systems and the procedures for determining their capital requirements. At issue here is the revision of the 1988 Basle Capital Accord.

To acquire legal force, the Basel Accords have to be included in European legislation. The 1988 Accord is included in Directive 89/647/EEC (currently consolidated in Directive 2000/12). The New Accord will also have to be included in a Directive. In this regard, the European Commission has been working in parallel with Basel, co-operating in the working groups of the Committee (directly and through the common members) and drawing up its draft Directive.

There follows a brief description of the most significant developments in Basel and in the European Union in 2002. Likewise, an explanation will be given of the characteristics of the questionnaire on the quantitative impact study of the New Accord proposals completed by banks between October and December 2002, and on which work continues.

### **A.2.1. The process in Basel**

The 1988 Accord fulfilled the significant function of setting minimum capital levels in the international arena, promoting a level playing field without ceasing to safeguard the solvency of banks. However, the need became apparent ten years later to make the 1988 framework more risk-sensitive, fostering at the same time the extension of the best risk management practices used by banks. And this was all to be done maintaining overall capital levels in the banking system and without undermining competition equality between institutions from different countries operating in the same markets.

Thus began the revision of the 1988 Accord, which is now in its final phase. After two consultative processes (November 1999 and January 2001), the key elements of the New Accord had taken shape (3) by late 2001. Still pending were developments in certain areas (e.g. securitisation, or operational risk), the fine-tuning and calibration of the treatment of certain specific bank operations (retail operations, with a breakdown of revolving credit cards; credit to SMEs; structured transactions), the treatment of Maturity in the IRB approaches and also the form to be given to certain matters relating to the so-called Pillars 2 and 3 (4).

### ***Current status of and timetable for the process***

Intense work continued throughout 2002 on these issues, to the extent that in September a complete draft Accord was available (although in the securitisation area it was presented as highly tentative), in keeping with the timeframe envisaged for conducting an impact study of the Accord as a whole (see section A.2.3). This will allow for the public release of a third consultative document with the necessary technical adjustments, where appropriate, so as to ensure quality and acceptability to those sectors interested.

The key dates of the process of the approval and entry into force of the New Accord are:

- 1 October 2002: release of the impact study (with three months for institutions to complete it)
- May 2003: publication of the third Consultative Document

(3) This is not the appropriate place to describe the draft New Accord. For further information, consult the Basel Committee website ([www.bis.org](http://www.bis.org)).

(4) It should be recalled that the New Accord is based on three so-called pillars. Pillar 1 requires minimum capital requirements to cover credit, market and operational risks (calculated on the basis of methodologies described therein); Pillar 2 is the so-called supervisory review, based on the requirement that institutions should have proper management and capital-calculation processes to cover their risks, which will be reviewed by the supervisor; and Pillar 3 stipulates public reporting or disclosure requirements so that market discipline may operate.

- 31 July 2003: end of the consultative period
- 31 October 2003: publication of the New Accord
- 31 December 2006: implementation of the New Accord

### ***Implementation of the Accord***

In addition to the technical aspects described in the foregoing section, the need to address the questions and difficulties arising from the implementation of the Accord was considered in 2002.

A capital accord such as that currently taking shape is not easy to implement in practice. Its flexibility is accompanied by greater complexity, as it offers several options which institutions may select and encourages the use of best practices. Moreover, many of the institutions at which it is applicable are very complex, and have subsidiaries and branches in many countries, some with widely differing financial cultures and markets. National supervisors must therefore agree on how to implement the New Accord so that the flexibility offered by it both to institutions and to national supervisors will not lead to an unlevel playing field for banks.

The Committee thus set up a new working group in 2002 (the Accord Implementation Group) to seek solutions to these implementation problems, making the exchange of information and experiences among various national supervisors easier in order to promote a consistent response by them.

#### **A.2.2. The process in the European Union**

As mentioned, a process has been under way in the European Union in recent years in parallel to that of the preparation of the New Accord in Basel. Indeed, the European Commission established its own working groups to draw up the new solvency Directive, taking into account developments in Basel, but adapting them to the actual circumstances in Europe when it was deemed necessary. The European Commission has thus conducted its own consultative processes, on approximately the same dates as the Basel Committee, submitting to consultation mainly the treatment of European particularities.

It is worth noting that there is clear intent that the European banking sector should be subject to the same rules as its international competitors. Consequently, the European directive should adhere as far as possible to what is established in Basel. Admittedly, however, certain adjustments are needed because of two European characteristics in this field. First, the scope of application of the rule is wider than in other countries that will adopt the Accord. This is because in Europe, for the sake of a level playing field in the internal market, credit institutions and investment firms are subject to the same regulations whatever their size. That means certain aspects or requirements of the Basle Accord must be adjusted to make them proportionate to the activity or size of the banking sector in Europe.

Second, there are issues of particular interest to Europe because they are characteristic of its economic and financial system. Some have been reflected in the Basle Accord, owing to the participation of EU countries in the Committee (5), and include most notably the treatment of SMEs or maturity; others have not been stipulated in the Accord, whereby they may be implemented on an independent basis in Europe.

Finally, the European Commission has a great interest in establishing the framework and mechanisms needed so that such lengthy, flexible and complex regulations may be implemented on time, that they may be adapted to market developments and that their implementation is consistent across the various Member

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(5) Germany, Belgium, Spain, France, Italy, Luxembourg, the Netherlands, Sweden and the United Kingdom.

States, thereby obviating competitive imbalances within the European internal market. These mechanisms will be described in section A.3.

### ***Current status of and timetable for the process***

There is a fairly advanced and complete draft directive which includes the new capital adequacy regulations (6), based on the new three-level legislative approach described in section A3.

Significantly, at a closer stage to their completion, the revision of the regulations on bank solvency was the focus of interest for various European political institutions (the Council and the Parliament, in addition to the Commission). There were thus various initiatives in 2002.

- In March, the Barcelona Summit called on the Commission to conduct a study on the consequences of the new regulations for the European financial and real sector (this will be entrusted to a university consortium). The findings of this study will be available at end-2003.
- The Commission is channelling the contribution of the European countries that are not members of the Basle Committee to the QIS3 quantitative impact study (along with that of the accession countries that have participated in it).
- In November 2002, the European Commission undertook what it called a “structured dialogue” with the interested parties (in particular the financial sector, SMEs and consumers). The publication of the draft directive has acted as a basis for discussion at two levels: the Commission with the European federations of credit institutions, and each of the Member States with their respective associations. This process, which ended in February 2003, has proven extremely fruitful. The findings will be disclosed on the same European Commission website as that quoted in footnote 6, where the response of both the Banco de España and of three of the Spanish associations of credit institutions may be consulted.
- The European Parliament is likewise aware of the main developments in the Basel regulations and the European approaches, and it is conducting a study on their effect.

