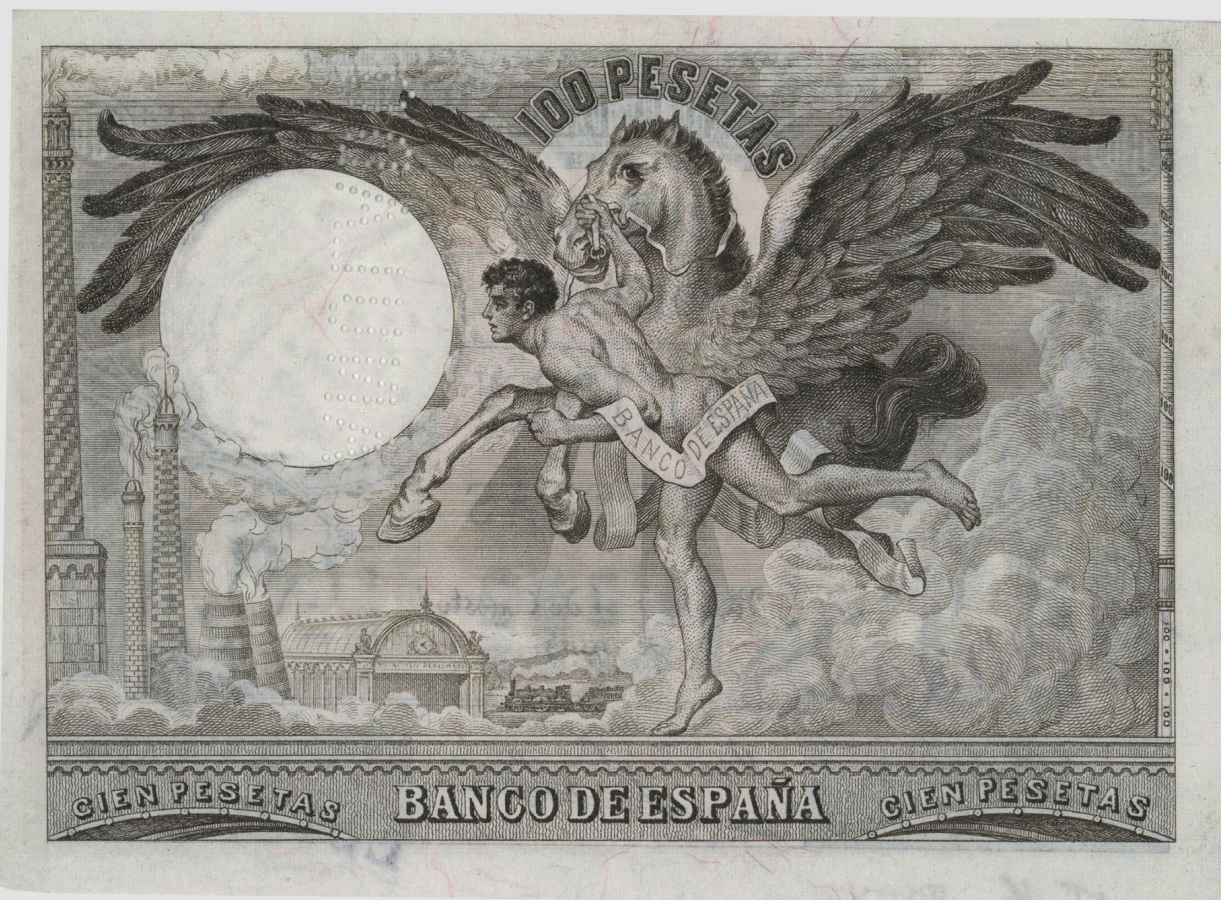


## 4 SUPERVISION OF INSTITUTIONS' CONDUCT



1905. Pegaso, chimeneas industriales y estación de ferrocarril (reverse).

## 4 SUPERVISION OF INSTITUTIONS' CONDUCT

In 2018, the Banco de España strengthened its strategic commitment to protect bank customers and promote best practices in the sector, by stepping up supervisory activity relating to institutions' conduct, which ensures customer protection and banking transparency. In so doing, it contributes to safeguarding users' trust in the financial system and, ultimately, to fostering the good functioning and stability of the banking system.

