

Carlos da Silva Costa: Banking conduct supervision - new challenges 10 years after the financial crisis

Opening address by Mr Carlos da Silva Costa, Governor of the Bank of Portugal, at the Conference on "Banking Conduct Supervision: new challenges 10 years after the financial crisis", hosted by the Bank of Portugal, Lisbon, 25 September 2018.

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As prepared for delivery.

Good morning and welcome,

It is with particular satisfaction that Banco de Portugal is hosting this Conference, 10 years after the Bank was given a far-reaching mandate in banking conduct supervision.

The importance given to supervising the conduct of banking institutions in their relationships with customers and depositors is still relatively recent, although we now know that it is a fundamental duty to ensure the confidence of bank customers, and subsequently safeguard the stability of the financial system.

I want to make three brief points in this opening address:

- ♦ The first point is about the growing importance of banking conduct supervision, from the perspective of safeguarding financial stability;
- ♦ The second is on the approach followed by Banco de Portugal in this respect;
- ♦ And finally a note about the digital challenge.

Importance and evolution of banking conduct supervision

The international financial crisis reinforced the perception that the relationship between bank customers and credit institutions tends to be asymmetrical and the uninformed behaviour of bank customers generates risks to the financial system. This risk is greater: (i) the lower customers' financial literacy is, in terms of having specific skills and the knowledge required to make financial decisions tailored to risk, and (ii) the lower customers' financial skills are, in terms of their capacity to manage day-to-day expenses and anticipate and prevent the risk of future financial expenses or burdens.

As a consequence, it has become clear that financial literacy and skills are a requirement for financial stability. Sound or sustainable financial decisions made by each individual functioning in a given economic and financial space – especially bank customers – are key to financial stability. However, they are not enough in themselves, as economic agents do not consider and therefore do not incorporate the externalities that derive from their decisions or actions, particularly the systemic risk. This observation is especially important when the market is euphoric, as is the case with the residential real estate and mortgage markets. The intensity and propagation of distorted expectations of asset price increases are greater the lower the financial literacy and experience of a particular population.

This means that an improvement in financial education contributes to financial stability but does not prevent negative externalities which threaten the stability of the financial system.

Measures are also needed to tackle negative systemic developments resulting from the interaction of individual decisions even when well-founded – measures which aim to mitigate negative systemic effects on the stability of financial institutions. Such measures would be incumbent upon the financial literacy and skills of the economic agents and, in particular, their

ability to interpret the signs that result from the intervention of the prudential authorities. As a rule, a reduced capacity to interpret this intervention creates a greater risk of a bubble developing in the market and as a consequence determines a need for more interventionist prudential measures on the credit granting side or on the savings application side, to guarantee financial stability.

Financial literacy and education are therefore key for financial stability and for the nature of conduct and macroprudential supervision policies.

In short, to safeguard financial stability, it is not enough to monitor individual choices or to regulate the conduct of banking institutions with their customers. It is also necessary to monitor the system as a whole, to mitigate the negative externalities of individual actions, as well as the supervision of each financial institution to ensure its financial strength, in particular its capacity to absorb the risks resulting from the application of the resources entrusted to it.

The relevance of financial literacy and education has increased even more with the globalisation of markets and growing sophistication of products. Widespread access to banking products and services that are ever more diverse and complex and the emergence of new sales channels have all brought new risk sources.

We have therefore seen, at international level, the progressive strengthening of the framework of rights granted to banking customers, a broadening of areas of intervention for conduct supervision and more intrusive action by the supervisors.

The objective is to encourage the adaptation of products and services to the characteristics and needs of customers and prevent conflicts between the interests of customers and institutions.

Financial information and education for banking customers has also come to be seen as a structural dimension of banking conduct supervision, complementary to regulation and oversight.

More informed customers and with a greater ability to understand the characteristics of banking products and services are generally more attentive and demanding.

They are also better prepared to choose banking products and services more suited to their financial situation, needs and risk profile, thus contributing to the efficient operation of the market and to safeguard financial stability.

Banco de Portugal's conduct supervision strategy

Banco de Portugal began exercising its conduct supervision mandate at the outbreak of the international financial crisis.

We have adopted a strategy based on three fundamental vectors of action since the beginning, which are mirrored in the themes of this conference's panels:

- ♦ **(i)** Firstly, Banco de Portugal's strategy is based on the development of a regulatory framework that covers and regulates the conditions to market the products and services of retail banks;
- ♦ **(ii)** Secondly, Banco de Portugal is responsible for compliance with the regulatory framework applicable to the relationships between credit institutions and their customers through effective oversight and sanctions procedures;
- ♦ **(iii)** And finally, but no less important, we have, since the beginning, worked hard to inform and educate banking customers. Examples of this are the Bank Customer Website, launched in 2008 and completely renewed in 2017, and the National Plan for Financial Education, promoted with the other financial sector supervisors and which is supported by a large network of partners.

Digital challenges

I will end my address, as I couldn't refrain from doing, with a reference to the challenges the conduct supervisor faces due to the progressive digitalisation of the channels used in the sale of financial products and services.

The digital environment encourages the emergence of innovative products and services and new suppliers, with business models that are sometimes disruptive in comparison to traditional banking.

Furthermore, the dematerialisation associated with using digital channels facilitates the sale of products and the provision of cross-border banking services.

Regulators and conduct supervisors must therefore take on an active role in the digital ecosystem, catalysing the benefits and safeguarding against risks that may emerge.

Regulation and supervision should not impede innovation but they should ensure that the bank customer is protected, regardless of the channel used to carry out banking transactions.

The conduct supervisor must therefore:

- ♦ Closely accompany the technological innovation process in the retail banking markets;
- ♦ Reflect on the suitability of the existing regulatory framework;
- ♦ Develop new oversight tools and surveillance strategies to ensure that the regulatory framework is suitably complied with, that conditions for all operators are equitable and that banking customers are protected.

Promoting the financial literacy of bank customers is also of particular importance. That is why the development of digital financial information and education initiatives is one of our top priorities.

So I invite you to get to know the campaign recently launched by Banco de Portugal on social networks and on the Bank Customer Website to promote the security of young people who use digital channels.

Thank you all and I hope that this Conference is beneficial to all those present.