



FINANCIAL REGULATOR
Rialtóir Airgeadais

Consumer Protection with Innovation,
Competitiveness and Competition

Annual Report of the Financial Regulator 2006



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Rialtóir Airgeadais

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Purpose Statement

*Our purpose is to help consumers
make informed decisions in a safe
and fair market and to foster sound financial
institutions in Ireland*

Introduction

This Annual Report outlines how the Irish Financial Services Regulatory Authority (Financial Regulator) performed its functions and exercised its powers during 2006. It incorporates the Consumer Director's and Registrar of Credit Unions' Annual Reports to the Authority. It also incorporates the Annual Reports required under the Unit Trust Act 1990, Consumer Credit Act 1995, Prospectus Regulations 2005 and Market Abuse Regulations 2005.

The Chairman's statements relating to corporate governance and our system of internal financial controls, which are required in order to comply with the various legislative codes and regulations, are contained in Chapter 7 - Corporate Governance.

Members of the Authority and Senior Executives





Brian Patterson
Chairman

Chairman's Statement

Our purpose is to help consumers make informed financial decisions in a safe and fair market; and to foster sound, dynamic financial institutions in Ireland.

So, what does this mean in practice?

- ▶ Consumers need to know that the institution which holds their savings or their life policies, insures their house or their car, is likely to be solvent and sound. This is the most basic protection for consumers. It is the focus of our prudential supervision.
- ▶ Consumers need to know that there are basic, enforceable standards for transacting business, which require transparency, ensure suitability and prohibit mis-selling. Our Consumer Code and our Minimum Competency Requirements for sales staff, ensure that this is the case.
- ▶ Consumers make their choices based on impartial, clear information. Our surveys and publications provide this.
- ▶ When consumers exercise choice, this fosters competition - which in turn increases value to the consumer. So we foster competition between the providers of financial services. We work constructively with them on competitiveness and innovation.

So, we have placed the consumer at the heart of financial regulation. And in so doing, we respect the right and ability of consumers to make their own informed choices and decisions, in a market which is safe and fair.

Ireland also has an important and growing international financial services industry. Here we also work to foster competitiveness and innovation, recognising that they are central to the industry's ability to compete in global markets.

We recently published our Strategic Plan for 2007 - 2009. It sets out in clear terms our purpose, values and goals and explains our regulatory approach. In particular, our principles-led approach to regulation aims to strike the right balance between under and over regulation - and to encourage competitiveness and innovation. We place the responsibility clearly with the Boards and managements of financial institutions to manage their businesses in a responsible and prudent manner. We insist on their fitness and probity to fulfil that responsibility. In so doing, we avoid the excesses of rules-based regulation, which can fail to see the wood for the trees and can suffocate innovation.

Our Authority is a public interest board. Its members give selflessly of their time, experience and wisdom, often well beyond the call of duty. We are fortunate to have such a great team, and I thank them for their commitment.

I also want to thank our Chief Executive, his management team and all our staff for their dedication and achievements. Our culture reflects their strong ethos of public service.

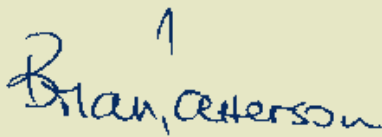
Thanks are also due to the Governor and staff of the Central Bank for their continued support.

I want to thank too the Minister for Finance, his officials and the various Government Departments and State Agencies who have worked with us throughout the year.

Our Consultative Consumer and Industry Panels play an important role in our accountability framework. Both Panels have made constructive suggestions to us during the year, many of which have been readily adopted or built into our planning. We value their commitment and expertise and we thank the members of both panels for their continuing input. We also thank all the representative bodies with whom we engage as we go about our work.

Finally I want to thank the consumers of financial services who place their trust in us to look after their interests. It is a trust we intend not to betray.

Our guiding light is the public interest. It is the value we strive to live.

A handwritten signature in blue ink that reads "Brian Patterson". The signature is written in a cursive style with a small number "1" above the letter "i".

Brian Patterson
Chairman



Patrick Neary
Chief Executive

Chief Executive's Report

Introduction

It is a great privilege and pleasure for me to present the Annual Report of the Financial Regulator for 2006.

We now supervise more than 10,000 financial service providers of varying size and nature including banking, insurance, collective investments, asset management firms as well as credit unions and retail intermediaries. 2006 was a year of significant growth in the financial services industry:

- ▶ Total assets of credit institutions increased by 19% from €941 billion to €1,116 billion;
- ▶ The nominal value of interest rate, foreign exchange, equity and commodity derivatives increased by 65% from €10,493 billion to €17,314 billion, clear evidence of the significant size and complexity of the trading activities of the banking sector;
- ▶ Net asset value of collective investment schemes also increased by 24% from €588 billion to €730 billion;
- ▶ Market capitalisation of the Irish Stock Exchange increased from €225 billion to €232 billion, an increase of 3 percent;
- ▶ Total assets of insurance undertakings increased by 28% from €116 billion to €148 billion;
- ▶ The total assets of credit unions increased by 11% from €13 billion to over €14 billion;
- ▶ Total assets under administration in the funds industry stood at €1.25 trillion; and
- ▶ During 2006 a total of 2,205 financial service providers and 738 collective investment schemes were authorised.

In 2006 we published our second Strategic Plan for the three years until the end of 2009. We set out goals against which our performance can be measured, becoming one of the few regulators worldwide to do so. In addition to our core purpose of helping consumers make informed financial decisions in a safe and fair market and fostering sound dynamic financial institutions in Ireland, we are also committed to facilitating innovation and competition in the financial services market. Our approach is aimed at empowering consumers of financial services and at the same time promoting and fostering a competitive and dynamic financial services industry.

Key Achievements

2006 was a milestone year in the development of financial services regulation. We introduced major new initiatives that will underpin the Irish financial regulatory system into the future.

New consumer protections

Major consumer standards were unveiled by the Consumer Director who published the new Consumer Protection Code, supported by Minimum Competency Requirements for sales staff dealing with customers. Ireland is now one of the few countries where, due to the introduction of the Consumer Protection Code, the financial services sector has an explicit consumer protection commitment. The code demands ethical business behaviour and complete integrity of those with whom consumers deal. These new standards will guide the Financial Regulator's programme of consumer-focused inspections and will result in a fairer financial services market - benefiting both the consumer and the industry.

New Fitness and Probity Standards

Our new Common Fitness and Probity framework for directors and senior managers of financial service providers was also published. This establishes a process to assure that only persons of probity and integrity serve in key positions of responsibility. Having a strong fitness and probity regime in place allows us to have a gatekeeper role in ensuring that suitable persons are involved in the management of the firm and client funds. It also lets businesses manage themselves. Moreover, the test is based on a partnership approach, with firms taking account of fitness and probity standards in their selection processes.

Taking Regulatory Action

We carried out over 800 inspections and review meetings and examined over 60,000 returns from financial service providers. The majority of issues that arose were resolved in consultation with firms, necessitating over 200 regulatory actions. In a small number of cases we felt it necessary to apply administrative sanctions against firms who we suspected had breached our requirements and against individuals who had participated in those breaches. These resulted in two administrative sanction settlements with firms and their directors. These actions reflect our approach to use the full range of regulatory measures at our disposal to resolve issues in the consumer interest by the most effective means possible.

We are also required to report information to other enforcement agencies if we suspect that a financial service provider has breached other legislation or may have committed an offence. As a result a total of 38 disclosures were made to other bodies in 2006.

At the Cutting Edge of Innovation

It is no accident that the international financial services firms at the cutting edge of financial product innovation and with enormous technical know-how and expertise are establishing a major presence in Ireland. The regulatory system we are developing is fully capable of meeting the challenge of overseeing such firms. But we are very aware of the need to focus on our own expertise, innovation, openness and responsiveness to ensure that the regulatory system here matches that of any other comparable jurisdiction.

Responding to an Evolving Financial Services Sector

We have responded speedily and fully to the international developments that are driving and shaping the future direction of financial services globally. This has been demonstrated in our timely implementation of the Capital Requirements Directive, our work on Solvency II, the Markets in Financial Instruments Directive (MiFID) and the Reinsurance Directive. We have further streamlined our funds authorisation process allowing for fast approval without diluting the necessary safeguards.

Ireland was the first country in the EU to implement the Reinsurance Directive, which gives the reinsurance industry in Ireland access to both European and global markets. A new regulatory capital regime for banks and investment firms was also developed, a new fast track authorisation process for qualifying investors funds was established. This, coupled with our new technology innovations such as our electronic web based reporting system which is now in place for credit unions and, to be implemented shortly for banks and investment firms, will save time and make the prudential reporting process for such financial service providers much more efficient.

A number of important initiatives took place in 2006 in relation to the credit union sector. We streamlined and standardised the process for approval of additional services offered by credit unions. This led to 26 credit unions receiving preliminary approval for mortgage services on a tied agency basis. An agreement was also reached with the sector, in consultation with the Department of Finance, which will allow qualifying credit unions to extend the percentage of loans which can be issued for longer terms.

International Recognition

Significantly, three international independent reviews of the Financial Regulator's performance published in 2006 contained positive assessments of our regulatory system:

- ▶ The International Monetary Fund (IMF) reported that the regulatory system in Ireland works well with an appropriate approach taken to various sectors;
- ▶ The Financial Action Task Force (FATF) also published positive findings of their examination of our system to combat money laundering and terrorist financing; and
- ▶ An IMF Research Paper ranked the Irish system and structure of financial regulation first in the world amongst the world's single financial regulators in terms of its independence and accountability.

Acting in the Best Interests of Consumers

Protecting Consumers

The Consumer Protection Code will be fully implemented during 2007. It was important to take the time to get this right. The Code sets out the principles underpinning the relationship between firms and consumers and requires firms to act in the consumer's best interests. The final Code follows an extensive consultation process involving all our stakeholders. It reflects our principles-based approach to regulation and will directly benefit the consumer and facilitate a level playing field for financial services firms.

The next important step is to examine appropriate provisions from the Code that can be applied to credit unions, taking into account the special structure and voluntary ethos of the credit union movement.

We also undertook a review of the moneylending industry last year, this will guide us in determining additional consumer protection measures that should apply to protect and inform the customers of moneylenders.

We actively monitor advertising by regulated firms and follow up on these and other issues that consumers bring to our attention. Last year we investigated a total of 84 advertising issues in the financial services sector. Based on this practical experience and as a result of our concerns that some advertisements may not fully inform consumers of the risks in certain products we brought in new requirements on advertising as part of the Code in 2006. This means that firms must include warning notices on some products, including refinancing products and tracker bonds, to help consumers understand the risks.

Pictured meeting with Ben Bernanke (centre), Chairman of the Federal Reserve in Washington are (l-r): Patrick Neary, Chief Executive, Brian Patterson, Chairman, Con Horan, Prudential Director, and Mary O'Dea, Consumer Director.



Competition in the Market

We strive to facilitate competition in the financial services market. Markets only work well if both sides of the market are functioning properly - the suppliers and the buyers. If consumers use their buying power they can effect real change in the level of competition in the financial services market. This Annual Report contains the Consumer Director's Statutory Report on the extent of competition and the degree of market power exercised by the largest firms in key segments of the banking and insurance industry. It shows that in the banking industry competition in the credit card, term/revolving credit and current account markets remained concentrated in 2006. Only the residential mortgage market showed higher measurements of competition. It also finds that within the top five firms in the term/revolving credit market, there was a further concentration of market share among the larger firms.

In relation to the insurance industry it shows an improvement in the motor and property insurance categories though competition overall remains weak. We are, however, concerned that within particular sub-sectors, such as motorcycle insurance and insurance of homes that are prone to flooding, there are fewer active market participants and their market power is consequently greater.

Empowering Consumers

Consumers who are alert and prepared to shop around and switch their service providers can make the market for financial services more competitive. There was a significant increase during the year in the numbers of consumers contacting us for information and assistance on a range of financial matters.

We were very active in 2006 in helping consumers see the benefits of shopping around and switching. Cost surveys on a range of financial products were published. Several co-ordinated press, marketing, advertising and research campaigns were organised and a number of new and revised consumer publications were produced. We also helped consumers with complaints through our arrangements with the Financial Services Ombudsman and Pensions Ombudsman.

Maturing SSIA's were identified as an important consumer issue and we implemented a dedicated information campaign to help consumers through the maturity process and to provide useful information in plain English on their options for their lump sum. We also visited a number of financial service providers to review their management of SSIA payments. This was one of many campaigns that informed the consumer of our role in providing independent information on financial products and services available in Ireland.

Consumer Borrowing

As consumer borrowing continued to grow in 2006 we continued to monitor the quality of credit extended. Our role is twofold:

- ▶ to encourage prudent behaviour on the part of lenders, and so to protect depositors; and
- ▶ to ensure borrowers take account of future risks.

We manage this through a combination of monitoring credit institutions' lending policies, consumer information initiatives and a stress testing programme with the Central Bank. We examined how lenders assess the ability of the borrower to repay loans both now and in the future should circumstances change. Affordability is the key issue both now and into the future. As a result of developments in the market last year, we imposed new risk weighting measures on higher loan-to-value mortgages, so that additional reserves are set aside now by lenders for the future. In addition, in order to assist consumers in making informed decisions about their individual debt levels we provided information about different types of credit, the cost of credit, how to weigh up whether borrowing more money was the best course for them and highlighted to consumers the inherent risks and consequences of over-borrowing.

Financial Capability

Towards the end of 2006, we established the National Steering Group on Financial Education which brings together key stakeholders to develop our approach to financial education. In the area of financial access, research we requested on barriers to access was published by the Combat Poverty Agency. Both of these developments will be important in our workplan for 2007. In addition, this work is highly dependent on the co-operation and input of our various stakeholders and we thank them for this valuable contribution.

Pictured with Patrick Neary, Chief Executive, Financial Regulator (l-r) are John O'Grady, Chairman, Chartered Accountants Insurance Group, Terry Murphy, Consumer Protection Codes Department, Financial Regulator, Anne Troy, Head of Investment Service Providers Supervision, Financial Regulator at the Chartered Accountants Insurance & Banking Groups Breakfast Briefing.



Effective Regulation, Fostering Innovation, Competitiveness and Competition in the Financial Services Industry

Mitigating Risk through Compliance

A principles-led approach to regulation is the right model for Ireland. It means that the responsibility for the proper management and control of a financial service provider, and the integrity of its systems, rests with its board of directors and its senior management. This approach focuses on outcomes, is robust and internationally credible. It both allows and requires financial service providers to manage themselves. This vital work is overseen by the Prudential Director. Financial service providers must have systems and policies in place to mitigate risk and monitor compliance with their internal policies. Our role involves oversight of the quality of the institution's corporate governance, including risk management and internal control systems.

We fully expect boards and senior management of all financial service providers operating in Ireland to adopt ethical behaviour and transparency in business dealings as key values. We do not examine each transaction or contract entered into by institutions to test compliance. Neither do we seek to interfere with the design of financial products. We expect all financial service providers, whether engaged in international or domestic activities, to comply with best practice. Where a financial service provider does not fulfil these reasonable expectations we have a number of enforcement measures available to us, culminating in administrative sanctions. I am satisfied that the majority of financial service providers operate to a high standard. This is borne out by the very small number of cases that required such actions in 2006.

Better Regulation

We strive for a regulatory system that is robust, is internationally credible and that allows financial service providers the freedom to run their businesses properly. We want to implement European regulation in a manner consistent with this approach. However, in keeping with this form of implementation, we must be able to depend on industry to honour the obligations and commitment that this model of supervision demands. We are committed to ensuring that our regulatory requirements do not become a barrier to competitiveness and innovation. We apply the Government's 'Better Regulation' principles and are active members of the Taoiseach's Better Regulation Group.

In accordance with the 'Better Regulation' principle of transparency, we consult publicly before introducing a new regulation. The Consultative Consumer and Industry Panels provide an important mechanism for ensuring that the consultation process with stakeholders is effective and efficient. Both Panels were invited

to make a number of valuable submissions to us on a range of regulatory proposals, including our Strategic Plan for 2007-2009 and provided us with comments on our draft statement of income and expenditure. 2006 has been a year of further development in our constructive relationships with the two Consultative Panels.



Pictured at the Insurance Institute Industry Leaders Conference with the Chief Executive Patrick Neary who spoke at the event are (l-r) Michael Brennan, President, The Insurance Institute of Ireland; Mary Fulton, Partner, Deloitte; and Cormac McCarthy, Group Chief Executive Officer, Ulster Bank Group.

