



IRISH FINANCIAL SERVICES
REGULATORY AUTHORITY

Review of Conduct of Business Rules for Financial Services Providers

March 2004

CONSULTATION PAPER CP2

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Introduction

We, the Irish Financial Services Regulatory Authority (IFSRA), also known as the Financial Services Regulator, started operating on 1 May 2003 as the single body for regulating all financial services in Ireland. A key driving force behind our establishment was a determination to put consumers at the heart of financial services regulation. Our mission is to help consumers make informed financial decisions in a safe and fair market and to foster sound dynamic financial institutions in Ireland, which can contribute to price stability.

One way that we can protect consumers is by developing and enforcing conduct of business rules. These oblige financial companies to act fairly and openly when dealing with consumers or potential consumers. The term 'codes' is used throughout this paper when referring to such rules.

Before 1 May 2003, codes already existed for credit institutions, insurance and investment intermediaries, investment business firms, stockbroking firms¹ and deposit agents. This meant that, at that date, a number of supervised bodies had no codes. In December 2003, we introduced interim codes for insurance companies, mortgage intermediaries and moneylenders, so that consumers of financial services could have a certain minimum level of protection, regardless of the type of firm they deal with². We now believe that a full review of the codes is timely because they are not completely uniform to the extent that varying standards may apply to different sectors and products and the layout may prevent consumers from fully understanding their rights.

¹ The Irish Stock Exchange implements and monitors the code of conduct currently applied to stockbroking firms.

² To access the existing codes, you may either request a copy by phoning 1890 923802 or view them on our website, www.ifsra.ie, by clicking on 'Industry' and then 'Codes and Requirements'.

Purpose of this review

We are carrying out a thorough review to develop unified codes that:

- contain the most appropriate level of protection for consumers taking account of legislation, consumer protection policy, experience in implementing codes and the range and complexity of products and services now available;
- apply to all providers of financial services, where relevant;
- focus on meeting consumers' needs without adding unnecessary regulation, which may reduce competition;
- are practical and open; and
- meet international best practice standards.

Our review has three aims:

- to ensure a consumer focussed standard of protection for purchasers of financial products and services;
- to ensure the same level of protection for consumers regardless of the type of financial services provider they choose, and
- to facilitate competition by ensuring a level playing field.

This paper begins the consultation phase of the review process. We are seeking views from all interested parties on the structure, format and general content of the unified codes. Once we receive your submissions, we will consider them and then draft unified codes. We will consider, on the basis of your comments, if a second consultation is necessary.

Guiding principles

In creating unified codes, we plan to apply the six core principles of better regulation that the Government put forward in its White Paper, '**Regulating Better**', which you can access from www.betterregulation.ie. The White Paper's six principles are:

- necessity
- effectiveness
- proportionality
- transparency
- accountability
- consistency

To whom do the codes apply?

The unified codes will apply to all financial services firms when operating in the State. In line with the structure of the European single market in financial services, these firms fall into three main groups:

- those authorised by us, the Irish Financial Services Regulatory Authority;
- those authorised by another competent authority in the European Union (EU) or the European Economic Area (EEA) that have at least one branch in Ireland ('establishment firms');
- those authorised by another competent authority in the EU or the EEA that provide services into Ireland without setting up a physical presence in this country ('passporting firms')³.

Structure of this paper

In this paper, we ask you to consider the elements to be included in the unified codes under the following general questions:

- Should the unified codes be principles based or detailed rules?
- Should the focus be on the provider, the service or the product?
- What other matters should we consider?

This last area might include, but is not restricted to, the following topics:

- unsolicited contact ('cold-calling');
- categories of intermediaries;
- complaints procedures;
- advertising rules;
- certifying loans;
- financial access;
- disclosing details of financial products; and
- voluntary codes.

Please note that this paper focuses on the structure, application and general content of future codes and not on the detailed content of individual rules. For now, we wish to produce unified codes, but we welcome any suggested detailed rules that can help us put the unified codes together.

Under each heading outlined above is:

- firstly, a short description of the main issues that we, the Financial Services Regulator, have identified; and
- secondly, an invitation to you to give your views on these issues and suggest specific alternatives.

³ The freedom of establishment provisions will apply to insurance intermediaries after the Insurance Mediation Directive is transposed on or before 15 January 2005.

Should the unified codes be principles based or detailed rules?