It is expected that all these initiatives will enable the deadline for the approval of the Community Directive in 2005 to be met, along with its transposition to the Member States’ national legislations so that it can be implemented in December 2006.

### **A.2.3. The quantitative impact study (QIS3)**

#### ***Background and aims***

As mentioned in connection with the completion of the third consultative document (CP3), the Basle Committee decided, prior to its publication, to conduct a fresh quantitative impact study (called QIS3) to assess how the Committee’s proposals affect institutions’ capital requirements.

The results of this exercise are intended to help ensure compliance with the objectives set by the Committee at the outset of this proposal: the principle of capital neutrality for the system as a whole, i.e. that capital requirements should not change in relation to those in place under the current regulations, and the setting of incentives for institutions to adopt more advanced approaches in their risk management and measurement systems.

(6) The November 2002 version of the text of this directive can be viewed on the European Commission’s website ([http://europa.eu.int/comm/internal\\_market/en/index.htm#](http://europa.eu.int/comm/internal_market/en/index.htm#)).

## Participation and group structure

13 member countries of the Committee have participated in the study. To analyse and present the findings, the participating institutions are divided into two groups. Group 1 is made up of the large internationally active banks, and group 2 of the remaining banks, which are usually smaller, focused on domestic operations and, on many occasions, specialists in some specific type of operation. 64 banks from group 1 have provided data for the study, and 117 from group 2. The sample used in group 1 is representative of the financial systems of the different countries, which is not always the case with the banks in group 2.

In the light of the acceptance of the 1988 Accord, the Committee expects the New Accord to continue to be a reference for solvency internationally. This is why the Committee considered the participation in this exercise of non-G10 countries – with the notable presence of countries which will join the EU in the near future – to be important.

Likewise, the European Commission considered it essential to assess the impact of the New Accord on European small and medium-sized institutions and to gather information on matters of particular importance for these institutions, namely the credit risk mitigation practices used and the effect of the proposals on their risks with small and medium-sized companies.

## Process

The exercise was based on a complex questionnaire that gathered a large volume of information and was accompanied by detailed instructions which, moreover, included all the Committee's proposals. The questionnaire was sent to banks on 1 October 2002, and may be consulted on the Committee's website (7). The results were sent by the institutions to supervisors on 20 December 2002.

Based on information provided by institutions, the risk-weighted assets are calculated for each of the new approaches, the standard approach (SA) and the two (foundation and advanced) IRB approaches, and also for the current Accord. This allows compliance with the aforementioned objectives to be analysed. Further, it provides considerable versatility when comparing results and analysing, where appropriate, the impact of the alternative proposals.

To smooth discussion with the institutions, the Committee decided to publish a weekly update of participating institutions' most frequently asked questions (FAQs). The aim was to harmonise criteria in interpreting the proposals and instructions of the QIS3, on the basis of the doubts arising both at banks and in the countries' internal supervisory authorities.

## A.3. RECENT DEVELOPMENTS IN THE STRUCTURE OF THE EUROPEAN UNION'S REGULATORY AND SUPERVISORY AGENCIES AND COMMITTEES

European financial institutions and markets have faced many changes in recent years (increased internationalisation, the launch of the euro, the development of new financial products and the tendency towards consolidation and conglomeration, to name but a few). The European structures to regulate and supervise these financial institutions and markets, and to promote financial stability, must be receptive to this environment. The structures have also to play a key role in eliminating the remaining obstacles to financial market integration in the European Union.

(7) Given the complexity and volume of information required, a provisional version had been sent to the participating institutions in July so as to facilitate data compilation.

Mindful of this need, the European finance ministers meeting in Ecofin appreciated that these issues merited prime consideration in the securities industry. In 2000 they duly called on a group of experts to study the means of attaining the EU's objectives for the dynamic, competitive and innovative development of capital markets. The result of this work was the *Lamfalussy Report*, named after its chairman, which proposed a four-level regulatory and supervisory approach:

- *Level 1*: EU legislation (agreed under the usual joint-decision procedure between the European Parliament and the Council of Ministers), consisting of high-level principles that contain only the essential elements of the regulation and which specify the non-essential elements which can be agreed upon in level 2;
- *Level 2*: to define, propose and decide upon those details that are non-essential for the regulation (which will also have legal force) following the mandate of or clearance by level 1. This will be done by a formal regulatory committee, the "level 2 Committee", chaired by the European Commission, which will be advised by the "level 3 Committee" described below;
- *Level 3*, under which supervisors that are members of the "level 3 Committee" co-operate in order to improve consistency in the transposition and implementation of the legislation agreed under levels 1 and 2; and
- *Level 4*, intended to reinforce the application of EU rules.

The *Lamfalussy Report* also recommended that the four levels be complemented with a greater degree of openness, consultation and transparency among the various institutions and agencies involved. The Lamfalussy report was backed by Ecofin and has been implemented in the securities area.

While the securities area was identified as being most in need of a reorganisation of its supervisory framework, the finance ministers did not ignore other financial sectors. Indeed, in recent years several reports (via the Economic and Financial Committee, which reports to Ecofin) have been commissioned to assess whether the current European regulatory and supervisory structure for the financial sector as a whole continues to respond appropriately to the need to safeguard financial stability, crisis management and financial integration:

- An initial report (the Brouwer report dated April 2000) concluded that although the institutional agreements in place provided a flexible and consistent basis for safeguarding financial stability in Europe, their functioning in practice needed to be improved.
- A subsequent report (April 2001, *Brouwer 2*) concluded that co-operation and co-ordination had to be further strengthened in order to ensure the management of a crisis in the EU, and it made a series of recommendations in this connection.
- Finally, the Economic and Financial Committee's report on financial integration (May 2002) recommended, inter alia, that consideration be given to applying the 4-level Lamfalussy approach to the banking and insurance industries.

On the basis of these reports, Ecofin asked the Economic and Financial Committee in May 2002 to assess and submit options for: (i) the future design and implementation of the new legislation for financial services, information exchange among supervisors and convergence in respect of best supervisory practices; (ii) policy advice to Ecofin and to the European Commission; and (iii) evaluation of potential threats to financial stability. The Commission was invited to contribute to the EFC's work with a report on the appropriate structure to facilitate the implementation and reinforcement of legislation, in line with the recommendations of the EFC report on financial integration.



During the following months several proposals were developed, involving dialogue between the interested parties and including an open consultation period. The EFC's final report was approved by Ecofin in December 2002. It made the following recommendations:

- The *Lamfalussy approach* should be applied in all financial sectors, with the same bases as those of the agreements already implemented in the securities field (albeit subject to sectoral specifications). This approach would benefit from the experience obtained in the securities area, ensuring that the existing institutional agreements were observed and incorporating the necessary accountability and reporting procedures.