Regulating Credit Unions

Protecting Credit Union Members

Recognising the unique nature of the credit union sector, with its volunteer and community-based ethos, we follow a different approach to the regulation of credit unions. The Registrar of Credit Unions and his staff have continued to work closely with credit unions around the country and their representative associations to enhance matters of regulatory importance and to ensure the safety of credit union members' funds.

Central to our activities is the protection of members' interests and particularly those of savers. Extensive and ongoing consultation and communication with the credit union representative associations continues to be an important part of our activities. The associations play an influential and active part in the life of the movement, which has €14.4 billion assets, a growth of 11% on 2005 figures. During 2006 considerable progress was made in developing the system for the regulation of credit unions with a view to building compliance.

Competitive Challenges

Although progress has been made by credit unions in adapting to an increasingly competitive financial services environment, important challenges still remain. The attraction of appropriately qualified volunteers to credit unions and the modernisation of the statutory governance structures within which they operate need to be addressed if the movement is to continue to thrive in the future. In this regard we have, at the request of the Minister for Finance, engaged with the credit union movement to find common ground in relation to the principles that might guide reform of the regulatory framework. We have also been actively engaged with the Irish League of Credit Unions on proposals to reform the structure of the existing Savings and Protection Scheme.

Assisting Boards and Management

289 credit unions were visited during the year. As credit unions now hold €7.3 billion of members' funds in the form of investments, we are anxious to ensure that no undue risks arise in the management of such funds. During 2006, following an extensive period of consultation with the representative associations, the Department of Finance, and Credit Union Advisory Committee (CUAC), we issued a Guidance Note on the classes of investment instruments which are suitable for credit unions to use for the investment of surplus funds. We continued to enhance awareness among credit union boards of the need for strong governance in the lending and credit control functions. We will provide guidance to assist boards and the relevant committees in operating this function to the highest possible standards. During the year it was necessary to appoint specialist external accountants to consider the affairs of 3 credit unions and assist the boards in implementing remedial actions in the interests of their members.

National Regulatory Policy Developments

Facilitating Innovation

The funds authorisation process was further streamlined during 2006. We introduced a fast track approval process for qualifying investor funds and we replaced the annual authorisation of mortgage intermediaries with 5 or 10-year approvals. We also worked closely with the Department of Finance and the financial services industry in developing a Bill to update the Asset Covered Securities Act 2001. The new legislation reflects Ireland's commitment to innovation and competitiveness in the covered bond market.

In response to the evolution of the captive insurance market in Europe and representations from the Dublin Insurance Management Association (DIMA), we have reviewed the prudential requirements for captive insurance firms. The primary result of this was a decision to ease the solvency requirements for captive insurers involved in specified, low risk business lines, to allow captive insurers to write more reinsurance business under specific conditions and, on a case-by-case basis, to allow credit for reinsurance ceded to related financial service providers. The new measures streamline the supervisory framework and enhance the competitiveness of Ireland as a captive insurance centre.

Risk Based Supervision

During 2006, we spent much time consulting on and preparing for the introduction of a revised framework for the calculation of the capital adequacy of banks - the Capital Requirements Directive (CRD). This involved dialogue with the Banking Industry on the exercise of a significant number of national discretions available under the CRD and culminated in the issuing of our requirements in December. Coupled with this we introduced new liquidity requirements for credit institutions to allow the use of improved techniques to measure and manage liquidity risk. Credit institutions and investment firms now have a modern risk based regulatory regime that allows institutions organise their internal governance arrangements, risk management systems and controls to the optimum extent.

Markets Developments

The Markets in Financial Instruments Directive (MiFID) will come into effect on 1 November 2007. The MiFID improves the "passport" for investment firms by more clearly describing how the responsibility is allocated between home and host states for passporting branches. It also generally clarifies some of the jurisdictional uncertainties that arose under the Investment Services Directive. In July 2006 we established the MiFID implementation forum to provide us and industry participants an opportunity to prepare for this and we also participated in the development of a number of EU consultation papers on a range of issues. Work in this area is progressing positively.

EU Policy Developments

Facilitating the EU Agenda

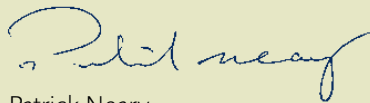
Throughout 2006, we continued our policy of consultation with the industry and other relevant stakeholders on the implementation of major EU Directives - Capital Requirements, Transparency, Reinsurance, Markets in Financial Instruments and Solvency II - as these projects make their way through the legislative process.

Over the last two years, we have worked through the Committee of European Banking Supervisors (CEBS) in their efforts to achieve EU wide convergence of supervisory practice in a number of key areas. This resulted in a common approach in areas such as the validation of internal models and supervisory reporting. Our efforts through the Committee of European Securities Regulators (CESR) focused on contributing to the completion of the Financial Services Action Plan in securities legislation. Our work in the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has contributed to technical advice to the Commission on the development of the new prudential insurance framework under the Solvency II project.

Towards the end of 2006, we created the position of EU and International Co-ordinator to maintain an overview of developments from EU and International fora, working across our Consumer and Prudential Directorates and also with our Consultative Industry and Consumer Panels. This is an important strategic step for internationally active institutions. To this end, I welcome the Industry Panel's establishment of an EU and International Industry Advisory Group to support this important initiative.

Conclusion

This Annual Report provides a very comprehensive account of extensive work carried out and of the various achievements of the Financial Regulator in 2006. This is only possible with the active leadership provided to me by the Chairman, as well as the support of the members of the Authority and the Governor and Board of the Central Bank and Financial Services Authority of Ireland. I am proud of the hard work, diligence and commitment to the highest of standards of the management and staff of the entire organisation.



Patrick Neary
Chief Executive

Strategic Plan 2007-2009





FINANCIAL REGULATOR
Rialtóir Airgeadais

Financial Regulator - 2006 at a glance

Financial Regulator 2006 at a glance

Sector	Advising on EU Directives and Irish legislation
Consumer Protection	<p>Publication of Consumer Protection Code Publication of Minimum Competency Requirements Renewal of Non-Life Insurance Regulations Review of money lending industry</p>
Consumer Information	<p>New advertising awareness campaign - 'on the bus' developed and launched 11 Cost Surveys published - Personal, Student and Business Current accounts, Home Insurance, Motor Insurance, Life Insurance, Personal loans, Credit cards, Car finance and Stockbrokers fees and charges Publications on SSIA's, Mortgages, Savings and Investments, Pensions, Your options at retirement, Getting financial advice and Managing your money published.</p> <p>Consumer information campaigns: Debt Management, mortgages, SSIA's, pensions, using your credit card abroad, fraud, motor pack, savings and investments, 28 regional visits nationwide, Private Motor Insurance Statistics 2003 and 2004, Research on Financial Access published, National Steering group for Financial Education established, Recommendations of Competition Authority Banking and Insurance reports progressed</p>
Authorisation and Funds	<p>Common Fitness and Probity test introduced New authorisation regime for qualifying investor funds and mortgage intermediaries Marketing of Non-UCITS to Netherlands agreed</p>
Banking	<p>Notice on the Implementation of the Capital Requirements Directive for banks Requirements for management of liquidity risk Additional capital required for high loan-to-value mortgages</p>
Insurance	<p>Full solvency regime for reinsurance companies introduced Revised supervisory regime for captive insurers Insurance Statistical Review 2005 Private Motor Insurance Statistics 2003 and 2004</p>
Investment Services	<p>Notice on the Implementation of the Capital Requirements Directive for Investment Firms Revised prudential handbooks for Investment & Stockbroking firms and Authorised Advisors and Restricted Intermediaries</p>
Markets	<p>Prospectus Rules and Market Abuse Rules</p>
Credit Unions	<p>Rollout of web-based Prudential Return completed Guidance Note on Investments by Credit Unions issued Credit Union Newsletter (RCU News) published Longer term lending limits reviewed Approval for provision of mortgage services by credit unions streamlined</p>
Corporate	<p>Annual Report 2005 and Strategic Plan 2007-2009 Industry Funding Regulations and Guide to Funding Levy 2006 Regulatory Connection - 4 issues Settlement of Administrative Sanctions cases</p>

Advising on EU and Irish Legislation	Activities / Key Statistics
Draft Directives for Consumer Credit and Markets in Financial Instruments	97 on-site consumer focused inspections Themed inspections on SSIA maturity process Payment Protection Insurance and Foreign Exchange 84 advertising issues investigated
	330,000 publications requested 325,000 online users visited www.itsyourmoney.ie 110,000 cost surveys downloaded 29,200 callers used our consumer helpline 6,500 visits to Information Centre
Draft Directive for Eligible assets.	2,205 financial service providers and 738 Collective Investment Schemes authorised 6,290 financial service providers and 4,090 Collective Investment Schemes under supervision 4 warning notices issued regarding unlicensed providers of financial products UCITS III Management companies converted
Capital Requirements Regulations Asset Covered Societies Act 2007 Building Societies Act 2006	1,589 returns analysed 60 inspections and review meetings
Reinsurance Regulations Draft Directive for Solvency II	510 (Life and Non-Life) returns analysed 199 inspections and review meetings
Draft Directive for Markets in Financial Instruments	2,679 returns analysed 55,676 funds returns analysed 167 inspections and review meetings
Draft Directives for Markets in Financial Instruments and Transparency. CESR Report on CESR Members' Powers under the Market Abuse Directive and its Implementing Measures. CESR Report on CESR Members' Powers under the Prospectus Directive and its Implementing Measures.	16 market abuse enquiries initiated 2,687 prospectuses approved
Amendments to Credit Union legislation.	289 inspections/visits undertaken Over 1,500 returns analysed
Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing	96% funding levy collected by end December Recommendations of Competition Authority Banking and Insurance reports progressed

Values of the Central Bank and Financial Services Authority of Ireland

In fulfilling our purpose, we make six core commitments, that:

1. We attach primacy to the public interest.
2. We act in the best interests of consumers of financial services.
3. We foster an internationally competitive and successful financial services industry.
4. We work with integrity and transparency.
5. We operate efficiently and effectively.
6. We respect and value each other as colleagues.

WE ATTACH PRIMACY TO THE PUBLIC INTEREST

We work to provide a stable, attractive, fair business environment by making sound, prudent decisions in the public interest.

We promote a sound economic and financial environment, directing our work towards achieving price stability.

We manage the official external reserves to the country's best advantage.

We view all matters in our domain as linked and interdependent.

We are good 'corporate citizens'.

WE ACT IN THE BEST INTERESTS OF CONSUMERS OF FINANCIAL SERVICES

Our decisions are made in the best interests of consumers.

We are accessible and have clear & open channels of communications.

We facilitate consumers in getting redress on financial matters.

Our policies, systems and behaviour are consumer-friendly.

We take the initiative in informing and educating all relevant parties, and we are responsive to them.

We promote transparency in the provision of financial services.

WE FOSTER AN INTERNATIONALLY COMPETITIVE AND SUCCESSFUL FINANCIAL SERVICES INDUSTRY

We design and operate a regulatory regime conducive to an internationally competitive financial services industry and one that is profitable and growing in both the domestic sector and the international sector based in Ireland.

We seek to be well informed about the needs and concerns of financial institutions through regular consultation and research.

We provide world-class service to financial institutions in all our dealings with them.

We work to ensure a safe and reliable payments system including production, circulation and use of high quality banknotes and coins.

We strive to fulfil our statutory roles thoroughly and at the minimum necessary cost.

WE WORK WITH INTEGRITY AND TRANSPARENCY

Integrity, impartiality and thorough professionalism characterise everything we do and say.

We have transparent, comprehensive, and proactive systems of accountability and external reporting.

We meet all requests for information within the constraints of the law.

WE OPERATE EFFICIENTLY AND EFFECTIVELY

We are responsive and dynamic in our approach to our constantly changing environment and strive for continuous improvement.

We seek to develop and execute our strategies successfully.

We review performance regularly and learn from experience, measuring ourselves against best international standards.

We embrace a performance culture and recognise achievement.

We make efficient use of resources and provide value for money.

Co-operation and teamwork is the norm across the organisation.

WE RESPECT AND VALUE EACH OTHER AS COLLEAGUES

Our human resource policies and practices are fair and transparent.

We have effective systems of communications and consultation.

Training and development opportunities are available to all.

We trust each other to act responsibly and with commitment.

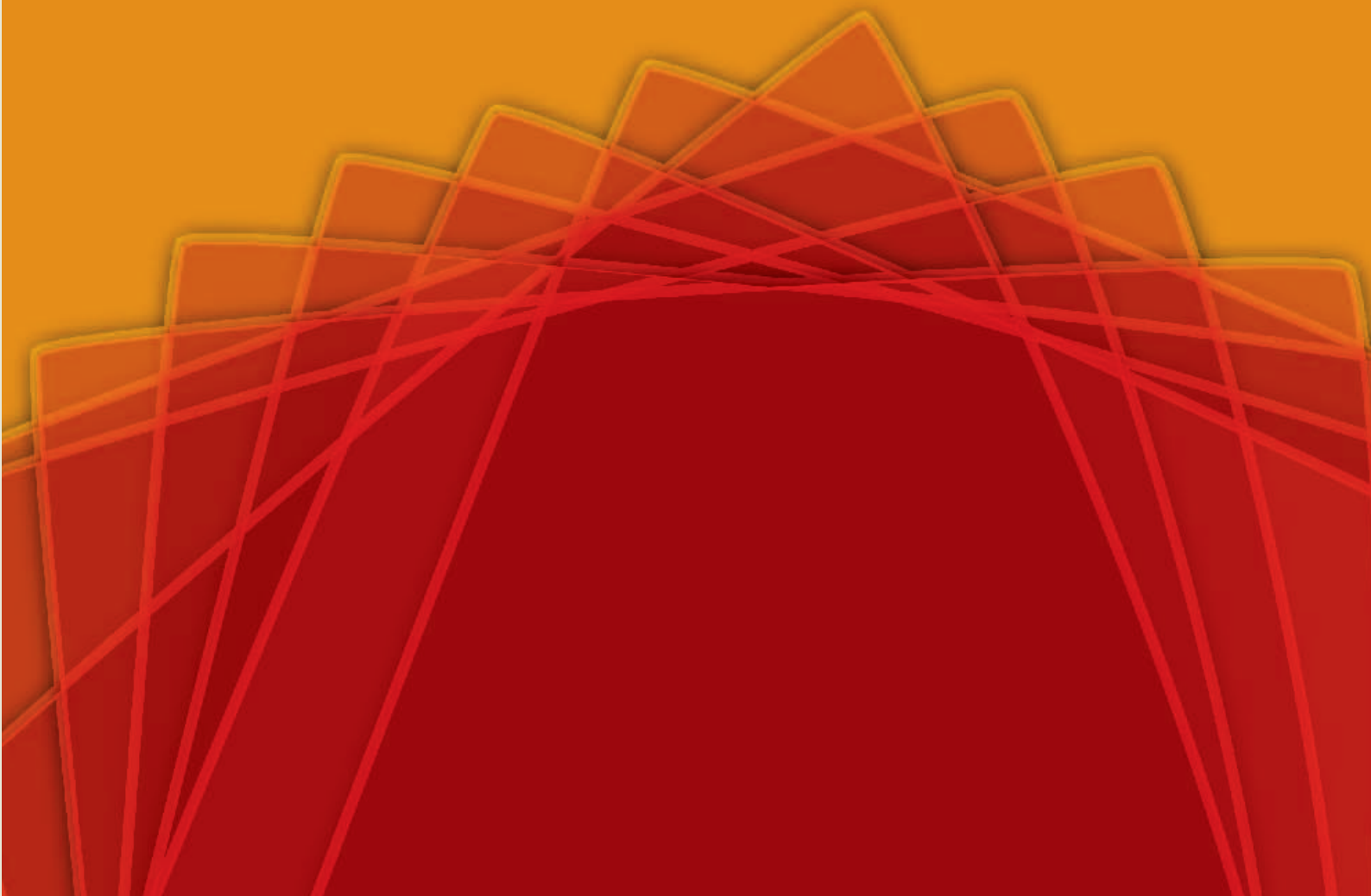
Our reward and recognition systems are fair and competitive.

We recognise the need to maintain a reasonable balance between work demands and family life.

We maintain a safe and healthy work environment.

