

INDEPENDENT EVALUATION OFFICE

LETTER FROM THE GOVERNING COUNCIL ON THE EXTERNAL EVALUATION OF THE BANCO DE ESPAÑA'S CONDUCT SUPERVISION

Banco de España

On 30 May the report on the external evaluation of the Banco de España's conduct supervision¹, carried out as part of the Bank's 2023-2024 annual evaluation plan, was submitted to its decision-making bodies.

The external evaluation was conducted by an Evaluation Committee ("panel") comprising three independent experts of recognised standing in the field of conduct supervision: Stefan Ingves, Hanzo van Beusekom and Pedro Duarte Neves.

Since the 2008 financial crisis, the financial sector has undergone sweeping regulatory change in the field of conduct and consumer protection. This has led to the development of new legislation in Spain and other countries. Consequently, in recent years, the Banco de España has conducted many actions to check compliance with transparency legislation in the mortgage lending, consumer credit and provision of payment services arenas. Among other actions, it has spearheaded the monitoring of advertising and customer services departments. In addition, one of the initiatives of the Bank's Strategic Plan 2024 was to strengthen the supervision of institutions' conduct.

Against this background, the Governing Council considers that the evaluation of this function has been particularly useful.

In its report, the panel highlights the significant headway made in recent years in conduct supervision at the Banco de España. The progress it welcomes includes the recently adopted strategic change from a predominantly legalistic corrective approach to a preventive supervisory policy (e.g. risk-based) one.

With regard to the main areas of improvement, the panel highlights that most conduct risks are usually market-wide risks, rather than being firm-specific, and therefore it recommends a rebalancing in risk assessment, putting the spotlight on market risks and relegating institution-specific risks to a second level.

¹ Conduct supervision consists of checking that institutions treat customers fairly, transparently and in line with the rules governing the arrangement of banking services.

To estimate institution-specific risk, the panel proposes defining additional indicators that complement the complaints-based ones. Further, it suggests broadening the supervisory tools used, publishing reports on cross-cutting topics, reviewing compliance with the supervisory expectations set and gaining deeper knowledge of institutions by analysing their culture, governance and internal control.

Similarly, it advises strengthening the current sanctioning regime, and that, where applicable, the Banco de España promote changes to facilitate its implementation by lawmakers.

Turning to efficiency improvements, the panel emphasises the importance of having a strategy to develop and apply new technologies and of using internal indicators, particularly those that measure the duration of inspections. From a human resources standpoint, it proposes hiring outside the traditional realm of economists and lawyers to incorporate complementary profiles – including data scientists, behavioural economists, communication experts – into the teams.

Lastly, to improve transparency and accountability, it recommends implementing a more proactive communication agenda that reinforces industry and public outreach, and monitoring supervisory expectations more closely.

As part of the action plan to address the above-mentioned improvements, the Banco de España will update the definition of conduct risk and its assessment and quantification methodology, focusing on the potential harm to consumers and a market-wide approach, rather than relying on a supervision model based solely on the case-by-case assessment of the institution-specific risks of supervised institutions.

In addition, the definition of institutions' risk profile will be revised to incorporate new qualitative and quantitative – preferably forward-looking – indicators, that enrich the predominantly complaints-based approach followed to date.

Similarly, market-wide supervisory actions will be strengthened in order to verify the degree of compliance with supervisory expectations. Supervisory actions will be fleshed out with a stronger focus on monitoring the most significant institutions, in order to gain more insight into their governance and internal control.

Efficiency and effectiveness metrics will also be established in order to streamline supervisory action processes and procedures. Moreover, the use of new technologies will be promoted, harnessing the synergies with the evaluation of SupTech in prudential supervision. In addition, an action plan will be defined to hire from outside the traditional realm of economists and lawyers. and to capitalise on in-house talent.

The Bank will also devise a communication strategy that establishes the communication milestones and the criteria for disclosing such information, aimed at supervised institutions, sectoral associations, consumer associations, other stakeholders and the general public. As part of its drive to boost transparency, every two years the Bank will publish a forward-looking document on the main sectoral risks identified from a conduct perspective and the Banco de España's expectations of how institutions should address them.

Lastly, and in line with Action Plan 4.2. in the Strategic Plan 2024 ("Programme for positioning the Banco de España as a leader in the Eurosystem and in the global arena"), two or three leading conduct supervision authorities will be identified to encourage the sharing of supervisory best practices and staff training.

The Governing Council thanks the panel for its evaluation and agrees with its main recommendations, particularly those referring to the use of a forward-looking risk-based model. It also shares its view on the critical role of communication, the importance of staff training and the harnessing of new information technologies to make efficiency gains. In this regard, the Governing Council welcomes the action plan submitted by management of the Banco de España in response to the evaluation.