

INDEPENDENT EVALUATION OFFICE

## EXTERNAL EVALUATION OF THE BANCO DE ESPAÑA'S CONDUCT SUPERVISION

Banco de España



# EXTERNAL EVALUATION OF THE BANCO DE ESPAÑA'S CONDUCT SUPERVISION

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**The views expressed in the report are those of the authors and not necessarily those of any institutions to which they are affiliated**

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## 1 Introduction

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In a market economy we often assume that markets function well and we understand what it means to buy and sell, how buyers and sellers agree on what is bought and how a transaction is completed. In many markets, not the least the financial sector, there is often an information asymmetry between buyers and sellers, and contracts can be complex. Often there are many small buyers and a more limited number of sellers. Two examples in our context are mortgages and consumer loans.

In order for markets to function, the market microstructure needs to guide and standardise how millions of transactions are handled. When markets are dysfunctional, transaction volume tends to decrease, and, in severe instances, the market may stop functioning, resulting in welfare losses to individuals, firms and society as a whole. Thus, it is in the public interest to ensure fair and functioning markets. To this end, conduct rules and conduct supervision are valuable public goods, which are not always recognised, but are one of the cornerstones of a well-functioning market economy.

The Banco de España is responsible for conduct supervision, an important activity with a clear vocation as a public good. A well-managed society at large gains from a job well done. However, if it is not well-managed significant reputational risk may ensue. Against this background, it is commendable that the Banco de España has asked for an external evaluation of its conduct supervision with a view to developing this function, so that it is fit to face future challenges.

This evaluation is one of a series of multiple reviews that are part of the [Banco de España's Independent Evaluation Office](#) covering many aspects of the Bank's multi-faceted work,<sup>1</sup> and its format is roughly similar to the others. The focus here is on the assessment of the Banco de España's supervision of banks' handling of their customer relationships (using a broad definition of banks). It is an examination covering the key aspects of conduct supervision, as defined in its [Terms of Reference](#): strategy, methodologies, data and resources. The members of the Evaluation Committee (or panel) were Stefan Ingves, Hanzo van Beusekom and Pedro Duarte Neves.

The structure of the report is as follows. To set the stage, Chapter 2 provides a brief overview of conduct supervision at the Banco de España from its origins to the present day. Chapter 3 introduces a stylised conceptual model for conduct supervision, which is taken as a reference for this external evaluation. Chapter 4 is the assessment itself conducted by the panel, addressing the subjects defined in the terms of reference. It highlights the main findings and recommends

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<sup>1</sup> The external evaluations already completed are related to the Banco de España's: (i) [research activities](#), (ii) [macroeconomic projections](#), (iii) [use of technological innovation in the prudential supervisory function \(Suptech\)](#), and (iv) [dissemination of economic and financial production](#). Further, there are two other external evaluations in progress, as part of the annual evaluation plan 2023-2024: (i) [international cooperation at the Banco de España](#), and (ii) [the Banco de España's macroprudential policy-making framework](#).

concrete actions to enhance the supervisory work of the Banco de España. Chapter 5 concludes with a proposal on the way forward for conduct supervision at the Banco de España.

This final version reflects the independent view of the panel, which is fully responsible for its content.<sup>2</sup>

The preparation of this report has benefited from many contributions. The panel has: (i) received extensive documentation provided by the Banco de España, explaining in detail how the supervision of banking customer protection is currently conducted; (ii) interviewed about forty key informants, including the Banco de España's top management and staff, senior management of other financial supervisory agencies, and representatives from the banking sector and the consumers' association; (iii) held regular progress meetings with the Banco de España's staff members; and (iv) exchanged views with some renowned supervisory experts on prevailing best supervisory practices in this field.

The panel is grateful to all those who agreed to exchange views with us. We are thankful for the excellent support provided by the Banco de España staff for their openness, cooperation, and enormous help in providing us with all the required materials. We particularly wish to thank Maria Gutiérrez de Ojesto and her team for their assistance in all the organisational aspects that made this external evaluation possible. Finally, the panel would like to thank Robbert Barth, senior strategist at the Netherlands Authority for the Financial Markets, for his valuable contributions.

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<sup>2</sup> A draft version of the report has been commented on and checked for facts by the Banco de España.

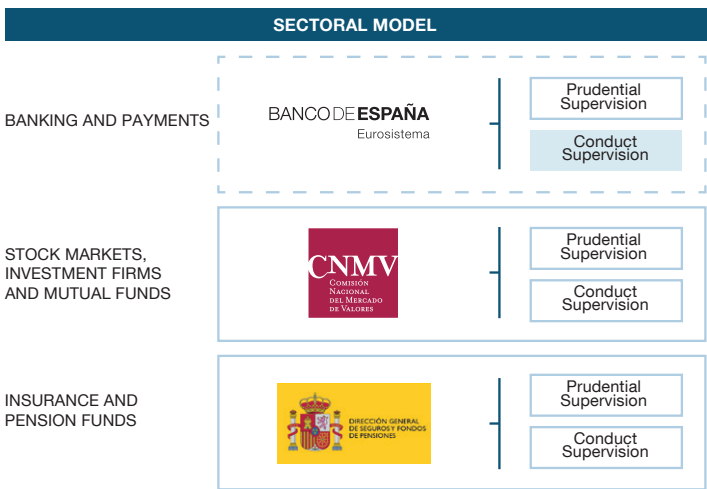
## 2 A brief history and structure of conduct supervision

### 2.1 The institutional financial sector set-up in Spain

Financial supervision in Spain is based on a sectoral model, with three different supervisors for each of the main financial sectors: the Banco de España for the banking and payment sector, the National Securities Market Commission (CNMV) for the securities sector and the Directorate General for Insurance and Pension Funds (DGSFP) for the insurance and pension funds sector.

The Banco de España exercises microprudential supervision of credit institutions and other financial intermediaries as part of the Single Supervisory Mechanism (SSM). The Banco de España exercises independently conduct supervision of credit institutions and other financial intermediaries, and in cooperation with the other national supervisors within the scope of their respective remits. The Institutions' Conduct Department oversees conduct supervision within the Banco de España.

Figure 1  
Financial supervision in Spain – Sectoral Model



SOURCE: Banco de España.