Chapter 1

Establishing the Regulatory System



Establishing the Regulatory System

1.1 Background

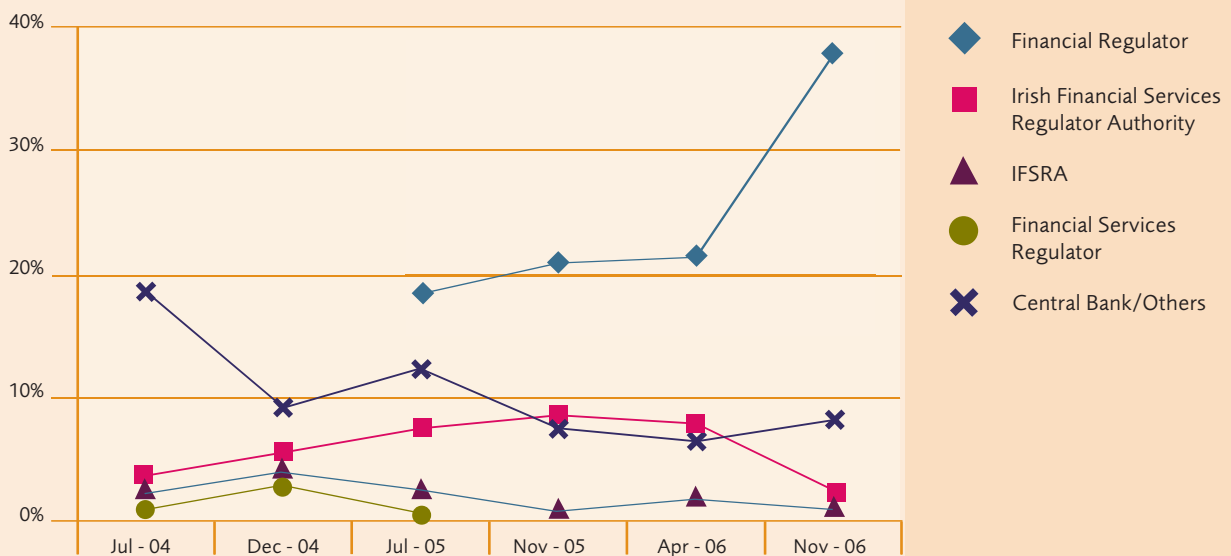
2006 was a challenging and busy year, during which we became responsible for the regulation of reinsurance companies. We improved the new regulatory capital regime for banks and investment firms through the implementation of the Capital Requirements Directive, a forward looking approach to liquidity management for credit institutions and established a new type of fund for qualifying investors. Our work on a Common Fitness and Probity test for directors and senior managers of financial service providers was completed. We commenced implementation of the new consumer protection code and minimum competency requirements for sales staff in financial service providers. We continued to promote awareness of our role and functions.

Graph 1.1 below also highlights the positive impact of our communications activities on brand awareness levels. We reached our highest rate in awareness levels among consumers to date (37% in 2006, up from 22% in 2005). And that figure grows to 41% if you take into account the additional numbers who correctly identified who regulated financial institutions, using any variation of our name. The results also highlight the importance of modifying our brand to Financial Regulator in April. The move to one strong brand meant that consumers were more likely to readily identify our name.

The biggest increase in awareness levels was between April 2005 and November 2006, which coincided with our most active period of communications activity.

Graph 1.1

Who regulates financial services in Ireland? Base: all adults 15+ (unprompted)



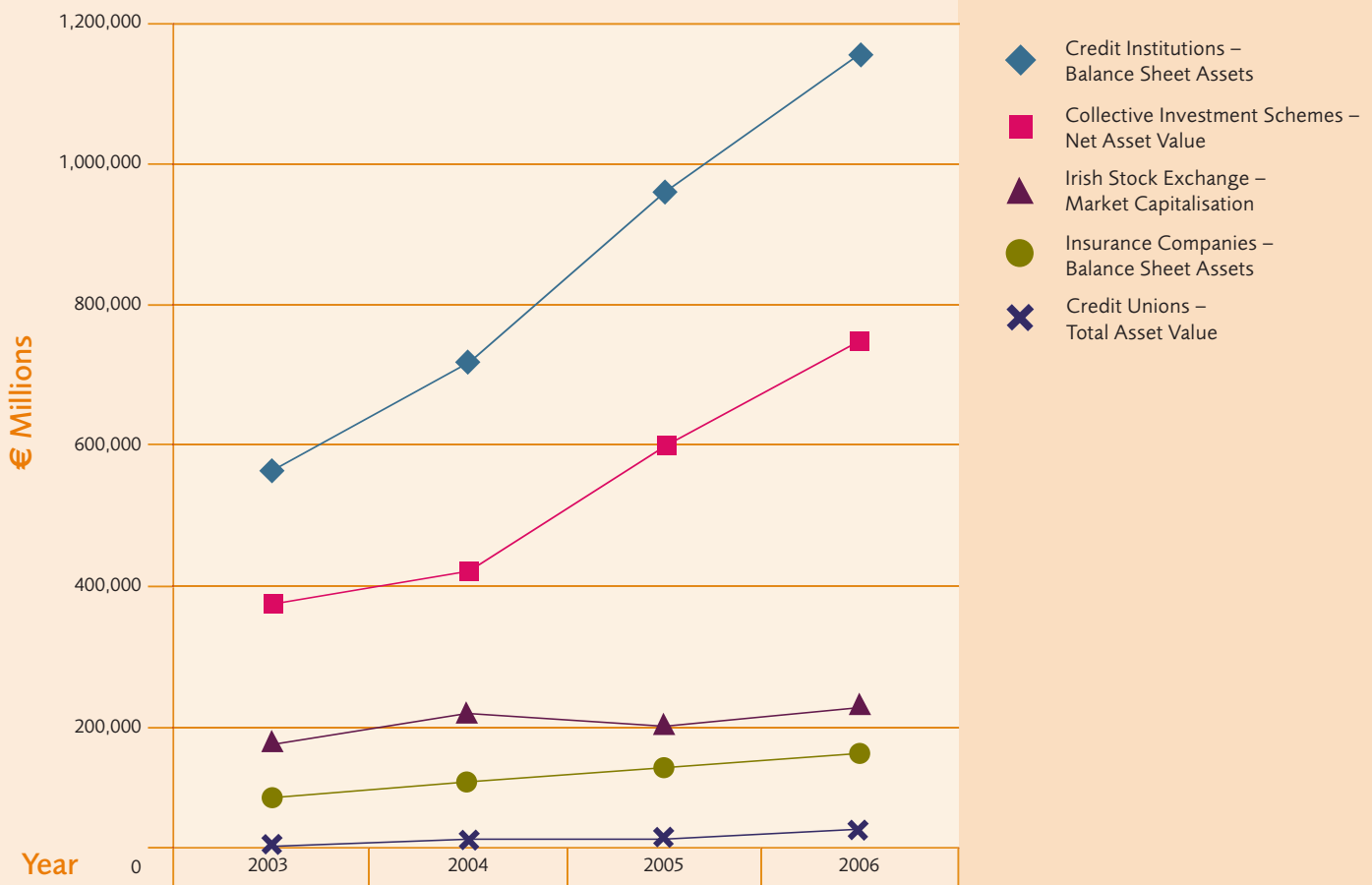
Growth in Financial Services Sector

The financial services sector continues to expand as demonstrated by the data in Graph 1.2. It shows that in the last year:

- ▶ Total assets of credit institutions increased from €941 billion to €1,116 billion, an increase of 19%;

- ▶ The nominal value of interest rate, foreign exchange, equity and commodity derivatives increased by 65% from 10,493 billion to €17,314 billion;
- ▶ Net Asset value of collective investment schemes increased from €588 billion to €730 billion, an increase of 24%;
- ▶ Market capitalisation of the Irish Stock Exchange increased from €225 billion to €232 billion, an increase of 3%;
- ▶ Total assets of insurance undertakings increased from €116 billion to €148 billion, an increase of 28%; and
- ▶ Total Assets of credit unions increased from €13 billion to over €14 billion, an increase of 11%.

Graph 1.2 Growth in Financial Services Sector



Other indicators of continued growth of the sector are that the:

- ▶ Employment in the banking and insurance sectors increased from 54,700 to 57,600, an increase of 5 percent; while the
- ▶ ISEQ Index (Irish Stock Exchange's official index of equities) grew from 7,364 to 9,408, an increase of 28 percent.

Over a relatively short period, Ireland has become a significant financial services hub. The number of financial service providers also increased. In 2006, the total number of new authorisations granted was 2,943 - an increase of 184 on 2005 (Table 1.1 refers). The figures demonstrate that the financial services industry continues to expand significantly in Ireland, particularly in the areas of funds management and mortgage intermediation. Ireland is also a major player in the issuance of certain security and debt instruments.

The total number of financial service providers we regulate now stands at 10,380 an increase of 7% over year end 2005 (Table 1.2 refers).

Table 1.1 - Number of Authorisations Granted in 2005 and 2006

	2005	2006
Credit Institutions	1	2
Life Insurance Undertakings	1	3
Non-Life Insurance Undertakings	9	5
Reinsurance Undertakings	0	5
Retail Intermediaries		
▶ Multi Agency Intermediaries	107	113
▶ Authorised Advisers	19	15
▶ Insurance/ Reinsurance Intermediaries	525	291
▶ Mortgage Intermediaries authorisations issued / renewed	1,446	1,633
Non Retail Intermediaries	15	7
Collective Investment Schemes (including sub funds)	582	738
Fund Service Providers	3	74
Credit Unions	0	0
Money Transmitters & Bureau de Change	0	9
Moneylenders	50	48
Stock Exchanges	0	0
Members of the Irish Stock Exchange	1	0
Moneybrokers	0	0
Total	2,759	2,943

Box 1.1 - Commentary on Authorisations

Two banking licences were issued to AIB Mortgage Bank plc and Elavon Financial Services Ltd and two bank licences were revoked at the licence holders' request namely Bank of Bermuda and KBL Bank Ireland. Several applications for a bank licence were under discussion and are expected to be issued in 2007.

Collective Investment Schemes are established for the purpose of investing the pooled subscriptions of investors (held as unit or shares in the schemes) in the investment assets in accordance with investment objectives published in a prospectus. The net asset value of Irish authorised collective investment schemes at 31 December 2006 was €730 billion compared to €588 billion at end 2005. 2006 was a very busy year for the authorisation of funds as 109 funds (738 including sub-funds) were authorised under the EC (UCITS) Regulations 2003, Unit Trust Act 1990 and Part XIII of the Companies Act 1990. This compares to 121 funds (582 including sub-funds) authorised in 2005. The number of revocations (all voluntary) of existing funds, including sub-funds, in 2006 was 446 (496 in 2005).

Table 1.2 - Number of Financial Service Providers at the end of 2005 and 2006		
	2005	2006
Credit Institutions (incl. branches of overseas credit institutions)	79	79
Life Insurance Undertakings	53	54
Non-Life Insurance Undertakings	133	133
Reinsurance Undertakings	-	168
Retail Intermediaries		
▶ Multi Agency Intermediaries	2,168	2,043
▶ Authorised Advisors	455	431
▶ Insurance/Reinsurance Intermediaries	524	813
▶ Mortgage Intermediaries	1,440	1,633
Non retail intermediaries	201	199
Collective Investment Schemes (including Sub Funds)	3,798	4,090
Fund Service Providers	230	220
Credit Unions	435	428
Money Transmitters & Bureaux de Change	14	21
Moneylenders	50	48
Irish Stock Exchange	1	1
Members of the Irish Stock Exchange	11	11
Futures and Options Exchanges	2	2
Moneybrokers	6	6
Total	9,600	10,380

Of the 168 reinsurance companies, five were authorised after the Reinsurance Regulations came into operation on 15 July 2006, namely: ITX Re Limited, XL Re Europe Ltd, Arkema Re Ltd, Organanon Biosciences Reinsurance Ltd and Atlas Reinsurance III plc. The remaining 163 companies were notified to the Financial Regulator prior to the regulations being introduced.

The figures for non-retail intermediaries has been restated for 2005 to exclude firms that were also included in retail figures.

The main categories of financial service provider we do not authorise / regulate include non-deposit lenders, the Post Office Savings Bank, credit intermediaries, pawnbrokers, investment property in Ireland and overseas. The Financial Regulator has no role in the regulation of Occupational Pension Schemes or Personal Retirement Savings Accounts; however, we may regulate the financial service provider who provides services in these products.

1.2 Better Regulation

With the financial services industry continuing to grow and become more diverse and innovative, the challenge for us is to ensure that we regulate appropriately. In order to ensure that our regulatory requirements do not become a barrier to competitiveness and innovation, we apply the Better Regulation principles which the Government published in January 2004 (see Table 1.3) and are an active member of the Taoiseach's Better Regulation Group.

Table 1.3 - Principles of Better Regulation	
Necessity	Is the regulation necessary? Can we reduce red tape in this area? Are the rules and structures that govern this area still valid?
Effectiveness	Is the regulation properly targeted? Is it going to be properly complied with and enforced?
Proportionality	Are we satisfied that the advantages outweigh the disadvantages of the regulation? Is there a smarter way of achieving the same goal?
Transparency	Have we consulted stakeholders prior to regulating? Is the regulation in this area clear and accessible to all? Is there good back-up explanatory material?
Accountability	Is it clear under the regulation precisely who is responsible to whom and for what? Is there an effective appeals process?
Consistency	Will the regulation give rise to anomalies and inconsistencies given the other regulations that are already in place in this area? Are we applying best practice developed in one area when regulating another?

The major initiatives carried out under the Taoiseach's Better Regulation agenda where the Financial Regulator has or is actively involved can be summarised as follows:

- ▶ Statute Law Revision - In December 2006, the Government announced the proposal for the consolidation and modernisation of financial services legislation. It was decided to establish an expert advisory group, including both industry and consumer representatives, to advise on this process.
- ▶ Regulatory Impact Analysis (RIA) - Regulatory Impact Analysis guidelines were published in July 2005.
- ▶ Consultation Guidelines - Guidelines on best practice in conducting public consultations were published in July 2005.
- ▶ Regulatory Appeals - The issue of regulatory appeals was the subject of a consultation paper which was published in July 2006 by Department of An Taoiseach. An outcome to this consultation is expected in 2007.

Implementing Better Regulation in the Financial Regulator

The establishment of the Financial Regulator in 2003 was itself an action of Better Regulation in merging the regulatory functions of four existing regulatory agencies and creating the single regulator for most financial services in Ireland in an effort to improve and enhance the systems and structures of financial regulation. The new structure of financial regulation provides for a more accountable system of financial regulation. An IMF Research Paper, published in February 2007, ranks the Irish system and structure of financial regulation first in the world in terms of its accountability arrangements as compared with other international single financial regulators. Table 1.4 below provides details of some actions we undertook to implement the Better Regulation principles.

Table 1.4 - Better Regulation Actions	
Action	Comment
Adopt a principles led approach to supervision of financial service providers	The principles which we expect financial services providers to abide by are set out in Table 1.7 below.
Consult widely with relevant stakeholders in developing new regulatory requirements.	Our practice is to consult widely with industry and public and to take account of all responses before imposing or reviewing regulatory requirements.
Regulatory Impact Analysis (RIA) on Consumer Protection Code.	First RIA conducted by the Financial Regulator, assessing the implications of developing a unified code so that consumers can expect similar standards from different industry sectors.
Minimum Competency Requirements for persons selling financial services.	Extensive consultation followed by public response to submissions and programme of presentations to representative bodies and educational institutes.
New fitness and probity regime.	Extensive consultation process resulting in substantial amendments to initial proposals. One test applies to all financial service providers.
Implementation Fora for EU Directives relating to Capital Requirements and Markets in Financial Instruments.	Established as an efficient and effective means of engaging with stakeholders and implementing these EU Directives.
Directors Compliance Statement	Decided not to use power except in extremely exceptional circumstances where it is required rather than seeking a routine annual statement from all.
RIA on Employer's and Public Liability insurance	Our second RIA, published in December 2006 demonstrated that it was not necessary to implement a recommendation as sufficient data was already available.
24 hour authorisation process for Qualifying Investor Funds (QIFs) aimed at institutional investors	Introduced following submission and consideration of proposal from funds industry.
UCITS Guidance Note 3/03 on Financial Derivative Instruments	Following a consultation process, some Collective Investment Schemes are now allowed to invest in derivatives.

Regulatory Impact Analysis (RIA)

We recognise the value of RIA for significant regulatory proposals and have actively participated in developing an RIA model specifically for financial services regulation with the Committee of European Securities Regulators (CESR). Representatives of the Committee of European Banking Supervisors (CEBS) and of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) also participated in the development of these guidelines.

To date, we have conducted two RIAs (Table 1.4): the first related to the introduction of the new Consumer Protection Code (published December 2005). The result of this RIA, while acknowledging that the compliance with the Code imposed some costs on industry, found that the proposed introduction of the new Code was appropriate, necessary and proportionate and did not exceed widely accepted standards of best practice.

