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SUPERVISION OF INSTITUTIONS' CONDUCT

Appropriate conduct of institutions, and in particular the way they interact with customers, is a key element for the proper functioning of the financial system and for maintaining a viable and sustainable banking business model in the medium and long term.

The situation ensuing from the pandemic also marked the pursuit of conduct-related supervisory activity in 2020, and has made clear the relevant role played by the banking sector, through which some of the measures aimed at alleviating the financial situation of households and firms have been implemented. From the outset of this crisis, the Banco de España has worked to ensure citizens are provided with the necessary information on these measures and to support institutions in their implementation.

Moreover, this environment has helped speed up the growing digitalisation of the sector and its impact on the way services are provided. Supervision has focused on this aspect to ensure that institutions' activity and their relationship with customers complies with regulations and to underline the importance of an appropriate conduct culture based on responsible, ethical and transparent behaviour.

4.1 Conduct-related supervisory activity

The bulk of supervisory work this year focused on monitoring actions taken by institutions to respond to the needs arising from the pandemic and to comply with the measures adopted to counter its economic impact. See Box 4.1 for more details.

In addition, the planned supervisory activity continued through different supervisory and individual follow-up actions, grouped by type of institution or subject (such as advertising or claims).

Annual supervisory planning takes into account the information gathered in the course of supervisory and ongoing monitoring actions and focuses on those institutions considered a priority according to their conduct profile.¹

¹ For further details, see Banco de España (2019), "Institutions' conduct profiles", Box 4.1, *Report on Banking Supervision in Spain*, 2018.

With the aim of mitigating the adverse economic impact of the measures to prevent the spread of COVID-19, the Spanish government launched a package of urgent measures; among the most prominent were legislative moratoria and State guarantees for certain bank loans to firms, since these had to be implemented mainly through banks.

From the outset of this crisis, the Banco de España has worked: i) to ensure that banks provide citizens with the necessary information and that their relations are conducted in a climate of trust, and ii) to support institutions in the implementation of the above-mentioned measures.

In addition, since the state of alert was declared in March 2020, the main supervised institutions were contacted to ascertain and analyse the measures that were being adopted to ensure continuity in the provision of services to their customers (including the temporary opening or closure of branches, ATM operability or the strengthening of online banking channels). Institutions' implementation of the measures approved to address the economic fallout of the pandemic was also monitored by analysing: i) the specific reporting on moratoria by the institutions; ii) claims and telephone and written

enquiries submitted to the Banco de España; and iii) information provided by the institutions via their websites.

This information was analysed both on an overall basis and on a specific basis for those institutions already subject to individual monitoring.

It should be noted that the exchange of information and the coordination between certain areas of the Banco de España was strengthened with the aim of establishing supervisory synergies.

Although administrative procedures were suspended during the state of alert, the Banco de España reactivated the claims mechanism to support customers as well as the institutions who had to continue to handle their claims.

In any case, considering the severe disruption wrought by COVID-19 on Spanish society and the Spanish economy, the Banco de España, in cooperation with the rest of the national and international supervisory authorities, will continue to supervise institutions' conduct in relation to these measures or others that may be adopted, and to contribute to maintaining the stability of the financial system.

The main areas of conduct supervision, shown in Figure 4.1, materialised in the supervisory actions shown in Chart 4.1.