General consumer protection policy is a shared competence by the State (the central government) and the regional (autonomous) governments, the latter within their respective territories. The central government promotes and coordinates strategies and draws up legislation. It also sees to the relationship with European Union (EU) institutions and the transposition of EU directives into national legislation. Inter-territorial coordination at the highest level is ensured by the *Conferencia Sectorial de Consumo*<sup>3</sup> (Sectoral Conference on Consumer Affairs). General consumer protection legislation is regulated and enforced by the Consumer Protection Authorities in Spain (see table on the next page).

3 Cooperation and coordination body between the central government and the Spanish regional (autonomous) governments, chaired by the Minister of Consumer Affairs and comprising the regional ministers competent in the matter from the different regional governments.



Table 1  
The institutional financial sector set-up in Spain

		Prudential and Conduct Regulation	Prudential and Conduct Supervision	Dispute resolution
Set-up for general consumer protection		<ul style="list-style-type: none"> <li>— Parliament</li> <li>— Central government</li> <li>— Regional governments</li> </ul>	<ul style="list-style-type: none"> <li>— Regional governments</li> </ul>	<ul style="list-style-type: none"> <li>— Courts</li> <li>— Consumer arbitration</li> </ul>
Financial activity Sectorial Approach	Banking and payments	<ul style="list-style-type: none"> <li>— Parliament</li> <li>— Central government</li> <li>— Banco de España (delegated acts)</li> </ul>	<ul style="list-style-type: none"> <li>— Banco de España</li> </ul>	<ul style="list-style-type: none"> <li>— Banco de España</li> <li>— Courts</li> </ul>
	Stock markets, investment firms and mutual funds	<ul style="list-style-type: none"> <li>— Parliament</li> <li>— Central government</li> <li>— CNMV (delegated acts)</li> </ul>	<ul style="list-style-type: none"> <li>— CNMV</li> </ul>	<ul style="list-style-type: none"> <li>— CNMV</li> <li>— Courts</li> </ul>
	Insurance and pension funds	<ul style="list-style-type: none"> <li>— Parliament</li> <li>— Central government</li> <li>— DGSFP</li> </ul>	<ul style="list-style-type: none"> <li>— DGSFP</li> </ul>	<ul style="list-style-type: none"> <li>— DGSFP</li> <li>— Courts</li> </ul>
	AML&KYC	<ul style="list-style-type: none"> <li>— Parliament</li> <li>— Central government</li> </ul>	<ul style="list-style-type: none"> <li>— Banco de España</li> <li>— SEPBLAC (FIU)</li> </ul>	<ul style="list-style-type: none"> <li>— Courts</li> </ul>

SOURCE: Banco de España.

## 2.2 A short history and introduction of the Institutions' Conduct Department

The Banco de España long-standing concern for the conduct of credit institutions and supervised entities in general dates back to 1987, when the Complaints Service was established. At the time, all the supervisory competencies, including those related to conduct, were assigned to the Directorate General Banking Supervision. In the following years, promoting compliance with transparency and disclosure rules and monitoring good market practices in the banking sector became more significant, and a key approach to sharpen the relationship with customers. This is in line with similar developments in other countries.

In 2013 conduct regulation, transparency and disclosure of information, good practices, banking advertising, consumer information, out-of-court dispute resolution and the like were merged. To ensure more conformity and increase efficiency, and because of the importance of the financial sector in 2013, the **Conduct Market and Complaints Department** was established within the General Secretariat. The new Department was formed by integrating the former Banking Customer Relations Division and the former Complaints Service.

In 2014, coinciding with the start-up of the SSM, the Banco de España restructured again. Some areas of supervision were not assumed by the SSM and continued to be within the remit of the national competent authorities. In this context, particularly all those related to conduct and consumer protection. A new division (**Oversight of Institutions Conduct Division**), responsible for surveillance and inspection of the conduct of all supervised entities was established. The new structure allowed the department to interact with supervised entities, monitoring their activities and compliance, including on-site and off-site inspections, as well as to adopt or propose the adoption of disciplinary measures. The new division used information available through the resolution of complaints to develop and implement preventive regulatory and monitoring policies, aimed at

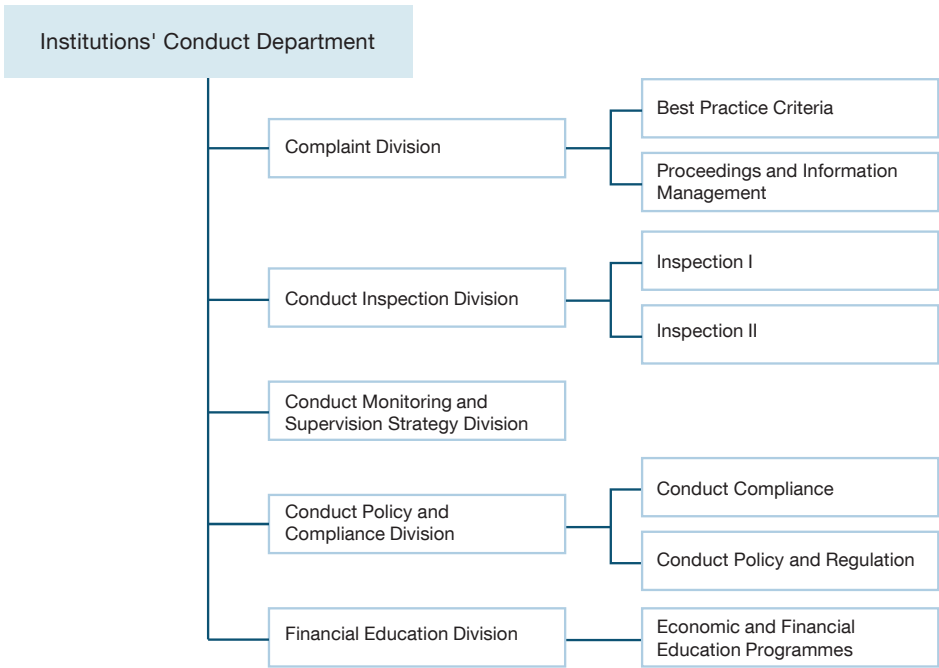


promoting the proper behaviour of banks with their customers. The expanded Department of Market Conduct and Complaints, which was later renamed the **Institutions' Conduct Department**, was still under the General Secretariat's remit, but by then separated from other supervisory tasks.

