
06.05.2024

Conduct supervision in bank customer protection*

Conference on the financial outlook for a year of uncertainty

La Voz de Galicia/ABANCA

A Coruña

Pablo Hernández de Cos

Governor

* English translation from the original in Spanish.

I would like to thank the organisers for inviting me to take part in this conference on the financial outlook.

On this occasion, I wish to focus on the importance of banks' proper conduct towards their customers and, in particular, on the supervisory work of the Banco de España in this area.

The importance of trust in the banking business and the role of supervision

Trust is the bedrock of the banking business and is based not only on the financial soundness of banks but also on their correct treatment of customers, underpinned by sound and balanced competition.

Indeed, the experience of recent years has shown that litigiousness generates significant financial costs, both for supervised entities and for the general public, general government and the economy as a whole.

The losses associated with the legal consequences of malpractice can also drive up banks' capital requirements. And, even more importantly, they can generate high reputational costs that may ultimately undermine banks' customer bases.

Aware as we are of the importance of this, a public regulatory framework has been set in place which establishes principles and standards for banks' actions, seeking to protect bank customers, accompanied by a supervisory regime to verify effective compliance with those principles and standards.

The deregulation of the Spanish financial sector – which, as regards fees and commissions and interest rates, culminated in 1989 with the freedom to set prices – was followed by a gradual increase in **banking conduct regulation** both in Spain and across Europe.

Initially, the regulations focused almost exclusively on defining various principles relating to **transparency and information for customers** and **appropriate advertising** of banking services.

The regulatory framework sought to ensure that customers received sufficient, clear and detailed information on the product or service they intended to choose, so that, at least in theory, they could make an informed decision on the legal and financial consequences involved.

However, the 2008 financial crisis triggered a paradigm shift towards a regulatory regime that envisages a more active role for banks. No longer is it just a question of having to meet certain obligations regarding information for customers; banks must also **act honestly, impartially, transparently and professionally**, taking into account the rights, interests and needs of their customers.

The **supervisory model** has also evolved in parallel with regulation. In particular, conduct supervision has shifted from an eminently legalistic model, focused on verifying compliance with the rules, towards a **more preventive and risk-based approach**.

Specifically, conduct supervision involves three main activities: detection, investigation and mitigation.

Detection comprises the systematic monitoring of known risks and early identification of new ones. This requires discipline in the analytical and follow-up work and an open, outward-looking mindset.

Investigation entails capturing the pattern of underlying behaviour and assessing its severity, which requires extensive experience, analytical skills and expert judgement.

Lastly, **mitigation** involves driving conduct change, employing a broad set of formal instruments (disciplinary measures) and informal instruments (such as dissemination and enforcement of good banking practice).

If robust detection and investigation are not accompanied by effective mitigation, the ultimate supervisory impact will be suboptimal; similarly, strong mitigation will make only a modest contribution to the ultimate supervisory impact if supervisory monitoring and the supervisory response are generally weak.

Conduct supervision at the Banco de España

Far from being oblivious to how the regulatory and supervisory approach has evolved, the Banco de España has in fact driven these developments, making changes to its **organisational structure**.

In June 2013 it created the Institutions' Conduct Department, taking in the existing Complaints Service. This department is responsible for centralising the Banco de España's powers in this area and for settling complaints, separately from prudential supervision.

Subsequently, in May 2022, the department became part of the new Directorate General Financial Conduct and Banknotes, which was created to support two initiatives included in our Strategic Plan 2024: improving banks' conduct towards their customers and promoting financial education among the general public. Accordingly, the department is also responsible for financial education.

Supervisory functions are exercised through **annual planning**, starting with **detection of the main risks**, identifying macroeconomic, legal, commercial or reputational factors that may affect how banks market their products and services to their customers, and in particular those products and services that entail a high risk of potential losses.

Specific supervisory assessments of banks are also taken into account. This information is obtained mainly from the continuous monitoring of banks, which involves analysing, among many other factors, their business models and strategies, exercising supervisory judgement as to their internal controls and assessing the degree of compliance with any disciplinary measures imposed. Another key factor is examining the information obtained from complaints filed.

On the basis of all the above, we are able to identify **supervisory priorities** and determine the detection, verification or monitoring actions to be taken.¹

All this work is described each year in our *Supervision Report*, the latest edition of which was published just recently.² Thus, a total of 153 conduct-related supervisory actions were carried out in 2023, of which 23 were unplanned.

As a result, one sanctioning proceeding was launched and over 100 requirement letters were issued, urging banks to adopt measures to remedy the shortcomings or weaknesses detected, along with 76 recommendation and clarification letters on the treatment applicable to certain specific products, operations or actions.

