

4 SUPERVISION OF INSTITUTIONS' CONDUCT

This is the second full year of activity in this area following the conferring of powers relating to the oversight of credit institutions' conduct and, in general, that of other institutions registered with the Banco de España (which extends to some aspects of institutions operating in Spain without an establishment), upon the Market Conduct and Claims Department (DCMR) in October 2014. In 2016, the Banco de España continued to work on the main areas of its supervisory strategy adopted in 2015, while also opening up new priority areas of action.

The Banco de España analyses the risk associated with institutions' marketing of each product type

This supervisory activity underpins the Banco de España's strategic commitment to avoiding the systemic risk associated with inappropriate conduct by financial institutions, while safeguarding the protection of bank customers, so as to restore trust in the financial system. Along with its conduct supervision tasks, the Banco de España performs other closely related tasks, such as promoting good practice in the financial services market, responding to queries by banking services users on the applicable transparency and customer protection rules, financial education, and resolving complaints and claims submitted to the Banco de España by customers of supervised institutions.

In the supervisory sphere, a methodology is followed that assigns and updates a conduct risk rating for each institution associated with each of the products it markets. This is used to define supervisory priorities, on the basis of which the monitoring and inspection action plan is drawn up, in the light of the limited resources available. The IT application to support the management and control of the planning and implementation of supervisory activities was designed in 2016 and will come into operation in 2017.

4.1 Supervisory actions

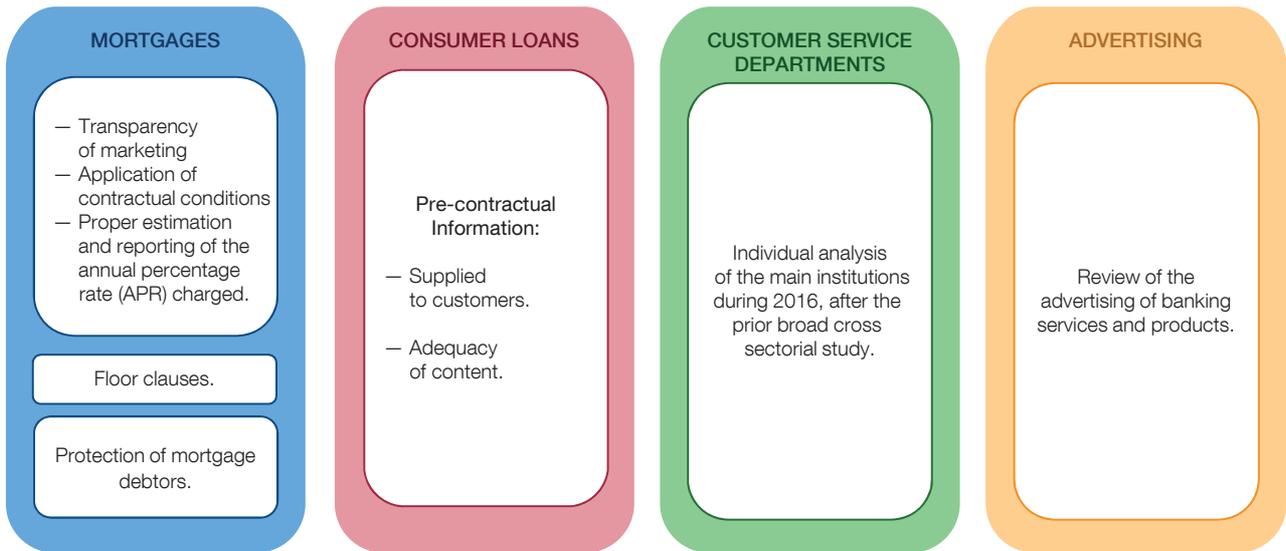
In the institutional conduct area, the actions carried out during the year included:

- those envisaged in the annual action plan (including both on-site visits to institutions and actions scheduled to be performed remotely), and
- unscheduled supervisory actions arising out of the need to respond to facts brought to the DCMR's attention over the course of the year, whether by other Banco de España departments, reports submitted by other public or private persons or institutions (regional authorities with competences for consumer affairs, for example), or following the observation of certain actions by supervised institutions in relation to which a specific supervisory action is deemed appropriate.