In 2022 the Banco de España created the **Directorate General Financial Conduct and Banknotes**. The creation of this new directorate general included, together with the Institutions' Conduct Department, the Cash and Issue Department, the Banknote Production Control Department and the Branch Offices Departments, which were within the former Directorate General Cash and Branches. One of the objectives of the reorganization was to take advantage of the branch network when developing on-site supervisory actions, as well as integrating and improving the coordination of the various financial education initiatives in which the Bank participates. To this end, a new **Financial Education Division** was created.

The organisational chart of the department, at the date of this report, can be found below.

Figure 2  
The organisational chart of the Institutions' Conduct Department



SOURCE: Banco de España.

The staff numbers increased from 16 in 2014 to 62 in 2023. This increase is significant, though overall levels are still very low in proportion to the number of staff performing supervisory and oversight functions at the Banco de España. In 2022 there were 894 employees working in supervision. Of these, 60% performed prudential supervision in the Directorate General Banking Supervision; 23% performed their tasks in the Directorate General Financial Stability, Regulation

and Resolution; 7% worked in the Institutions' Conduct Department; 6% in the Deputy General Secretariat; and 4% in the Directorate General Operations, Markets and Payment Systems.

International comparisons of staff numbers devoted to conduct supervision are not easy to make accurately, because the national institutional set-up and the structure and the size of the financial sector matter. There is also a minimum size necessary to execute meaningful supervision. That said, the panel has the impression, after performing a comparison with a few other euro area countries, that the staff resources allocated to conduct supervision seems tilted to the low side, despite the increase in staff for quite a number of years. Chapter 4 of this report returns to this issue.

At the end of 2023, 1,096 financial institutions and persons with a permanent establishment were registered. Among them, 47 banks, 61 credit cooperatives, 576 real estate credit intermediaries and 140 real estate lenders. There are also more than 700 institutions authorised to operate in Spain without a permanent establishment registered with the Banco de España. They also fall within the scope of the conduct regulations and must observe the applicable regulatory and disciplinary provisions. In sum, the Banco de España and its Institutions' Conduct Department are responsible for, in one form or another, supervising a large number of entities with a limited number of staff.

## **2.3 How supervisory actions are planned**

Supervision and enforcement require thorough planning and active trade-offs, bearing in mind the large number of institutions under supervision and the existing size of the staff. The risks that affect the conduct of the supervised entities are defined, assessed, and recorded yearly.

The institution-specific supervisory priority is determined by its conduct profile, which has two components: (i) the conduct category, which classifies supervised institutions based on the relative importance of the businesses and activities they carry out; and (ii) the conduct risk for institutions, based on their "conduct footprint". The supervisory experience acquired over the years informs this quite mechanistic approach with qualitative elements based on supervisory judgement. Depending on the conduct profile a supervisory cycle of supervisory intensity is assigned. These cycles are not rigid: the frequency may vary depending on the developments observed and on expert judgement.

Ongoing conduct-related monitoring involves analysis of product offerings, the treatment and subject-matter of complaints, the analysis of the reported data, or how to address the problems of mortgage debtors in vulnerable situations. In addition to the verification activities, cross-cutting activities are also carried out with the main focus on the assessment of a certain aspect of institutions' conduct or of compliance with regulations for a set or type of supervised institution. This more thematic analysis of a certain operation or business model is more general and covers a group of institutions.

42 inspections of individual institutions were carried out in 2023 and 111 supervisory actions were performed, including some cross-cutting supervisory actions related to responsible lending in consumer credit, customer services departments, deferment of payment at points of sale, contractual limits on payment services, payment account switching service, among others. The number of inspections and supervisory actions gradually increased by a factor of two between 2015 to 2023 (from 77 to 153).

In addition, individual monitoring (28 institutions), grouped monitoring (188 institutions), monitoring of supervisory measures (131) and monitoring by subject (3) were carried out. These supervisory activities led to various types of enforcement measures, which are also listed in the table below.

Table 2  
**Supervisory activities 2023**

Supervisory activities 2023	
Inspections	42
Supervisory actions	111
Subtotal	153
Individual monitoring	28
Grouped monitoring (188 institutions)	1
Monitoring of supervisory measures	131
Monitoring by subject (complaints, consultation and advertising)	3
Subtotal	163
Total	316
Supervisory Measures Adopted and Advertising Requirements	
Initiation of sanctioning proceedings	1
Requirements (a)	44
Recommendations (b)	76
Advertising requirements (c)	57
Total	178

**SOURCE:** Banco de España.

- a** Letters requesting compliance with legal requirements or requesting to cease a certain conduct or adopt certain rectification measures.  
**b** Letters making clarifications or explaining a supervisory expectation, or reminding good banking practice, when it could not be clearly proved or considered a legal infringement.  
**c** Specific requirements related to the advertising activity of the financial institutions.

Lately, a substantive effort has been made to reduce the time frame of inspections. An overview of the average duration of supervisory actions over the last ten years shows that the duration of inspections has shortened in recent years. The objective defined by the Banco de España is to continue on this path and carry out agile inspections with a narrower scope and within a much-reduced time frame.

## 2.4 A new strategy

The Banco de España is gradually implementing a new strategy. The aim is to move from a predominantly legalistic corrective approach to a preventive supervisory policy (e.g. risk-based)

approach. This move involves strengthening monitoring by improving the knowledge of markets and institutions; improving the planning of supervisory actions; exploring more efficient and effective inspections; searching for greater impact of supervision through mechanisms that amplify its results; and defining a policy for communication with supervised entities and the general public. Some of these objectives are already implemented and some others are still under development.

## **2.5 The future of complaints resolution**

Regarding the institutional framework for alternative dispute resolution, a political decision has been made to create a single agency responsible for handling financial complaints. This new authority will replace the existing Complaints Services of the sectoral financial supervisors (i.e. the Banco de España, the CNMV and the DGSFP), which will, however, retain all their powers to supervise the conduct of business requirements in their respective areas of activity, including the proper functioning of the customer services of supervised institutions.

A hybrid supervisory architecture model will be established, which is neither aligned with the current model nor an integrated two-pillar (“Twin Peaks”)<sup>4</sup> model, posing new challenges in terms of inter-institutional cooperation to ensure adequate coordination and information exchange between the new authority and the sectoral supervisory authorities. In this respect, the draft law establishes mechanisms for the exchange of information and adequate coordination that will require further development.

