

## 4 SUPERVISION OF INSTITUTIONS' CONDUCT

2015 was the first full year of application of the institutional changes within the Banco de España whereby the powers relating to the oversight of institutions' conduct were assigned to the Market Conduct and Claims Department in October 2014 following its creation in 2013. Those changes meant that such oversight was performed by the aforementioned department with functional and organic independence with respect to microprudential supervision.

These changes reinforce the Banco de España's strategic commitment to prevent systemic risk associated with institutions' improper conduct and to safeguard banking customer protection in order to restore confidence in the financial system.

The Market Conduct and Claims Department has other functions assigned to it that are closely related to the oversight of conduct, such as the promotion of best market practices, the resolution of complaints and claims filed with the Banco de España by customers of supervised institutions, and financial education.

### 4.1 Methodology

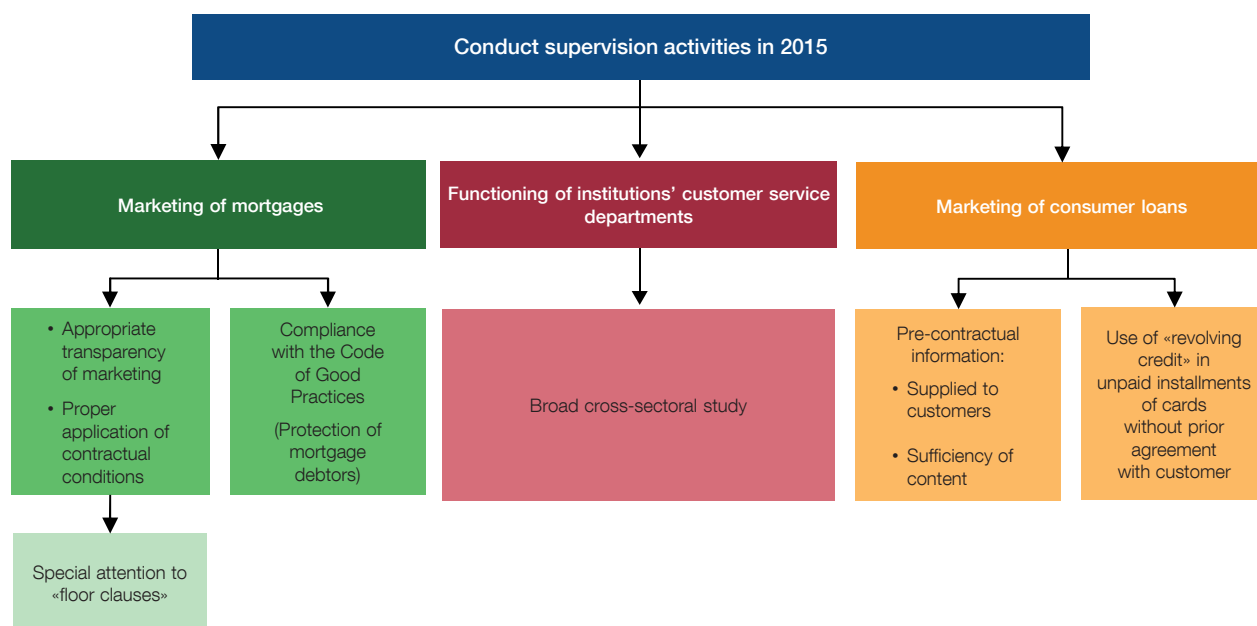
Along with the supervisory activity, in 2015 a series of procedures and methodologies applicable to such tasks was established. Thus, the Banco de España implemented a methodology aimed at providing a uniform framework for the supervisory classification of the risk associated with each institution which allows supervisory priorities to be established and resources to be allocated. The supervisory priority lies in the selection of the most appropriate supervisory method and intensity for each institution, which might consist of monitoring actions (individualised or aggregate) or on-site inspections (with different target scopes, durations and frequencies). The methodology is based on determining and maintaining two parameters: the conduct category and profile of each institution.

The conduct category classifies supervised institutions into five groups on the basis of the relative importance of their businesses and activities. Assignment to each group will be determined by the institutions' market share for certain financial products and services, their type and whether or not they provide banking services to individuals.

The conduct profile involves an estimate of the market conduct risk profile, based on the knowledge that is acquired of the institutions' conduct in the course of the supervisory activity and the information held by the Market Conduct and Claims Department. One of the most valuable sources of information for these purposes is the analysis of the claims filed with the Banco de España, which is a good indicator of the problems each institution has with its customers and of its level of commitment towards tackling those problems. Valuable information is also obtained from the regular statements the institutions must submit to the Banco de España and the allegations made by any agent. All of this is supplemented by the knowledge acquired on the functioning of the institutions' customer care services.