The second RIA, which was published in December 2006, related to our consideration of a recommendation of the Competition Authority on the collection and publishing of statistics relating to employers and public liability insurance. The analysis concluded that sufficient data is already publicly available through the Insurance Statistical Review, the Irish Insurance Federation's Factfile, the Companies Registration Office and from private-sector data suppliers. The RIA also found that the costs involved in producing additional data or in replicating data already in the public domain was not warranted, as no significant additional benefits to potential market participants would accrue. As a result, it was decided not to implement the Competition Authority's recommendation.

Public Consultations

In accordance with the Better Regulation principle of transparency we consult publicly before introducing a new regulation. Appendix 1 details the consultations which we undertook in 2006, the number of submissions received and where we issued formal public responses. The Consultative Consumer and Industry Panels have assisted us by commenting on many of these proposals (see below). We have also found that implementation fora, representative of all stakeholders, are an effective means of consultation and engagement (Box 1.2 refers).

Box 1.2 – Innovative approach to consultation

In accordance with the Better Regulation principles of proportionality, transparency and accountability we established an implementation forum as an efficient and effective means of engaging with stakeholders to implement the EU Capital Requirements Directive (CRD).

This forum brought together representatives from the Financial Regulator, the Department of Finance, the Irish Banking Federation and individual credit institutions. It provided a means for all parties to discuss and progress issues relating to CRD implementation in Ireland which are of significant strategic importance; to communicate and discuss issues related to the implementation of the CRD in Europe, and as a way of pre-consultation of key aspects of our approach to implementation of the CRD.

The development of the Financial Regulator's consultation paper (CP22), issued in October 2006 was informed by the feedback from the forum. This permitted the smooth and timely publication of our Implementation Notice in December 2006.

Consultative Panels

The Consultative Consumer and Industry Panels, which were established under the Central Bank and Financial Services Authority of Ireland Act 2004, provide an important mechanism for ensuring that the consultation process with stakeholders is effective and efficient. On invitation, both panels made a number of valuable submissions to us on a range of regulatory proposals and on our Strategic Plan for 2007-2009 and provided us with comments on our draft statement of income and expenditure.

The Consultative Consumer Panel made formal submissions to us in relation to Consultation Papers on Administrative Sanctions, the draft Consumer Credit Directive, Fitness and Probity, Collation and Publication of Insurance Liability data, Mergers of UCITS and a draft Consultation Paper on Compliance Statements and related Auditors' Reports. They also made submissions concerning Equitable Life, pensions issues, our performance, regulation of credit unions, compensation schemes for Irish consumers of overseas financial services companies and low interest deposit accounts-notification of better rates to consumers. We have had a constructive dialogue with the Panel following the publication of their second annual report on our performance. We are pleased to acknowledge their positive comments concerning our surveys, the SSIA's campaign, credit unions, and our work on finalising the Consumer Protection Code. We are also conscious of their criticism concerning the speed with which we deal with controversial issues.

The Consultative Industry Panel made formal submissions in response to our consultations on Administrative Sanctions, Consumer Protection Code, Minimum Competency Requirements, Fitness and Probity and Compliance Statements and Related Auditors' reports. We also supported the Panel in conducting a survey of industry's perception of our role and performance. This survey was published in July 2006. The main findings show that we are perceived as a strong regulator, which industry appreciates, that we are approachable, but we need to be more attuned to the special needs of the smaller firms. The survey also indicated that we should place more emphasis on innovation and competitiveness. In this context, we are therefore pleased to have been able to adopt as one of our high level goals in our 2007-2009 Strategic Plan a commitment to foster competitiveness and innovation, which has also been a consistent recommendation of the Panel. They also provided assistance to us in developing a protocol which sets out targets and mutual expectations relating to our interaction with stakeholders.

We are committed to a continuing review of our business processes to implement improvements, eliminate redundant processes and reduce red tape whenever possible so as to further improve productivity and competitiveness.

Assisting Government with New Legislation

We provide assistance to a number of Government Departments on the development of new legislation including:

- ▶ The Department of Finance in relation to the early stages of the consolidation and simplification of financial services legislation project and in relation to the transposition of the EU Markets in Financial Instruments, Reinsurance and Capital Requirements Directives and Asset Covered Securities legislation; Consumer Protection Act 2007;
- ▶ The Department of Justice with the 3rd Anti- Money Laundering Directive;
- ▶ The Department of Enterprise, Trade and Employment in preparing for the transposition of the EU Transparency Directive; and
- ▶ The Department of Environment, Heritage and Local Government in modernising building societies legislation.

In addition we provided assistance to the Company Law Review Group, which is reaching the final stages of the preparation of a major restructuring of Irish company law.

1.3 EU Regulation

The breadth of our responsibilities together with the diversity in topics under discussion at EU & International fora meant that we were actively engaged with EU and International policy related work throughout 2006. The EU Financial Services Action Plan continues to demand a significant amount of our resources. During 2006, we were heavily involved in the implementation of the Reinsurance and Capital Requirements Directives. Substantial progress was made in making the appropriate preparations for the implementation of Markets in Financial Instruments, Transparency and Anti-Money Laundering Directives. More details are provided in Chapter 3. Table 1.5 lists the main EU Directives whose development we have been involved with and their current status.



Table 1.5 - EU Legislation	
Directive/Proposal	Status
Reinsurance	Implemented 15 July 2006
Capital Requirements	Implemented 1 January 2007
Markets in Financial Instruments	Transposed 15 February 2007 - effective 1 November 2007
Transparency	To be transposed in 2007
Prevention of Money Laundering & Terrorist Financing	Due to be transposed by 15 December 2007
Unfair Commercial Practices	Transposed on 1 May 2007
Eligible Assets	Published 19 March 2007
Solvency II	Implementation Target is 2010
Credit Agreements for Consumers	Council Working Group First Reading
Insurance Guarantee Schemes	Commission Working Group

We participate in a number of international committees which give technical advice to the EU Commission on the drafting of Directives, and help clarify practical issues involved with their implementation. These are Committees of European Banking Supervisors, Insurance and Occupational Pensions Supervisors and Securities Regulators:

Committee of European Banking Supervisors (CEBS)

The principal issue addressed by this committee during 2006 was the Capital Requirements Directive. In addition, we have contributed to the production of EU consultation papers for industry on a framework for supervisory disclosure, a common reporting framework, financial conglomerates, own funds, large exposures and data protection and security.

Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

The draft Solvency II Directive dominated the agenda of this committee. In addition, significant work was also carried out in the area of supervisory co-operation and convergence. Protocols on Occupational Pensions and Insurance Mediation and a model Memorandum of Understanding between the EU and US supervisors were agreed.

Committee of European Securities Regulators (CESR)

Work focused on the implementation of the Markets in Financial Instruments (MiFID) and Transparency Directives. In relation to MiFID, we have contributed to the development of guidance on the minimum records to be held, inducements, best execution, transaction reporting and passporting and to the publication of market transparency data. We also provided advice on the investment instruments that UCITS may be permitted to invest in.

We continue to contribute at other international fora concerned with the development and co-ordination of regulatory policy. Table 1.6 outlines the number of such meetings attended.

Table 1.6 - Participation at EU and other international committees		
Committee	Participation by Financial Regulator staff	
	2005	2006
EU		
Committee of European Banking Supervisors (CEBS) and other EU Banking committees	21	33
Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and other EU Insurance committees	44	71
Committee of European Securities Regulators (CESR) and other EU Securities committees	85	64
Financial Action Task Force on Money Laundering, Anti-Money Laundering Task Force and other EU Money Laundering committees	9	15
EU Consumer Protection	4	15
European Central Bank	6	3
Other EU	9	22
International		
International Association of Insurance Supervisors	4	2
International Organisation of Securities Commissions	4	5
World Council of Credit Unions	3	3
Other	7	1
Total	196	234

1.4 Monitoring Compliance with Regulations

Principles led Regulation

In line with the Better Regulation principles, we adopt a 'principles led' approach to regulation. This means that responsibility for the proper management and control of a financial service provider, and the integrity of its systems, rests with the board of directors and its senior management. Ethical behaviour and transparency in business dealings are key values expected of boards and senior management of all financial services providers operating in Ireland. We do not examine each transaction or contract entered into by institutions to test compliance. Neither do we seek to interfere with the design of financial products. We expect all financial service providers, whether engaged in international or domestic activities, to comply with best practice. The principles which guide our approach to regulation are set out in Table 1.7.

Table 1.7 - Principles we expect financial service providers to abide by

We expect financial service providers to:

1. Conduct their functions in a transparent and accountable manner;
2. Act with prudence and integrity and in the best interests of their customers at all times;
3. Maintain at all times sufficient financial resources to meet all their commitments;
4. Have in place sound corporate governance procedures;
5. Have oversight and reporting systems that allow the board and management to monitor and control all operations;
6. Have in place internal controls that are adequate for the nature, scale and complexity of their operations;
7. Have risk management policies and risk control systems appropriate to the nature, scale and complexity of their operations;
8. Comply with any regulatory rules set down by the Financial Regulator in relation to, for example, solvency and capital adequacy, liquidity, segregation of client funds, consumer protection codes; and
9. Produce accurate, complete and timely information, when required.

In order to assist financial service providers to become aware of their legal obligations and to clarify what we mean by 'principles led' we issued a number of regulatory rules and guidance notes during 2006. The Consumer Protection Code and the Minimum Competency Requirements were published in July 2006. In addition, rules relevant to banks, investment firms and collective investment schemes were issued. A full list of regulatory rules and notices issued is provided in Appendix 2. Appendix 3 provides a list of guidance notes issued.

Administrative Sanctions

Our 'principles led' approach to regulation also means that it is a matter for each financial service provider to determine for itself how best to abide by regulatory requirements. Proactive compliance with legislation, codes and supervisory requirements is our preferred approach. Where issues arise our goal is to resolve them to the benefit of consumers speedily and efficiently. In setting out our philosophy on the use of administrative sanctions, we have stated that major factors which we will consider before we decide to pursue a sanctions case are:

- ▶ The nature and seriousness of the contravention;
- ▶ The conduct of the financial service provider after it came to light;
- ▶ The previous compliance record of the financial service provider; and
- ▶ The availability of other appropriate regulatory actions.

Where the need arises, however, we will not hesitate to use all the sanctioning powers available to us.

Our Administrative Sanctions Procedure permits a settlement agreement to be reached between a financial service provider or individual and us. Where we have reasonable grounds to suspect that a financial service provider has committed a breach or an individual has participated in such a breach, the agreement must be in writing and is binding on us and on the parties involved.

While both sides must voluntarily agree to a settlement, we will only enter into such an arrangement where it achieves our regulatory goals, in particular protecting consumers and achieving compliance, both in the financial service provider and the wider industry. The advantage to both the Financial Regulator and the financial service provider is a real saving in terms of time, cost and staff resources. We also take account of the potential cost savings in our negotiations in the settlement process. We have a preference for publicising settlement agreements.

Data on the number of regulatory actions undertaken in 2006 is presented in Table 1.8. Boxes 1.3 and 1.4 provide details of two settlement agreements entered into with financial service providers and persons concerned in their management. Our approach to monitoring compliance is described in detail in the chapters 2 to 4.

Table 1.8 - Regulatory actions taken in 2006	
Type	Number of actions
Administrative Sanction Settlement Agreements.	2
Warning notices issued regarding unauthorised activity.	4
Authorisation / Licence / Registration refused.	1
Issue of post inspection or other letter with at least one significant matter to be addressed.	112
Direction / requirement imposed under legislation.	12
Appointment of independent auditor / inspector required.	4
Advertising issues investigated	84
Total	219

Box 1.3 - Regulatory Principle 2 - We expect financial service providers to act with prudence and integrity and in the best interest of their customers at all times.

On 14 December 2006, we entered into a settlement agreement with M.I.S. Financial Services Limited and Mr. Stephen Donnelly, Director. The breaches in question related to a failure to act honestly and fairly in the best interests of clients and the integrity of the market and a failure to take all reasonable steps to ensure that actions in the best advantage of the client were taken. The affected clients had not been properly informed about the actual terms of their investment policies. In fact, they had been led to believe that the terms of the policies were more favourable than was actually the case. M.I.S. Financial Services Limited agreed to relinquish its authorisation and Mr. Stephen Donnelly agreed to a disqualification from being a person concerned in the management of a regulated financial service provider for a period of 5 years, commencing from the date of the agreement. The Financial Regulator's power to disqualify a person solely relates to their involvement in the management of a regulated financial service provider.

Additionally, Mr. Stephen Donnelly, agreed to pay a sum equal to the commission earned after 1 August 2004 to affected clients. The parties also agreed to a public statement on the matter. Notwithstanding the binding nature of settlement agreements, these cannot preclude us from complying with our reporting obligations to various regulatory / enforcement bodies, as appropriate, such as the Garda Síochána; the Revenue Commissioners; the Director of Corporate Enforcement and the Competition Authority.

Box 1.4 - Regulatory Principle 8 - We expect financial service providers to comply with any regulatory rules set down by the Financial Regulator.

On 30 June 2006, we entered into a settlement agreement with Broadstone Fund Management Limited (in Voluntary Liquidation) and Messrs. Gerard O'Neill, Director, and David Murray, former Director, in relation to breaches of certain regulatory requirements. Specifically, these breaches concerned a failure to control operational risk, inadequacy of financial and management resources and a breach of authorisation requirements.

The Director and former Director agreed to a disqualification from being persons concerned in the management of an Irish regulated financial service provider for a period of 18 months, commencing from the date of the agreement. The firm agreed to seek the revocation of its authorisation. The parties also agreed to a public statement on the settlement.

Outcome of legal proceedings

Our obligations concerning the disclosure of confidential information relating to supervised financial service providers, limits our ability to disclose underlying concerns in individual cases. Notwithstanding such limits, we are able to make the following comments (Boxes 1.5 and 1.6 refer) in relation to two sets of proceedings which concluded favourably in 2006.

Box 1.5 - Court Case re delay in Authorisation

In December 2004, Mr. Bruce Ashmore brought a claim for damages in the High Court against Goodbody Stockbrokers and the Financial Regulator. The claim against the Financial Regulator related, inter alia, to an alleged delay in the authorisation of Pilot View Capital Ltd. (pursuant to the Investment Intermediaries Act 1995) and the subsequent approval to appoint Mr Ashmore as a director of that company. The Financial Regulator denied all allegations and vigorously defended the proceedings at all times.

The case was listed for trial on 16 May 2006, at which stage Mr. Ashmore settled his claim against the Financial Regulator (and Goodbody Stockbrokers) and withdrew:

- ▶ All allegations of bad faith, misfeasance and all other wrongdoing against the Financial Regulator, its officers and its employees and;
- ▶ All his claims against the Financial Regulator.

Mr Ashmore accepted that at all times the Financial Regulator and its officers and employees acted in good faith in accordance with their statutory duties. The Financial Regulator made no payment in the proceedings (including any payment in relation to costs). The Financial Regulator requested and received contributions towards its legal costs from the parties.

Box 1.6 - Refusal of authorisation of mortgage intermediary

Mr. Maurice Mason applied for an authorisation to act as a mortgage intermediary under section 116 of the Consumer Credit Act 1995. The Financial Regulator refused his application in July 2004.

In August 2004 Mr. Mason appealed the decision of the Financial Regulator.

The case was first listed for hearing in July 2006 but was adjourned to facilitate Mr. Mason and was subsequently listed for hearing on 19 December 2006.

On 15 December 2006, Mr. Mason indicated that he would be withdrawing his appeal. The appeal was withdrawn and the proceedings struck out on 19 December 2006. The effect of this is that the Financial Regulator's original decision stands.

Liaison with other Enforcement Agencies

We are required to report information to other bodies if we suspect that a financial service provider has committed a criminal offence or has breached company, competition or anti-money laundering legislation. Table 1.9 outlines the disclosures which we have made.

Table 1.9 - Disclosure of Information to other enforcement authorities

Authority	Number of cases referred under S.33 AK CBFSAI Act 2003	
	2005	2006
Gardaí	21	27
Revenue Commissioners	4	3
Director of Corporate Enforcement	1	1
Irish Auditing and Accounting Supervisory Authority	-	2
Sub Total	26	33
	Number of cases referred under Criminal Justice Act (Anti-money laundering)	
Gardaí & Revenue Commissioners	7	5
Total	33	38

Cross Border Cooperation

Where financial service providers are located in more than one country, meetings are held on a regular basis with the financial regulators from these countries as part of the ongoing exchange of relevant information. During 2006 bilateral meetings were held with the financial regulators from Australia, Austria, Belgium, Canada, Denmark, Isle of Man, Netherlands, United Kingdom and United States.