The draft law stipulates that the responsibility for developing and defining best practice standards, as well as for answering queries and consultations, will remain with the supervisory authorities. These criteria and standards will then be applied by the new authority. This future new structure will have organisational consequences and, once implemented, will require future focus.

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4 Twin Peaks is a form of supervisory specialisation by objectives, with prudential and conduct responsibilities separated in two different agencies. Daniel Calvo, Juan Carlos Crisanto, Stefan Hohl and Oscar Pascual Gutiérrez. (2018). “[Financial supervisory architecture: what has changed after the crisis?](#)”. *FSI Insights on policy implementation*, 8. BIS Financial Stability Institute.

## 3 Conceptual model for conduct supervision

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### 3.1 Introduction

There is no internationally recognised assessment framework for conduct supervision. This chapter introduces a stylised, conceptual model for conduct supervision which will be used as the reference for this external evaluation. The model is based on a set of international good practices for conduct supervision, supplemented by the panel members' own experience.

### 3.2 Objectives

Conduct supervision has two overarching objectives.

- a. The main objective of conduct supervision is to have an **impact**, to achieve the agency mission, i.e. to ensure a marketplace where entities comply with rules and regulations, where entities conduct themselves appropriately and where no harm is done. Or, in practice, the supervisory agency aims to limit risks, non-compliance and harmful behaviour.
- b. The second objective refers to professionalism and the **reputation** of the agency. Supervisory agencies have an important public role in society. Activities, actions and results – or the lack thereof – need to be explainable. This requires, among other things, accountability, a reflective attitude and high standards within the agency. Moreover, a strong reputation is a prerequisite for trust in the agency and having an impact.

### 3.3 Context

The way an agency, department or team conducts supervision depends on the **context** it operates in. The work is neither fixed nor one-size-fits-all. The approach and the supervisory tools that are used are a means to an end and derived from, among other things, the agency mission, legal framework and development of risks:

- a. **Legal framework:** the mandate, regulation and the legal framework determine what is required from the agency and provide it with the instruments to do the work. It is essentially exogenous to the supervisory agency. More broadly, the greater the agency's leeway to decide where to focus its attention and how to perform its activities, the more opportunities to design its own supervisory approach.
- b. **Agency mission:** the choice between a narrower mission (compliance) and a broader one (harmful conduct and outcome) drives all aspects of the supervisory approach. A narrower mission typically comes with a narrower interpretation of risk (risks are always related to specific entities and compliance). A broader mission requires a broader view of risks (all sorts of developments, circumstances and behaviours can lead to harm).

- c. **The development of risks:** two distinct phases in the life cycle of risks can be distinguished. There are current known risks that are regular and for which there is typically a developed supervisory approach. There are also future potential new risks that are emerging, yet to be fully understood and that require a forward-looking supervisory approach. These risks are essentially, but far from being exclusive, exogenous to the supervisor, meaning that they somewhat reflect the endogenous evolution of market conditions (technology, competition, digitalisation, cross-border).

An agency consciously reflects on these types of contextual factors when designing its risk-based supervisory approach. The approach is subsequently applied consistently.

### 3.4 Approach: core activities

Conduct supervision is risk-based and the way an agency operates depends (largely) on the type and development of risks.

**Risk** is defined here as: market conditions where a pattern of behaviour by actor(s) leads to undesired outcomes. This simple definition has multiple elements: market conditions (such as rising inflation, intensified competition, digitalisation or cross-border deepening), pattern of behaviour (e.g. aggressive lending practices), actors (specific entities or groups of consumers) and undesired outcomes (non-compliance, harm).

Conduct supervision needs to be more focused on important risks than on lesser risks, because it is constrained by its limited budget and capacity. Not all risks can be monitored, not all entities can be investigated intensively, and not all issues can be acted upon. Particularly, not at the same time. Choices need to be made. Making tough choices is difficult and uncomfortable because of limitations in the available information and the comparability of options, and because choices have consequences if you get them wrong.

Conduct supervision consists of three core operational activities: to **detect**, **investigate** and **mitigate**.

- a. **Detect:** to systematically identify and monitor known risks and being alert and open to new risks. This requires both organisational discipline and an unbarred, outward-looking mindset. Examples of detection activities are conducting an annual industry-wide risk identification analysis by processing signals and claims, and interviewing industry experts.
- b. **Investigate:** to understand a situation, grasp the underlying pattern of behaviour and assess its severity. The investigation shows whether an issue is an isolated incident, a symptom of more fundamental issues within an entity or a sign of a wider problem

within the sector. This requires extensive expertise, analytical skills and sound judgement.

- c. **Mitigate:** to have the desired impact by addressing the underlying causes and drivers of behaviour and by using a wide set of formal (enforcement and sanctioning) and informal instruments (for instance, soft law). A mitigation strategy is designed to change the way transactions and market activities are carried out. To achieve this requires a skilled regulator to apply a range of tools, as well as perseverance and versatility. Supervised entities and their staff easily change their behaviour.

The activities are guided by **strategic direction and annual (risk) prioritisation and planning**. How scarce resources are employed requires making trade-offs, e.g. the time spent on: (i) detecting/investigating versus mitigating (formal enforcement is time-consuming); (ii) current known versus future potential new risks (the latter lacks urgency); and (iii) current supervisory work versus prospective enhanced support systems and capabilities.

### 3.5 Support systems

The effective operation of an agency requires efficient support systems and different types of organisational capabilities. Three critical elements are briefly discussed below:

- a. **People:** a supervisory agency can only be successful if it is able to attract, retain and develop high-quality staff. The ability to detect, investigate and mitigate known and future risks calls for a wide range of expertise, skills, and attitudes. It involves teamwork and, therefore, the ability to cooperate. It is complex work demanding judgement, discipline, alertness and the courage to make tough decisions. It is important and sensitive work requiring craftsmanship.
- b. **Technology:** supervisory work could be framed as an information problem. Detecting and investigating are ways to limit information asymmetry by obtaining as much relevant data about the market and its participants as possible. Mitigation is the reverse challenge: the ability to get information to participants in a timely and effective manner. Both can be assisted by basic to very advanced technological solutions.
- c. **Processes:** a supervisory agency's work involves many processes that can be optimised, ranging from licensing and complaint processing to on-site inspections and sanctioning. From a management perspective the processes around planning and monitoring the agency's work are especially important as they allow the focus to remain on the agency's performance. It should allow management to answer questions such as "what are the most important risks and how are they developing?"; "which work has been prioritised?"; "is it on track?"; and "are the choices clear and accountable?".

