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SUPERVISION OF INSTITUTIONS' CONDUCT

Appropriate customer relations are a key element of any forward-looking banking business model. They are also the basis for maintaining the industry's reputation and confidence in the banking system, the pillars upon which financial stability rests.

Therefore, the Banco de España continued to place particular emphasis on institutions' conduct in 2019. It remains particularly mindful of society's demands for increasing levels of consumer protection, as revealed by the recent amendments to banking legislation (e.g. the new mortgage loan regulations reinforcing, among other matters, responsible credit underwriting).

This conduct-related supervisory function is implemented outside the SSM framework and affects all institutions in the Banco de España's Official Registers (including foreign branches) and certain aspects of the business of institutions operating in Spain without an establishment.

4.1 Conduct-related supervisory activity

Conduct-related supervisory activity in 2019 focused mainly on the areas shown in Figure 4.1.

Chart 4.1. shows the supervisory actions conducted in 2019. A number of the actions were cross-institutional in nature, enabling an analysis of how various institutions address the same subject matter. A significant number of the actions were unplanned, including those conducted as a result of complaints received.

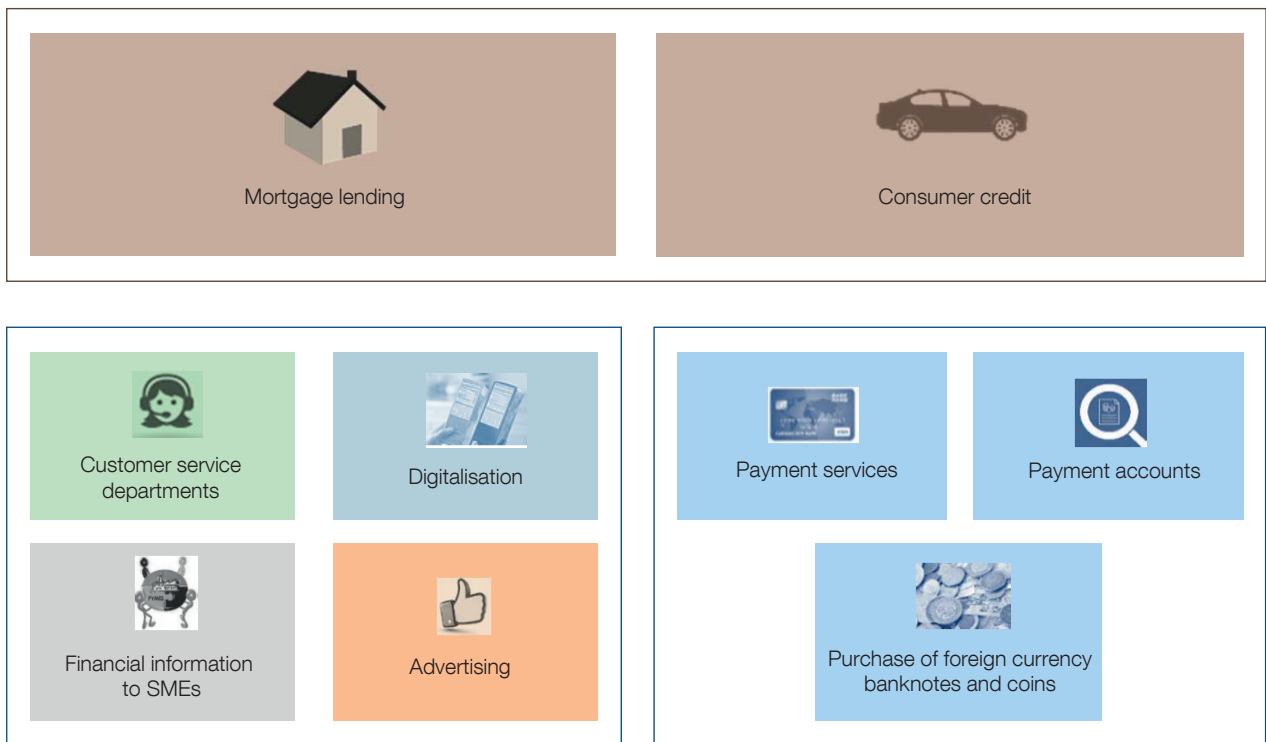
In addition to the supervisory actions on specific areas and/or institutions, the Bank has continued to pay special attention to ongoing oversight through monitoring, allowing for improved knowledge of institutions¹ – on an individual or group basis – and certain processes (such as how complaints are handled or control over advertising). The information obtained from these activities is the basis for determining institutions' conduct profiles, which is key for planning annual supervisory actions.