Memoranda of Understanding were signed with the Federal Office of Private Insurance, Switzerland. Negotiations were also held with the financial regulators in Canada, Guernsey, Jersey and USA during 2006 and it is anticipated that Memoranda of Understanding will be signed with these regulators in 2007.

This work is very important. It is increasingly recognised that, given the global nature of financial markets, increased international co-operation between regulators is essential for effective supervision and the promotion of financial stability.

Liaison with the Financial Services Ombudsman and the Pensions Ombudsman

A Memorandum of Understanding was agreed between the Financial Services Ombudsman, the Pensions Ombudsman and the Financial Regulator and came into effect from the beginning of April 2006. Its purpose is to provide a framework for the relationship between the three separate bodies and reflects the fact that while being independent of each other, we need to co-operate and communicate constructively in order to carry out our functions effectively.



Pictured signing the Memorandum of Understanding between the offices of the Financial Regulator, Financial Services Ombudsman and Pensions Ombudsman that came into effect on 1 April 2006 are (l-r) Paul Kenny, Pensions Ombudsman, Joe Meade, Financial Services Ombudsman, Patrick Neary, Chief Executive of the Financial Regulator.

The main areas covered by the agreement are:

- ▶ The roles of each of the bodies;
- ▶ Jurisdiction for the purposes of handling complaints;
- ▶ General co-operation;
- ▶ Information sharing and consultation;
- ▶ Confidentiality and use of shared information; and
- ▶ Regular meetings between the bodies.

During 2006, we received a total of 184 complaints from consumers which were referred to the Financial Services Ombudsman. The vast majority of these related to the banking and insurance sectors, with the remainder in the broking, stockbroking and credit union sectors. This compares with a total of 139 complaints referred by us to him in 2005, following the commencement of operations by his Office in April 2005.

The Financial Services Ombudsman referred 13 issues to us during 2006 for consideration. These referrals, together with our regular liaison meetings with the Ombudsman and the exchange of information, are very useful to us in identifying possible general issues and trends that may need further investigation by us with individual financial service providers or with the industry as a whole. An example of how one such case was managed is provided in Box 1.7

Box 1.7 - Working with the Financial Services Ombudsman

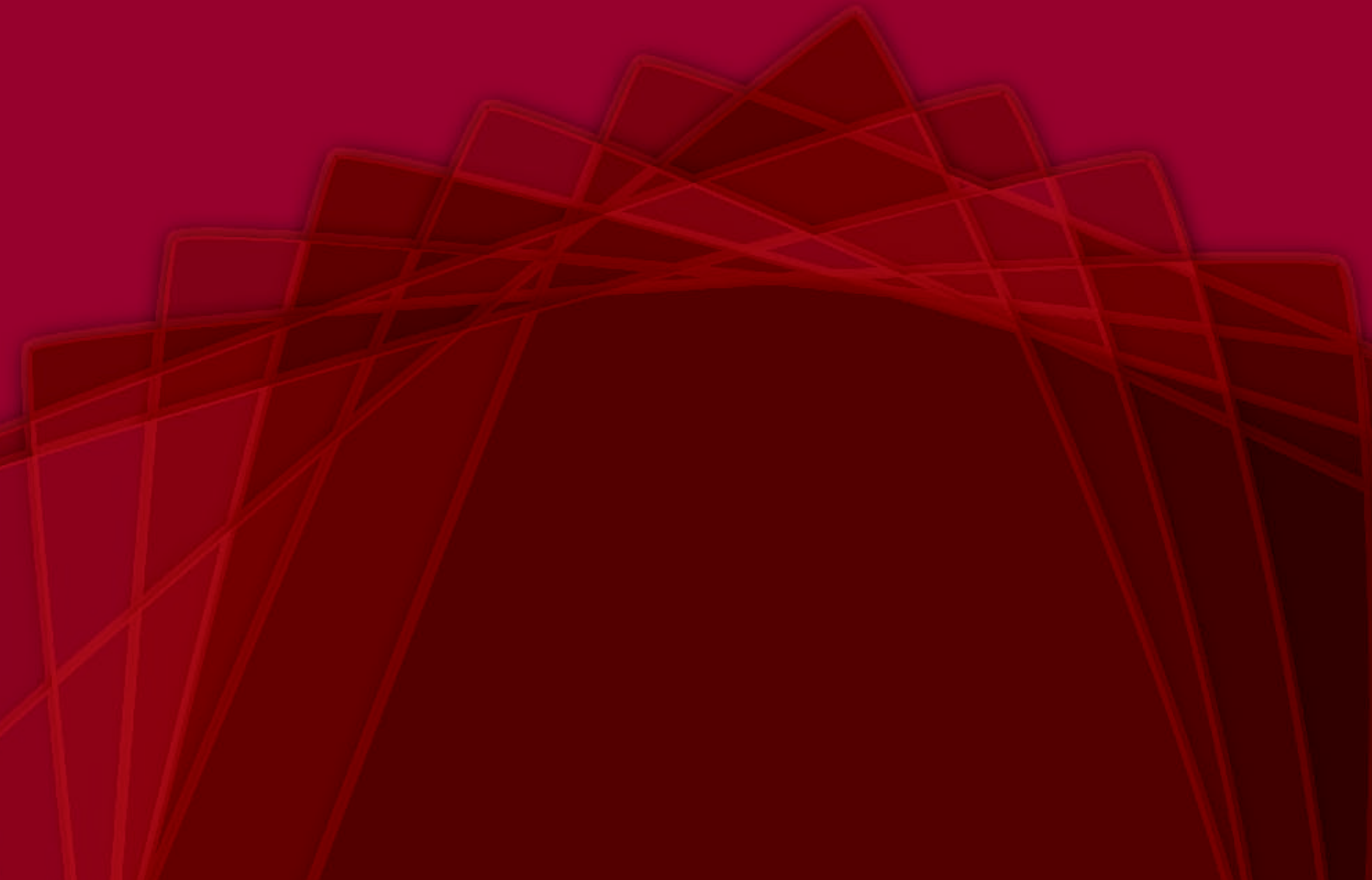
The Financial Services Ombudsman (FSO) reached a settlement with a credit institution in May 2006, requiring the partial refund of an early redemption charge on a loan, which had been imposed on a commercial borrower. In accordance with the terms of our memorandum of understanding with the FSO and the Pensions Ombudsman, the matter was referred to us to enable us to consider any wider implications for other potentially affected borrowers of that institution in a similar position. In light of the terms of the settlement with the FSO, the credit institution subsequently proposed a programme to us, whereby it would examine similar charges for customers in a similar position over a period of 6 years, and would reimburse customers where relevant. This eliminated the necessity for all potentially affected borrowers to refer their individual complaints to the credit institution and/or the FSO.

In relation to pensions, we also received a large number of queries from consumers, which we dealt with either by providing information where we were in a position to do so, or in the case of occupational pensions or more detailed technical queries, explaining the roles of the Pensions Ombudsman and the Pensions Board and providing the contact details for those bodies where appropriate. Two specific pensions complaints were referred to the Pensions Ombudsman for investigation.

The Pensions Ombudsman referred 3 issues to us during the year for consideration. Exchange of information also took place through meetings and contacts with the Ombudsman and his staff.

Chapter 2

Promoting the Best Interests of Consumers



Consumer Director's Statement



Mary O'Dea
Consumer
Director

2006 was a very important year for all consumers of financial services with the Financial Regulator delivering on a key objective for consumer protection - the Consumer Protection Code. The Code is a significant development in the protection of consumers. This legally binding single code of conduct for regulated financial service providers has resulted from extensive consultation with all interested parties. In addition to the Code we also published the Minimum Competency Requirements. These Requirements oblige everyone who provides advice on or sells retail financial products to obtain specified minimum competencies. Consumers in Ireland will now, as a matter of law, have a fairer deal in all their financial transactions.

Our role is to protect, inform and educate consumers of financial services. We listen to consumers and carry out research so that we can identify their needs and provide the most appropriate responses. For example, in 2006 we responded to increases in personal debt by providing consumers with information about different types of credit, the cost of credit and how to weigh up whether borrowing more money was the best course for them. We published cost surveys on a range of financial products, ran several co-ordinated press, marketing, advertising and research campaigns and produced a number of new and revised publications including *Savings and Investments made easy*, *Pensions made easy* and *Getting financial advice*. Our new advertising campaign "on the bus" proved very popular and generated greater awareness of the Financial Regulator and more contact from consumers. In the six months following the TV campaign, awareness levels of the Financial Regulator rose from 22% to 37%.

Throughout 2006, we actively pursued the interests of consumers of financial services at European level where Directives currently at draft stage will in the future underpin protection of consumers of financial services throughout the EU. This work continues.

Consumers who are alert and aware and are prepared to shop around and switch their service providers can make the market for financial services more competitive. Markets only work well if both sides of the market are functioning properly - the suppliers and the buyers. If consumers use their buying power, however small it may seem, they can effect real change in the level of competition in the financial services market by rewarding those who provide good value and good service with their business and by moving their business away from those who do not.

Among our highlights for 2006 was the significant increase in the numbers of consumers contacting us for information and assistance (a 56% increase on 2005) through our consumer website www.itsyourmoney.ie, our helpline and our Information Centre. Our campaign to ensure consumers were well informed on the issues around their maturing SSiAs was also highly successful.

Another important highlight was our memorandum of understanding with the Financial Services Ombudsman (FSO), who deals with complaints from individual consumers of financial services. This working relationship underpins the protection of consumers by ensuring that issues identified by the FSO through examination of individual consumer complaints are referred to us to enable us to determine if they signal wider implications for other customers of a financial services provider.

The ongoing job of on-site consumer focused inspections of regulated financial service providers continued through 2006, with 97 inspections. These covered both specific issues and themes such as those arising from SSIA maturities. Where we identified problems we told the firm in a detailed post-inspection letter and set out the corrective action we expected. Issues found through themed inspections were followed up through letters to all firms in the industry outlining these issues and our expectations.

With regard to financial access, we commissioned Combat Poverty to undertake research, and the resulting report was published in December 2006. A Stakeholder Forum was established to promote dialogue and to consider issues arising from the research.

We are continuing our work to increase consumers' knowledge of their financial options by providing information on financial products and services in plain English and by researching consumers' financial capability in order to deepen our understanding in this area so that we can better fulfil our consumer protection role.

In addition to implementing the Code, our challenges in 2007 include developing our financial education strategy so that we can help build consumer confidence and help consumers to be more capable financially.

2006 saw a significant difference for consumers of financial services. We continue to build on the strong foundations we have laid. I would like to thank all the team for their continuing commitment, professionalism and personal support.



Mary O'Dea
Consumer Director

2.1 Consumer Protection Initiatives

Consumer Protection Code

The publication of the Consumer Protection Code in 2006 marked a key development for the protection of consumers of financial products and services. Since 2003, we have been involved in an extensive project to develop a single code of conduct for regulated financial service providers engaged in providing financial products and services to consumers. Following two public consultations on the scope and content, the publication of a Public Response Document on issues raised and a Regulatory Impact Analysis, the final Consumer Protection Code was developed and some of the provisions came into effect on 1 August 2006.

The Code is a legally binding document comprising a set of general principles supplemented by more detailed rules which regulated financial service providers must adhere to when providing financial services to consumers. The General Principles of the Code (See Box 2.1), and existing provisions carried forward from previous codes and handbooks must be complied with from 1 August 2006. The following new provisions were also brought in with effect from 31 August 2006:

1. The prohibition on making the sale of one product contingent on the purchasing of another product;
2. The requirement that a consumer must positively indicate acceptance of any optional extras for which there is a charge;
3. Application of changes in interest rates;
4. The prohibition on unsolicited pre-approved credit;
5. The requirement to advise consumers who are thinking of surrendering certain life assurances policies before they mature of the existence of a secondary market, where they may get a higher amount for their policy; and
6. The requirement for warning statements in certain advertisements must be included in all relevant advertisements created after 1 August 2006.

Financial Service Providers were informed that they should take immediate steps to implement the necessary changes for compliance with the Code. However, we acknowledged that ensuring full compliance represents a substantial undertaking in terms of implementing the necessary changes to systems, procedures, documents and staff training in all these businesses and would take some time.

We recognise the efforts made by industry in order to meet the compliance requirements of the Code. In the interests of achieving the best outcome for consumers, we have endeavoured to assist regulated financial service providers in becoming Code-compliant as soon as possible by engaging with industry representative bodies, conducting bilateral meetings with regulated financial service providers, participating in seminars and workshops, and dealing with queries on an ongoing basis.

The Code came into full effect on 1 July 2007.

Box 2.1 - General Principles of the Consumer Protection Code

A regulated financial service provider must ensure that in all its dealings with customers and within the context of its authorisation it:

1. Acts honestly, fairly and professionally in the best interests of its customers and the integrity of the market;
2. Acts with due skill, care and diligence in the best interests of its customers;
3. Does not recklessly, negligently or deliberately mislead a customer as to the real or perceived advantages or disadvantages of any product or service;
4. Has and employs effectively the resources and procedures, systems and control checks that are necessary for compliance with this Code;
5. Seeks from its customers information relevant to the product or service requested;
6. Makes full disclosure of all relevant material information, including all charges, in a way that seeks to inform the customer;
7. Seeks to avoid conflicts of interest;
8. Corrects errors and handles complaints speedily, efficiently and fairly;
9. Does not exert undue pressure or undue influence on a customer;
10. Ensures that any outsourced activity complies with the requirements of the Code;
11. Without prejudice to the pursuit of its legitimate commercial aims, does not, through its policies, procedures, or working practices, prevent access to basic financial services; and
12. Complies with the letter and spirit of the Code.

Minimum Competency Requirements

We published the Minimum Competency Requirements in July 2006 following two public consultations and discussions with industry representative bodies and the educational institutes active in this area. The Requirements came into effect on 1 January 2007 and oblige persons who provide advice on or sell retail financial products to obtain specified competencies. In addition, they are required to undertake a programme of continuous professional development.

While relevant European legislation requires that insurance and reinsurance intermediaries possess appropriate knowledge and ability, as determined by the home Member State of the intermediary, we decided that the requirements should apply to all financial service providers subject to the Consumer Protection Code. Consumers need to be confident that those selling them financial products or advice understand fully the products themselves. Following publication of the Requirements we gave a number of presentations at industry-organised seminars around the country.

Consumer Protection Framework for Credit Union Members in respect of their Core Business

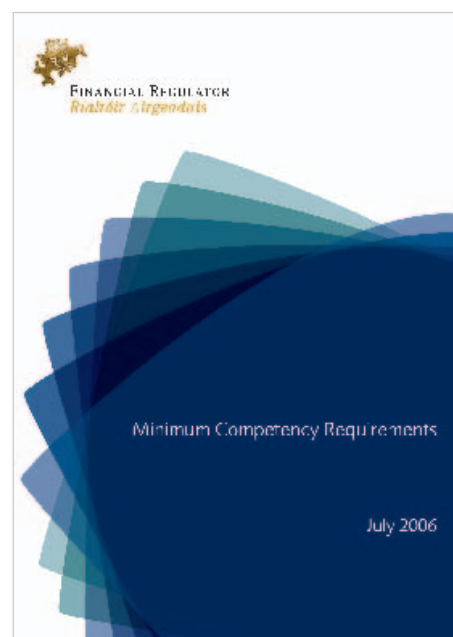
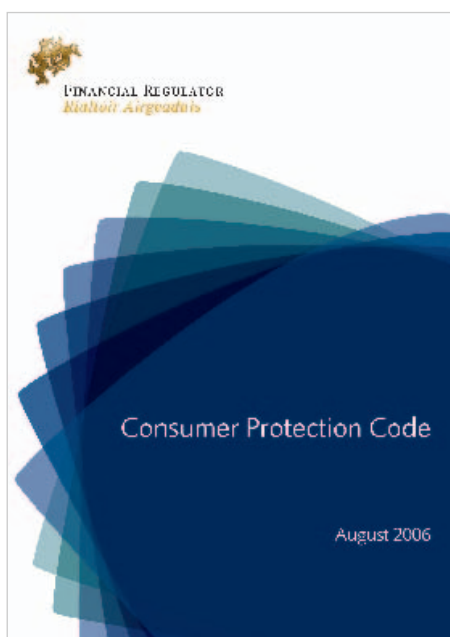
We stated in our public response to the Consultation Paper, on the Consumer Protection Code (CP10) that: "Following the publication of the Code, we will commence discussions with the Department of Finance, credit union representatives, consumer and social groups and other interested parties, with a view to applying an appropriate Code for Credit Unions. The Code for credit unions will take into consideration the special structure and voluntary ethos of the credit union movement". Preliminary consultations commenced in late 2006 and we are continuing to engage in extensive consultation on this matter during 2007.