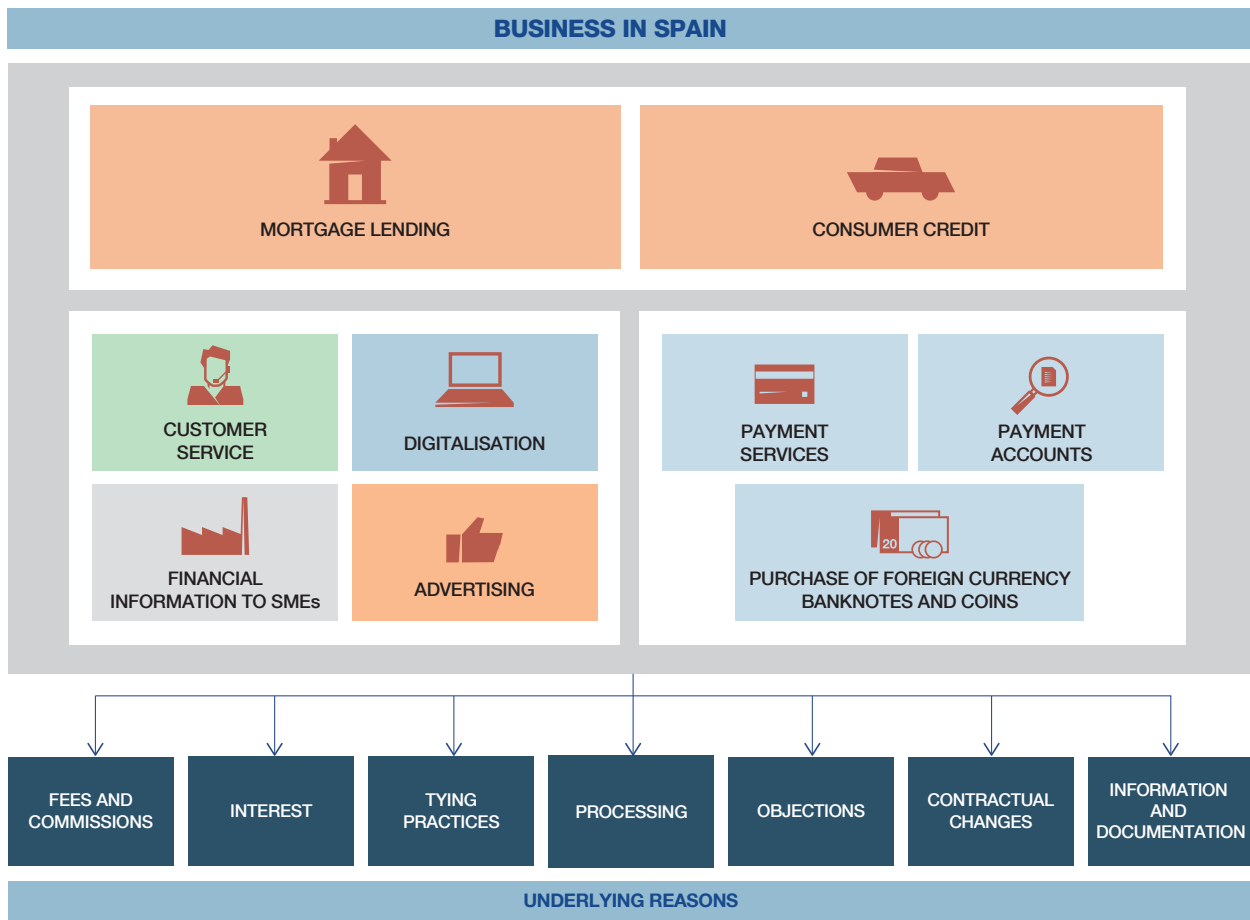
Supervision of consumer credit took on an important role during 2020. This essentially involved verifying the degree of compliance with the organisational and disciplinary rules of Law 16/2011 of 24 June 2011 on credit agreements for consumers. In particular, work has been completed on the verification of the marketing of revolving credit cards,² financing for car purchase, credit linked to the supply of goods or the provision of services and other consumer financing with no specific purpose, and loans granted in the form of overdrafts on sight deposits. Responsible lending practices and policies in this financing area have also been reviewed.

These supervisory actions on consumer credit have generally been cross-institutional in nature, making it possible to analyse how different institutions

² For further details, see Banco de España (2020), "Marketing of revolving credit cards", Box 4.1, *Report on Banking Supervision in Spain*, 2019.

Figure 4.1

SUPERVISION OF CONDUCT: MAIN AREAS OF ACTIVITY



SOURCE: Banco de España.

handle the same subject matter, provide a homogeneous response to the common shortcomings detected, identify best banking practices and work on drawing up supervisory guidelines on the marketing of revolving credit.