By subject matter in supervisory activity, supervision of consumer credit has continued to gain in prominence in 2019. However, supervisory activities in other

¹ For further information see Box 4.1 of the *Report on Banking Supervision in Spain 2018*.

Figure 4.1

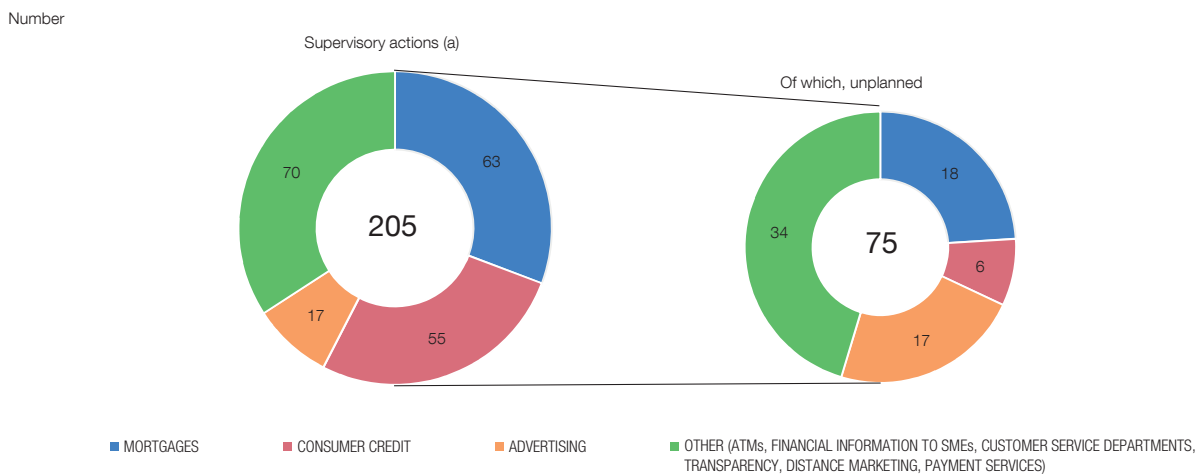
SUPERVISION OF CONDUCT: MAIN AREAS OF ACTIVITY



SOURCE: Banco de España.

Chart 4.1

CONDUCT-RELATED SUPERVISORY ACTIONS IN 2019 BY SUBJECT MATTER



SOURCE: Banco de España.

a Of these supervisory actions, 65 were initiated before the beginning of 2019.

MARKETING OF REVOLVING CREDIT CARDS

In 2019 the Bank conducted a cross-institutional supervisory action on 26 of the institutions that most actively market revolving credit cards. The aim was twofold: to increase the supervisor's knowledge of this market; and to monitor the degree of compliance with Law 16/2011 of 24 June 2011 on credit agreements for consumers.

Revolving credit cards have an associated credit limit. The drawn credit is not repaid in full at the end of each settlement period, but rather paid off in regular instalments. The drawable credit is partially replenished as the borrower pays the instalments, less interest and fees.

While there are credit cards that operate exclusively as revolving credit cards available on the market, there are also others that accept different payment methods. The most common method is paying off the full due balance at the end of the calendar month.

A high proportion of the credit cards operating solely as revolving credit cards are issued with the default configuration for the payment of a pre-set minimum instalment. This considerably lengthens the time it takes to pay off the credit drawn, and may even result in it never being paid off if the instalments only cover interest and fees.

Credit cards with several payment modalities tend to be configured, by default, for the full balance to be paid off at the end of the month interest-free; however, some are issued as deferred payment cards with pre-set minimum instalments.