The Banco de España supervises institutions' conduct independently, outside the SSM framework. Its supervisory powers in this area encompass all institutions registered with the Banco de España, and extend to some aspects of institutions operating in Spain without an establishment.

In 2018, it further strengthened the operational capacity of the conduct supervision function by providing it with more human, IT and organisational resources.

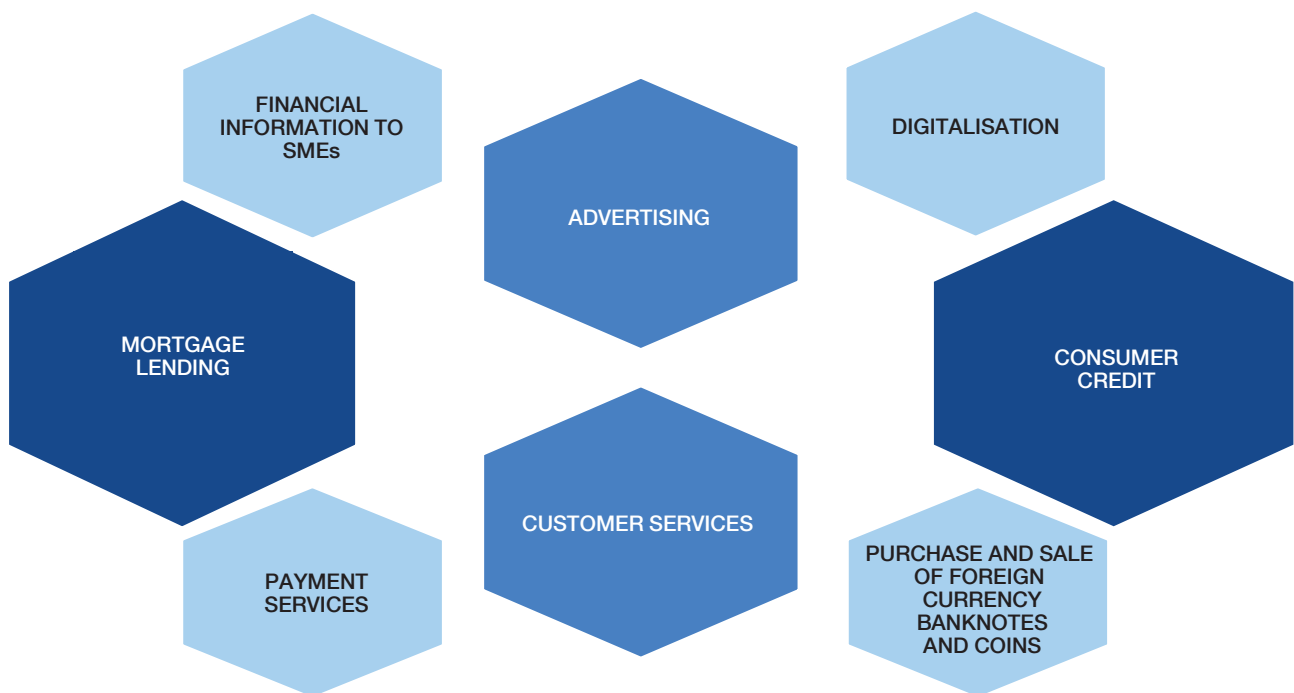
### 4.1 Conduct-related supervisory activity

Conduct-related supervisory activity in 2018 focused on the institutions identified as priorities in determining conduct profiles (see Box 4.1) and on the thematic areas shown in Figure 4.1.

Supervisory activities comprised both on-site actions and off-site monitoring, and the subsequent verification of compliance with the corrective measures that institutions were asked to adopt. In addition, a number of cross-cutting actions were undertaken during the year, which will continue in 2019.

SUPERVISION OF CONDUCT: MAIN AREAS OF ACTIVITY

FIGURE 4.1



SOURCE: Banco de España.

The Banco de España, in the exercise of its supervisory activity, has developed a methodology which provides a uniform framework for the supervisory classification of the conduct profile associated with each institution, which contributes to establishing supervisory priorities and drawing up the supervisory programme. To this end, two parameters are combined: the institution's conduct category and conduct risk.

- The conduct category assesses the institution's business, based on the market share of the most relevant products in terms of conduct.
- The institution's conduct risk can be assessed by observing its behaviour in the four main areas of activity defined for conduct supervision purposes.