A principles based approach sets out high level requirements within which financial services firms operate, while a rules based approach is more prescriptive in relation to the requirements that should be implemented in specific circumstances.

The codes that are currently in force are primarily principles based rather than comprising a set of detailed rules. They set out how each regulated entity should behave in a particular set of circumstances, although certain requirements are presented in more detail than others. The Financial Services Regulator's preference is to continue with this principles based approach and to supplement those principles with specific rules where it is considered to be in the best interests of consumers to do so.

Arguments for and against the different approaches

The arguments in favour of a principles based approach are that:

- it allows financial services firms a certain flexibility to develop their own compliance ethos within the context of their own markets, legislative backgrounds and cultures;
 - it is more likely to encourage new entrants into the market, particularly from outside the State, and thus foster competition;
- while a code comprising detailed rules:

- may lead to an unthinking mechanical compliance culture rather than a realisation that the purpose of the codes is to promote the fair treatment of consumers;
- may prompt firms to seek ways around rules rather than complying with the principles of consumer protection;
- can restrict innovation and impose additional costs on financial services firms and perhaps ultimately consumers;
- might create uncertainty for companies that are faced with a situation for which no specific rule or requirement has been decided.

The arguments in favour of the rules based approach are that:

- it makes it clear to financial services firms how they should comply with rules in specific cases; and

- it is more likely to lead to a consistent approach between different firms, so consumers are aware of the level of compliance they can expect.

While a principles based approach may create uncertainty:

- for firms that may be unsure if the approach adopted fully complies with the codes; and
- for consumers who are faced with different approaches to compliance from different firms.

In certain areas, general principles may not be appropriate and more detailed codes are required. For example, a more complicated investment product may need specific rules to make sure that consumers are adequately informed of the costs, risks and potential returns associated with the product. In all circumstances, including those where detailed requirements are considered necessary, the overriding responsibility will be to comply with the spirit of the high level principles.

The Central Bank and Financial Services Authority of Ireland No. 2 Bill proposes to give us, the Financial Services Regulator, the power to impose sanctions on firms that fail to comply with their regulatory obligations. When we have that power by law, it will be important that regulated entities clearly understand what is expected of them in terms of compliance.

In light of the outline of the two approaches above, we wish to hear your views. In particular, please comment on:

- the merits of a principles based versus a detailed rules approach; and
- any areas in which more detailed rules would be more appropriate or could be used to supplement the high level principles.

Should the focus be on the provider, the service or the product?

We developed the current codes according to the different categories of firm, the types of service they provide and the legislative basis for regulating them. These codes were mainly based on protections for investment business consumers and were adapted gradually for other types of financial businesses. However, it is time to review the purpose of the codes' protections to make sure they are consumer-friendly and do not hamper competition.

Consumers must be able to expect that the same standards apply to the sale of a financial service product regardless of who the seller is. We believe that it is worth unifying the content of the codes for all institutions to create a level playing field and to help consumers know and understand their rights. However, the structure of the unified codes is important.

Because of this, we ask you to give your views on whether the codes should:

- continue to be structured according to service provider (for example, by credit institution, insurance company or moneylender);
- change their focus to services, so that all service providers – banks, insurance companies, intermediaries, solicitors or accountants – must obey common rules when providing a certain service;
- focus on types of product so that firms must comply with a common set of rules when advising on or selling a particular product;
- reflect a combination of two or more of the above suggested approaches; or
- call for a new approach not listed above.

When you consider the structure of the codes, please consider the advantages and disadvantages of the possibilities listed above. In particular, please concentrate on how the structure would affect consumers in terms of clarity, competition and financial access – issues that are discussed later in this paper. You may propose options other than those listed above. If you suggest an approach not listed above, please explain the advantages and disadvantages to consumers of your suggested approach. Also, your proposal should take account of the laws within which different types of firms operate and focus on the important role of the unified code in a consumer protection regime.

Our preference is for product focussed unified codes that take account of the particular legal frameworks, both European and domestic, under which different providers operate. However, it is important to point out that we do not approve products but instead concentrate on ensuring that all products are explained in a clear and open manner prior to the consumer buying them.

What other matters should we consider?

Other matters that may be worth considering in the review are briefly described below. This list is not exhaustive, so you may comment on other matters not specifically raised in this paper. If you believe that a particular approach is ineffective, you should suggest alternatives that are consistent with our duty to protect consumers.