Supervisory priorities in recent years

Considering the financial burden that **mortgage credit** entails for Spanish households, and against a backdrop of sharp interest rate hikes, one area of particular interest for conduct supervision in the period 2022-2023 was to verify the effective implementation of the various measures approved by the authorities to mitigate the negative effects of these rate hikes on households, especially on the most vulnerable groups.

Accordingly, we checked that banks were complying with the **codes of good practice**, that they were informing their customers of their existence and that they were reporting the corresponding confidential information to the Banco de España.

Following review of that information, we identified room for improvement among the banks assessed as regards the information available on the codes of good practice on their websites, the information supplied to customers and the training provided to staff.

Similarly, considering the rapid technological advances and the proliferation of new **consumer credit** channels, in recent years we have concentrated our actions on verifying that banks are applying **responsible lending principles**, to avoid over-indebtedness, and are implementing the new obligations on transparency and creditworthiness assessment in **revolving credit operations**. As you know, revolving credit is a quite complex product that is often targeted at the most economically vulnerable segments of the population, so special vigilance is required.

In this case, the weaknesses detected were concentrated on how customers' ability to pay was assessed, bank staff training, the information provided to customers facing financial difficulties and the use of active debt workout policies.

Another part of our supervisory actions has focused on verifying that banks are complying with the regulations on the **provision of payment services**, especially with regard to the need to give advance notice of the current account maintenance fee increases that were applied across the industry in the run-up to the interest rate hikes.

¹ Some unplanned actions may also be required, generally as a result of unforeseen events.

² <https://www.bde.es/wbe/es/publicaciones/informes-memorias-anauales/memoria-supervision/memoria-de-supervision-2023.html>
(English version forthcoming).

We have also focused on checking that banks are complying with the regulations on **basic payment accounts**. In this case we have observed that banks provide information on these accounts on their notice boards and websites and that bank staff are aware of their existence.

However, we have noted some shortcomings regarding how familiar they are with these types of accounts (especially with their being free of charge for certain groups and the prior information that must be provided to applicants). We have also identified a lack of proactivity by banks when they offer this product.

These actions have also helped specify the best market practices, including most notably mechanisms to identify groups in difficulties to whom this account is offered.

The Banco de España has submitted some regulatory change proposals to the Ministry of Economic Affairs, Trade and Enterprise, to mitigate the practical difficulties we have observed in the marketing of these accounts.

Specifically, as the main reason for refusing to open a basic payment account is that the applicant has another account open in the same system, we have suggested that customers be allowed to exercise their right to transfer or convert their traditional account into a basic payment account, whether at the same or at a different bank, which would substantially reduce the rejection rate.

In addition, in view of the rising cases of **card and digital payment fraud**, we have revised the internal control procedures with the aim of mitigating this risk.

We have also reminded banks of the importance of developing and implementing communication strategies to raise awareness among their customers about financial fraud. Indeed, an awareness-raising campaign, promoted by banking associations, the National Cybersecurity Institute (INCIBE, by its Spanish acronym), the National Police Force and the Civil Guard, was launched recently.

Supervisory priorities for 2024

This year, the supervisory plan focuses on risks deriving from the macroeconomic environment and from digitalisation in the provision of banking and payment services.

Thus, we will (i) continue to review compliance with the measures approved to encourage **early mortgage repayments and novation and subrogation processes** to change from a variable to a fixed rate mortgage; (ii) improve our knowledge of **new operators** which play an increasingly active role in the **digital provision of banking services**, sometimes from another EU Member State; and (iii) foster – in the field of preventive supervision that we wish to shore up – analysis of the **internal control frameworks** and the functioning and efficiency of banks' lines of defence in the prevention, detection and correction of weaknesses in their relationships with customers.

I would also like to mention that the Banco de España is working on diagnosing the degree of **financial exclusion** in Spain. Following the publication of an initial report,³ we will periodically update its content to assess the effectiveness of the measures adopted by banks in compliance with the Strategic Protocol to Reinforce the Social and Sustainable Commitment of the Banking Sector.

In this connection, the draft law for the creation of an authority for the protection of financial customers⁴ envisages the periodic reporting of data that will enable the Banco de España to analyse changes in the level of financial inclusion in Spain.

Future challenges and supervisory response

Kindly allow me to focus in the last part of my address on some of the challenges ahead and how I believe we can face them in the exercise of the powers conferred upon us.

The first supervisory challenge arises from the banking sector's digitalisation and the emergence of new technologies, which have led to the **entry of new operators** that provide traditional banking products in an innovative manner.