The information obtained from the claims received by institutions, those subsequently handled by the Banco de España, is particularly significant when assessing conduct risk, as is the knowledge of the institution acquired as a result of supervisory actions.

The conduct profile assigned to the institution determines the degree of supervisory intensity to be applied, that is, whether

the institution will be subject to standard or enhanced supervision. The latter involves periodic individual monitoring and a more frequent supervisory cycle; in other words, a higher degree of supervisory intensity.

The Banco de España trusts that institutions will step up efforts to improve their conduct profiles and has been promoting the adoption of measures in this connection through ongoing contact with them and by increasing its supervisory activity.

These efforts must include the development of a strong compliance culture in the institution, whose values should be built around respect for customers and their interests, with the involvement of the governing bodies at the highest level. These values should permeate every stage of the marketing and management of banking products and services. Achieving this not only requires strong monitoring of regulatory compliance in this area, but also the strengthening of customer service departments, so that they can improve their handling of claims and have an authoritative voice in the governing bodies. The control of conduct risk begins with the appropriate design and governance of marketed products and the branch network sales incentive plans. In short, it requires an integrated approach that places customers and their interests at the centre of the institution's attention.

Category of conduct	Conduct risk			
	High	Medium-high	Medium-low	Low
C1	ENHANCED SUPERVISION			
C2				
C3				
C4				
C5				

In addition, 2018 saw the consolidation of ongoing oversight activities and knowledge obtained about institutions through regular monitoring. Such monitoring may be carried out at an individual or aggregate level, depending on the conduct profile assigned to each institution. Moreover, special monitoring is conducted on specific matters, such as the claims submitted to the Banco de España, the enquiries received or advertising issues.

The work to verify the correct adoption by institutions of the requirements or recommendations made was particularly intensive in 2018. The supervisory measures adopted in relation to mortgage lending in prior years or advertising in 2017 were reviewed in particular detail.

Número

By type	On-site supervisory actions (a)	Off-site monitoring (b)	Total	Of which, unplanned
Mortgages				
Mortgages (transparency)	32	4	36	7
Mortgages (Code of Good Practice)	1	12	13	12
Consumer credit	4	36	40	34
Advertising	0	11	11	11
Other (ATMs, financial information to SMEs, customer service departments, transparency, online channels, payment services)	1	33	34	29
<b>TOTAL</b>	<b>38</b>	<b>96</b>	<b>134</b>	<b>93</b>

SOURCE: Banco de España.

**a** Of these on-site supervisory actions, 28 were initiated before the beginning of 2018.**b** Of these off-site monitoring activities, 22 were initiated before the beginning of 2018.

The intensity of supervisory actions varied, with on-site activities being more exhaustive in nature than off-site monitoring. As in previous years, many of these actions were unplanned, given the unique characteristics of conduct-related supervision<sup>1</sup>.

Table 4.1 presents the details of the supervisory actions taken in 2018.

#### 4.1.1 MORTGAGE LENDING AND MEASURES TO PROTECT MORTGAGE DEBTORS EXPERIENCING FINANCIAL HARDSHIP

**The Banco de España is aware that taking out a mortgage loan is a major decision affecting people at a personal and financial level.** For this reason, the correct compliance with the regulations on transparency applying to mortgages was once again a priority in 2018. Box 4.2 describes the supervisory activity carried out.

As in previous years, considerable efforts were made to protect mortgage debtors experiencing serious economic difficulties,<sup>2</sup> by checking that the Code of Good Practice (CGP) contained in the annex of Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgage debtors experiencing financial hardship (RDL 6/2012) was being correctly applied by its signatory institutions.

In 2018, a total of 33 on-site supervisory actions and 16 off-site monitoring actions were carried out on matters relating to mortgage lending.

#### 4.1.2 CONSUMER CREDIT

**Supervisory activity relating to consumer credit was strengthened in 2018**, in response to the growth in this type of lending in recent years. The fact that borrowers are not required to provide additional guarantees and that these products are usually easier to arrange, make them a very attractive option for bank customers.

Consumer credit is specifically regulated in Law 16/2011 of 24 June 2011 on credit agreements for consumers, the most salient aspects of which are highlighted in Figure 4.2, although other regulations further develop certain obligations such as that of complying with the rules on responsible lending set out in the Ministry of Economic Affairs and Finance Order EHA/2899/2011 of 28 October on transparency and customer protection in banking services.