The supervisory action centred on the marketing conditions for these products. Specifically, it focused on the following matters:

Advertising for these cards not omitting relevant information or including skewed or incomplete information; in particular, the issue free of charge of the card as a means of payment being omitted unless there is clarification that such lack of charge, as is often the case, does not apply to the drawing of credit or the associated interest rate.

The assistance that should be provided to the consumer not being limited to the provision of pre-contractual information or the information available on the institution's website. Instead, it should be accompanied by appropriate explanations. These, among other information, should detail the risks associated with the chosen payment method. The institution must ensure that the personnel marketing the product have the knowledge required to provide appropriate advice, particularly in the case of outsourced or externalised services.

Institutions ensuring the customer is always provided with the Standard European Consumer Credit Information form prior to commencing the process to take out the product, and it not having any content- or form-related shortcomings.

Lastly, as regards responsible lending, institutions ensuring the underwriting analysis procedures, methods and policies are sufficient and appropriate to assess the consumer's creditworthiness and that, in any event, suitable documentation for such purpose is requested.

The aim of this action is to contribute to improving consumer protection in this market, by sending to the institutions in question the appropriate requirements letters to correct inappropriate conduct and by using the information obtained to identify best practices that guide regulatory action in this field.

areas remain important, i.e. mortgage lending, the transparency of payment services, advertising, the functioning of customer service departments and the activity of establishments buying and selling foreign currency banknotes and traveller's cheques.

In addition to the activities conducted on revolving credit cards detailed in Box 4.1, consumer credit supervisory actions included focusing on financing for car purchases and credit linked to the supply of goods and services. The Bank has instituted a cross-institutional action aimed at ensuring correct application of transparency and consumer protection legislation, and banking best practices when granting loans in the form of overdrafts on sight deposits.

Figure 4.2

MATTERS GIVEN PRIORITY IN THE SUPERVISORY REVIEW OF COMPLIANCE WITH LAW 16/2011 OF 24 JUNE 2011 ON CREDIT AGREEMENTS FOR CONSUMERS

AREAS OF ACTION	MATTERS GIVEN PRIORITY
GOVERNANCE AND PRODUCT OVERSIGHT	<ul style="list-style-type: none"> – Correct definition of internal powers over product design and approval – Definition of a target customer – Establishment of controls over intermediaries – Definition of sales staff training plans – Establishment of remuneration criteria associated with service quality
PRE-CONTRACTUAL INFORMATION	<ul style="list-style-type: none"> – Provision of appropriate explanations to the consumer regarding the credit agreement, giving a balanced description of the product's advantages and risks – Provision of the Standard European Consumer Credit Information (SECCI) to the customer in good time and, in any event, prior to the customer assuming any contractual obligation – Substantiation of the provision to the customer and storage of the pre-contractual information; establishment of a procedure to do so – Constant updating of pre-contractual information models to bring them into line with the prevailing legislation
CONTRACTUAL DOCUMENTATION	<ul style="list-style-type: none"> – Constant updating of model agreements to bring them into line with prevailing legislation
RESPONSIBLE LENDING	<ul style="list-style-type: none"> – Lending procedures should be in line with the responsible lending provisions and principles laid down, respectively, in Rule Twelve of, and Annex 6 to, Circular 5/2012
REGULAR INFORMATION TO CUSTOMERS	<ul style="list-style-type: none"> – In each periodic settlement of interest or fees, customers must be provided with a settlement document that expresses clearly and accurately the matters metioned in Rule Eleven of, and Appendix 4.3 to, Circular 5/2012
UNARRANGED OVERDRAFT	<ul style="list-style-type: none"> – Accuracy of the APR calculation and compliance with the limitation in Article 20(4) of Law 16/2011 – Conformity of the interest rates and fees with those stipulated in the agreement and the maximum rates and fees issued in Annex 2 to Circular 5/2012 – Transparency and information provided to the customer prior and subsequent to opening an unarranged overdraft

SOURCE: Banco de España.

Figure 4.2 breaks down by area the matters given priority in the review of compliance with Law 16/2011 of 24 June 2011 on credit agreements for consumers.