Unsolicited contact (cold-calling)

The existing codes place restrictions on the situations in which financial services firms may cold-call. A cold-call is an uninvited personal visit or oral communication to an existing or potential private client who is an individual. This means that an individual should not receive an unexpected call from a person offering to sell them an investment service or product. We recently relaxed these rules for non-investment related products, such as general insurance, after consulting industry bodies and a number of consumer groups that favoured the active selling of these products.

Please submit any proposals you may have in relation to cold-calling rules, but make sure you focus on the fact that codes are there to make sure that consumers avoid inappropriate or pressurised selling techniques. Under this heading, you could also consider the issue of lenders offering unsolicited or pre-approved credit facilities.

Categories of intermediaries

After it assumed responsibility for regulating insurance intermediaries in 2001, the Central Bank divided insurance intermediaries – or insurance brokers – into two main groups:

- authorised advisors; and
- multi-agency intermediaries.

Authorised advisors and multi-agency intermediaries:

An **authorised advisor** is an intermediary that provides advice to consumers on the full range of products in a particular market, regardless of whether they can deal directly with the company that can provide the most suitable product for the consumer's needs. A **multi-agency intermediary** may advise only on the products available from the companies that they deal with. So, for example, whereas an authorised advisor should give information on the general insurance policies offered by many different companies, a multi-agency intermediary can only give information on those offered by the companies that they can deal with.

This structure has been in place now for three years, so it is worth considering if it is best for the consumer. When giving your views on this area, please consider if the structure remains appropriate and, if it does not, suggest a more consumer-friendly framework. You could also suggest ways in which the categories could be made more transparent so that the consumer is aware if their broker checks the full market or provides a restricted service. You should bear in mind Article 12 of the Insurance Mediation Directive (Directive 2002/92/EC), which will require insurance brokers to advise consumers of the range of insurance contracts that they consider when making a recommendation.

Composite intermediaries

Another issue arises in relation to what are known as composite intermediaries. These intermediaries can specialise in offering independent advice to consumers on products and services within one particular market, but they may also want to provide other, more restricted, advice on other products and services. The fact that they may want to provide this extra, restricted advice makes it difficult for them to pass the authorised advisor test.

To resolve the issue, some insurance brokers have established multi-agency intermediary subsidiaries to provide the extra services, while others have entered into referral arrangements with other authorised advisors. We would like your views on how to approach these cases. For example, do you think an insurance broker should be allowed to act as an authorised advisor for, say, life assurance policies while also acting as a multi-agency intermediary for general insurance?

While there would be clear benefits to intermediaries from the structure outlined above, we need to be satisfied that such a change would be in the best interests of consumers. When giving your views, please bear in mind that consumers should always be told:

- the nature and type of service that the intermediary is allowed to provide;
- how any distinction between authorised advisors and multi-agency intermediaries would operate; and
- how the intermediary would disclose its status so that consumers can more easily understand the different types of service on offer from the separate parts of the same firm.

Complaints procedures

We welcome views on the essential elements that financial service providers should include in their complaints procedures. Your views should concentrate on developing procedures that ensure complaints are handled efficiently and that the complainant is kept informed of the status of their complaint at all stages in the process.

If you are a consumer who has gone through the experience of making a complaint we would especially welcome your views and any suggestions you may have as to how the service may be improved. In doing so, you may wish to consider a range of issues, including whether the firm:

- fully explained the complaints procedure to you, including your options and your rights;
- gave you a clear timeframe for dealing with your complaint;
- up-dated you regularly on the progress of your complaint;
- clearly explained the outcome; or
- told you about other channels for pursuing your complaint, if they couldn't resolve it.

Advertising rules

Financial services providers are among the largest advertisers across all advertising media. In many cases, the first time consumers are exposed to the services on offer is through advertising. It is critical then that all advertisements should be fair and truthful and that consumers get a clear indication of what is on offer. Because of this, we intend to include advertising provisions in the unified code.

When making your submission, please consider the structure of advertising requirements and whether certain products need more specific rules than others. The rule that consumers are likely to be most familiar with is the one that requires firms to indicate in all advertisements that they are regulated by the Irish Financial Services Regulatory Authority. Do you think this rule makes consumers more aware that they should only deal with a regulated firm or, does it seem that we, the Financial Services Regulator, are endorsing the particular product being advertised?