There should be three separate sectoral committees at each of the levels 2 and 3 (for banking, securities and insurance), and an additional committee at level 2 for financial conglomerates. These Committees should co-ordinate on inter-sectoral matters.

- *Policy assessment* on financial matters should be provided by a group made up of representatives from Finance Ministries and chaired by a Member State. This will be called the *Financial Services Committee* (described in the report as the reconstituted FSPG, in reference to its forerunner). This group would report to the Economic and Financial Committee (which in turn reports to Ecofin) and should bridge the gap between the policy and technical regulatory levels, reflecting the inter-sectoral strategies, without forming part of the legislative process.
- The Economic and Financial Committee would report to Ecofin on *financial stability matters* to contribute to its work in this field.

As regards the EU agreements for regulation and banking supervision, the biggest direct impact will stem from the first of these recommendations. The finance ministers believe that the existing structures for committees in the banking sector (briefly described at the start of this annex) have been useful, but that they should be transformed so as to meet the recommendations:

- The Economic and Financial Committee recommend that the "level 2 banking committee" should be formed by drawing on and converting the current Banking Advisory Committee (BAC). This "recast BAC" would act as a regulatory committee (voting on technical implementation issues proposed by the European Commission on the basis of advice from the "level 3 committee") and as a consultative committee, advising the Commission on the mandates to be given to the "level 3 committee". The functions of the current BAC not transferred to the "level 2 committee" shall be located in the "level 3 committee".
- A new high-level committee of banking supervisors shall be set up and entrusted with level-3 banking responsibilities. The remit of this committee will be as follows: it will advise the Commission, in particular, on the preparation of the proposals addressing the matters submitted at level 2 (both those requested of it and those stemming from its own initiative); it will promote consistency in the implementation of EU directives and convergence in respect of Member States' best supervisory practices; and it will provide for an effective operational network for improving day-to-day supervision, including information exchange. The level 3 Committee will be operationally independent. Its Chairman and Secretary will be chosen from among its members, and each country represented will have a vote. So as to take into account the synergy between banking supervision and central banks, the related banking supervision authorities and the central banks without direct supervisory responsibilities, including the ECB, will participate. The other two existing committees (the ECB Banking Supervision Committee and the Groupe de Contact) will have observer status on the level 3 committee.
- The current EEA banking supervisor Groupe de Contact will continue with its work, as well as becoming the main working group for the "level 3 banking committee". This remit will include information exchange.

On approving the report by the Economic and Financial Committee, Ecofin stated that the current inter-institutional agreements should be observed and that there should be a full and open overhaul in 2004. The issue of the delegation of powers to the Commission (to adopt implementation measures) was left open, pending talks with the European Parliament. However, Ecofin noted that other aspects of the new structure could be implemented, and invited the Commission to set up the level 2 committees (with an advisory capacity only) and the level 3 committees as soon as possible.

## **A.4. BILATERAL RELATIONS WITH OTHER SUPERVISORS**

### **A.4.1. Supervision of foreign credit institutions in Spain**

As at 31 December 2002, there were 59 branches of foreign credit institutions in Spain, 50 of which were institutions of EU countries. The presence of subsidiaries of foreign credit institutions was also notable.

As the subsidiaries of foreign credit institutions are for legal purposes Spanish institutions, they are subject to supervision by the Banco de España. Nonetheless, if the supervisor of the parent or the supervisor of the consolidated group wishes to conduct an examination of a subsidiary in Spain, the Banco de España poses no obstacles. In order to proceed, the supervisor in question notifies the Banco de España of its intention beforehand and, in many cases, a prior meeting is held. There may also be meetings after the examination to discuss the results.

As regards branches, a distinction should be drawn between those of institutions belonging to the EU and those of other countries.

Regarding those belonging to EU and following the adoption of the Second Banking Co-ordination Directive (Directive 646/89/EEC), now included in the Codified Banking Directive (Directive 12/2000/EC) establishing the principle of mutual recognition, the opening of branches of EU institutions does not require prior authorisation in Spain, but communication to the Banco de España by the competent authority in the home country. The Second Directive also established the principle that the supervision of branches is the responsibility of the home country, whereby examinations are conducted by the competent authorities of the home country, whether directly or via auditors. Only in the case of the supervision of liquidity is competence retained by the host country. In this case too, there will be prior notification from the home-country supervisor before examining the branch, and there is usually a meeting before the examination begins and after its completion.

The opening of branches of third countries is subject to prior authorisation in Spain. Such authorisation is the competence of the Ministry of Economy, further to a report by the Banco de España. Although branches are part of a credit institution that is devoid of legal personality, the opening of branches of third countries is subject to most of the rules governing the authorisation of credit institutions. In this case the Banco de España does have supervisory competence and conducts examinations, albeit without standing in the way of examination by the supervisory authority of the country in which the institution is incorporated.

### **A.4.2. Memoranda of Understanding (MoU)**

The Banco de España is signatory to seven MoU with the competent authorities of EU countries where there are branches of Spanish credit institutions, or vice versa. These protocols were drawn up to determine the details of the provisions laid down in the Second Directive regarding notifications for the establishment of branches by the credit institution of one EU Member State in another, the information



that should be exchanged, co-operation in the supervision of liquidity, the action to be taken in the event of non-compliance or a crisis, and the potential for co-operation and information exchange in examinations, etc. As stated, the scope of application of the protocols is branches, as this is what is regulated in the Second Directive. However, the protocols always include a reference to co-operation in the monitoring of reciprocal subsidiaries. Further, regular meetings are envisaged in which, in addition to reviewing the activities of branches and subsidiaries, information is exchanged on legislative changes bearing on financial and supervisory practices.

Apart from the bilateral MoU entered into with competent authorities of EU Member States, the Banco de España is signatory to eight MoU, one of which signed in 2002, with the authorities of the Latin-American countries where the most important subsidiaries of Spanish banking groups are to be found. On signing these protocols the Banco de España has sought clearly to define the respective supervisory responsibilities and to ensure that the parent institution has at hand all the information required for the managerial control of its subsidiaries. Furthermore, the protocols should allow the Banco de España to perform its attendant supervisory functions on a consolidated basis.

ANNEX 2

**CONSOLIDATED GROUPS  
OF SPANISH CREDIT INSTITUTIONS**



## EXPLANATORY NOTE

Consolidated groups (CGs) are classified in accordance with the nature of the parent institution. Credit institutions (CIs) that are not part of any CG (those that report own funds on an individual basis) are listed as such at the foot of the respective institutional blocks.

The code on the left is the number of the institution in the Banco de España's Register of Institutions.