### 4.2 Supervisory actions

As a result of the above assessment, a supervision programme is drawn up, which includes both on-site inspections to institutions and off-site activities designed to check compliance with obligations that are the competence of the department. However, without prejudice to the content of the aforementioned programme, it is also necessary to carry out "reactive" supervisory actions, i.e. those not envisaged ex ante, which are intended to verify conducts or events brought to the attention of the Banco de España by means of the other sources of information described above. Those activities are summarised in Schema 4.1.



SOURCE: Banco de España.

Table 4.1 contains a summary of the supervisory actions carried out in 2015.

## OVERSIGHT OF INSTITUTIONS' CONDUCT IN 2015

TABLE 4.1

Number

	Off-site monitoring (a)	Inspections (b)
Mortgages (Code of Good Practices, floor clauses, transparency)	21	10
Consumer loans	4	3
Customer service departments	7	0
Transparency (reporting obligations, commissions and payments)	23	1
Other	8	0
<b>TOTAL</b>	<b>63</b>	<b>14</b>

SOURCE: Banco de España.

**a** Of these actions, 12 were initiated in 2014.**b** Of these inspections, 1 was initiated in 2014.

In addition to the data in Table 4.1, mention should be made of the supervisory activity of the Market Conduct and Claims Department in the monitoring and control of the advertising of banking services and products. In 2015 there were 197 requirements for the withdrawal or rectification of press and Internet advertisements, all of which were complied with.

In this first full year of activity, conduct oversight was focussed on institutions' behaviour regarding mortgages, which are perhaps the most socially important of all banking products and services because of the large section of society they affect, the large amount they usually represent for individual customers, their long duration (without prejudice to the possibility of early repayment) and the subsequent loyalty they tend to imply with the lender, the detrimental consequences they can have for the customer in the event of failure

to meet obligations or, in short, the impact on such a valuable asset that is one's home or business premises.

Unquestionably, too, the importance of mortgages has been particularly affected by the recent economic crisis. The last few years have been noteworthy because various different strata of society have been urging the public authorities to adopt measures to protect mortgage debtors and requiring lenders to be especially clear and prudent in marketing those products.

Against this backdrop, the supervisory actions were focused on verifying the transparency in marketing and the correct application by institutions both of the contractual terms and conditions of mortgages and of the protective measures from which mortgage debtors without means benefit.

#### 4.2.1 MARKETING OF MORTGAGE PRODUCTS

The most intense work has been in relation to the supervision of compliance with the transparency requirements laid down in Ministry of Economic Affairs and Finance Order EHA/2899/2011 of 28 October on transparency and customer protection in banking services, regarding loans secured by mortgages on homes located in Spain granted to individuals resident in Spain. To this end, 8 on-site inspections were initiated at credit institutions which, based on the information available, were considered priority and are among the largest in that market. At 2015 year-end, those inspections were fully under way and, due to their wide-reaching scope (a portfolio comprising 61.14% of mortgage loans to households in Spain for house purchase is under review) and the various verification factors involved, they have lasted in some cases until the second quarter of 2016.

#### 4.2.2 "FLOOR CLAUSES"

Of the matters under review in the inspections, mention should be made of the correct inclusion of the clauses limiting interest rate fluctuations known as "floor clauses". In accordance with the legal grounds of the Supreme Court judgment of 9 May 2013, when such clauses form part of a contract entered into with consumers, they are subject to a double transparency filter, whereby formal compliance with the requirements of the "transparency and banking customer protection" regulation and the legislation relating to the "general contractual conditions" is not sufficient, and the "true comprehensibility" of the clause in question is also essential. Of the foregoing criteria, only the formal compliance with the requirements of the transparency and banking customer protection regulation falls under the direct competence of the Banco de España. Any possible classification and declaration of the contractual clauses as void corresponds to the courts, rather than to the Banco de España.

Accordingly, the supervisory tasks performed in this area have consisted of checking that those "floor clauses" meet the transparency requirements of the regulatory and disciplinary regulations and that their effective application by the institutions responds to the content of the corresponding contracts.

#### 4.2.3 PROTECTION MEASURES FOR MORTGAGE DEBTORS WITHOUT MEANS

Also, numerous actions were performed with the aim of verifying the correct application of the Code of Good Practices (CGP) contained in the annex of Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgage debtors without means (RDL 6/2012) by the institutions subject to it.

In particular, two on-site inspections are in progress at credit institutions, the scope of which is the verification of compliance with the aforementioned RDL 6/2012. Both inspections are expected to be completed in 2016. Also, as a result of the claims submitted

by different agents against various credit institutions due to alleged breaches of said RDL, 19 supervisory checking and monitoring actions were performed, 15 of which were concluded at the end of 2015 with eight recommendations and observations letters and four requirements letters being sent.