We would be grateful for your views on the value to consumers of this form of disclosure in advertising, and for any suggestions that would ensure that advertisements do not lead to over optimistic expectations among consumers. When commenting on advertising provisions, you should address not only advertising in the mainstream print or electronic media, such as newspapers, TV or radio, but also consider whether the codes should apply to other forms of advertising, such as marketing and sponsorship.

Certifying loans

A recent survey of mortgage practices which we carried out brought to light some matters relating to consumer protection. While lenders carry out various checks on the borrowers ability to repay a loan, the borrower almost certainly is the best person to judge whether they can meet the repayments on a particular loan. You are asked to consider if it would be worthwhile to introduce a measure that requires each lending institution to obtain from the borrower, in writing, agreement of its assessment of the borrower's ability to repay, including a reference to any assumed levels of expenses that form part of that assessment.

By having to formally sign-off in this way, the borrower may need to focus on the assumptions that the lending institution has made about his or her ability to repay. However, it may be worth considering if introducing such a measure would serve only to increase "red tape" and provide further protection for the lender rather than help the consumer.

Another possibility involves borrowing from the practice of insurance and investment brokers, who must give a written statement of the suitability of a product to clients, outlining the reasons why they are recommending a particular product or investment strategy. This statement, commonly called a "reason why" letter, explains the rationale for recommending one product or provider above others. In your submission, please consider if introducing a similar rule for loans would be useful to consumers.

Financial access

We in IFSRA have a role in improving access to appropriate financial products that meet the particular needs of consumers. Some sectors of society experience difficulties in accessing different types of financial services. We welcome submissions from interested parties or organisations that represent those sectors on how the codes might address their concerns.

In its **Consultation Paper on the Law and the Elderly**⁴, the Law Reform Commission (LRC) raised issues on protecting the elderly and other vulnerable adults against financial abuse. The consultation paper proposed that we, as the Irish Financial Services Regulatory Authority, "should consider adopting and implementing codes of practice which would bring greater protection for vulnerable people and better redress mechanisms for customers who may have been exploited". The LRC recommended that the codes should oblige financial institutions to:

- give clear information or warning notices to people (other than spouses) operating joint bank accounts;
- warn people about the consequences of equity release schemes and of providing backing and similar guarantees for loans;
- make sure that elderly people entering equity release schemes have access to independent legal advice.

In your response, please consider the most effective way for us to address the Law Reform Commission's proposals and whether they are relevant to other areas of financial services not mentioned in the LRC's paper. You may also wish to expand the issue of vulnerable people, to include other groups, for example, minors operating accounts without their parents' consent.

⁴ You can access this from the LRC's website, www.lawreform.ie.

Disclosing details of financial products

A vital element of any consumer protection regime is that consumers understand the product they are buying and are fully aware of the risks and potential rewards involved in the product. Financial services providers must sell and market their products in a way that lets consumers understand them and make informed decisions on whether or not to purchase them. For example, it can be difficult for consumers to calculate the return on a tracker bond or to estimate the interest charge on a future credit card bill, so firms need to explain this to them.

We would like your views on how the codes of conduct could promote openness in light of the fact that consumers enter into complicated legal contracts and depend on the advice and guidance of their advisor. In doing so, you could consider what type of information should be disclosed, such as:

- what would be the maximum potential loss and the maximum potential gain on any investment product;
- what type of guarantees are provided and the name of the guarantor;
- the effect of a change in interest rates on any assumptions made about loan repayments or returns on investments;
- the relationship, if any, that exists between the advisor and the firm with which the investment is made;
- the publication of product documentation in language that can be clearly understood by the consumer; or
- the disclosure of information in such a manner as to meet the needs of consumers with reading difficulties.

It is important that any information disclosed is relevant to the consumer – too little information means that the consumer would be unable to make an informed choice, while too much might confuse the consumer as to what is vital for them to know. We welcome any views on how to strike a balance between these extremes and whether additional disclosure obligations might discourage international firms from entering the Irish market because they may have to alter their standard documentation for the Irish market.

You should also consider how financial services providers should inform consumers of their right to compensation if the provider defaults on an agreement. The single financial services market in Europe is continuing to expand, so it is essential that firms tell consumers of the

compensation scheme of which the firms are members. For example, when a consumer makes an investment with a UK insurance company, the company should tell them whether they can claim from a UK compensation scheme or another one.

