FSB FINANCIAL STABILITY BOARD

Press release

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FSB completes peer review of Spain

The Financial Stability Board (FSB) published today the report on the peer review of Spain. This forms part of a regular programme of peer reviews of FSB member jurisdictions, which began with the publication of the peer review of Mexico in September 2010. Italy also underwent a peer review in 2010 and its report is published today concurrently with the one for Spain. Australia, Canada and Switzerland volunteered to undergo a peer review in 2011, and their reports will be published following approval by the FSB Plenary.

The objective of FSB country peer reviews is to examine the steps taken or planned by national authorities to address Financial Sector Assessment Program (FSAP) recommendations concerning financial regulation and supervision as well as institutional and market infrastructure. FSB member jurisdictions have committed to undergo an FSAP assessment every five years and, to complement that cycle, an FSB peer review two to three years following an FSAP. To assist in the initiation of the peer review programme, Spain volunteered in 2010 to undergo a peer review, which follows up on the recommendations of the FSAP that was undertaken by the International Monetary Fund (IMF) in 2006.

The Spanish financial system weathered the initial brunt of the global financial crisis relatively well compared to other advanced countries, primarily due to a strong regulatory stance and sound supervision, as well as an efficient, retail-oriented bank business model. However, the financial crisis had significant after-effects since it led to the bursting of Spain's real estate bubble that had built up prior to the crisis. In that context, the risks identified in the FSAP relating to rapid credit growth in the housing sector and to the regulation, supervision and governance of savings banks ("cajas") have materialised. The adoption by the Spanish authorities of tighter regulatory capital and loan loss provisioning requirements for banks' real estate exposures, as recommended by the FSAP, proved to be an insufficient buffer against the risks emanating from such activities. Savings banks have been particularly hit and are undergoing significant restructuring and downsizing.

FSB members welcomed the actions taken to date by the Spanish authorities to address financial system vulnerabilities – such as the reforms to strengthen corporate governance and the ability to raise capital from external sources for cajas – and urged them to continue on this path in view of recent market developments. However, such determined actions became necessary partly because of the delay in addressing earlier the structural weaknesses of savings banks highlighted in the FSAP. Enhanced disclosures by banks of perceived problem exposures can play a valuable role in maintaining confidence, and the FSB commends the authorities for the importance they have given to transparency. The

Spanish Government also recently announced measures intended to enhance confidence in the Spanish banking system, including by increasing minimum capital requirements for all credit institutions.

The authorities have made good progress in addressing FSAP recommendations in other areas. They have implemented measures to reduce incentives for banks to make large equity investments in nonfinancial companies ("industrial participations") and to manage related conflicts of interest; adopted additional prudential requirements for insurers; and improved the functioning of securities settlement systems.

Going forward, a few issues highlighted by the FSAP deserve further consideration. These involve, in particular, additional regulatory efforts that may be necessary to ensure that industrial participations do not generate conflicts of interest or other risks, and further strengthening the autonomy of financial regulators as well as delegating to them the authority to issue norms and sanction violations. When markets are less volatile, the Spanish authorities may also want to reconsider the current institutional framework for financial supervision taking into account the relevant FSAP recommendations.

Spain's experience holds valuable lessons for other FSB members. These include the importance of a sound and forward-looking regulatory and supervisory framework, as demonstrated by the successful use of dynamic loan loss provisions during the crisis; the need for a variety of micro- and macro-prudential policy measures to address the build-up by banks of real estate exposures, coupled with sufficient supervisory independence and powers to be able to calibrate them appropriately; and the need for savings banks to follow very conservative risk-taking policies when they lack access to external capital sources.

Notes to editors

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

A country peer review evaluates the progress made by the jurisdiction in implementing IMF-World Bank FSAP recommendations against the background of subsequent developments that may have influenced the policy reform agenda. It provides an opportunity for FSB members to engage in dialogue with their peers and to share lessons and experiences. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, nor does it provide an assessment of its conjunctural vulnerabilities or its compliance with international financial standards.

The report published today describes the findings and conclusions of the Spain peer review, including the key elements of the discussion in the FSB Standing Committee on Standards Implementation (SCSI). The draft report for discussion was prepared by a team of experts drawn from FSB member institutions and led by Alexander Karrer, Deputy State Secretary, Swiss Federal Department of Finance. The review benefited from dialogue with the Spanish financial authorities and from discussion in the FSB SCSI and in the FSB Plenary.

The FSB is chaired by Mario Draghi, Governor of the Bank of Italy. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.