In 2016, it was necessary to launch 42 supervisory actions and 6 inspections that were not initially scheduled

In 2016, it was necessary to initiate a significant number of unscheduled on-site inspections and actions, accounting for a very significant percentage of the actions and inspections listed in Table 4.1. This consumed considerable resources.

The actions and inspections carried out, whether scheduled or not, are still concentrated in the three areas of activity identified back in 2015, to which have been added the review of the advertising of banking services and products by supervised institutions. These activities are summarised in Schema 4.1. Table 4.1 also summarises the supervisory actions undertaken in 2016.



SOURCE: Banco de España.

OVERSIGHT OF INSTITUTIONS' CONDUCT IN 2016

TABLE 4.1

| Topic | Off-site monitoring (a) | Inspections (b) |
|---|-------------------------|-----------------|
| Mortgages (Code of Good Conduct, floor clauses, transparency) | 23 | 10 |
| Customer service departments | 31 | 0 |
| Transparency (reporting, commissions and payments) | 23 | 19 |
| Advertising | 2 | 0 |
| Other | 1 | 0 |
| TOTAL | 80 | 29 |

SOURCE: Banco de España.

- a Of these actions, 11 were begun in 2015.
- b Of these inspections, 11 were begun in 2015.

4.1.1 FUNCTIONING OF INSTITUTIONS' CUSTOMER SERVICE DEPARTMENTS

The proper functioning of customer service departments has an impact on consumer protection, in particular, as well as on institutions' reputations and the restoration and maintenance of trust in the financial system as a whole. The absence of a customer service department is therefore considered a serious infringement, as is the inadequate functioning of the department, unless the shortcomings detected by the Banco de España are rectified by the established deadline.

Following an aggregate analysis of the functioning of institutions' customer services the information available on the most significant institutions' customer services was reviewed in 2016

The second phase of an ambitious action begun the previous year was completed in 2016. In the first phase, which took place in 2015 and early 2016, an aggregate analysis was performed on the qualitative and quantitative information obtained from the responses to an exhaustive questionnaire sent to 266 institutions on various aspect of their customer service departments. This focused on three areas: i) the organisational set-up, objectives and resources of customer services; ii) criteria and procedures for receiving, handling and resolving complaints and claims; and iii) lines of communication and mechanisms for claim monitoring and control.

The results of this aggregate analysis were shared with institutions at a seminar held at the Banco de España on 12 April 2016. This aggregate and comparative analysis has made it possible to identify best practice in this field.

From the overall results of the exercise it may be concluded that, in general, there is considerable scope for improvement to the functioning of customer services, particularly as regards aspects where a significant number of institutions have (or will have) to redouble their efforts to address shortcomings or weaknesses in mechanisms to prevent or deal with conflict of interest; training plans; action plans or objectives; mechanisms for publicising their existence and how to contact them, procedures for receiving claims and complaints; access and information passed on to the board, and mechanisms for the control and monitoring of claims and complaints.

The volume and detail of the information analysed has also made it possible to identify weaknesses and shortcomings in various institution's customer services. Based on this information, a second phase was begun in 2016, in which 24 supervisory actions were conducted, aiming to evaluate, and where appropriate, rectify, the shortcomings detected in the set-up and functioning of the main institutions' customer service departments. At the same time, supervisory actions were also carried out with a view to rectifying omissions in the information detected in the context of the annual report each institution's customer service department is to prepare on the exercise of its tasks.

4.1.2 MORTGAGE LENDING

A mortgage is the contract with the biggest economic impact most people ever sign. The Banco de España's priority objective is to ensure they are marketed in a transparent way

Work in this area focused primarily on overseeing compliance with the transparency requirements laid down in Ministry of Economic Affairs and Finance Order EHA/2899/2011 of 28 October on transparency and customer protection in banking services, regarding loans to individuals resident in Spain secured by mortgages on homes located in the country. Given the high level of detail on the aspects examined and the broad scope of the portfolio reviewed (comprising 61.14% of mortgage lending to households in Spain for housing purchases) work continued in 2016 on the eight on-site inspections of credit institutions that were under way at the end of the previous year. These were due to be completed in the first half of 2017.