The on-site inspections and the other supervisory actions on this matter are centred on verifying the following:

- Information with which the participating institutions must mandatorily provide their customers on the possibility of having recourse to the CGP when they detect a failure to pay mortgage payments or general difficulties.
- Application of the CGP forecasts from the moment when the customer states that he/she has reached the exclusion threshold.
- Internal procedures defined to control the correct application of the RDL.
- Information submitted to the Banco de España on the application of the CGP measures.

Those inspections involved simultaneous visits to the branches of the network of institutions in various locations in Spain, without prior appointment. 42 visits were made with the purpose of verifying the information and knowledge of the network's employees as well as the application of their internal procedures relating to the CGP (in short, the information that the institution is in a position to offer its customers).

#### 4.2.4 CONSUMER CREDIT

The oversight of institutions' conduct in 2015 was also affected by the proliferation of institutions specialised in offering and marketing personal loans. That product causes concern because of the immediacy and ease with which it is arranged, which can make it difficult, in the pre-contractual stage, for the customer to correctly assess the conditions offered. In many of these cases it is particularly important that the customer is aware of the consequences of the potential failure to pay the instalments, since this can trigger a spiral of late-payment interest and costs which end up pushing certain customers into economic and social exclusion.

Three inspections and four supervisory actions were performed in this area with the focus on verifying the pre-contractual information with which the institutions must provide their customers under Law 16/2011 of 24 June 2011 on credit agreements for consumers. In this regard, the supervisory focus was on the verification of both the effective delivery to the customer of that pre-contractual information in the terms provided for in the legislation and the transparency and sufficiency of the content of that information in relation to the interest conditions of the financing granted.

The correct and complete inclusion in the pre-contractual information of all the costs comprising the total cost of the loan in addition to interest and late-payment interest was specifically reviewed. Also, in relation to revolving credit cards (which allow two methods of payment, at the end of the month and on credit), a practice was identified whereby, upon the non-payment of the monthly settlement of a credit card arranged with the month-end method of payment, the institution automatically switches the unpaid amount to the revolving credit method, without giving the customer the opportunity to consent to that change. The actions in this regard have focused solely on reinforcing customer transparency.

#### 4.2.5 FUNCTIONING OF INSTITUTIONS' CUSTOMER CARE SERVICE

The Banco de España considers that the correct functioning of customer care departments or services and customer ombudsmen is a key element of conflict resolution between institutions and their customers. The good functioning of customer care has an impact on both customer protection and the institution's reputation.

Consequently, with a view to analysing the functioning of the aforementioned departments or services of the institutions in more depth and identifying the best practices in that area, a supervisory check and monitoring was performed on 226 institutions subject to the Banco de España's supervision. The conclusions of that study, which will be published in the second quarter of 2016, will offer a far-reaching view of these departments or services while facilitating the identification of institutions whose customer care services might function inadequately with respect to the regulatory requirements and the diligent and responsible protection of their customers.

#### 4.3 Adoption of supervisory measures

The supervisory actions carried out may lead, in ascending order of importance, to recommendations, observations or other letters being sent to the institution by the Market Conduct and Claims Department, to requirements previously approved by the Executive Commission of the Banco de España being sent or, potentially, to sanctioning proceedings being initiated. Table 4.2 shows the type of measures in which the actions concluded in 2015 culminated.

#### SUPERVISORY MEASURES TAKEN

TABLE 4.2

Number

	Measures taken after off-site actions (a)	Measures taken after inspections (b)
Initiation of penalty procedures	0	1
Letter of requirements (c)	5	2
Recommendation and observation letters	25	2
Other letters	12	0
Cases closed	16	0
<b>TOTAL</b>	<b>58</b>	<b>5</b>

SOURCE: Banco de España.

**a** Of these actions, 11 were initiated in 2014.

**b** Of these inspections, 1 was initiated in 2014.

**c** 5 requirement letters issued in the field of verification actions contain 12 specific requirements for entities. The requirements formulated in respect of inspections contain 15 specific requirements.

It should be noted that one inspection concluded with a proposal for the initiation of sanctioning proceedings against the institution as a result of possible breaches observed in the pre-contractual and contractual information made available to its customers. That proposal was accompanied by a letter of requirements and recommendations. Another inspection concluded in 2015 with the formulation of requirements, recommendations and observations.

In any case, it should be highlighted that the initiation of proceedings is not restricted to situations in which major irregularities are identified, since the sanctioning regime applicable to credit institutions (and, in general, to the other supervised institutions) provided for in Title IV of Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions, categorises, in the area in question, some occasional or

isolated breaches as minor infringements. Accordingly, following an assessment of the adequacy of the measure in the terms expressed in the aforementioned law, the Banco de España may also initiate sanctioning proceedings due to breaches that are not systematic or widespread.