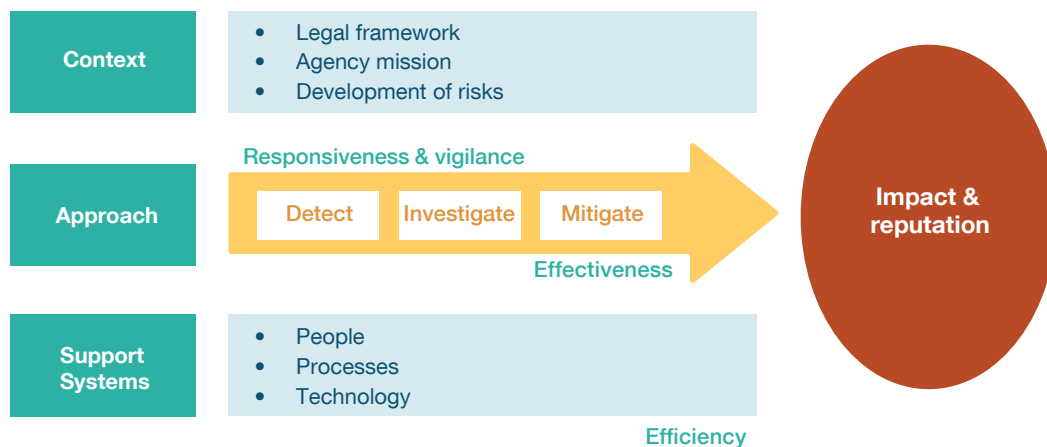


### 3.6 The role of the conceptual model in this external evaluation

The terms of reference of this external evaluation state that it should assess “the responsiveness, efficiency and effectiveness of the banking customer protection supervision function at the Banco de España” and identify “the potential for improvement”. This is the subject of Chapter 4, which identifies the findings and recommendations to further strengthen the conduct supervision function at the Banco de España.

The conceptual model for conduct supervision, schematically illustrated in the figure below, constitutes a reference for this assessment. It distinguishes between the context, the supervisory approach, and the support system. It also highlights the interpretation of what *responsiveness*, *effectiveness* and *efficiency* really are.

Figure 3  
A visualisation of the conceptual model of conduct supervision



SOURCE: Banco de España.

As outlined above, the supervisory approach consists of three complementary activities: detection, investigation, and mitigation. Detection and investigation are closely associated; it is not easy to define a borderline between them. They address aspects such as the identification of risks (market and institution-specific) and the use of supervisory tools (like inspections) to identify possible detrimental situations from the consumer protection standpoint. These closely linked activities characterise the degree of both the vigilance and responsiveness of the supervision function.

However, they do not characterise the *effectiveness* of conduct supervision, which comes with enforcement and, in the sense that it discourages future detrimental situations, sanctioning. Mitigation corresponds to addressing and correcting behavioural patterns that are detrimental to the banking customer through enforcement, soft law that becomes the norm in the market,

communication that levels up market practices or, in the sense mentioned above, sanctioning. If a strong detection and investigation function is not accompanied by effective mitigation, the final impact of conduct supervision is suboptimal. In the same vein, a strong mitigation function brings a modest contribution to the final impact of conduct supervision when vigilance and supervisory responsiveness are weak overall.

*Efficiency* means that the agency disposes of and combines, in the best possible way, the different capabilities – people, technology, and processes – in supervisory activities. Efficiency requires (i) the amount and skills composition of the staff to be adequate; (ii) the use of the most advanced technological possibilities; and (iii) the design and effective implementation of internal processes.

## 4 Assessment of the Banco de España's Conduct Supervision

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### 4.1 Focus and methodology

This report focuses on the assessment of the Banco de España's conduct supervision. In the previous two chapters the panel has focused on how conduct supervision has evolved up to the date of this report, and considerations about the execution of supervision in this field. This chapter examines the key aspects of conduct supervision: strategy, methodologies, data and resources. The related subjects of financial literacy and the treatment of complaints are not addressed, as the Banco de España did not include these matters in the terms of reference.

The assessment follows the terms of reference defined for this external evaluation, as referred to in Chapter 1. The panel opted for a somewhat different structure, building on the conceptual model for conduct supervision as presented in the previous chapter.

The moving context – more specifically, the enhanced supervisory approach envisaged by the Banco de España – gave rise to this assessment. The Banco de España has decided to move from a mostly legalistic approach, which tends to be reactive, to a predominantly forward-looking risk-based approach. This new perspective forms the backdrop for this assessment.

This report assesses whether the supervisory approach (detect, investigate, mitigate) and support systems are aligned with this broader interpretation of the mission. It also presents the tentative findings on the Banco de España's impact. Finally, it delivers recommendations that are intended to contribute to the design and development of a more forward-looking, risk-based approach.

### 4.2 Findings and recommendations

Here the panel identifies the main findings of the evaluation (that is, the panel's assessment of how the Banco de España is supervising banking customer protection, identifying the relative strengths and weaknesses) and provides a set of recommendations for the future (what the panel recommends the Banco de España to implement to further strengthen this supervisory function). As a general guideline, the first paragraph of each subheading below presents, for each specific item, the panel's findings. The remaining paragraphs for the same subheading identify the recommendations put forward by the panel.

#### Detect & investigate

##### a) Identification of market risks

The Banco de España produces a heatmap for a comprehensive list of market risks. In addition, it also classifies the institutions into different buckets. The inspections are defined in accordance with that classification: the riskier the institution and the larger its size, the more frequent the

inspection. The heatmap and the risk classification of institutions are useful and not far from prevailing supervisory practices.

The panel finds that most conduct risks are usually market-wide risks, rather than being firm-specific. As a result, the panel recommends a rebalancing in risk assessment, moving to the center of analysis market risks and relegating institution-specific risk to a second level. More specifically, the panel recommends releasing a public report, with a predominantly forward-looking perspective, to (i) state how the Banco de España understands and views consumer protection; (ii) identify the key risks for financial services customers; and (iii) set supervisory expectations on how regulated firms should address those risks. The panel supports a broader definition for risks, pivoting away from pure non-compliance with any stated rules towards a more flexible measure of (potential) harm to financial consumers.