The reviews carried out focus on verifying proper compliance with the regulations on precontractual and contractual information, so the customer is aware at all times of the conditions and risks assumed. In particular, this information has made it possible to ascertain the effective cost of the transaction, which, along with the contractually determined interest rate, includes: i) fees, commission and other expenses the customer is required to pay; ii) taxes; (iii) other types of associated expenses known by the institution (except the notary public's fees); and iv) the cost of ancillary services relating to the loan contract (in particular, insurance premiums) if the conditions under which the loan is offered are subject to the provision of these services.

The review also includes verification of the correct application of the contract clauses and the regime for the substitution of official indices, the correct calculation of fees for early repayment, and the proper reporting to the Banco de España of the weighted APR on mortgage loans, verification of this latter aspect having been extended to a further 16 institutions.

Without prejudice to the conclusions each inspection may ultimately reach, while they were being conducted recommendation and requirement letters were sent to the inspected institutions in order to clarify and resolve some of the incidents that were detected.

4.1.3 FLOOR CLAUSES

It is for the judicial bodies to decide whether contract clauses are null and void, not the Banco de España. Thus, without prejudice to the Supreme Court judgment on 9 May 2013, the Banco de España, precisely because of the limitation on the scope of its powers, has

to restrict the checks that it performs to verifying formal compliance with the requirements of banking transparency and customer protection law.

Nevertheless, in 2016 the Banco de España continued to check that such clauses were included in contracts correctly. In this area, compliance with the requirements made of two institutions that they review all their variable rate loan and mortgage loan transactions to which floor clauses may have been applied in a way not in keeping with the agreed terms was verified. The review had to be extended in the case of one of these institutions as a result of extraordinary and unexpected circumstances in 2015 and 2016, culminating in the repayment of amounts corresponding to a significant number of customers affected by the incorrect application of floor clauses.

4.1.4 PROTECTION MEASURES FOR MORTGAGE DEBTORS WITHOUT RESOURCES

Numerous actions were performed with the aim of verifying the correct application of 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 without resources (RDL 6/2012) by its signatory institutions. Specifically, in these cases the correct application by institutions of the three obligations, non-compliance with which is classified as a serious infringement, was confirmed. These obligations are summarised in Schema 4.2.

LEGISLATION ON REGULATION AND DISCIPLINE

SCHEMA 4.2

| OBLIGATION | Royal Decree-Law 6/2012 |
|---|--|
| Effective implementation date | Art. 5.4 Institutions adhering to the Code of Good Practice (CGP) are required to apply the code whenever a customer is deemed to be on the exclusion threshold. This ultimately envisages possible loan restructuring, reduction or dation in payment measures. |
| Transparency and provision of information under the CGP | Art. 5.9 The participating institutions must provide their customers with the option of recourse to the CGP. The relevant information must be made available through the branch network, and, in particular, must be given in writing to customers who have failed to meet any mortgage repayments or who have otherwise shown themselves to be having difficulties repaying their mortgage. The information provided is to include a concrete description of the content of the CGP and the possibility of recourse to this code. |
| Information submitted to the Banco de España | Art. 6.5 The participating institutions are to send the information required by the CGP Compliance Monitoring Committee to the Banco de España on a monthly basis. |

SOURCE: Banco de España.

The Banco de España is committed to verifying that signatory institutions of the CGP are genuinely proactive about informing customers and applying the code's measures as it requires

In 2016, work took place on 18 supervisory actions motivated either by evidence coming to light as a result of customer complaints to the Banco de España or reports submitted by various agents against credit institutions for alleged non-compliance with Royal Decree-Law 6/2012. In late 2016, these actions resulted in sanction proceedings being brought against one institution, and various institutions being sent requirements letters, one being sent a letter of observations and recommendations, and three being sent other types of letters.