Renewal of Insurance (Non-life)

In late 2006 the Consumer Director announced that she would publish new regulations which require renewal notices to be issued at least 15 days in advance of the renewal dates for all classes of non-life insurance policies (including motor insurance). The regulations:

- ▶ Specify the minimum level of information that must be included in motor insurance renewal notices;
- ▶ Require insurers to issue renewal notices for other classes of non-life insurance; and
- ▶ Permit renewal notices to be issued through insurance intermediaries.

These Regulations came into operation on 1 July 2007 and replace regulations dating from 2002 which applied to motor insurance only.



2.2 Ongoing Monitoring

Consumer Focused Inspections

During 2006 we continued our programme of on-site consumer focused inspections of financial service providers. Table 2.1 outlines the range of financial service providers covered and the number of inspections undertaken. These inspections were both entity based, which looked at a number of issues, and themed such as Special Savings Incentive Account (SSIA) maturity issues.

In order to determine the level of compliance with the statutory and regulatory requirements among these financial service providers, we continued to conduct consumer-focused inspections throughout 2006. These included:

- ▶ Inspections of individual insurance companies where we identified specific problems to be addressed. Any matters arising were set out in detail in a post-inspection letter which outlined the corrective action and recommendations to be implemented;
- ▶ Inspections of licensed moneylenders in order to continue our monitoring of compliance with the Consumer Credit Act;
- ▶ Inspections of mortgage intermediaries in order to monitor the impact, level of understanding and preparedness in respect of the future implementation of the Consumer Protection Code; and
- ▶ Inspections of investment intermediaries continued in order to monitor the level of compliance in this sector.

Table 2.1 - Consumer Focused on-site Inspections

Financial Service Provider	2005	2006
Mortgage Intermediaries	46	33
Multi-agency intermediaries	29	15
Authorised Advisors	21	6
Insurance Undertakings	10	16
Credit Institutions	4	19
Moneylenders	2	5
Investment Firms (s10 firms)	-	1
Themed - sales practices	3	-
Bureau de Change	1	2
Total	116	97
Other		
Off-site review meetings	-	70
Mystery shopping exercises	1	1
Overall Total	117	168

Themed Inspections

Insurance Undertakings

In 2006, we undertook a combination of themed and institution specific inspections on insurance undertakings. The themed inspections concentrated on the SSIA maturity process in the life insurance sector and on the claims area in the non-life sector. We highlighted the need to both the life and non-life industry which address the following matters:

- ▶ Failure to issue reminders to consumers whose claims were not being progressed because they had not provided the outstanding documentation required to settle the claim;
- ▶ Companies requiring customers actively to opt out of optional extra benefits on their insurance policies;
- ▶ Deduction of incorrect excesses on the settlement of motor insurance claims;
- ▶ Failure to restore or issue refunds to a policyholder of a no claims bonus discount after the settlement of an ongoing claim; and
- ▶ Failing to issue renewal notices as required under existing legislation.

Credit Institutions

In 2006, we undertook a combination of themed and institution specific inspections related to Payment Protection Insurance (see Box 2.2) and the maturity of Special Saving Incentive Accounts (SSIA) (see Box 2.3).



Mary O'Dea, Consumer Director at launch of 'Your Little Book of SSIA's' March 2006

Box 2.2 - Payment Protection Insurance

Following on from concerns raised in relation to how payment protection insurance (PPI) was being sold, it was decided to carry out a review of sales practices in relation to PPI and to examine the systems and controls in relation to the refunds of PPI premium on early termination of loans. We have now completed this review and the findings were communicated to the industry in a letter in February 2007. The findings from the review include:

- ▶ Eligibility as opposed to suitability being used in the selling of the product to customers;
- ▶ Customers not being aware of key information with regard to PPI when the product is sold to them (documentation is not always provided prior to sale of the product);
- ▶ The lack of documentation provided to customers;
- ▶ Customers are not always aware that the product is optional;
- ▶ A central monitoring of the sales process not always being in place and the scope of compliance and internal audit reviews did not always include PPI;
- ▶ Sales staff not being fully aware of the key product features and procedures when selling PPI; and
- ▶ Refunds of PPI premium on early termination of loans were not always made to customers. A number of restitution projects are ongoing and we will monitor these to completion.

The sale of PPI is now subject to provisions in the Consumer Protection Code which incorporate specific requirements including:

- ▶ Where a regulated entity offers payment protection insurance in conjunction with a loan, the initial repayment estimate of the loan advised to the consumer must be exclusive of the payment protection premium;
- ▶ A combined application form can be used, provided that all information relating to PPI is contained in a separate section and this section also contains a requirement for the consumer to sign in order to apply for PPI; and
- ▶ A text box indicating that the PPI is optional must be included in the application form immediately above where the consumer is required to sign.

We have also highlighted awareness of the issues surrounding PPI through the various information fact sheets and cost surveys, which we have produced and promoted.

Ana Sophia Feiritear, Liam Dagg and Katie Hannafin (children of staff) at the launch of 'Savings and Investments made easy'.



Box 2.3 - Special Savings Incentive Accounts (SSIAs) - Information Campaign and Themed Inspection

We undertook a dedicated information campaign to inform consumers about the issues involved in maturing SSIAs and undertook a themed inspection during 2006. Over 1.1 million SSIAs were taken out when the scheme opened. The estimated value of SSIAs maturing with SSIA providers (credit institutions and insurance companies) is over €13 billion. Although the bulk of accounts did not mature until 2007, we considered that consumers would be overwhelmed with offers of investment opportunities.

Information Campaign

The objectives of our SSIA information campaign were to:

- ▶ Provide consumers with independent information about the SSIA maturity process;
- ▶ Encourage consumers to become well-informed before making any decisions about what to do with their money;
- ▶ Highlight some of the options consumers could consider for their SSIA money, including reinvesting, paying off some debts or saving for their retirement;
- ▶ Warn consumers about un-regulated investments; and
- ▶ Highlight the relationship between risk and reward and warn consumers that investments promising a high return usually mean taking a very high risk.

We launched our campaign in March 2006, two months before the first accounts matured, with the publication of *SSIAs Your little black book*. Throughout 2006, the following issues were highlighted:

Campaign Action	Date
SSIA savers warned to read correspondence carefully	May
SSIA savers urged to use SSIA funds to tackle debts	May
Equity SSIA savers concerned about stock market performance	July
SSIA savers urged to consider pensions options	October
Financial Regulator monitoring SSIA maturity process	November

The campaign received widespread media attention. Market research conducted between April and May 2006, at the early stages of the campaign, showed that 63% of SSIA holders were aware of our SSIA campaign and by the end of 2006, consumers had requested over 32,000 copies of our SSIA publication.

The campaign continued into 2007, when over 700,000 of the 1.1 million SSIAs matured.

Box 2.3 - Special Savings Incentive Accounts (SSIAs) - Information Campaign and Themed Inspection (contd.)

Themed Inspection

In January 2006, we requested relevant information from SSIA providers. This included product brochures and terms/conditions, details on the number of policies and a quarterly breakdown of the number and estimated values at maturity and samples of information to be issued to policyholders in advance of the maturing SSIA's.

In March 2006, we warned financial service providers who sold SSIA's of the potential for mis-selling of replacement products, and requested that segregated complaints logs for SSIA's be maintained.

Commencing in August 2006, we conducted a series of 19 on-site inspections of insurance undertakings and credit institutions who sold SSIA's. Some of the issues identified included:

- ▶ Insufficient resources set aside to adequately process maturing SSIA's ;
- ▶ Amendments to customers' standing order/direct debit instructions not being put through in time or at all;
- ▶ The length of time taken to encash matured unit linked funds;
- ▶ A level of consumer confusion over the term of the products and the actual date of encashment;
- ▶ Problems with third party service providers; and
- ▶ Absence of centralised monitoring of SSIA complaints.

We issued a general letter to relevant financial service providers in October 2006 regarding these matters. During 2007 we will continue to monitor the encashment of SSIA's for the remaining months of the maturity process.

Reimbursement Programmes

We continue to monitor a number of reimbursement programmes relating to charging issues as reported in our 2005 Annual Report in respect of a number of financial service providers. As expected, the number of new charging issues reported to us has declined and the reimbursement programmes previously reported to us are progressing to completion. The estimated figure provided in last year's report reflected the particular stage the firms were at in quantifying the errors they had identified. During 2006, a number of firms provided revised final figures on the previously estimated reimbursement amounts notified to us in 2004 and 2005. This has resulted in an increase of €49m in the estimated overall reimbursement figure. This means that a total of approximately €167m relating to issues dating from the early 1990's to the present, has been identified, €118m of which we reported on last year.

These reimbursement programmes are being carried out by the financial service providers concerned, in line with our General Principles in relation to reimbursement (see Box 2.4). This ensures that customers are compensated and reimbursed as appropriate.

The General Principles, as established in 2005, have been extended to incorporate a principle which deals with the investigation of very old issues in a fair and efficient manner. This additional principle formalises what has been happening in practice and will provide additional clarity for affected firms. In these cases a specific approach for dealing with such incidents must be agreed with the Financial Regulator.

Box 2.4 - General Principles in Relation to Reimbursement

A financial service provider will:

- ▶ Make all reasonable efforts to make a refund (with appropriate interest) to all customers who have been affected by the overcharging;
- ▶ Commit indefinitely to paying legitimate claims arising from the charging issue referred to at (1) above, with appropriate interest.
- ▶ Not benefit from any balance out of the claims (arising in (1) above), which cannot be repaid.
- ▶ Keep available for our inspection a file of any cases where any affected customer is not happy with the approach taken to reimbursement, arising from the charging issue. Each case will state how the financial service provider has sought to bring about a resolution to the issue. This file will be subject to periodic review by Internal Audit.

We recognise that financial service providers may on occasion encounter difficulties in investigating very old issues. These issues can arise from a significant lapse of time and / or the absence of complete records and information for the relevant period. Where a financial service provider can demonstrate to our satisfaction that such difficulties are being experienced by it in investigating past issues, a specific approach for dealing with such investigations will be agreed with us, in the context of the rest of these principles.

AIB Foreign Exchange and other Charging Issues

Following on from the investigations into foreign exchange and other charging issues within AIB in 2004, a range of issues under foreign exchange and other headings were identified by AIB. AIB issued a statement in September 2006 which detailed that two major issues had been identified relating to specific instances of the application of incorrect margins or overcharging on foreign exchange transactions in the early 1990s and other instances related to overcharging which arose in the late 1980s. The investigation of these issues was completed in 2006, the process of which we actively monitored and which culminated in additional payments totalling €31.6 million to be made by AIB (€11 million for repayment to customers and €20.6 million for payment to charitable causes because identification of customers was not possible). These figures form part of the overall reimbursement figure referred to above. As in all such cases, we will continue to monitor the restitution programmes to completion.

Advertising Issues

We actively monitor the media for advertisements of financial services and products, which are subject to certain codes and requirements. In an effort to improve compliance, we issued a general letter to the industry which outlined the common problems we identified. The main advertising issues of concern in 2006 were:

- ▶ The potentially misleading nature of certain advertisements;
- ▶ The size of small print / rushed disclosures;
- ▶ Omissions e.g. absence of regulatory disclosure, Annual Percentage Rate (APR) or warning notices;
- ▶ The misleading name of products;
- ▶ The advertising of rates that are not available;
- ▶ Insufficiently prominent warning notices; and
- ▶ Unfair comparisons with competitors.

The number of issues investigated during 2006 is set out in Table 2.2.

Table 2.2- Advertising issues investigated		
Source	Number of Issues	
	2005	2006
Financial Regulator Monitoring	105	40
Complaints:	10	44
Total	115	84

We have received an increased number of complaints in respect of advertising issues. We feel this reflects an increased awareness of our role in this area. Following the introduction of the Consumer Protection Code, which includes a chapter on Advertising, future complaints will be considered in the context of this Code.

Consumer Credit

The Consumer Credit Act 1995 requires financial service providers (credit institutions, bureaux de change and money transmission businesses) to notify us of any proposal to introduce new or increased charges, for certain financial services. In 2006, we issued letters of direction on foot of 53 notifications from credit institutions, bureaux de change and money transmission businesses. The submissions received from these financial service providers ranged from an individual charge, charges in respect of new products launched and entire suites of charges for credit institutions. We are required under the legislation to consider each notification using a range of criteria which include the commercial justification, impact on the relevant consumers and on competition in the sector. 29 notifications were approved in full, 21 were partially rejected and 3 were rejected.

In addition, we issued 48 licences to moneylenders under the Consumer Credit Act.

During 2006, we reviewed the notification processes and procedures and in 2007 we will implement improvements resulting in a more streamlined process.

Foreign Exchange Mystery Shopping Survey

In July and August 2006, we conducted a nationwide survey of foreign exchange charges being imposed by credit institutions and bureaux de change on consumers in respect of retail foreign exchange transactions. The purpose of the survey was to confirm whether these providers of foreign exchange facilities imposed such charges in accordance with the provisions of the Consumer Credit Act.

During our mystery shopping exercise, we visited 8 foreign exchange providers (5 credit institutions and 3 bureaux de change) in a total of 68 branches and bureaux de change outlets. The survey focused primarily on the costs imposed by these financial service providers when a consumer sought to buy or sell sterling or US dollars. The following issues were identified during the survey but it should be noted that the issues found were not consistent across any one financial service provider:

- ▶ Some FX rate boards were either blank, not clearly visible or were not being regularly updated to reflect current exchange rates;
- ▶ The commission associated with a transaction was not disclosed to the consumer in advance; and
- ▶ The margins and commissions being imposed marginally exceeded what the service provider was entitled to impose.

In general, we saw an improvement in the provision of foreign exchange services compared to a similar survey conducted in 2005. We have discussed our findings with the institutions concerned to ensure that the appropriate internal procedures, controls and checks are put in place for the benefit of customers and to ensure compliance with the Consumer Credit Act.

Review of the Moneylending Industry

In 2006, we conducted a review of the licensed moneylending industry. The objectives of this review were to gain a greater understanding of the industry and to determine whether it is appropriate, necessary and reasonable to change current regulatory policies. This report was published in April 2007 and contained the findings of research conducted. The information gathered will be used by us in our review of the requirements which apply to licensed moneylenders.

As part of this review, we surveyed 333 customers of licensed moneylenders, 47 licensed moneylenders and a number of the Money Advice and Budgeting Service offices nationwide. The survey of customers of licensed moneylenders incorporated the following:

- ▶ Borrowing patterns;
- ▶ Repayment experience;
- ▶ Knowledge of interest rates charged;
- ▶ Awareness of illegal moneylenders;
- ▶ Attitudes towards credit and the availability of credit; and
- ▶ Customer satisfaction.

We have now commenced a review of the Interim Code of Practice for Moneylenders in light of the findings of the research, with a view to improving the consumer protection framework.

Equity Release

The Joint Oireachtas Committee on Finance and the Public Service raised concerns about the sale of equity release products to elderly and vulnerable persons and about the lack of regulation of providers of equity release products. At its meeting on 18 January 2006 we expressed the view that we would welcome the introduction of regulation for these products. A working group chaired by the Department of Finance, on which we are represented, is undertaking a review to establish whether or not home reversion products and/or their providers should be further regulated.

2.3 Consumer Awareness Initiatives

We ran several co-ordinated press, marketing, advertising and research campaigns in 2006 (See Table 2.3 below). Our campaigns were designed to:

- ▶ Increase awareness and demand for our consumer information and services; and
- ▶ Highlight relevant issues for consumers (costs, risks and benefits) of financial products.