<sup>1</sup> Especially as regards the handling of the variety of complaints filed against supervised institutions.

<sup>2</sup> For more details, see section 4.1.2 of the 2017 Report on Banking Supervision in Spain and section 3.5.4 of the 2017 Complaints Report.



The review conducted in 2018 encompassed many of the institutions most actively engaged in lending to households secured by residential mortgages in Spain, and included verification of proper compliance with regulations on transparency and customer protection, particularly Ministry of Economic Affairs and Finance Order EHA/2899/2011 of 28 October. In addition to other supervisory measures, some of the supervised institutions were urged to remedy certain shortcomings relating to, among others the following areas:

#### Pre-contractual and contractual information

- Submitting the personalised information form (FIPER, by its Spanish abbreviation), containing the regulatorily required data, to ensure that customers have sufficient information to compare the loans available on the market, assess their implications and make an informed decision as to whether or not they enter into a loan contract.
- Informing the customer of the annual percentage rate (APR) applicable to the transaction (information regulatorily established as essential to enable customers to compare the financial conditions of the different offers), which, along with the contractually determined interest rate, includes: i) the fees, commissions and other expenses that the customer is required to pay; ii) taxes; iii) other types of associated expenses (except the notary public's fees) insofar as they are assumed by the customer; and iv) the cost of related services if the conditions on which the loan is granted are subject to the provision of these services.
- Similarly, when institutions offer products that include the possibility of obtaining subsidies on the mortgage interest rate, the FIPER should include not only the cost of purchasing

each product (when known or estimated by the institution), but also the APR resulting from the possible application of the related subsidies.

#### Early repayment

- Adhering to the agreed terms and to the current regulatory limits on the amounts to be charged to the customer in the event of early repayment, and clarity and transparency as regards settlements, particularly when compensation for interest-rate risk is applied to fixed-rate transactions or transactions with a rollover period of more than one year.
- Also, correctly charging fees for the removal of a discharged mortgage from the Land Registry, which should be limited to cases that effectively involve the provision of a service requested by the customer, noting that, in any event, no fees should be charged for issuing notification of discharge or for the expenses incurred by the bank's legal representative when travelling to the public notary's office.

#### Settlement

- Correctly calculating and notifying settlements. In particular, having an appropriate procedure in place for calculating the interest accrued, ensuring that the interest rate applied complies with regulations and the contractually agreed terms, especially in cases where floor clauses have been applied and of interest rate rounding.
- In addition, correctly applying the rules for interest rate replacement provided for in the aforementioned Order EHA/2899/2011 and its implementing regulations.

The Banco de España has been working on minimising the risks that may arise from the incorrect marketing of this type of product by supervised institutions, checking that they comply with the regulations. The checks performed focus in particular on oversight of the stages prior to entering into a credit agreement, that is, on the advertising and pre-contractual information provided to the potential customer, and on the actions of credit intermediaries.

With respect to consumer credit, in 2018, work was carried out to verify compliance with the transparency and customer protection requirements for this type of credit, in four on-site supervisory actions and 36 off-site monitoring actions. In particular, the aforementioned

MAIN OBLIGATIONS	LAW 16/2011 OF 24 JUNE 2011 ON CONSUMER CREDIT AGREEMENTS
ADVERTISING	<ul style="list-style-type: none"> <li>Any advertising which indicates an interest rate or cost of credit to a consumer must specify in a clear, concise and prominent way, by means of a representative example, the <b>cost, APR, duration and form of payment</b> of the credit.</li> </ul>
PRE-CONTRACTUAL INFORMATION	<ul style="list-style-type: none"> <li>The lender and, where applicable, the credit intermediary, must furnish <b>free-of-charge</b> the pre-contractual information by means of the <b>Standard European Consumer Credit Information (SECCI)</b>, before any obligation whatsoever is entered into.</li> </ul>
CONTENT OF CREDIT AGREEMENTS	<ul style="list-style-type: none"> <li>The credit agreement must be provided in writing on paper or other <b>durable medium</b> and be clearly legible.</li> <li>It must specify clearly and concisely, inter alia, the <b>borrowing rate</b>, whether it is fixed or variable, the <b>total amount of credit</b>, the <b>APR</b>, the <b>duration</b> of the credit agreement and the <b>total amount</b> of the instalments.</li> </ul>
ANNUAL PERCENTAGE RATE (APR)	<ul style="list-style-type: none"> <li>The <b>APR</b> determines the <b>total cost of the credit to the consumer</b> and its purpose is to allow different offers of credit to be compared.</li> </ul>
CREDIT INTERMEDIARIES	<ul style="list-style-type: none"> <li>The scope of <b>credit intermediaries' functions</b> and any parties representing them must obligatorily be indicated in their advertising and the documentation intended for consumers.</li> </ul>