The identification of the key market risks could be based on a heatmap approach, as is the case today. The panel recommends that the methodology used to produce the heatmap should be described in a supporting document – potentially, but not necessarily, for public release – identifying both objective inputs (quantitative and qualitative indicators) and the role of subjective assessment. The range of indicators should be as complete as possible: complaints, consumer surveys, focus panels, interactions with the industry, supervisory findings, international trends as identified by peer supervisors, press reviews and any other indicators obtained, for instance, from AI processes.

The panel recommends distinguishing between a short-term or current heatmap (more relevant for enforcement) and a two-to-three years ahead heatmap (more relevant for prevention). In addition, the methodology should clearly specify the processes used to identify concerning emerging trends (early warning indicators). In conclusion, the identification of market risks should be risk-based. This essentially means that the aim is to prevent the most harmful cases, which is achieved with a predominantly forward-looking perspective.

## **b) Identification of institution-specific risks**

With regard to institution-specific risks, the panel finds that the Banco de España has a comprehensive approach. There is a clear understanding of the different types of institutions and a well-developed system to classify the supervised population.

The panel recommends, again, formal documentation of the methodologies to measure institution-specific risks and how findings from inspections, complaints, public perceptions and consumer views are combined. It should also define the level at which the approach starts to be focused on specific market segments rather than on individual entities.

The panel recommends that the Banco de España reduce its emphasis of basing its risk profile on the number of complaints. Complaints are an important but rather noisy and reactive information

source. The number and timing of complaints is a function of many factors, not all of which correlate well with the importance of the underlying risk. Complicating factors are, for example, visibility of the risk to the consumer, time before the risk materialises, willingness to complain, etc.

In addition, the panel recommends the Banco de España explore governance and culture reviews at the institution level, attaching a relevant role to them in risk grading. Conducting governance and culture reviews – which constitute an essential vigilance tool – should bring very important insights into the identification of institution-specific risks.

### **c) Inspections**

The Banco de España has a strong focus on inspections, which constitute the most prominent feature of its toolkit. It performs thorough and in-depth inspections, resulting in the identification of findings and the necessary follow-up. These supervisory actions leverage on the staff's expertise, benefiting considerably from their microprudential experience. Over time these inspections have become less focused on non-compliance and have moved towards identification of more relevant risks to consumers. The time required for these inspections has been reduced, but is still on the long side. These inspections are developed in line with well-defined reference standards.

With regard to the inspection tool itself, the panel identifies four aspects that could be improved: classification and duration of inspections, excessive role of inspections in the supervisory process, enforcement and communication with the institutions. These last three aspects will be addressed below in d), e) and f), respectively.

With regard to the duration of inspections, the panel finds that more concrete guidelines should be defined by the Banco de España. More specifically, inspections should be rigorously time-boxed by type. Examples of type are on-site (further differentiated into full scope on-site inspections, targeted on-site inspections, surprise on-site inspections and thematic reviews) and off-site inspections (either general or on thematic aspects, market monitoring, desk-based reviews possibly benefiting from automation and machine learning).

Ideally, two to three types of focused on-site inspections (defined in terms of focus and duration) could be defined, of which large investigations should be completed in, say, no longer than eight months. These duration timelines should be set according to a specific definition of the different stages (preparation, if needed, obtainment of data tapes, on-site duration, finalisation of the report). The Banco de España needs to maintain a “red list” of inspections that take longer than expected or go “off track” for other reasons. Such reporting should be a part of the key performance indicator (KPI) reporting framework.

The Banco de España could also assess whether legislative changes, making it more straightforward to conduct mystery shopping inspections would be justified.

#### **d) Other tools**

Supervision can be seen as a craft. To be successful in this craft one needs to be versatile with a broad range of tools, just like a carpenter uses many tools to build a piece of furniture. When and how to use these tools should depend on the size and the shape of the risk at hand.

The Banco de España uses a number of effective tools to control conduct risks, but overuses some and underutilises others. The panel finds that the Bank relies too much on inspections (particularly on on-site inspections) as a tool for conduct supervision, somewhat neglecting the potential benefits of other supervisory tools within the supervisory toolkit. Examples of other supervisory tools that could be used more often are activities leveraging on the findings of thematic reviews, supervisory expectations (soft law), cultural and governance reviews, as well as various forms of industry outreach. The tools used to mitigate should be well-tailored to the size and shape of the risk in question.

The full exploitation of the synergies provided by thematic reviews should be further enhanced, by assessing, for instance, how market practices compare with supervisory expectations. Thematic reviews – selected from a forward-looking risk perspective – could lead to generic reports identifying the main findings, how far the industry is from supervisory guidelines (soft law), what have been the identified best market practices and how enforcement will proceed. Capitalising on the findings of thematic reviews constitutes an essential communication tool with the general public and the industry. See also f) below.

This should be further enhanced with seminars and online guidance with the industry. This focus would enhance the Banco de España's communication on how it is striving to create public value by reducing consumer harm and risks.

Finally, the discipline of learning lessons from earlier cases and benchmarking against the best practices used by other regulators, as identified by FinCoNet and others, should constitute a regular part of the work at the Banco de España. A pragmatic and versatile combination of complementary supervisory tools reinforces the supervisory approach, constituting an essential element of the required vigilance.

### **Mitigate**

#### **e) Enforcement**

Enforcement is the most well-known tool to mitigate conduct risks. The Banco de España employs a range of enforcement measures, advertising requirements, recommendations and sanctioning proceedings (see the corresponding table included in Chapter 2). Requirements and recommendations as issued by the Banco de España impose obligations on the supervised entity to adopt measures, address the weaknesses or solve the problems that are found during

inspections. The follow-up corrective measures implemented by the supervised institutions are monitored closely.

The number of punitive measures aimed at supervised entities seems relatively low. In most markets where serious financial conduct risks are present, a higher level of punitive enforcement measures may be required to structurally alter firm behaviour. This does not mean that the Banco de España's enforcement is not effective. It could be the case that firms change their behaviour with less formal enforcement measures.