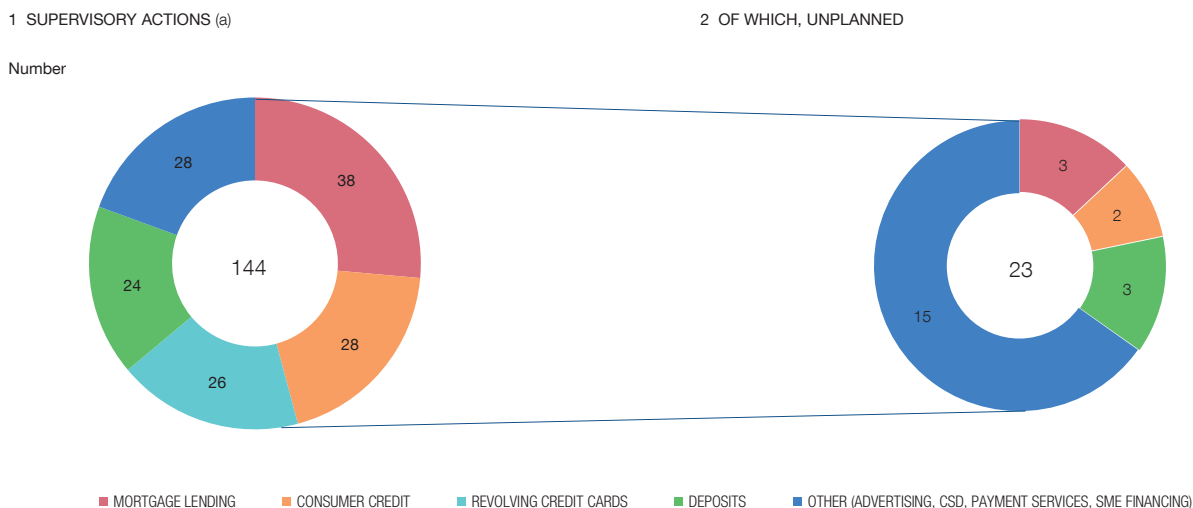
Given its particular importance, mortgage lending has also been the focus of much of the annual supervisory effort. The Banco de España is aware of the importance of institutions ensuring transparency both in the marketing of such loans and over their life. Thus, work has continued to verify that “floor clauses”, i.e. clauses that set a lower limit on interest rates, are properly applied in accordance with regulations and the provisions of mortgage loan agreements. The information provided on interest rates and the measures applied to protect mortgagors in serious economic difficulties were also checked.

The main aspects **relating to the review of advertising of banking products and services** are shown in Figure 4.2. Banco de España Circular 4/2020 of 26 June 2020 was approved in relation to this issue. This new rule constitutes an essential

Chart 4.1

CONDUCT-RELATED SUPERVISORY ACTIONS IN 2020, BY AREA

During 2020, in addition to the work on the follow-up of the measures adopted by institutions in the wake of the COVID-19 pandemic, conduct-related supervisory activity focused mainly on the areas of activity relating to mortgage lending, consumer credit, revolving credit cards and deposits. The supervisory effort during 2020 was marked by the above-mentioned supervision and follow-up work on the financial measures to counter the economic impact of the pandemic.

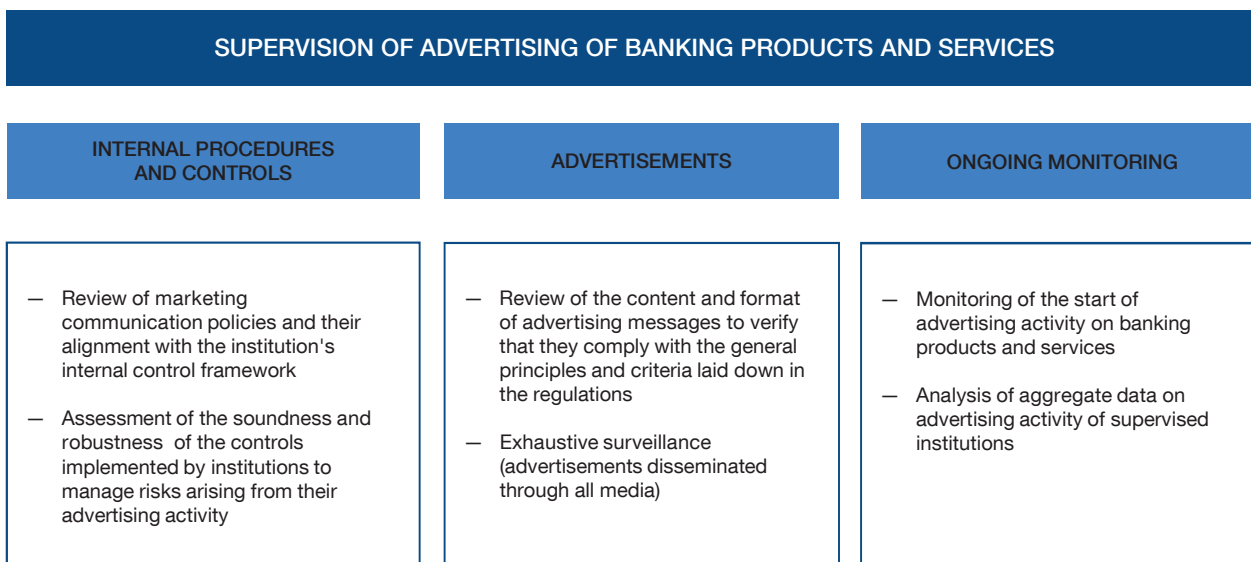


SOURCE: Banco de España.

a Of these supervisory actions, 103 were initiated before the start of 2020.