Voluntary codes

Many representative bodies in the financial services sector have introduced voluntary codes. We wish to consider the future role of voluntary codes and their relationship to the codes that we are putting together. Voluntary codes complement the codes set down by law, as they can concentrate on a single sector and can be adapted to changing circumstances more quickly than a statutory code can. However, our main concern with voluntary codes relates to whether effective action can be taken against a firm that breaches a rule in a voluntary code and what redress consumers can expect. We are interested in your views on the future role of voluntary codes and the issues and concerns that such codes should address.

Developments in legislation

When we produce our final codes, we must make sure they comply with current and proposed EU and national law. The following EU-level developments will have a significant impact on the final codes.

- The **Insurance Mediation Directive** (Official Journal L009 15/01/03), which must be transposed into Irish law by 15 January 2005, extends the single market in financial services to insurance brokers. It allows these intermediaries to provide services in other EEA member states and harmonises the rules on registration and supervision.
- The Directive concerning the distance marketing of consumer financial services (Directive 2002/65/EC), which must be transposed into Irish law by 9 October 2004 (Official Journal L271 09/10/02). This Directive introduces harmonised consumer protection requirements to facilitate freedom of choice and to enhance consumer confidence in distance selling of financial services.
- The proposed EU Directive on Markets in Financial Instruments (commonly called ISD2) currently under discussion, plans to introduce a harmonised conduct of business regime across the EU for investment firms. The Committee of European Securities Regulators (CESR) has been given a mandate to develop such a regime. The CESR has issued a set of rules in its paper, 'A European Regime of Investor Protection - The Harmonisation of Conduct of Business Rules' (Ref: CESR/01-014d, of 9/4/2002).

National developments include the **Central Bank and Financial Services Authority of Ireland Bill, 2003**, the **Final Report of the Motor Insurance Advisory Board** and the recommendations of the Oireachtas Committee for Enterprise & Small Business in their **Interim Report on Reform to the Irish Insurance Market**.

Please consider how these and other developments may affect the unified codes.

Other consultations

During the first half of 2004, we will be consulting publicly on a number of other consumer protection issues. These are outlined below.

Tracker bonds

We are concerned about the ability of consumers to make informed decisions about the merits of any particular tracker bond based on the information available to them. We propose to consult on the openness of firms in relation to costs, charges and clear disclosure of the potential risks and rewards associated with these products.

Minimum competency of sales staff

We will seek views from the industry and consumers on the best way of working out the minimum competencies that sales staff need when dealing with customers. Our main focus will be on ensuring that those selling financial advice and products to consumers:

- understand fully the products that they sell;
- understand and can explain the potential risks and rewards associated with products; and
- have the skills to make sure that the recommended products meet the needs of consumers.

Commission structures

We have in the past expressed some concern over categories of commission, that could distort competition in the market and that may not be in the best interests of consumers. Examples include soft commissions, loyalty bonuses, including overrides, and other non-cash inducements, which are triggered when a specified amount of business is transacted by an agent. In the future, we will seek your views on the commissions model and on introducing an appropriate commission disclosure regime that makes sure that consumers can adequately compare the cost of financial services from the different providers.

Switching Accounts

We are committed to introducing rules that will make it easier for consumers to transfer accounts from one financial institution to another. We have already held initial discussions with the Irish Bankers' Federation with a view to a wider public consultation on the issue in the future.

Making your submissions

The closing date for submissions is **14 May 2004**. Comments are welcome from all interested parties. Please make your submissions in writing and, if practical, by email or on disk. You can post them, fax them or email them to us (see details below).

When addressing any issue raised in this paper, please use the corresponding headings in this paper to identify the section you are referring to. If you are raising an issue that we have not referred to in this paper, please indicate this in your submission.

We place a high value on the openness of the consultation process. Consequently, we intend to make submissions available on our website after the deadline for receiving submissions has passed. Because of this, please do not include commercially sensitive material in your submission, unless you consider it essential. If you do include such material, please highlight it clearly so that we may take reasonable steps to avoid publishing that material. This may involve publishing submissions with the sensitive material deleted and indicating the deletions.

Despite the approach outlined in the paragraph above, we make no guarantee not to publish any information that you deem confidential. So, be aware that, unless you identify any commercially sensitive information, you are making a submission on the basis that you consent to us publishing it **in full**.



ÚDARÁS RIALÁLA SEIRBHÍŚ
AIRGEADAIS NA HÉIREANN

Please clearly mark your submission '**Code Review Submission**' and send it to:

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