SOURCE: Banco de España.

supervisory activities included some that were cross-cutting in nature and, notably, actions centred on analysing revolving credit cards, financing for car purchases or credit linked to the supply of goods or services, considering the significant impact on claims relating to these areas.



Market Conduct and Claims Department.

Spanish firms have traditionally relied on bank-based financing. This is especially true of SMEs, which have difficulties accessing financial markets, despite accounting for the bulk of business in Spain. The decline in lending following the economic crisis that started a little over a decade ago has thus been particularly pronounced in the case of SMEs.

To alleviate this situation, Chapter I of Title I of Law 5/2015 of 27 April 2015 on the promotion of business financing, implemented by Banco de España Circular 6/2016 of 30 June 2016 as regards the content and format of the SME-Financial Information document, establishes (with some exceptions) a set of measures or obligations, notably including the obligation to give at least three months' notice of the intention to reduce financing flows by more than 35% and the provision free of charge of a document containing information on their financial situation (SMEs-Financial Information) to enable SMEs to adapt to a new financial situation or to look for alternative sources of financing.

In 2018, a cross-cutting supervisory action was conducted at the 13 institutions with the highest volume of financing extended to

SMEs, in order to analyse their degree of compliance with these obligations.

This review revealed that: i) on the whole, institutions have procedures and policies in place to comply with these obligations, although there is often room for improvement in the way these are shared with the branch network; ii) some contracts at some institutions do not yet include mention of these rights; iii) although the content of notifications is not standardised, sufficient minimum content was identified; iv) in general, notifications are sent within the set deadlines, but greater internal control is required to check that all the necessary notifications are duly sent; and v) the obligation to make the information document available to SMEs is widely complied with. In any event, the shortcomings observed regarding content do not prevent borrowers from having sufficient information to make decisions.

Institutions should continue to step up their efforts to comply with the provisions of the aforementioned regulations and promote awareness thereof among SME.

#### 4.1.3 OTHER ACTIONS

The supervision of conduct in other areas in 2018 notably included:

- i) reviewing compliance with obligations to provide information on the financial situation and payment history of SMEs and self-employed persons, through the "SME-Financial Information" document, details of which are provided in Box 4.3 below.
- ii) carrying out new supervisory actions deriving from ongoing monitoring of advertising activity.
- iii) as regards digital contracts, verifying the pre-contractual information provided by institutions when offering demand deposits that can be arranged on their websites and mobile applications, gaining more in-depth knowledge of institutions' digital adaptation strategies or contributing to the international debate on adapting supervision tools to the digital environment (see Section 6.3). These actions will continue in 2019.
- iv) overall compliance with transparency obligations by payment institutions; and
- v) monitoring of activities conducted by the owners of establishments that perform transactions comprising the purchase and sale of foreign banknotes and traveller's cheques.



Number	On-site supervisory actions (a)	Off-site monitoring (b)
Initiation of sanctioning proceedings	6	0
Letters of requirements	8	6
Recommendation and observation letters	7	65
Other actions concluded	16	29
<b>TOTAL</b>	<b>37</b>	<b>100</b>

SOURCE: Banco de España.

**a** The 8 requirements letters contain 91 specific requirements for institutions.

**b** The 6 requirements letters contain 10 specific requirements for institutions.

#### 4.2 Adoption of supervisory measures

Box 4.2 describes the supervisory measures adopted in 2018. Such measures, which are intended to remedy the shortcomings detected by supervisors, entail subsequent monitoring to verify effective compliance by institutions. **Noteworthy in this connection were the six sanctioning proceedings initiated as a result of on-site actions on mortgage lending.**