## BANKS

		CONSOLIDATION METHOD APPLIED (I)
GRUPO ATLÁNTICO		
0008	BANCO ATLÁNTICO, S.A.	11
8916	ATLÁNTICO SERVICIOS FINANCIEROS	11
	(INSTITUTIONS: 2)	
GRUPO DEUTSCHE, SAE		
0019	DEUTSCHE BANK, SAE	11
0205	DEUTSCHE BANK CREDIT, SA	11
	(INSTITUTIONS: 2)	
GRUPO BSCH		
0049	BANCO SANTANDER CENTRAL HISPANO, SA	11
0011	ALLFUNDS BANK, SA	11
0030	BANCO ESPAÑOL DE CRÉDITO, SA	11
0036	SANTANDER CENTRAL HISPANO INVEST.	11
0038	BANESTO BANCO DE EMISIONES, SA	11
0073	PATAGON BANK, SA	11
0083	BANCO ALICANTINO DE COMERCIO, SA	11
0086	BANCO BANIF, SA	11
0091	BANCO DE ALBACETE, SA	11
0100	BANCO DE VITORIA, SA	11
0109	BANCO DESARROLLO ECONÓMICO ESPAÑOL	11
0224	HBF BANCO FINANCIERO, SA	11
4757	SANTANDER CENTRAL HISPANO LEASE, EF	11

(I) Consolidation method applied:

11.—Global consolidation method.

22.—Proportionate consolidation method.

4797	SCH MULTILEASING, SA, EFC	11
8206	HIPOTEBANSA, EFC, SA	11
8236	HISPAMER SERVICIOS FINANCIEROS	11
8314	BANSANDER DE FINANCIACIONES, SA	11
8490	SANTANA CREDIT, EFC, SA	11
8906	SCH FACTORING Y CONFIRMING, SA, EF	11
8910	BANESTO FACTORING, SA, EFC	11
(INSTITUTIONS: 20)		
GRUPO PARIBAS		
0058	BNP PARIBAS ESPAÑA, SA	11
0225	BANCO CETELEM, SA	11
8512	UNIÓN CRÉDITOS INMOBILIARIOS	11
8798	EURO CREDITO, EFC, SA	11
8914	BNP PARIBAS LEASE GROUP, SA, EFC	11
(INSTITUTIONS: 5)		
GRUPO MAPFRE		
0063	BANCO SER. FIN. CAJA MADRID-MAPFRE	11
0125	BANCOFAR, SA	11
4837	MADRID LEASING CORPORACIÓN, SA	11
8793	FINANMADRID, SA, EFC	11
(INSTITUTIONS: 4)		
GRUPO PASTOR		
0072	BANCO PASTOR, SA	11
8620	PASTOR SERVICIOS FINANCIEROS	11
(INSTITUTIONS: 2)		
GRUPO POPULAR		
0075	BANCO POPULAR ESPAÑOL, SA	11
0004	BANCO DE ANDALUCÍA, SA	11
0024	BANCO DE CRÉDITO BALEAR, SA	11
0082	BANCO DE CASTILLA, SA	11
0095	BANCO DE VASCONIA, SA	11
0097	BANCO DE GALICIA, SA	11
0216	BANCO POPULAR HIPOTECARIO, SA	11
0229	BANCOPOPULAR-E, SA	11
0233	POPULAR BANCA PRIVADA, SA	11
8903	HELLER FACTORING ESPAÑOLA, SA	22
(INSTITUTIONS: 10)		
GRUPO SABADELL		
0081	BANCO DE SABADELL, SA	11
0118	BANCO DE ASTURIAS, SA	11
0185	SABADELL BANCA PRIVADA, SA	11
0230	ACTIVOBANK, SA	11
4719	BANSABADELL LEASING, EFC, SA	11
8211	BANSABADELL HIPOTECARIA, EFC, SA	11
8225	SOLBANK LEASING, EFC, SA	11
8789	BANASTURIAS LEASING, EFC, SA	11
8909	BANSABADELL FACTORING, EFC, SA	11
(INSTITUTIONS: 9)		
GRUPO BANCOVAL-DEXIA		
0094	BANCOVAL, SA	11
0231	DEXIA SABADELL BANCO LOCAL, SA	11
(INSTITUTIONS: 2)		
GRUPO ZARAGOZANO		
0103	BANCO ZARAGOZANO, SA	11
8905	BANZANO GROUP FACTORING, SA, EFC	11
(INSTITUTIONS: 2)		

GRUPO URQUIJO		
0112	BANCO URQUIJO, SA	11
0228	BANCO CDC URQUIJO, SA	22
(INSTITUTIONS: 2)		
GRUPO BANKPYME		
0142	BCO. PEQUEÑA Y MED. EMPRESA	11
4753	EDAMLEASING, EFC, SA	11
8734	MULTIAHORRO, EFC, SA	11
(INSTITUTIONS: 3)		
GRUPO BBVA		
0182	BANCO BILBAO VIZCAYA ARGENTARIA, SA	11
0009	FINANZIA, BANCO DE CRÉDITO, SA	11
0035	BBVA PRIVANZA BANCO, SA	11
0057	BANCO DEPOSITARIO BBVA, SA	11
0113	BANCO INDUSTRIAL DE BILBAO, SA	11
0121	BANCO OCCIDENTAL, SA	11
0129	BBVA BANCO DE FINANCIACIÓN, SA	11
0132	BANCO DE PROMOCIÓN DE NEGOCIOS	11
0227	UNOE BANK, SA	11
1004	BANCO DE CRÉDITO LOCAL DE ESPAÑA	11
8321	FINANZIA TRUCKS, EFC, SA	11
8908	BBVA FACTORING, EFC, SA	11
(INSTITUTIONS: 12)		
GRUPO B. FINANZAS		
0186	BANCO DE FINANZAS E INVERSIONES	11
(INSTITUTIONS: 1)		
GRUPO UBS		
0226	UBS ESPAÑA, SA	11
(INSTITUTIONS: 1)		
GRUPO INVERDIS		
0232	BANCO INVERDIS NET, SA	11
(INSTITUTIONS: 1)		

## INSTITUTIONS ONLY CONSOLIDATED WITH OTHERS NOT SUBJECT TO BANCO DE ESPAÑA SUPERVISION OR PROPORTIONATELY

0042	BANCO GUIPUZCOANO, SA	11
0078	BANCA PUEYO, SA	11
0128	BANKINTER, SA	11
0188	BANCO ALCALÁ, SA	11
0198	BANCO COOPERATIVO ESPAÑOL, SA	11
0211	SDAD. ESPAÑOLA BANCA NEG. PROBANCA	11
1000	INSTITUTO DE CRÉDITO OFICIAL	11
0061	BANCA MARCH, SA	11
0065	BARCLAYS BANK, SA	11
0079	BANCO INVERSIÓN, SA	11
0122	CITIBANK ESPAÑA, SA	11
0130	BANCO SIMEÓN, SA	11
0131	BANCO ESPIRITO SANTO, SA	11
0138	BANKOA, SA	11
0200	PRIVAT BANK, SA	11
0217	BANCO HALIFAX HISPANIA, SA	11
0222	JP MORGAN BANK, SA	11
(INSTITUTIONS: 17)		