Two on-site inspections on this matter took place in 2016. These were begun in late 2015 and concluded with the initiation of sanction proceedings against two institutions, and the sending of recommendation and requirement letters (see Section 4.2).

4.1.5 ADVERTISING

Advertising is the first contact between a bank and its customers, so it is essential that it be truthful, clear and concise

A large-scale supervisory action was begun in 2016 to obtain as much detail as possible about institutions' customary practices, procedures and internal controls in relation to their advertising and evaluate them appropriately. This had the aim of confirming whether these practices, procedures and internal controls comply with the current legislation and are, therefore, adequate to protect customers' legitimate interests and management the risks arising from their advertising activity.

This action, which will continue in 2017, reaches all the institutions within the scope of application of Ministerial Order EHA/1718/2010 of 11 June 2010, on regulation and control of the advertising of banking services and products. This Order modified the rules on advertising of banking products, replacing the previous system based on prior scrutiny of advertising, with a system of ex post checks combined with self-regulation by institutions. Since it came into force, the Banco de España does not authorise institutions' advertising campaigns in advance, but analyses a sample of them once they are in circulation. In 2016, this activity gave rise to 485 demands that advertising in various media (press, internet, etc.) be stopped or rectified.

4.1.6 CONSUMER LENDING

The Banco de España's website offers a simulator calculating the maturity date of the loan with the selected instalment payment

The focus of the Banco de España's activities and concerns remains the clarity, appropriateness and adequacy of the information provided to customers during the marketing of personal loans and credit cards.

As the regulations repeatedly state, it is particularly important in this connection that customers are aware of the consequences of the potential failure to pay their instalments, since this can trigger a spiral of late-payment interest and costs which end up pushing certain customers into economic and social exclusion. Similarly, in the case of revolving credit cards, the instalments paid may fail to cover the interest accruing. In this case, repayment may be postponed indefinitely, leading to the debt to grow to the point that it becomes difficult to pay off.

Accordingly, the supervisor's attention has focused on two on-site inspections verifying the precontractual information institutions are to provide to their customers in accordance with Law 16/2011 of 24 June 2011 on credit agreements for consumers, and in particular the adequacy of this information when revolving cards and insurance linked to personal loans are marketed. This need to strengthen transparency also arises in situations in which, in the event of default on payment of the monthly settlement of a credit card contracted for full payment at the end of the month, the institution automatically switches the unpaid amount to the revolving mode, without asking the customer for the requisite consent for this modification.

4.2 Adoption of supervisory measures

Supervisory activities may lead to, in rising order of importance, the sending of recommendations or observations to the institution, or possibly the initiation of sanction proceedings. Table 4.2 shows the type of measures in which the actions concluded in 2016 culminated.

SUPERVISORY MEASURES TAKEN IN 2016

TABLE 4.2

| Number | Measures taken following off-site actions (a) | Measures taken following inspections (b) |
|--|---|--|
| Recommendation and observation letters | 101 | 4 |
| Letter of requirements | 11 | 6 |
| Initiation of penalty procedures | 2 | 5 |
| TOTAL | 114 | 15 |

SOURCE: Banco de España.

a 11 requirement letters issued following verification actions, containing 38 specific requirements upon institutions.

b 6 requirement letters issued following inspections, containing 34 specific requirements upon institutions.

The Banco de España initiated seven sanction proceedings in 2016 in relation to conduct, five deriving from on-site inspections and two from customer complaints sent to the DCMR

Seven sanction proceedings were initiated in 2016: five as a result of inspections of institutions and two deriving from complaints received and dealt with by the Banco de España in which it was concluded that there had been a possible breach of the transparency and customer protection rules.

Of the five sanction proceedings initiated as a result of inspections, two concern the application of Royal Decree-Law 6/2012, and two the application of various aspects of the banking transparency and customer protection legislation. The fifth proceedings, begun against a currency-exchange bureaux, concerns the breach of the rules of organisation and discipline applicable to the operators of such establishments.