Table 2.3 - Consumer Information Campaigns		
Campaign	Date	Activity
Mortgages made easy	Guide launch February 2006	Media
Debt management/ Managing your money booklet	Booklet launch March 2006 Press releases March, May, August, October and December 2006	Media
SSIA campaign (for further information, see Box 2.3 in Themed Inspections section)	Booklet launch March 2006, Press releases March, May, July, October and November 2006	Media Advertising Research
Pensions made easy and Your choices at retirement booklet	June 2006	Media and direct mail promotion
Using your credit card abroad	July 2006	Media
Savings and investments made easy	Guide launch July 2006	Media
Advertising campaign 'on the bus'	August/ September 2006	Advertising
Information poster campaign	August/ September 2006	Promotions
Motor pack	Launch October 2006	Media Advertising Marketing and promotions
Internal 'consumer information' staff day	November 2006	Marketing and promotions
Fraud campaign	December 2006	Media Research
Publication of 11 Cost Surveys	Throughout the year	Media

Information Service

A combination of our extensive media coverage, promotional campaigns, regional events and advertising activities throughout the year led to significant increases in overall demand for our information and service in 2006. Table 2.4 provides data on the numbers of people using the various contact points we operate. This includes our website www.itsyourmoney.ie, our consumer help-line, the Information Centre in Dublin and a team of skilled staff to answer queries, provide information and where appropriate refer complaints to the Financial Services Ombudsman. The number of contacts shows a significant increase (56%) on 2005. Box 2.5 gives an example of one type of query we deal with.

Table 2.4 - Consumer contacts by channel			
Channel / Year		2005	2006
Website visits		191,844	324,632
Helpline 1890 77 77 77		16,637	29,233
Direct calls		2,534	2,080
Information Centre	Browsers	3,561	4,671
	Consultations	1,315	1,844
Emails		1,406	2,453
Letters		756	639
Total		218,053	365,552

In 2006 we reviewed our suite of publications and introduced a number of revised and new publications (Table 2.5 and Appendix 4 refers). The review process includes consultation with consumer and industry bodies and feedback from consumers and market research to ensure our information addresses the queries and issues of concern to consumers.

Table 2.5 - Consumer publications	
New and Revised Publications	Top five downloads from website
SSIA's Your little black book (New)	Motor insurance cost survey
Motor Pack (New)	Credit card cost survey
Pensions made easy (New)	SSIA's Your little black book
Managing your money (New)	Mortgages made easy
Getting financial advice (New)	Savings and investments made easy.
Your choices at retirement (New)	
Savings and investments made easy (Revised)	Most popular printed copy requests
Mortgages made easy (Revised)	SSIA's Your little black book
	Savings and investments made easy

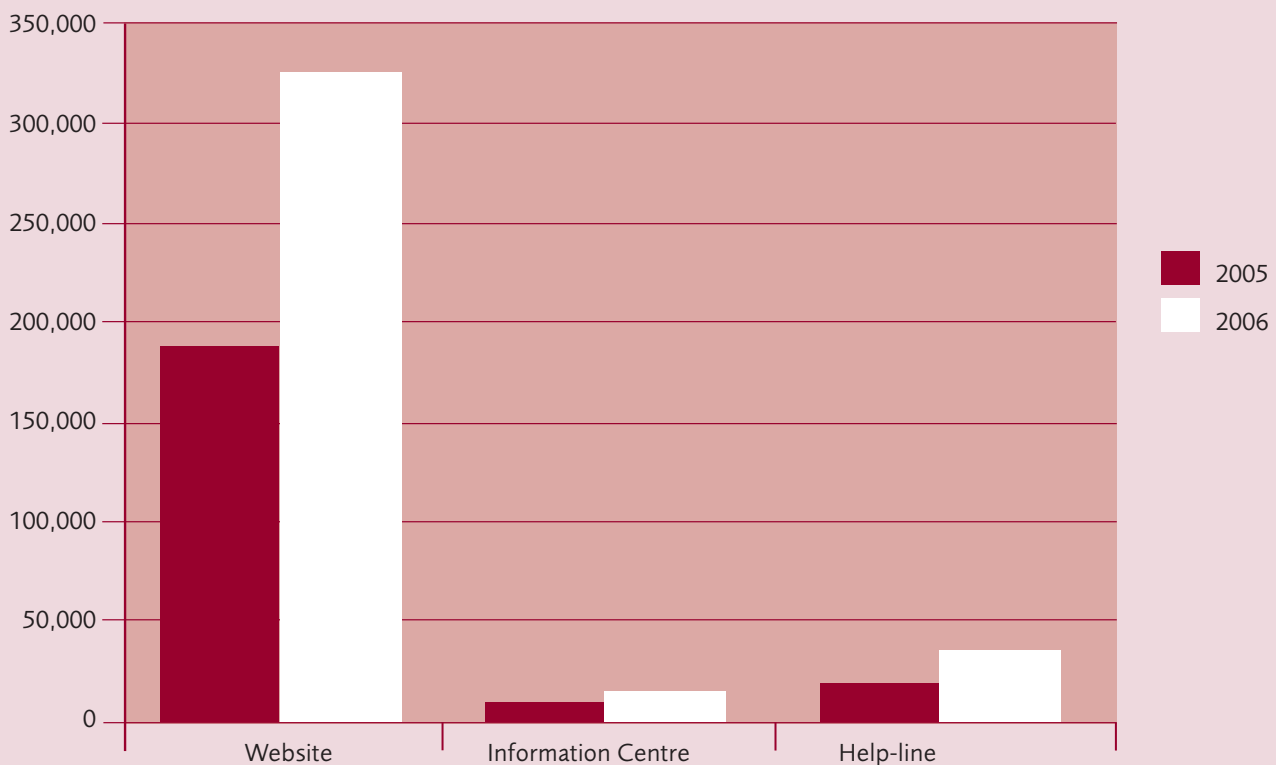
We continued to raise consumer awareness of the costs of financial products and of the benefits of shopping around and switching, by publishing cost surveys on a range of financial products including personal current accounts, student current accounts, credit cards, personal loans, car finance, motor insurance, home insurance and life insurance. We also produced two new cost surveys on business current accounts and stockbrokers fees and charges. Appendix 4 provides a full list of publications.



- ▶ Almost 325,000 online users visited www.itsyourmoney.ie - this is an increase of 69% compared to 2005 figures. Demand for online publications was up 100% in 2006 compared to the previous year, see Graph 2.1.
- ▶ Over 29,200 callers used our consumer helpline - this represents a growth of 76% compared to 2005.
- ▶ Over 6,500 consumers visited our consumer Information Centre - 34% more than 2005.
- ▶ Consumers requested nearly 330,000 publications from us - which is an increase of 70% compared to 2005. Graph 2.1 refers.
- ▶ We distributed an additional 117,000 publications to our mailing list and to selected outlets.
- ▶ Consumers downloaded 110,000 cost surveys from our website alone - this is an increase of 64% compared to the previous year.

Graph 2.1

Consumer Demand for Publications by Channel – 2006 (329,801) vs 2005 (194,014)



Box 2.5 - Bank draft fraud

A consumer contacted our help-line seeking assistance. This consumer had sold goods to a person in another country and had been paid for them with a bank draft for a larger amount than had been invoiced. The consumer explained to the sender that he had overpaid, but the reply was that the overpayment should be returned along with the actual goods. The consumer was suspicious and waited for bank confirmation that the funds were cleared, before withdrawing the cash for the refund. He then sent it on as requested. After the refund was sent on, the bank contacted the consumer with the information that the original draft had been fraudulent.

The consumer was at the loss of the money sent but luckily had delayed in sending on the goods. The consumer had no idea how to take this issue forward and asked for our assistance.

We advised the consumer to report the fraud to the Gardaí and to consider making a complaint to the bank involved. We explained in detail how best to make such a complaint and about the role of the Financial Services Ombudsman in investigating unresolved complaints. The consumer submitted a written complaint to the bank and requested a meeting with the bank to discuss the matter. Following this meeting the manager of the bank resolved the issue by refunding the full amount withdrawn. The consumer contacted us to express appreciation for our assistance.

Debt Management campaign

With the increasing levels of personal debt, we developed a new campaign with the following objectives:

- ▶ Provide consumers with independent information about loans, money management and issues surrounding debt;
- ▶ Encourage consumers to become well-informed before making any personal finance decisions;
- ▶ Highlight the cost and risk implications of consolidating loans;
- ▶ Partner with Money Advice and Budgeting Service (MABS), who are key advocates of our information; and
- ▶ Warn consumers about the impact of interest rates increases on their budget.

Our campaign started in March 2006 and gave us the opportunity to promote related publications and highlight issues around loan debt and management including:

Campaign Action	Date
Consumer Director warns of risks and cost of re-mortgaging	March
SSIA savers urged to tackle debt with SSIA	May
Interest rate increase and managing your money	August / October
Financial Regulator warns students to borrow wisely	August
A loan is not just for Christmas	December

As part of our on-going sponsorship of the 'It's your money' column in the Irish Daily Star, 11 of the 26 articles focused on debt-related issues. Throughout the year we issued 10 press releases on the subject of borrowing and debt and gave 45 radio and television interviews on debt related topics. By the end of 2006, consumers had requested over 54,000 copies of debt management related publications.

New advertising campaign - reaching consumers nationwide

We developed a new advertising campaign which covered TV, print, radio and online media. The objectives of the campaign were to:

- ▶ Continue to publicise the organisation so that consumers understand our role and in particular our information remit;
- ▶ Promote our information service in a way that clearly differentiates us from regulated financial service providers; and
- ▶ Show consumers how they benefit from using our services by becoming more informed.

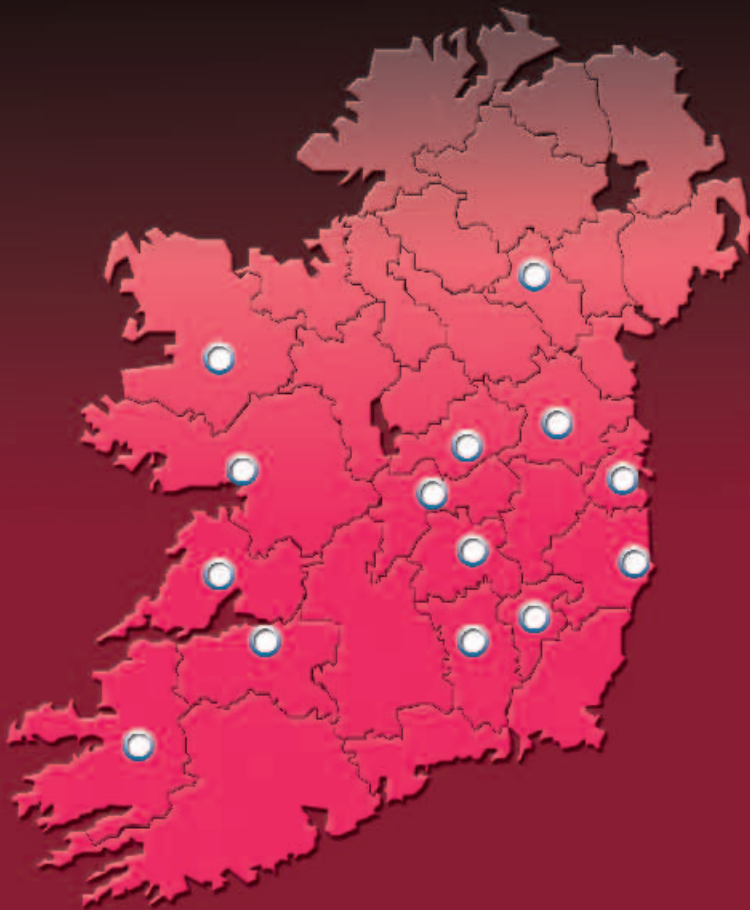
We ran a new pre-tested TV advertisement in the second half of the year. Research conducted in November 2006 found that:

- ▶ 58% of people questioned recalled seeing the ad;
- Of these:
- ▶ 64% liked it and recalled that it was for the Financial Regulator; and
 - ▶ 74% felt it explained our role.

We also ran additional advertising in print, radio and online to promote the Information Centre and the new Motor Insurance pack. 71% of consumers who have heard of the Financial Regulator know us through our own consumer advertising (Lansdowne Market Research - November 2006)



Location of Consumer Regional Information Visits and Special Events



County	2005	2006
Carlow		1
Cavan	1	
Clare	1	
Cork	1	
Donegal	1	
Dublin	11	13
Kerry		3
Galway		1
Kilkenny		1
Laois		1
Limerick		1
Louth	1	
Mayo	1	1
Meath		1
Monaghan		1
Offaly	1	1
Sligo	1	
Tipperary	1	
Waterford	1	
Westmeath	1	2
Wexford	1	
Wicklow		1
Total	23	28

Financial Education

Following a public consultation with stakeholders in 2005 regarding financial education, we established a National Steering Group for Financial Education in 2006 with the first meeting taking place in December. The Consumer Director chairs the group and its members are representatives of relevant government departments, the financial services industry, the education sector and those involved in the delivery of assistance and financial education in the community.

The main purpose of the National Steering Group for Financial Education is to oversee and co-ordinate financial education in Ireland based on best international practice.

Other Education Initiatives

We participated in the third level StudentCents national promotion in the spring and autumn of 2006. 45,000 copies of the 'Money Tips for Students' fact sheet were distributed in the May promotion pack, and the same number of third level current account cost surveys in the fresher packs were distributed in early September.

Arising from the StudentCents promotion, student liaison staff from the Dublin Institute of Technology, Cathal Brugha Street, and UCC invited us to give presentations to their first year students in September as part of an induction programme for new students. The main goal of all our activities with third level institutions in 2006 was to help students make informed choices in selecting product offerings from financial service providers and to encourage them to manage their finances prudently while in third level education.

During the year we prepared a case study entitled "Consumer Rights and Responsibilities" for the Irish Times Business 2000 10th edition of case studies which was distributed to post-primary schools nationwide. Our case study included sections dealing with the Consumer Protection Code, the advertising of financial products and how to make a complaint.

We attended the Business Teachers' Association of Ireland Annual Conference held in Cork. The theme of the conference was: 'Planning for the future - today's business world'. The event was well attended by business teachers, and demand for our publications was very strong, with 2,500 copies of our publications distributed.

Second level students were also given a presentation by the Press Office on the roles and functions of the Central Bank and Financial Services Authority of Ireland.

Access to Financial Services

It is our view that financial access means that consumers know what their financial options are and have choices with regard to products and services. To gain a better insight into barriers to financial access we commissioned Combat Poverty to undertake research in this area. The research was published in December 2006 and represents a very important contribution to the understanding of issues surrounding access to financial services in Ireland. We are working to progress the policy implications contained in the report that come within our remit.

We will continue our work to increase consumers' knowledge of their financial options by providing information on financial products and services in plain English, by researching consumers' financial capability and by adopting an education strategy aimed at raising the level of financial capability.

2.4 Market and Competition issues

The Role of the Financial Regulator in relation to Competition

Our statutory role in relation to competition is to:

- ▶ Monitor the provision of financial services to consumers of those services to the extent that the Consumer Director considers appropriate, having regard to the public interest and to the interests of those consumers, and
- ▶ Publish information specifying the extent to which competition exists among providers of those services in so far as it affects consumers of those services.

Monitoring compliance with competition legislation is the sole responsibility of the Competition Authority. The Financial Regulator and the Competition Authority are required by legislation to consult with one another for the purpose of ensuring the establishment and pursuit of consistent policies regarding the regulation of financial services in the State, and we do this through regular meetings and through formal consultations.

Market Developments

Product innovation continued in the market with "transaction free" current account banking becoming more prevalent among institutions. These offers, together with the operation of the voluntary switching code by market participants, shows that in some market segments there is increasing competition for consumers business, and value to be found by consumers who are willing to switch.

On the mortgage front, market participants continued to develop their product range, with many banks offering 100 per cent mortgages to certain borrowers. The tracker mortgage market seems particularly competitive, especially for borrowers with low loan-to-value ratios. In addition, several retail banks encouraged consumers to switch mortgages by offering to pay a fixed sum towards legal fees, valuation fees, or surveyor's fees. 2006 also saw a continuation in the evolution of the sub-prime market for less creditworthy borrowers who cannot demonstrate a good credit history.

Ahead of the maturing of the bulk of SSIA's, competition also gathered apace in the deposit and investment product markets.

In the private health insurance (PHI) market the Minister for Health and Children commissioned a report from the Competition Authority and the Health Insurance Authority. We made a submission explaining the nature of our regulatory relationship with each of the three main market participants at that time. The Competition Authority and the Health Insurance Authority published separate reports early in 2007.

Measures of competition

As in previous years we have calculated the two main indicators of market concentration (five-firm concentration ratios and Herfindahl-Hirschman (HH) indices). These show the degree of market power exercised by the largest financial service providers in key segments of the banking and insurance industries.

Box 2.6 - Statistical measures used to assess the extent of competition

Five-firm concentration ratios and Herfindahl-Hirschman (HH) indices are designed to measure industry concentration, and by inference the degree of market control of the largest financial service providers in the industry.