## INSTITUTIONS THAT ARE NOT CONSOLIDATED AND SHOW OWN FUNDS ON AN INDIVIDUAL BASIS

0003	BANCO DE DÉPOSITOS, SA
0021	BANCO CONDAL, SA
0031	BANCO ETCHEVERRÍA, SA
0123	BANCO DE HUELVA, SA, EN LIQ.
0151	JP MORGAN CHASE BANK, SE
0155	BANCO DO BRASIL, SA, SE
0161	BANKERS TRUST COMPANY, SE
0169	BANCO DE LA NACIÓN ARGENTINA, SE
0214	ARAB BANK, PLC, SE
0219	BANQUE MAROCAINE COM. EXT. INTERNAT.
0220	BANCO FINANZIA SOFINLOC, SA
1485	BANK OF AMERICA, NA, SE
0136	BANCO ÁRABE ESPAÑOL, SA
0191	EUROBANK DEL MEDITERRÁNEO, SA
0223	GENERAL ELECTRIC CAPITAL BANK, SA
(INSTITUTIONS: 15)	

## SAVINGS BANKS

### GRUPO CAJA CATALUÑA

2013	CAIXA D'ESTALVIS DE CATALUNYA	11
4779	LEASING CATALUNYA, EFC, SA	11
8915	FACTORCAT, EFC, SA	11
(INSTITUTIONS: 3)		

### GRUPO M. P. CÓRDOBA

2024	CAJA DE AHORROS Y M. P. DE CÓRDOBA	11
8612	COMERCIANTES REUNIDOS DEL SUR, SA	11
(INSTITUTIONS: 2)		

### GRUPO CAJA MADRID

2038	CAJA DE AHORROS Y M. P. DE MADRID	11
0099	ALTAE BANCO, SA	11
0063	BANCO SER. FIN. CAJA MADRID-MAPFRE	22
0125	BANCOFAR, S.A.	22
4837	MADRID LEASING CORPORACIÓN, SA	22
8793	FINANMADRID, SA, EFC	22
(INSTITUTIONS: 6)		

### GRUPO CAJA ASTURIAS

2048	CAJA DE AHORROS DE ASTURIAS	11
0115	BANCO LIBERTA, SA	11
(INSTITUTIONS: 2)		

### GRUPO CAJA BALEARES

2051	CAJA DE AHORROS Y M. P. DE BALEARES	11
4838	SA NOSTRA DE INVERSIONES, EFC, SA	11
(INSTITUTIONS: 2)		

### GRUPO CAJA CANTABRIA

2066	C. AHORROS DE SANTANDER Y CANTABRIA	11
4819	BANCANTABRIA INVERSIONES, SA, EFC	11
(INSTITUTIONS: 2)		

### GRUPO C. SAN FERNANDO

2071	C. A. P. S. FERNANDO DE SEVILLA Y JEREZ	11
8596	UNIÓN CTO. FIN. MOB. INM. CREDIFIM	11
(INSTITUTIONS: 2)		

GRUPO BANCAJA		
2077	BANCAJA	II
0093	BANCO DE VALENCIA, SA	II
(INSTITUTIONS: 2)		
GRUPO CAIXA VIGO		
2080	CAIXA VIGO, OURENSE E PONTEVEDRA	II
0046	BANCO GALLEGO, SA	II
(INSTITUTIONS: 2)		
GRUPO IBERCAJA		
2085	IBERCAJA	II
4832	IBERCAJA LEASING Y FINANCIACIÓN	II
(INSTITUTIONS: 2)		
GRUPO KUTXA		
2095	BILBAO BIZKAIA KUTXA	II
4809	ADEFISA LEASING, EFC, SA	II
(INSTITUTIONS: 2)		
GRUPO CAJA PENSIONES		
2100	C. AHORROS Y PENSIONES DE BARCELONA	II
0133	BANCO DE EUROPA, SA	II
4767	CAIXALEASING Y FACTORING, EFC, SA	II
8209	HIPOTECAIXA, EFC, SA	II
8221	CORPORACIÓN HIPOTECARIA MUTUAL	II
8776	FINCONSUM, EFC, SA	II
8788	FINANCIACAIXA 2, EFC, SA	II
(INSTITUTIONS: 7)		
GRUPO CAJA GUIPÚZCOA		
2101	CAJA AHORROS GIPUZKOA Y S. SEBASTIÁN	II
0059	BANCO DE MADRID, SA	II
8811	GRUPO SERV. HIP. ON-LINE, EFC, SA	II
(INSTITUTIONS: 3)		
GRUPO UNICAJA		
2103	UNICAJA	II
0184	BANCO EUROPEO DE FINANZAS, SA	II
(INSTITUTIONS: 2)		

## INSTITUTIONS ONLY CONSOLIDATED WITH OTHERS NOT SUBJECT TO BANCO DE ESPAÑA SUPERVISION OR PROPORTIONATELY

2000	CONFED. ESPAÑOLA CAJAS DE AHORROS	II
2010	M. P. Y CAJA GRAL. BADAJOZ	II
2018	CAJA DE AHORROS MUNICIPAL DE BURGOS	II
2030	CAIXA D'ESTALVIS DE GIRONA	II
2031	CAJA GENERAL DE AHORROS DE GRANADA	II
2032	CAJA DE AHORRO PROV. DE GUADALAJARA	II
2037	CAJA DE AHORROS DE LA RIOJA	II
2041	CAIXA D'ESTALVIS DE MANRESA	II
2042	CAIXA D'ESTALVIS LAIETANA	II
2043	CAJA DE AHORROS DE MURCIA	II
2052	CAJA INSULAR DE AHORROS DE CANARIAS	II
2054	CAJA DE AHORROS Y M. P. DE NAVARRA	II
2059	CAIXA D'ESTALVIS DE SABADELL	II
2065	CAJA GENERAL DE AHORROS DE CANARIAS	II
2073	CAIXA D'ESTALVIS DE TARRAGONA	II
2074	CAIXA D'ESTALVIS DE TERRASSA	II



2081	CAIXA D'ESTALVIS DEL PENEDÈS	11
2086	CAJA AHORROS INMACULADA DE ARAGÓN	11
2090	CAJA DE AHORROS DEL MEDITERRÁNEO	11
2091	CAJA DE AHORROS DE GALICIA	11
2094	CAJA DE AHORROS Y M. P. DE ÁVILA	11
2096	CAJA ESPAÑA DE INVERSIONES	11
2097	CAJA DE AHORROS DE VITORIA Y ÁLAVA	11
2098	M. P. Y CA. DE HUELVA Y SEVILLA	11
2099	CAJA AHORROS Y M. P. DE EXTREMADURA	11
2104	CAJA AHORROS DE SALAMANCA Y SORIA	11
2105	CAJA AHORROS DE CASTILLA-LA MANCHA	11
(INSTITUTIONS: 27)		