Structural non-compliance with potential detrimental effects for financial consumers should lead to serious punitive measures and, where appropriate, individual accountability. The current legal framework does not make this easy for the Banco de España. Our recommendation is for the Bank to look for opportunities to strengthen formal enforcement within the current legal framework and, where appropriate, advocate for legal changes to facilitate punitive measures in conduct supervision.

Effective enforcement, essentially meaning swift supervisory action to prevent and correct detrimental outcomes for consumers, is a key element of the mitigation component of the supervisory approach.

#### **f) Soft law, communication, and other tools**

The panel finds that the Banco de España is gradually improving its communication and openness towards financial market participants. This is a positive development. The industry clearly recognises this altered approach. It is also true that some banking sector representatives commented that the supervisory expectations are not always fully clear, and asked for a broader regulatory dialogue. The panel perceived strong demand for more communication and a broader regulatory dialogue with regulated entities.

Clear, focused and effective communication is an essential mitigating element. Communication could be reinforced in many ways: policy guidance, generic reports, industry round tables, white papers, social media presence. The panel recommends three complementary avenues.

First, the Banco de España should set supervisory expectations (soft law) for specific areas of concern that specifically identify what the supervisor expects from the sector. The use of soft law, which at present seems to be limited, could provide clearer and more effective guidance for the industry. The release of supervisory expectations – either in a regular public report or in regular “Dear CEO” letters – should constitute a regular communication tool with the industry, covering a couple of topics per year, defined from a preventive, e.g. forward-looking, perspective.

Second, thematic reviews taking place after the recommended implementation period (one year, for instance) would assess whether or not these expectations are being met by market



participants. A by-product would be the identification and communication of the good (or best) practices prevailing in the banking sector, in order to share them with the industry.

Third, the Banco de España should create dedicated fora to meet regularly with the main stakeholders: industry and consumer representatives, other financial supervisors, as well as possibly other public agencies, such as competition and data protection authorities. These fora could cover the whole range of banking services under the remit of the Banco de España and/or specific segments of the market (e.g. consumer credit). Two possible suggestions are the Forum for Banking Conduct Supervision and the Forum for Banking Consumer Credit Conduct Supervision. This also speaks in favour of an annual communication plan and inclusion among the KPIs.

## Efficiency

### g) Planning and monitoring

The Executive Commission of the Banco de España approves annually the Supervisory Programme that contains all the supervisory actions planned. The documents provided to the Executive Commission explain the key factors and risks that affect institutions' conduct and present the supervisory priorities to be taken. Specific individual supervisory actions are described, as well as the areas that are going to be monitored.

The department has the duty to inform the Executive Commission annually about the fulfilment of this programme, indicating the status of each supervisory action, including delays, alterations and cancellations of actions. It also includes additional actions that were taken but not originally planned. Each supervisory action carried out by the department is either approved by or reported to the Executive Commission, in accordance with the mandate. The department reports to the Executive Commission quarterly.

Additionally, the teams performing the actions report weekly to the department to discuss the main issues and findings. If and when needed there are ad hoc planning and monitoring meetings with various stakeholders within the Banco de España.

The panel finds that the internal planning and monitoring cycle works appropriately and can be further enhanced to increase efficiency. Suggestions for further improvement include:

- A stronger link between the heatmap and the planned activities. Ideally, the planned supervisory activities should have a strengthened, consistent and logical connection with the size and shape of the risks as outlined in the heatmap.
- A set time frame per type of activity. Inspections often take longer than expected. It helps if there are well defined time limits per type of activity, e.g. on-site and off-site inspections, varying with complexity (see c) above).

- Stronger operational steering. If activities threaten to overrun allotted time frames, appropriate measures should be taken to increase capacity, reduce the scope, decide to finish the action or, only when strictly necessary, reschedule to allow for the extra time needed.
- A further developed set of internal KPIs can help to support this move towards greater efficiency. Examples of KPIs are hours or days spent on supervisory action, the number of actions outstanding (on time/over time/rescheduled), average duration of supervisory action (by type) and types of measures imposed. Over time the set of KPIs should move from input (e.g. time spent) and throughput (e.g. duration) towards output (number of actions and reports) and outcome (indications of consumer harms reduced).

## **h) Human resources**

The staff of the Banco de España is highly qualified, strongly motivated, well-aware of the importance of its work for society and the public interest and very proud of what is being achieved in the name of the public interest. The panel was pleasantly surprised by the enthusiasm expressed in the interviews. Moreover, the staff considers that there is a good degree of autonomy and fluent communication within units, and recognises the managers' leadership capacity. The staff also finds that the incentives are about right, with higher rotation and training aspects to be improved. Experience brought from prudential supervision has been extremely useful for inspections and has generally informed the work. As prudential and conduct supervision have inherently different characteristics, there is some progress to be made.

Staff levels are difficult to assess. Supervisors are always short on staff and long on risks: risk-based supervision addresses this by focusing on the main risks and accepting that some risks remain unaddressed. Bearing in mind the timeline defined for this external evaluation, it was not possible to conduct a thorough benchmarking exercise of the human resources dedicated to conduct supervision within Europe. The Banco de España provided some figures for a small number of euro area central banks. The comparison is not straightforward as, for instance, mandates are not the same. With all this in mind, the panel finds that the Banco de España's conduct supervision is certainly not overstaffed.

Were the Banco de España to increase the size of its staff, the panel would recommend a gradual and selective approach to enable adequate on-boarding. From that perspective, the panel would recommend hiring outside the traditional realm of economists and lawyers. Complementary skills – data scientists, risk analysts, behavioural economists, psychologists, communication experts – could contribute decisively to the strengthening of the conduct supervisory function.

Productivity gains could be achieved through two different means. The use of IT tools should be promoted to increase efficiency gains. Training should also be reinforced, by exploring synergies with supervisory peers (see i) and k), respectively).

#### **i) Technological tools**

The Banco de España has implemented some IT applications to plan and monitor its workflow. There is limited use of innovative regulatory and technological tools (e.g. SupTech<sup>5</sup> and Big Data). This is not totally unexpected, as supervisors are adapting to these new supervisory tools at different paces.

The panel recommends that the Banco de España develop a strategic view on the IT approach to conduct supervision (RegTech, SupTech and social media), drawing on the most effective international practices.<sup>6</sup> It could consider making this strategy public, as this increases transparency and accountability.