These include, for instance, (i) "neobanks", which provide specialised services using exclusively digital means; (ii) large e-commerce platforms, which have entered the payment sector and the consumer credit market; (iii) suppliers of services based on crypto-assets; and (iv) suppliers of payment deferral services at points of sale, known as buy-now-pay-later (BNPL) services.

Additionally, the transposition of the new Consumer Credit Directive will foreseeably include in the regulatory perimeter operators and contracts that are currently unregulated, such as **fast loans and microcredits**.

Overall, although these developments will enhance guarantees for customers and provide for a level playing field across the different operators in the financial sector, they will also entail a substantial increase in the supervisory function, which will require an adequate response.

Second, various legislative initiatives (which have yet to be approved) seek to address the new social and demographic challenges. Their aim is to ensure that customers, particularly groups that are vulnerable or facing financial difficulties, are treated appropriately. In particular, I refer to a **personalised provision of banking services**.

In essence, banks are expected to bear in mind the personal circumstances of their customers, such as their age, if they have any disability or are foreign and their level of digital competence, aside from the characteristics of the geographical area in question.

³<https://www.bde.es/wbe/en/publicaciones/analisis-economico-investigacion/documentos-ocasionales/%5Bla-accesibilidad-presencial-a-los-servicios-bancarios-en-espana--informe-de-seguimiento-2023%5D.html>

⁴https://www.congreso.es/en/busqueda-de-iniciativas?p_p_id=iniciativas&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&_iniciativas_mode=mostrarDetalle&_iniciativas_legislatura=XV&_iniciativas_id=121%2F000018

Once again, these developments entail new challenges for supervision, which increasingly requires more specialisation.

Against this backdrop, I consider it is especially important to continue with the conduct supervision transformation process we initiated in 2022.

To this end, supervisory work should (i) bolster the **early identification and quantification of market conduct risks**, (ii) **foster dialogue with banks** to inform them early about the supervisory criterion for certain current issues or emerging risks, thus reinforcing the preventive nature of supervision, and (iii) **strengthen continuous monitoring** of banks and their internal control frameworks, to ensure that the business models and commercial organisation structures in place lead to adequate market practices and appropriate conduct towards customers. In short, the idea is to replicate the detection, investigation and mitigation model I mentioned earlier.

In this respect, we have already taken significant steps to provide greater transparency for supervisory priorities and expectations. For instance, the regular meeting of the Supervisory Forum with the sector – which has now been held twice – and publication of the “Guidelines on the governance and transparency of revolving credit”.

Thus, in the last few years we have seen an improvement in the design of banks’ corporate governance systems and internal control frameworks. Examples of this improvement are the growing importance of the compliance function (sometimes called the “conduct function”), inclusion of the customer service department in the organisation chart and the increasing number of cross-departmental committees.

Lastly, I would also like to highlight the importance of **financial education** as a tool for achieving a balanced and efficient market.

Promoting financial stability requires not only sound regulation and supervision, but also appropriate financial education for the population at large, so that people can understand the characteristics of the financial products they purchase and the risks and opportunities involved.

The importance of this preventive approach, also through education, inspires the efforts made by the Banco de España over the years in this field. We have recently created new internal structures, such as the Financial Education Committee, which aims to define and review the Bank’s strategy in this area and to ensure that it is properly implemented by coordinating the actions required.

The Committee has an ambitious work programme for the coming years which combines its own actions with others carried out under the framework of the Financial Education Plan, together with the National Securities Market Commission and the Ministry of Economic Affairs, Trade and Enterprise.

All this with the aim of improving the financial culture and digital skills of the groups targeted, to help them better understand the products on offer and how they meet their actual needs.

Conclusions

I would like to conclude by reiterating that the banking business is based on public trust, which is achieved by demonstrating not only financial soundness and appropriate risk management, but also correct conduct and customer service.

The Banco de España is fully committed to strengthening banks' conduct and fostering a model for relationships with their customers which places them at the centre.

Achieving these goals not only requires undertaking efficient supervisory work, but also improving the level of economic and financial education among the public at large so that they can take responsible and informed decisions. The supervision of banks' conduct and the promotion of financial education should, therefore, go hand in hand.

To illustrate the Banco de España's commitment to place our work in this field on a similar level to that of our international peers, the Banco de España's conduct supervision is undergoing an independent external evaluation⁵ whose conclusions will help to continue improving this function and to assess the adequacy of the new organisational structure.

Thank you.

⁵<https://www.bde.es/wbe/en/sobre-banco/programa-de-evaluaciones/evaluaciones/evaluacion-externa-de-supervision-de-conducta.html>