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2040	CAIXA D'ESTALVIS COMARCAL MANLLEU	
2045	CAJA DE AHORROS Y M. P. ONTINYENT	
2092	CAJA PROVINCIAL DE AHORROS DE JAÉN	
2017	CÍRCULO CATÓLICO OBREROS DE BURGOS	
2056	COLONYA-CAIXA D'ESTALVIS POLLENSA	
2069	CAJA AHORROS Y MONTE PIEDAD SEGOVIA	
(INSTITUTIONS: 6)		

### CREDIT CO-OPERATIVES AND SPECIALISED CREDIT INSTITUTIONS

#### GRUPO LAB. MONDRAGÓN

3035	CAJA LABORAL POPULAR, CC	11
4788	AROLEASING, EFC, SA	11
(INSTITUTIONS: 2)		

#### GRUPO LICO

4713	LICO LEASING, SA, EFC	11
(INSTITUTIONS: 1)		

#### GRUPO RENAULT

4726	ACCORDIA ESPAÑA, SA, EFC	11
8345	RENAULT FINANCIACIONES, SA, EFC	11
(INSTITUTIONS: 2)		

#### GRUPO TARCREDIT

4784	TRANSOLVER FINANCE, EFC, SA	11
8640	TARCREDIT, EFC, SA	11
(INSTITUTIONS: 2)		

#### GRUPO PRYCA CONTINENTE

8795	SERVICIOS FINANCIEROS CARREFOUR, EF	11
8815	FINANDIA, EFC, SA	11
(INSTITUTIONS: 2)		

### INSTITUTIONS ONLY CONSOLIDATED WITH OTHERS NOT SUBJECT TO BANCO DE ESPAÑA SUPERVISION OR PROPORTIONATELY

3008	CAJA R. DE NAVARRA, SCC	11
3017	CAJA R. DE SORIA, SCC	11
3025	CAIXA C. DELS ENGINYERS, SCC	11
3058	CAJA R. INTERMEDITERRÁNEA, SCC	11
3084	CAJA R. VASCA, SCC	11

3085	CAJA R. DE ZAMORA, CC	II
3159	CAIXA POPULAR-CAIXA RURAL, SCCV	II
3172	CAJA CAMINOS, SCC	II
3183	CAJA DE ARQUITECTOS, SCC	II
8807	ARALAR, EFC, SA	II

(INSTITUTIONS: 10)

## INSTITUTIONS THAT ARE NOT CONSOLIDATED AND SHOW OWN FUNDS ON AN INDIVIDUAL BASIS

3001	CAJA R. DE ALMENDRALEJO, SCC
3005	CAJA R. CENTRAL, SCC
3007	CAJA R. DE GIJÓN, CC
3009	CAJA R. DE EXTREMADURA, SCC
3016	CAJA R. DE SALAMANCA, SCC
3018	C. R. S. AGUSTÍN FUENTE-ÁLAMO, SCC
3020	CAJA R. DE UTRERA, SCALC
3021	CAJA R. DE ARAGÓN, SCC
3022	CAJA R. DE FUENTEPELAYO, SCC
3023	CAJA R. DE GRANADA, SCC
3029	CAJA DE CRÉDITO DE PETREL, CR, CCV
3045	CAIXA R. ALTEA, CCV
3056	CAJA R. DE ALBACETE, SCC
3060	CAJA R. DE BURGOS, CC
3062	CAJA R. DE CIUDAD REAL, SCC
3063	CAJA R. DE CÓRDOBA, SCC
3064	CAJA R. DE CUENCA, SCC
3067	CAJA R. DE JAÉN, SCC
3070	CAIXA R. GALEGA, SCCLG
3076	CAJA R. DE TENERIFE, SCC
3078	CAJA R. DE SEGOVIA, CC
3083	CAJA R. DEL DUERO, SCCL
3089	CAJA R. NTRA. SRA. GUADALUPE, SCCA
3095	CAJA R. S. ROQUE DE ALMENARA, SCCV
3096	CAIXA R. DE L'ALCUDIA, SCVC
3098	CAJA R. NTRA. SRA. DEL ROSARIO, SCA
3102	CAJA R. S. VICENTE FERRER, SCCV
3104	CAJA R. NTRA. SRA. DEL CAMPO, SCAC
3105	CAIXA R. DE CALLOSA D'EN SARRIA, CC
3110	CAJA R. CATÓLICO-AGRARIA, SCCV
3111	C. R. LA VALL "S. ISIDRO", SCCV
3112	CAJA R. S. JOSÉ DE BURRIANA, SCCV
3113	CAJA R. S. JOSÉ DE ALCORA, SCCV
3114	CAJA R. CASTELLÓN S. ISIDRO, SCCV
3115	CAJA R. "NUESTRA MADRE DEL SOL", SCA
3116	CAJA R. COMARCAL MOTA DEL CUERVO, SCC
3117	CAIXA R. D'ALGEMESÍ, SCVC
3118	CAJA R. DE TORRENT, CCV
3119	CAJA R. S. JAIME ALQUERÍAS, SCCV
3121	CAJA RURAL DE CHESTE, SCC
3123	CAIXA R. DE TURIS, CCV
3127	C. C. A., C. R. DE CASAS IBÁÑEZ, SC
3128	CAJA R. DE LA RODA, SCC
3130	CAJA R. S. JOSÉ DE ALMASSORA, SCCV
3134	C. R. NTRA. SRA. ESPERANZA DE ONDA, SCC
3135	CAJA R. S. JOSÉ DE NULES, SCCV
3137	CAJA R. DE CASINOS, SCCV
3138	CAJA R. DE BETXI, SCCV
3140	CAJA R. DE GUISSONA, SCC
3144	CAJA R. DE VILLAMALEA, SCCA