Possible tools to be explored include the following. With regard to RegTech, develop regulatory reporting solutions, e.g. automated data submission, or web portal data upload. As for SupTech, possibilities such as e-reporting, web scraping, NPL data mining and topic modelling could be explored. Finally, turning to social media monitoring, tools like consumer sentiment analysis, reputational analysis and active social media searches could bring some gains.

The Bank should consider outsourcing the development of such tools – or testing other already available “off the shelf” IT applications –, allowing, however, for a full in-house capacity to use them in daily supervisory activities. In addition, the Banco de España could assign certain staff members to be “Tech ambassadors”, leveraging the current role of the Bank’s “Digital Champions”, to bridge the gap between supervisors and IT specialists.

### **Impact and reputation**

#### **j) Communication with the public**

Communication with the general public on consumer protection appears to be very limited. For instance, there are virtually no press releases on the Banco de España’s conduct supervisory activities. Communication is important both as a supervisory tool and as an accountability instrument.

The panel recommends wider engagement with the public, by designing communication initiatives such as the identification and communication of the main risks to banking customers, issuance of

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5 See the [Banco de España’s External evaluation on the use of technological innovation in the prudential supervisory function \(Suptech\)](#).

6 See for instance “SupTech Tools for Market Conduct Supervisors”, FinCoNet, November 2020, and “The Next Wave of SupTech Innovation: SupTech Solutions for Market Conduct Supervision”, Technical Note, World Bank Group, March 2021.

interactive factsheets on these risks (with Q&As), release of the most important results of preventive supervisory initiatives and initiatives with the two other financial supervisors, highlighting the focus on the public interest of financial integrity.

The panel recommends a proactive communication agenda, rather than an overall more reactive approach. To implement such an agenda requires: (i) a focus on communication skills; (ii) training to acquire those skills within the conduct supervision department; and (iii) top management's willingness to participate in some of the communication activities in a planned way. In addition, senior management could consider increasing the number of speeches whose primary focus is consumer protection and the role of the Banco de España in conduct supervision.

#### **k) International cooperation with supervisory peers**

The Banco de España is an active and highly respected participant in the relevant international fora on consumer protection (the FinCoNet, the Joint Committee of the European Supervisory Authorities and the European Banking Authority).

However, the panel finds that it is not fully exploiting the possibilities that international conduct networks could bring in two different areas: sharing of best practices and training of staff. This report has already concluded that there is room for improvement in the Banco de España's conduct supervision risk assessment: use of technological tools, incorporation of behavioural finance and communication stand as the most natural candidates.

The panel recommends that the Banco de España create, with a small number of supervisors (at most three or four), regular working groups – or thematic events – specifically intended to share methods and tools, with the aim of identifying the best supervisory practices (either in general or focused on the above topics). These groups could document and discuss, with a considerable degree of technical detail, the best performing processes and methodologies, with a view to adopting them.

Turning to training, the Banco de España could also consider the possibility of having members of staff visit (secondments of one to three months) peer supervisors to benefit from their knowledge on, and experience in, selected areas.

#### **l) Reputation**

The panel has conducted interviews with regulated financial institutions, industry associations and consumer representatives. These interviews confirmed that the Banco de España also has a strong reputation in the conduct arena. Interviewees expressed a willingness to follow the Banco de España's directions, to ensure that a greater level of public value is created, and that financial consumers are appropriately protected from conduct risks.

From these interviews it also became clear that (i) there is a strong desire on the part of market participants to have a sharper picture of what the Banco de España's priorities and views on specific issues are and (ii) there is a willingness to engage more frequently and intensively. The panel sees this as a positive development.

## 5 The way forward: The Banco de España's strategy to move towards greater impact

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The Banco de España has identified the need to move from a predominantly corrective and legalistic supervisory approach to a more forward-looking and risk-based one. The need for change appears well-recognised and rooted in the organisation. Many projects are at the development stage or at different stages of completion. This new approach is expected to be gradually implemented over the next few years.

The panel agrees with the Banco de España's move, which is reasonable and highly commendable. The trajectory defined by the Bank will have a positive impact on the conduct supervision function, with the ultimate aim being consumer protection.

The panel finds that further work needs to be done to clarify, both internally and externally, the practical implications of this enhanced strategy. The ideas around the term 'risk-based' need to be further developed towards their practical implications, as outlined above in Section 2 of Chapter 4. The focus should be firmly anchored on (i) the timely identification of the current and emerging risks to consumer outcomes, (ii) the definition of an adequate mix of supervisory tools and (iii) the prevention of harmful conduct outcomes for consumers. The consistent implementation of this risk-based approach over the coming years will be very challenging. To steer this effort, it is important to be clear on the Banco de España's strategic goals.

The panel recommends the following strategic goals: (i) protecting consumers from the impact of conduct risks by limiting risks of non-compliance and harmful behaviour; (ii) promoting the integrity of the Spanish financial sector and, as a result, (iii) promoting trust in the banking sector. Different supervisory strategies and tools should contribute in a coordinated way to achieving these strategic goals.

The panel recommends the following supervisory principles to drive conduct supervision at the Banco de España:

- Risk-based, essentially meaning with the aim of preventing the most harmful cases (*risk-based*);
- Forward-looking and vigilant to prevent consumer harm (*forward-looking and vigilant*);
- Pragmatic and versatile in the selection of supervisory tools (*pragmatic and versatile*);
- Swift enforcement, to establish clear norms and prevent damage in the present (*effective enforcement*);
- Rigorous analytical and data-driven approach empowered by IT (*factual and data-driven*);

- A further developed system for internal resource planning and monitoring (*efficient operation*); and
- Clear communication of regulatory priorities, expectations and outcomes (*clear communication*).

Finally, the panel recommends that the Bank consider the possibility of developing centres of excellence – leveraging on the extremely varied and highly analytical knowledge across the Banco de España, which is likely to bring sizeable synergies – that could make it a global conduct supervision leader on selected topics. The following examples illustrate this possibility:

- Analytical identification of risk (early identification of emerging risks);
- Use of behavioural economics (to improve disclosures, communication, financial literacy);
- Technological tools based on AI and Big Data (both for reporting, automation of routine tasks, and supervisory monitoring);
- Identification and interpretation of consumer sentiment (using social data monitoring, consumer panels, focus groups, among others).

The Banco de España has ample opportunity to succeed in achieving the above.