As regards mortgage loans, one of the agreements with the greatest impact on consumers, the Banco de España has endeavoured to ensure transparency both when such loans are marketed and over their term, with particular focus placed on the protection of those mortgagors facing grave economic hardship. In line with the approach of recent years, the Bank has continued to review the mortgage portfolio of the industry's most significant institutions. In addition to monitoring formal compliance with the requirements under the aforementioned legislation, in 2019 the Banco de España continued to monitor whether floor clauses were properly applied in accordance with the provisions of mortgage loan agreements.

MONITORING COMPLIANCE WITH TRANSPARENCY OBLIGATIONS AT BANK BRANCHES

In order to assess whether the information and documentation provided to bank customers at branches comply with the legislation governing the transparency of banking products and services and bank customer protection, in March 2019 Banco de España employees visited 189 branches of 12 institutions throughout Spain.

The analysis of the documentation obtained and the information gathered in interviews with the employees of those branches provided the supervisor with a privileged insight into the degree of the sales network's awareness of the need for appropriate conduct when dealing with bank customers.

This action is part of a supervisory strategy promoting the "conduct culture" in institutions in order to prevent inappropriate practices detrimental to the customer. It has also made it possible to better convey the related supervisory expectations to institutions' regulatory compliance areas.

The following matters were monitored through this action:

The *Mortgage Loan Access Guide* being included in the pre-contractual information made available to interested customers and appropriate explanations about the commercial offer being given with the Pre-contractual Disclosure Document (FIPRE by its Spanish name).

Information provided on the procedure and costs to remove the discharged mortgage from the Land Registry clearly stating that the institution will not charge any amount to merely issue a certificate evidencing repayment of the loan or for a legal representative appearing before a notary to execute a public deed declaring the loan repaid.

In relation to the pre-contractual information for personal loans and revolving credit cards, the "European Standardised Information Sheet" (ESIS) including the necessary information and being used as the pre-contractual disclosure document upon which the explanations of the financing offered are based.

The information on submitting complaints to the institution being available on the branches' notice boards and the institution ensuring proper receipt and referral of the complaints to the customer service department.

The form provided to customers to claim allegedly unauthorised card charges or complain about discrepancies concerning cash withdrawals from ATMs including a warning about the temporary nature of the possible payments of the amounts claimed.

The information relating to the Code of Good Practice for protecting mortgagors experiencing financial hardship being available on the notice board and provided to the customer.

Customers being aware of limits on withdrawals above or below an amount. Timetable restrictions not specifically stipulated in the agreement cannot be placed on the provision of a basic cash service.

This action allowed 306 advertisements to be analysed; some shortcomings were detected, the most common being expired advertising.

This action at the point of sale is deemed a particularly useful tool for preventing inappropriate conduct, since it bolsters institutions' conduct culture. It will therefore continue to be performed in coming years.

Along with identifying and correcting institutions' inappropriate conduct, all the aforementioned supervisory activities sought to promote the implementation of a conduct culture and appropriate governance that, with the commitment of the institutions' governing bodies, pervade the entire organisation. In that way, banks may constantly behave responsibly and ethically in their dealings with customers, irrespective of the channel used. In this connection, the Bank is bolstering those supervisory actions that monitor the marketing conditions at the point of sale. Box 4.2 details a supervisory action conducted at bank branches.

Lastly, as part of the supervisory efforts to monitor marketing conditions across all possible channels, digital technology's huge impact on the way institutions interact

TECHNOLOGY'S IMPACT ON THE SUPERVISION OF INSTITUTIONS' CONDUCT

The financial sector, like the rest of society, has been impacted by the technological change linked to digitalisation. Adapting to it is crucial to the future of the banking business. Nonetheless, it is essential that in this changing environment institutions continue to treat their customers responsibly and ethically.

New technologies mean that customers have a wider variety of products available to them, which they access through new, faster and personalised channels. Such speed and misunderstood ease may pose additional risks when taking out certain credit products and incentivise rash consumption.

It is also important that institutions' processes and internal applications are included in the technological change, since banks' internal operations are key to providing an appropriate service to customers.

