national consumer agency
gníomhaireacht náisiúnta tomhaltóirí

putting consumers first

CONSULTATION ON IMPACT METRICS FOR THE RISK BASED SUPERVISION OF FINANCIAL FIRMS BY THE CENTRAL BANK AND ON IMPACT BASED LEVIES

SUBMISSION FROM THE NATIONAL CONSUMER AGENCY

February 2011

About the National Consumer Agency

The National Consumer Agency (NCA) is a statutory body established by the Irish Government in May 2007. It aims to defend consumer interests and to embed a robust consumer culture in Ireland. In March 2010, the NCA assumed responsibility for the statutory consumer information and education functions of the Financial Regulator.[1]

The NCA provides free, independent information that helps consumers to understand financial products, ask the right questions and make the right choices about personal finances. The NCA's personal finance website www.itsyourmoney.ie provides a range of information to consumers including cost comparisons on day-to-day banking, savings, credit and insurance where consumers can compare the costs of various products offered by various regulated financial institutions.

Introduction and general comments

In principle we support and endorse a risk-based approach to the allocation of resources and the application of the levy. While allocating finite resources is a challenge for many public bodies and regulatory authorities it is imperative that all risks are identified, and appropriately defined and that the resulting metric is fit for purpose.

We would be concerned at the implications of systemic institutions having one risk score that crosses prudential and consumer protection. It is unclear how this would result in clear criteria for the allocation of resources devoted to each type of regulation, as both require dedicated resources.

While we are cognisant of the extreme risks to which consumers and indeed taxpayers are exposed due to the recent failures of prudential regulation we do not believe that it is appropriate to in any way dismantle or under-resource non-systemic consumer protection in response. The last reform of financial sector regulation was in 2003 when the Financial Regulator was established. This was partly in response to consumer protection scandals involving overcharging and mis-selling. We should not forget this and should be mindful of not paving the way for the next swing of the pendulum.

Definition of consumer loss

The NCA would question the definition of 'consumer loss' which appears to be very narrowly focussed. While actual monetary loss is easily calculated (by reference to amounts on deposit or under management) it is actually in reality more complex.

[1] This follows a Government decision to transfer the statutory consumer information and education functions of the Financial Regulator, including www.itsyourmoney.ie, to the National Consumer Agency.

Consumer detriment can occur that indirectly leads to loss. It would not appear that 'consumer loss' in the context of this consultation includes for example:

- loss of time or opportunity;
- loss arising from poor advice (where a person pays too much, or receives too little return on a product or service);
- loss arising from mis-selling where a consumer is sold an unsuitable product – including a loan* or insurance contract;
- loss caused by churning or where a consumer is enticed away from a good value product into a poorer value one (for example from a tracker mortgage to a variable rate); or
- loss caused by unfair terms in consumer contracts.

*It is worth noting that the mis-selling of home loans in the US was a contributory cause of the Global liquidity crisis.

Further, the measures proposed by the Central Bank in its recent consultation paper on the Consumer Protection Code would seem to indicate that the Bank is concerned about the ongoing risk of consumer detriment (outside of direct monetary loss) but this does not appear to be reflected in this paper.

Customer Impact

In relation to customer impact we would argue that where the consultation refers to 'loss for a large number of customers' we would add 'or large losses for a smaller number of customers'. This brings the risks inherent in smaller firms into relief. While size and retail customers / no of accounts can provide proxy measures for the risk metrics of the former – it is in fact the opposite for the latter.

Smaller firms can be riskier as they may not have the systems, in-house compliance functions or legal advisors, and the natural checks, balances and diversity of views of larger firms. Smaller firms who do not have non-executive directors and who are reliant on only one or two key personnel can be argued to pose a potentially higher risk of consumer detriment/loss. The model proposed in the consultation paper assumes the opposite. While this might be captured in the likelihood that a failure might occur we would like to see a clearer acknowledgement of the potential impact of smaller firms on consumers – particularly in the current environment.

Proposed risk metrics

In relation to the risk metrics proposed we would suggest that a proxy measure of proportion of staff with formal professional qualifications and 'staff turnover rate' (or perhaps that ratio of same to customer numbers) could be good indicators of potential risk. This would capture larger firms who may pursue a policy of hiring 'on the cheap' or quickly disenfranchising staff – indicating deeper problems in a firm that may warrant a closer look. For smaller firms it would focus on both appropriate professional qualifications for principals and also the extent to which minimum competency requirements (outside of grand fathering) are being met.

Other potential impact metrics might include previous regulatory issues or sanctions already imposed (if these are not captured by the probability score).

Many of the metrics proposed could mean that the firm is lower or higher risk. For example, in relation to staff numbers – it is not clear whether this metric will lead to a higher or lower risk rating. If it is a higher risk rating then this is purely a proxy measure of the size of the firm. However, lower staff numbers could indicate that a firm is under-resourced which poses a higher risk of non-compliance, both prudential and consumer-related.

Finally, the NCA would be concerned that the prevailing environment for firms is not reflected in the proposed model. In reality this has an impact on the behaviour of firms and the risks posed by them.