3146	CAJA ESCOLAR DE FOMENTO, SCC
3147	CAIXA R. DE BALEARS, SCC
3150	CAJA R. DE ALBAL, CCV
3152	CAJA R. DE VILLAR, CCV
3157	CAJA R. LA JUNQUERA CHILCHES, SCCV
3160	CAIXA R. S. JOSEP DE VILAVELLA, SCCV
3161	CAJA R. S. FORTUNATO, SCCCL
3162	CAIXA R. BENICARLÓ, SCCV
3165	CAJA R. S. ISIDRO VILAFAMES, SCCV
3166	C. R. S. ISIDRO LES COVES VINROMA
3171	CAIXA DELS ADVOCATS-CAJA ABOGADOS
3174	CAIXA R. VINARÓS, SCCV
3177	CAJA R. DE CANARIAS, SCC
3179	CAJA R. DE ALGINET, SCCV
3181	CAJA DE ELCHE
3186	CAIXA R. ALBALAT DELS SORELLS, CCV
3187	CAJA R. DEL SUR, S. COOP. CRÉDITO
3188	CRÉDIT VALENCIÀ, CRCCV
3189	CAJA R. ARAGONESA Y DE LOS PIRINEOS
4789	H. SANTOS, EFC, SA
8219	PRAGA HIPOTECAS Y CTOS., EFC, SA
8233	AHORROGESTIÓN HIPOTECARIO, SA (EFC)
8235	BILBAO HIPOTECARIA, SA, EFC
8240	CREDITER, SA, EFC
8342	LUZARO, EFC, SA
8524	MONTJUICH, EF, EFC, SA
8567	FINANCIERA OVIEDO, SA, EFC
8618	MONETICIA, SA, EFC
8769	UNIÓN FINANCIERA ASTURIANA, SA
8796	COFIDIS HISPANIA, EFC, SA
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8814	ACCORDFIN ESPAÑA, EFC, SA
8816	SDAD. CONJUNTA EMISIÓN G. M. P., EFC, SA
8817	CARTUJA FINANCIERA ANDALUZA, SA
8911	ELECTROLUX FINANCIERA, SA, EFC
8918	TELEFÓNICA FACTORING, EFC, SA
3059	CAJA R. DE ASTURIAS, SCC
3080	CAJA R. DE TERUEL, SCC
3081	CAJA R. DE TOLEDO, SCC
3082	CAJA R. DEL MEDITERRÁNEO, SCC
3094	CAJA CAMPO, CAJA RURAL, SCC
8308	FINANCIERA CARRIÓN, SA, EFC
4706	CATERPILLAR FINANCIAL CORP. FINAN.
4709	ING LEASE (ESPAÑA), EFC, SA
4761	IBM FINANCIACIÓN, EFC, SA
4799	MERCEDES-BENZ CREDIT, EFC, SA
8234	AIG FINANZAS, SA, EFC
8307	VOLKSWAGEN FINANCE, SA, EFC
8714	GMAC ESPAÑA, SAF, EFC
8778	XEROX DE FINANCIACIÓN, SA, EFC
8780	BMW FINANCIAL SERVICES IBÉRICA
8804	COFIBER FINANCIERA, EFC, SA
8805	FINANCIERA EL CORTE INGLÉS, EFC
8806	VFS FINANCIAL SERV., EFC, SA
8813	SCANIA FINANCE HISPANIA, EFC, SA
8912	INTER-FACTOR EUROPA, SA, EFC

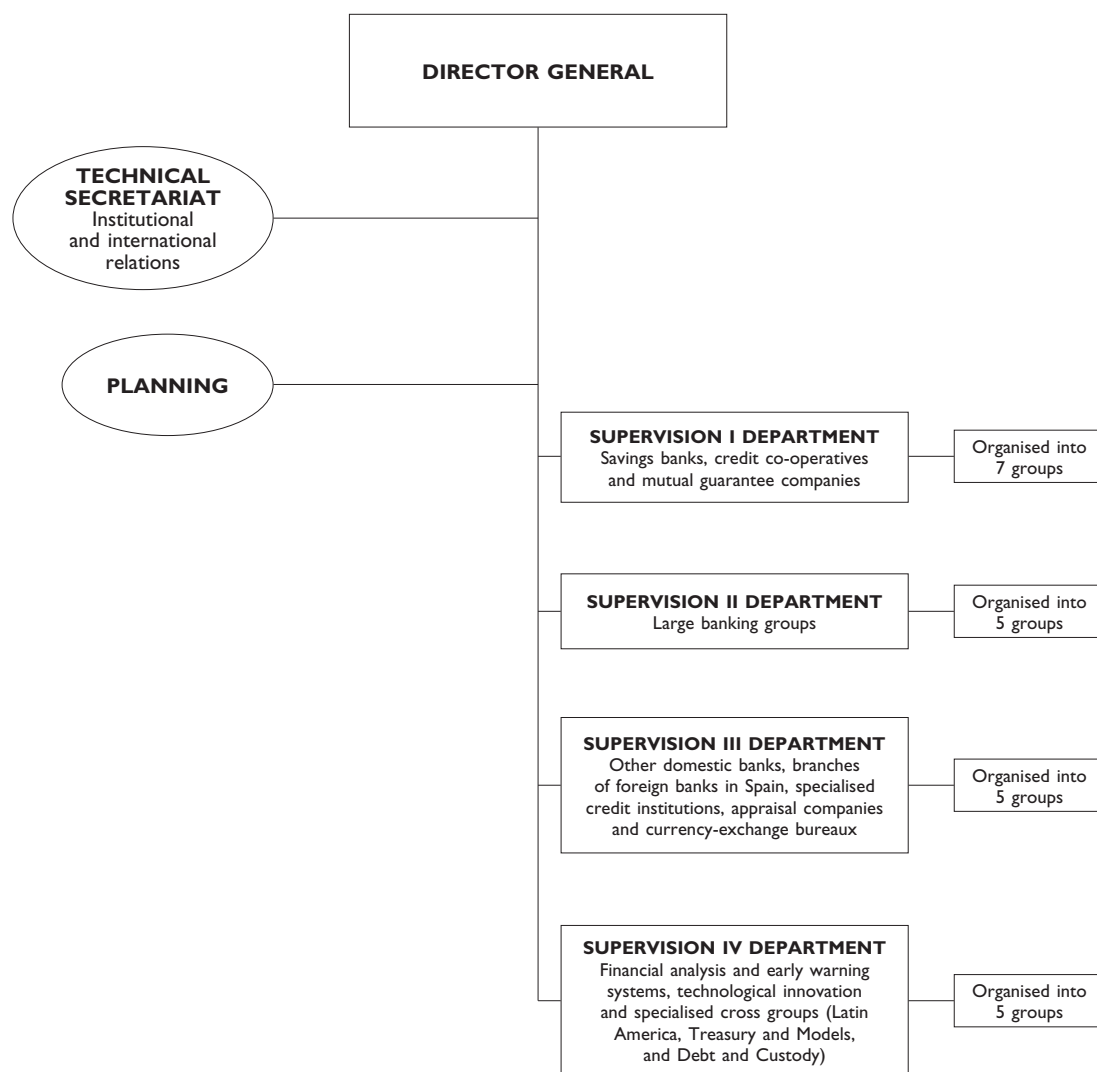
(INSTITUTIONS:107)