Figure 4.2

SUPERVISION OF ADVERTISING ACTIVITY



SOURCE: Banco de España.

SUPERVISION OF CUSTOMER SERVICE DEPARTMENTS

The proper functioning of institutions' customer service departments (CSDs) is a key element to resolve conflicts between institutions and their customers. During 2015 and 2016, several cross-institutional supervisory actions were carried out aimed at assessing CSDs in detail and, where necessary, remedy the shortfalls detected.

Based on the experienced gained, an addendum was published to the 2016 Annual Claims Report identifying the best practices observed in institutions' CSDs.

As a continuation of this effort, in 2020 work was conducted on supervisory guidelines on the organisational and operational criteria of the CSDs of institutions supervised by the Banco de España.¹ These guidelines will be published over the course of 2021. Specifically, the guidelines are structured along two main lines:

- General principles applicable to the organisation and functioning of CSDs.
- Basic supervision principles that can be divided into three blocks: the composition and functioning of CSDs, claim and complaint handling and, lastly, communication and control mechanisms.

These criteria have been defined bearing in mind both the applicable national regulations and the supervisory guidelines adopted by the Banco de España in this area, in particular those of the Joint Committee of the European Supervisory Authorities on claim and complaint handling for the securities and banking sectors (JC 2018 35).

Recurrent supervisory activities carried out in relation to CSDs include, inter alia, the review of the internal rules

governing their functioning and analysis of the suitability of their head officers.

The management body of the institution must approve the customer protection regulations governing the functioning of the CSD. Subsequently, these internal rules must be verified by the Banco de España, which will check that they comply with the provisions of the applicable legislation (except for savings banks or credit cooperatives whose activities are confined to one region, in which case the verification shall be the responsibility of the regional competent body).

Furthermore, pursuant to Article 5 of Ministerial Order ECO/734/2004, the management body of each institution shall appoint a CSD head officer, who must be a person of commercial and professional integrity with appropriate knowledge and experience for the exercise of their functions. The institution must notify the appointment to the Banco de España and provide evidence of compliance with these requirements.

In the course of this work, a total of 514 letters were sent to various institutions in 2020 regarding the organisation and functioning of their CSDs. 102 files were processed on the suitability of the head officers of CSDs and 221 on the verification of their regulations.

All the CSD-related supervisory actions carried out are aimed at ensuring their proper functioning and organisation, so that they can efficiently handle and resolve claims and complaints, thereby contributing to improve customer protection and, consequently, the reputation of the institution itself and of the entire system.

¹ Institutions subject to Ministerial Order ECO/734/2004 of 11 March 2004 on the customer service department and ombudsman of financial institutions (hereinafter, Ministerial Order ECO/734/2004).

regulatory framework for institutions to pursue this activity and a powerful tool for its proper supervision (see Section 8.1.4).

The activity of customer service departments (CSDs) was also supervised to verify the suitability of their head officers, the content of their operating rules and overall compliance with transparency obligations. As set out in Box 4.2, in 2020 work was carried out to draw up the first conduct supervision guidelines on the functioning of CSDs (see Section 8.2).

SUPTECH TOOLS FOR CONDUCT SUPERVISION

Conduct supervision requires a large number of documents collected during supervisory actions to be analysed annually. They include largely unstructured information on which no automated processing (searches, extractions, mass selections) is possible. Consequently, analysing them is time-consuming and requires limiting the sample size of the files to be reviewed.

With the aim of improving efficiency and speed in the processing of this information, a first test was launched in 2019 to apply supotech tools to a supervisory action on consumer financing. To this end, machine learning and computer vision techniques were used with the aim of verifying the acceptance and signature of insurance policies linked to loan agreements.

In 2020, these same techniques were used for reviewing the proper application of mortgage deed clauses, including floor clauses, i.e. those that set a lower limit on interest rates. This is a particularly complex task owing to the difficulty inherent in managing a large volume of information and to the lack of standardisation of clauses (even within the same institution). To make this task easier, a file processing and reviewing tool has been developed for:

- Automatically reviewing files to search for standard clauses.

- Quickly navigating through relevant clauses in different files.
- Flagging relevant sections in the files to ensure immediate traceability between evidence and the conclusions of the review.
- Using machine learning and natural language processing techniques that feed back into the mass review process and the identification of new relevant clauses.

This tool has made it possible to increase the number of files and documents reviewed. Thus, a single supervisory team has analysed almost 4,000 mortgage deeds from nine different institutions in less than two months.

These examples show that the use of supotech tools makes it possible to increase the sample size of the reviewed files and to review a larger number of institutions by allowing inspection teams to focus on the tasks with the highest supervisory added value.