Digitalisation does not just affect the banking sector. Naturally, it also impacts supervisory activity and, specifically, the supervision of conduct. This change results in new areas and, particularly, new channels to be supervised to ensure that the digital transformation is not in any way damaging to the level of customer protection.

Greater knowledge of institutions' digital transformation was obtained in 2019. Information was gathered from institutions on their approach to digitalisation. This includes their methodology and strategies, and digitalisation's impact on each phase of each product's marketing process.

In this connection, the Banco de España has continued to assess the distance marketing of current and savings

accounts through channels such as institutions' websites and smartphone applications. The Banco de España has checked that adequate explanations, using clear, concise language highlighting the information on costs and fees, are furnished and that the prior information is provided in good time before the consumer is bound by any credit agreement. It is important that the customer understands the consequences of taking out the banking product and that the risks stemming from the immediacy of taking out products digitally are minimised.

The Banco de España has continued to participate in the international discussion on adapting conduct-related supervisory tools to the digital environment, particularly through its involvement in the International Financial Consumer Protection Organisation (FinCoNet).

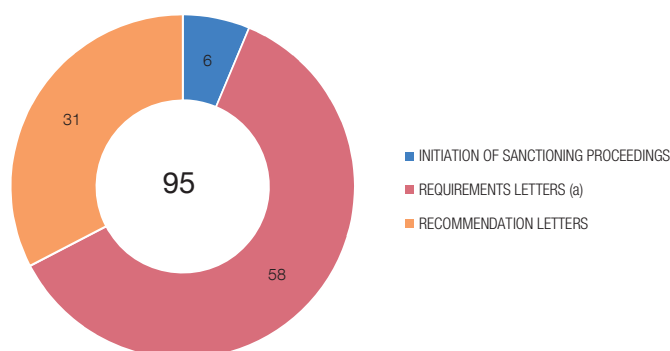
New technologies have also been integrated into the supervisory activity. For instance, machine-learning techniques have been implemented to support management and analysis of the data gathered when conducting supervisory activities. These techniques, based on the tool's "continuous learning", make it possible to analyse more data and documentation by extracting and automatically identifying certain data, automatically categorising documents and transforming unstructured data into structured reports.

Digitalisation applied to supervision ultimately results in greater insight into supervised institutions' degree of compliance with transparency legislation, thus opening up a new range of opportunities for supervision in general and for market-conduct supervision in particular.

with their customers cannot be ignored. Box 4.3 shows how analysis of the impact of digitalisation on banking activity continues to be a supervisory priority.

4.2 Adoption of supervisory measures

Noteworthy among the supervisory measures adopted is the initiation of six sanctioning proceedings. These stem from five inspections conducted in the mortgage loan area and one inspection concerning the application of the Code of Good Practice included in the annex to Royal Decree-Law 6/2012 of 9 March 2012 on urgent measures to protect mortgagors experiencing financial hardship (Royal Decree-Law 6/2012). Chart 4.2 details the supervisory measures adopted in 2019 as a result of the verifications conducted in the various supervisory actions.

SUPERVISORY MEASURES ADOPTED IN 2019

SOURCE: Banco de España.

a The 58 requirements letters contain 222 specific requirements for institutions.

The requirements and recommendations necessitate follow-up to verify effective compliance. Part of the supervisory efforts in 2019 centred on verifying effective compliance with the requirements and recommendations issued to correct shortcomings detected in the completed supervisory actions.

Also, as regards the supervisory review of advertising in 2019, which monitors whether customers receive clear, sufficient, impartial and accurate information, 441 letters were sent requesting the removal or rectification of advertising that did not meet the legislation's requirements.

Lastly, it should be noted that over the last five years, since October 2014 when the powers to supervise institutions' conduct were conferred on the Market Conduct and Claims Department, approximately 650 supervisory actions have been conducted. These have resulted in 26 sanctioning proceedings, 218 requirements letters and 469 recommendation letters. Several of these measures may correspond to the same action.

All the supervisory activities have made a major contribution to bolstering institutions' banking-product regulatory compliance function and the role of customer service departments. The compliance function and the customer services department are key to developing and promoting the conduct culture that must permeate institutions' business.