ANNEX 3

**DIRECTORATE GENERAL BANKING  
SUPERVISION: ORGANISATION CHART**



## Directorate General Banking Supervision





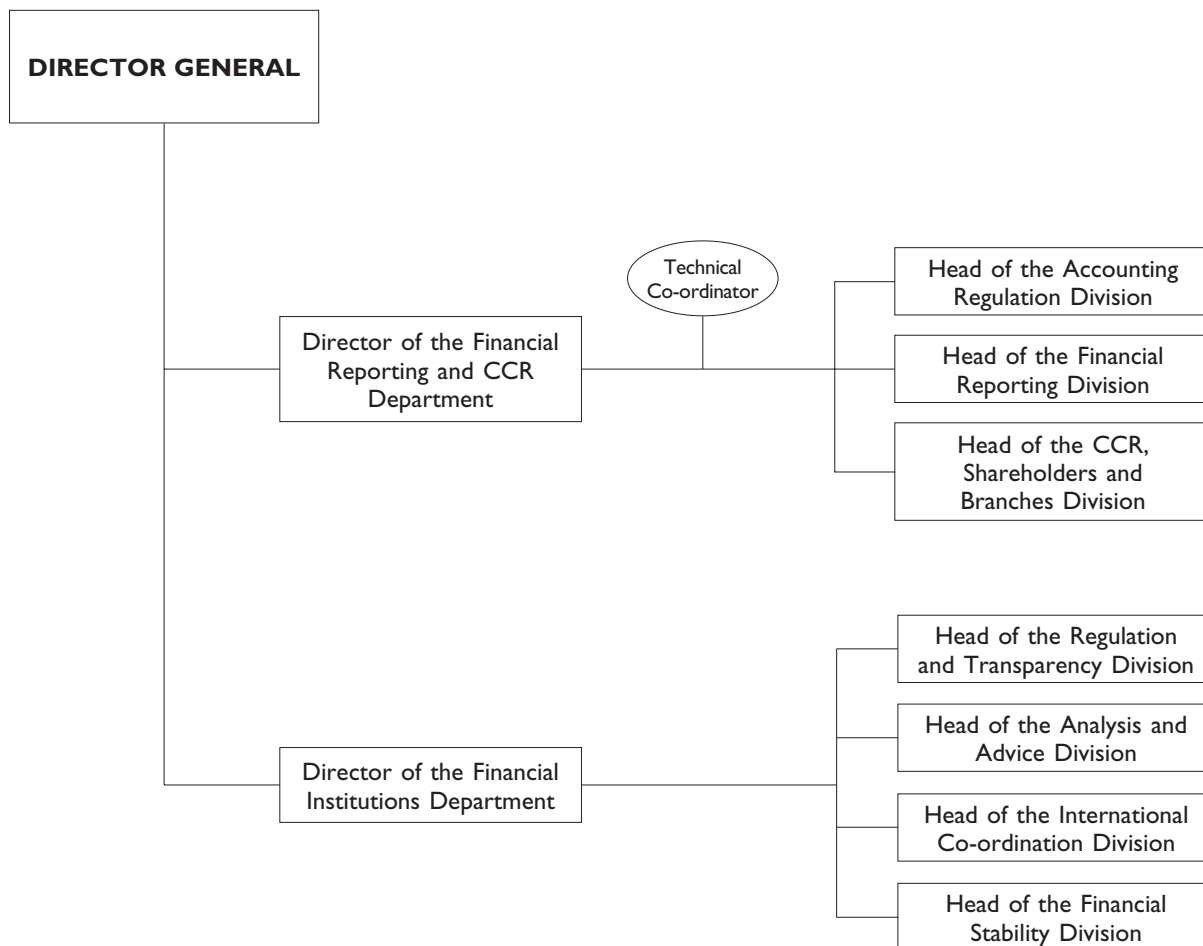
ANNEX 4

**DIRECTORATE GENERAL BANKING  
REGULATION: ORGANISATION CHART**





## Directorate General Banking Regulation





ANNEX 5

**DISCIPLINARY PROCEEDINGS  
INITIATED DURING THE PERIOD 1998-2002**



### Disciplinary proceedings initiated during the period 1998-2002

INSTITUTIONS	1998	1999	2000	2001	2002	TOTALS
Banks	8	8	2	2	4	24
Savings banks	3	2	1			6
Credit co-operatives	2	4	4	5		15
Specialised credit institutions		1	3	1		5
Appraisal companies			1		3	4
Mutual guarantee companies	1					1
Appraisal company revocations			3	1		4
Use of names or pursuit of activities reserved for credit institutions	2	4	2	2	4	14
Currency-exchange bureaux					5	5
Advertising	2					2
Non-compliance with ECB min. res. requirements		5	6	7	10	28
<b>TOTALS</b>	<b>18</b>	<b>24</b>	<b>22</b>	<b>18</b>	<b>26</b>	<b>108</b>



## ANNEX 6

# PROCEEDINGS BY TYPE OF INFRINGEMENT





## Proceedings by type of infringement

Year	Number of proceedings	Infringement			Proceedings dismissed	Reserved name (art. 29, LDI)	Appraisal companies (RD 775/97)	Non-compliance with ECB min. res. requirements
		Very serious	Serious	Minor				
<b>1998</b>	18 proceedings against institutions		14			2	2	
<b>1999</b>	24 proceedings against institutions		15	1	3	2		5
	1 proceeding against particular directors of such institutions					1		
<b>2000</b>	22 proceedings against institutions	4	15	5		2	3	6
	76 proceedings against particular directors of such institutions	20	80	24				
<b>2001*</b>	12 proceedings against institutions	1	6	1			1	7
	19 proceedings against particular directors of such institutions	13	18		3			
<b>2002</b>	17 proceedings against institutions	1	14	2	2	2		10
	43 proceedings against particular directors of such institutions	13	102		4			



## BANCO DE ESPAÑA PUBLICATIONS

### REGULAR PUBLICATIONS

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 FINANCIAL ACCOUNTS OF THE SPANISH ECONOMY (bilingual Spanish/English edition) (annual) (▲)  
 THE SPANISH BALANCE OF PAYMENTS (in Spanish and English) (annual) (▲)  
 CENTRAL DE ANOTACIONES EN CUENTA (annual) (▲)  
 BOLETÍN ECONÓMICO (monthly) (▲)  
 ECONOMIC BULLETIN (quarterly) (▲)  
 BOLETÍN ESTADÍSTICO (monthly) (▲)  
 BOLETÍN DE ANOTACIONES EN CUENTA (daily)  
 CENTRAL DE BALANCES. RESULTADOS ANUALES DE LAS EMPRESAS NO FINANCIERAS (annual monograph) (▲)  
 CIRCULARES A ENTIDADES DE CRÉDITO (▲)  
 CIRCULARES DEL BANCO DE ESPAÑA. RECOPIACIÓN (four-monthly) (▲)  
 REGISTROS DE ENTIDADES (annual) (▲)  
 FINANCIAL STABILITY REPORT (in Spanish and English) (half-yearly) (▲)  
 MEMORIA DEL SERVICIO DE RECLAMACIONES (annual) (▲)  
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