The Banco de España remains committed to innovation and digitalisation as a means of increasing the efficiency of supervision and exploring new areas of supervisory competence that benefit from the experience gained in the use of machine learning techniques.

Another aspect that received particular attention is the digitalisation of supervised institutions. To gain a better understanding of the sector's digital transformation and its impact on each stage of the life cycle of banking products and services (mainly current and savings accounts and consumer credit), a series of measures have been adopted to minimise the risks arising from the immediacy of taking out products digitally.

Digitalisation demonstrates the importance of institutions' transparency transcending formal considerations; not only must they conform to regulatory requirements, they must also use language that is clear and to the point, with scrupulous attention to form, for a better understanding and to better adapt to the channel through which the product is marketed.

New technologies have also been incorporated into the supervisory process itself, as detailed in Box 4.3, increasing the efficiency of supervision in the areas of banking transparency and customer protection.

Lastly, during 2020 work was carried out on the drafting of a circular on confidential conduct-related information, which will result in better information being available for more efficient supervision (see Section 8.2). The new information will improve knowledge of institutions' business models and market trends for banking products and services, including those that generate most controversy. This last aspect is relevant given the continuous innovation in this sector and the growing priority given to transparency and customer protection.

In short, the aim of conduct supervision is to better protect banking customers by preventing and correcting inappropriate conduct, encouraging institutions to implement, through their regulatory compliance function, a suitable culture of conduct in their relationship with customers, and to strengthen the role of their CSDs in order to maintain a sustainable and viable banking business model.

4.2 Adoption of supervisory measures

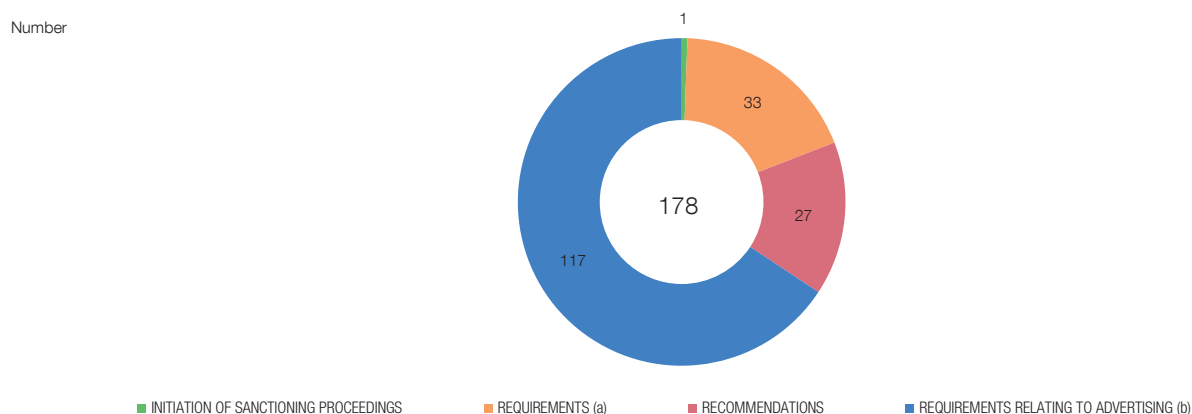
Noteworthy among the supervisory measures adopted in 2020 were the initiation of one sanctioning proceeding and the issue of 33 requirements.

Chart 4.2 provides a breakdown of all these measures.

Chart 4.2

SUPERVISORY MEASURES ADOPTED AND REQUIREMENTS IN RELATION TO ADVERTISING IN 2020

During 2020, as a result of the supervisory actions carried out, one sanctioning proceeding was initiated and 33 requirements and 27 recommendations were issued focusing mainly on aspects relating to the marketing of revolving credit cards and to the mortgage portfolio, among others. In addition, as part of the supervisory activity on advertising, 117 requirements were issued, resulting in 56 withdrawals and 61 rectifications.



SOURCE: Banco de España.

a The 33 requirements contain 189 specific requirements for institutions.

b The 117 advertising-related requirements resulted in 56 withdrawals and 61 rectifications.

Effective compliance with the requirements and recommendations issued by the Banco de España in previous years was also checked. This follow-up work is key to verify that institutions remedy the shortcomings detected in the supervisory work, thus achieving effective customer protection.

As a result of the supervision of advertising activity, 117 requirements were issued to withdraw or rectify advertising that did not comply with regulatory requirements.

As for CSD supervision, in addition to the adoption of the above supervisory measures, 514 letters were sent during 2020 as a result of the verification of the operating rules of CSDs and suitability assessments on their head officers.