The five-firm concentration ratio measures the percentage of total market share held by the five largest financial service providers. Concentration ratios can fall into low, medium, and high concentration.

- ▶ **Low Concentration:** A concentration ratio of 0 to 50 percent is commonly interpreted as a competitive industry with many market participants, resulting in limited opportunities to exercise market power.
- ▶ **Medium Concentration:** A concentration ratio of 50 to 80 percent is considered an industry with medium concentration displaying modest levels of competition.
- ▶ **High Concentration:** An industry with a concentration ratio of 80 to 100 percent is commonly viewed as a highly concentrated, uncompetitive market in which price rises may be easier to sustain.

Herfindahl-Hirschman indices (HHI) are calculated by squaring the market share of each participant in a market and then summing the results. The higher the HH number, the more concentrated is market power. Increases in the index occur as the number of competitors in a market decreases and/or the disparity in size between financial service providers' increases. Another relevant factor is where market share is relatively evenly distributed among participants, this will give rise to a lower HH number than where there is a small number of financial service providers that all enjoy a high market share. Markets in which the HHI is between 1000 and 1800 points are considered to be moderately concentrated, and those in which the HHI is in excess of 1800 points are considered to be concentrated.

Banking**Table 2.6 - Five Firm Concentration Ratios in Key Segments in the Banking Industry**

	2002	2003	2004	2005	2006
Credit Cards	94.3	94.5	94.9	94.8	96.95
Terms/Revolving Loans	74.39	76.86	78.15	79.77	83.58
Residential Mortgages	72.77	72.23	67.72	67.29	66.96
Current Accounts	90.03	88.88	90.92	87.69	92.07

Table 2.7- Herfindahl-Hirschman Indices in Key Segments in the Banking Industry

	2002	2003	2004	2005	2006
Credit Cards	2,584.08	2,516.41	2,468.38	2,450.45	2575.86
Terms/Revolving Loans	1,331.23	1,527.52	1,653.93	1,719.96	1869.26
Residential Mortgages	1,295.71	1,282.07	1,162.75	1,135.58	1098.08
Current Accounts	2,728.80	2,654.71	2,760.01	2,236.93	2535.29

Tables 2.6 and 2.7 indicate that the credit card, term / revolving credit and current account markets remained concentrated in 2006 with only the residential mortgage market showing higher measurements of competition. Of particular note is the increase in the Herfindahl-Hirschman index for term / revolving credit (such as car loans), indicating that within the top 5 financial service providers in the market there has been a further concentration of market share among some of the larger firms. Given that credit unions and finance houses, who are active in the term loan market, are not included in these calculations, the indicators may understate the level of competition in that market. In addition, for many consumers, hire purchase agreements are an acceptable substitute for term loans. These calculations do not factor in that substitution effect.

Insurance

Table 2.8 - Five Firm Concentration Ratios in Key Segments in the Insurance Industry

	2002	2003	2004	2005
Motor Insurance	73.98	80.60	81.92	81.72
Property Insurance	79.46	77.52	78.86	77.00
Liability Insurance	62.68	64.38	65.26	66.77
Life Insurance	69.92	71.50	74.61	78.61

Source: Calculations based on figures quoted in the Insurance Annual Reports 2000 - 2002 and Insurance Statistical Reviews 2003 - 2005. As at the date of publication of this report data for 2006 is not available

Table 2.9 - Herfindahl-Hirschman Indices in Key Segments in the Insurance Industry

	2002	2003	2004	2005
Motor Insurance	1,747.12	1,681.77	1,658.92	1544.57
Property Insurance	1,593.03	1,521.99	1,546.03	1504.60
Liability Insurance	1,104.54	1,098.20	1,097.23	1136.55
Life Insurance	1,369.90	1,433.25	1,869.26	1845.72

Source: Calculations based on figures quoted in the Insurance Annual Reports 2000 - 2002 and Insurance Statistical Reviews 2003 - 2005. As at the date of publication of this report data for 2006 is not available.

Tables 2.8 and 2.9 indicate that the five-firm concentration ratios and the HH indices for all of the selected sectors of the insurance industry continue to be at the upper end of the range. In addition it is worth noting that the above measures may in fact understate the degree of market power exercised within particular sub-sectors. Examples that have come to our attention include motorcycle insurance, insurance of drivers who have convictions, insurance of homes that are prone to flooding and insurance of rented accommodation. In each of these cases active market participants are few and market power is consequently greater.

Though the market share of the largest five financial service providers for motor insurance has remained relatively constant the fact that the Herfindahl-Hirschman index has been falling indicates a degree of redistribution of business among those firms. The HH index in the motor insurance sector continues its downward trend, showing the market has become more competitive.

Liaison with Competition Authority

During 2006, we continued to work with the Competition Authority on issues of common concern. In particular, we have continued to address the recommendations directed to us in the Competition Authority's studies on competition in the non-life insurance market (March 2005) and in the non-investment banking market (September 2005).

In relation to non-life insurance, we have implemented 7 recommendations, and will consider many of the other recommendations in the context of a review of the intermediary market scheduled to commence in 2007. One recommendation in the non-life insurance report was the subject of a regulatory impact analysis (see Chapter 1). In relation to the recommendations addressed to us relating to non-investment banking, 7 have been fully implemented and the remaining 2 have been partially implemented.

Private Motor Insurance Statistics 2003 and 2004

When the term of office of the Motor Insurance Advisory Board (MIAB) ended on 30 September 2004 responsibility for the continuation of the statistical work previously conducted by the MIAB transferred to the Financial Regulator. The primary objective of these statistics is to examine the level of accident frequency and costs, and their consequent impact on the allocated premium differentials by driver profile. The 2003 and 2004 Private Motor Insurance Statistical reports were published in July and December 2006 respectively. The reports are based on the analysis of policy, premium and claims data for 2003 and 2004 submitted by the Irish Insurance Federation (IIF) to the Financial Regulator. By publishing the data for two years in 2006, the Financial Regulator has accelerated the publication of this information. The Private Motor Insurance Statistics for 2005 will be published towards the end of 2007 and we will continue our efforts to achieve more timely publication.

Box 2.7 - Key Findings of the Private Motor Insurance Statistics 2004

- ▶ The motor insurance market grew by 81% to almost 1.5 million policies between 1997 and 2004.
- ▶ 2004 saw a significant change in premium trends. Average premiums fell by 12% for comprehensive cover and by 10% for third party fire and theft cover.
- ▶ Accident frequency grew for the first time since 1997, increasing by 7% for comprehensive cover and 13% for third party fire and theft.
- ▶ Average claim costs rose in 2004 for the first time since 1997, with an 11% increase in costs for comprehensive cover and a 20% increase for third party fire and theft cover.
- ▶ In the context of these trends in premiums, accident frequency and claim costs, average surplus per policy (year one development) in the industry has decreased between 2003 and 2004. Surplus in 2004 (year 1 cost development) averaged €512 per policy for comprehensive cover and €705 per policy for third party fire and theft cover. This compared with €653 per policy for comprehensive cover and €860 for third party fire and theft cover in 2003 (year 1 cost development), which is equivalent to a decrease of 22% and 18%, respectively.

Pictured at the launch of the IBF Business Account Switching Code: Eimer O'Rourke, Head of Member Services - Retail, Irish Bankers Federation; Mary O'Dea, Consumer Director, Financial Regulator; Patricia Callan, Director, Small Firms Association



Switching

We have been monitoring the implementation of the Irish Banking Federation's voluntary code of practice on switching accounts since its introduction in January 2005. Over 35,000 consumers have switched their accounts from one bank to another using the code at 30 April 2007. We continue to monitor progress of this code through mystery shopping exercises and from enquiries to our consumer help-line. The switching code has increased mobility in the market and acted as a stimulus to competition. A voluntary code for switching for business customers was fully implemented by the Irish Banking Federation in June 2006. At 30 April 2007, approximately 600 business customers had switched their accounts using the voluntary code. We will continue to monitor the progress of both codes.

Box 2.8 - Why don't consumers switch from high interest rate credit cards to low interest rate cards?

Our credit card cost surveys shows that currently interest rates charged by card providers on purchases on standard credit cards range from 9.5% to 18.9%, and that most consumers have cards that charge rates at the upper end of this range. Why don't consumers switch from high interest rate credit cards to low interest rate cards?

We have considered this question, looking in some detail at the Irish and European markets (including some market research in Ireland), and also looking at some of the published international research on this subject. We suggest a number of reasons that explain why more consumers don't switch:

- ▶ Many consumers are not aware of the interest rate applied to credit card,
- ▶ Credit card issuers do not compete strongly on the ongoing interest rate charged,
- ▶ Many consumers only use their credit cards as a convenient payment method and don't use their credit cards to borrow. For these consumers the interest rate charged is irrelevant, and
- ▶ Consumers may overestimate the degree of difficulty involved in switching from one credit card provider to another.

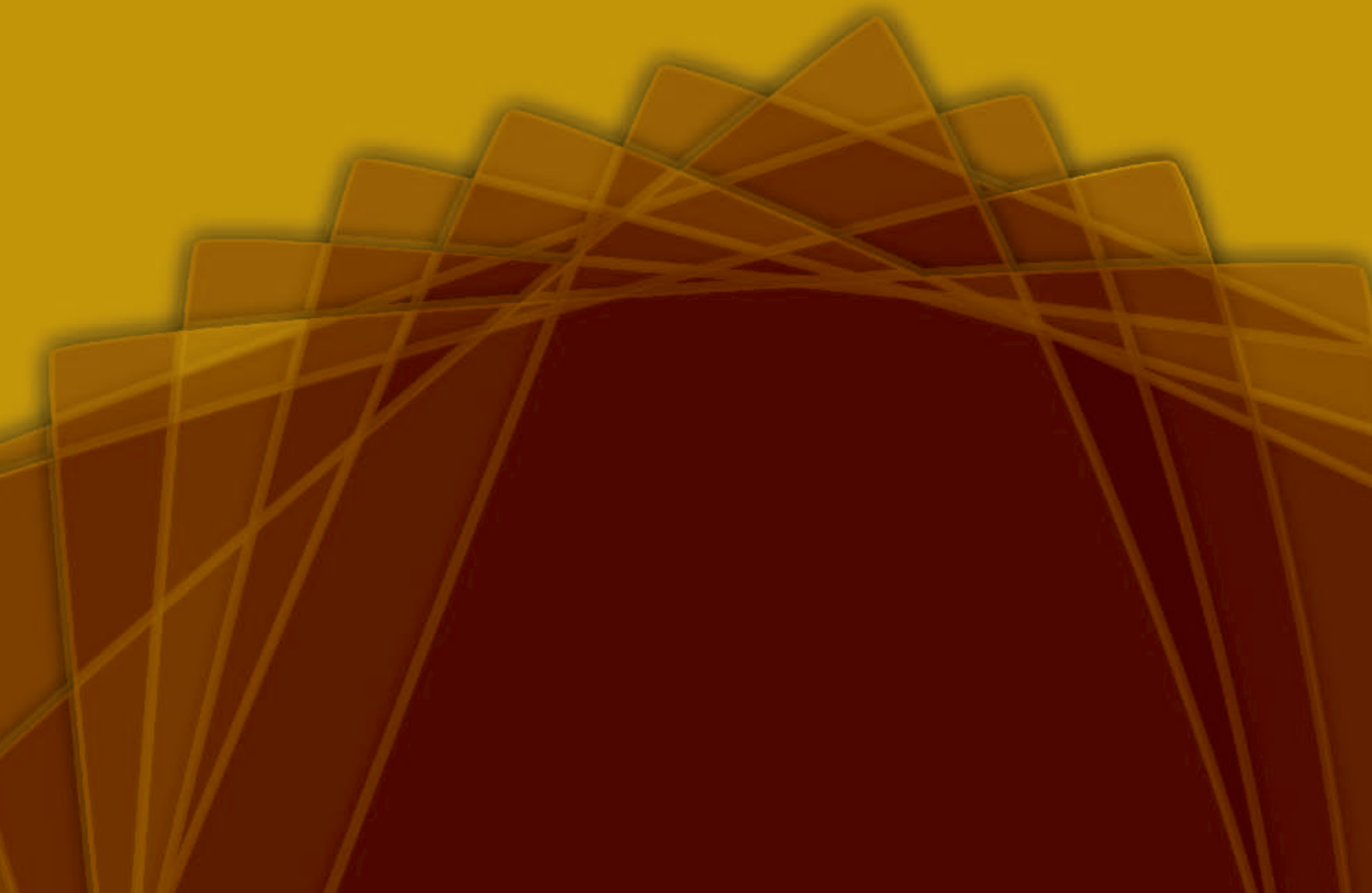
For more details on the work we have done on this issue please refer to Appendix 7.

Developments at EU level

We monitor the work of European Commission and in particular the activities of the Competition and the Internal Market and Services Directorates. In April 2006, the Competition Directorate published an interim report of their investigation into competition in retail financial services across the EU, which focused on core retail banking. It found that many EU banks and card issuers enjoy high profits, the current account banking and payment card markets are highly concentrated, entry barriers exist for new participants and markets remain fragmented along national lines with consumers paying significantly different prices for retail financial products across the EU.

Chapter 3

Fostering a Sound and Reputable Industry



Prudential Director's Statement



*Con Horan
Prudential
Director*

In the period 2005 to 2006, the Financial Regulator has moved from a situation of contributing to the preparation of a number of European directives under the Financial Services Action Plan to the practical implementation of these measures at a national level. These directives set new standards across all areas of the financial services industry and required significant attention, resources and structural change from industry and the Financial Regulator alike. While this has been and continues to be a demanding process, we should not lose sight of the ultimate objective. The creation of the single market in financial services in Europe provides significant opportunity to the industry and consumers by enhancing competition in a market operating to high standards. This process will continue with the implementation of the Markets in Financial Instruments Directive (MiFID) which is now at an advanced stage. It is important that the industry considers the full impact of this directive in terms of opportunity and increased competition and puts in place measures to deal with the change in advance of the commencement date of 1 November 2007.

Domestically we announced our new fitness and probity tests for directors and managers of financial service providers, which is a critical element of our system. We have always tested the fitness and probity of proposed directors and managers and this pre-approval process will continue. However, although these tests were similar in substance across the various sectors we regulate, there were variations in form and practice. Now, in line with the Better Regulation Principles, we have streamlined the form and associated processes to create a common test to be applied across all sectors of the financial industry. The new test is based on a partnership approach with industry, beginning with fit and proper considerations being embedded in the recruitment and promotion selection processes of financial service providers.

The successful development of the industry in Ireland is of course dependent on far more than the efficiency of the regulatory regime. As a principles led regulator we have consistently highlighted the role of directors and management in ensuring that proper systems of internal controls are in place to monitor, measure and manage risks. The nature, dynamism and innovative approach of industry imposes an obligation on individuals holding senior positions to exercise proper diligence and ensure their understanding of the business. It also requires a conscious focus on achieving the balance between current earnings and long-term sustainability. In the current environment there are a broad range of risks that require attention at board level. These include:

- ▶ The dangers attaching to individual and sectoral concentration risks. Concentrations in exposures require boards and management to devote significant attention to understanding correlations and linkages within the portfolio and to the management of the risks arising;
- ▶ High turnover of staff or shortages of proper skill sets. This is a source of operational risk and must be proactively managed. Business growth must occur in an environment where management is confident that the control environment is commensurate with the risks arising;
- ▶ Proper pricing of risk in the products sold or traded. Failure to price for risk exposes an institution to loss when markets become less favourable; and
- ▶ The need for robust controls over treasury activities. Recent losses in the trading operations of a number of international banks outside of Ireland re-enforce the responsibilities of boards and management in relation to understanding and managing risks attaching to trading in financial instruments.

The Financial Regulator has also drawn attention to the need for industry to actively contribute to the formulation of domestic and European regulatory legislation and policy, by active participation in the consultation processes that exist. There has been a material improvement in this over 2006 and I would particularly draw attention to the very positive role industry has played in the development of the Capital Requirements Directive and MiFID. Broader participation in this process will enhance the overall regime and reduce the resources required to deal with problems arising following the introduction of new requirements.

Finally I would like to thank all the staff for their contribution in 2006. The extent and complexity of the role has grown significantly over recent years and it is the continuing dedication and professionalism of the people involved that has enabled us to meet our objectives.



Con Horan
Prudential Director.

3.1 Prudential Supervision

Our aim is to foster a stable financial services industry where depositors, policyholders and investors can place funds with a degree of confidence. The structure of regulations governing the prudential operations of financial service providers is primarily driven by EU Directives in areas such as capital adequacy, solvency, own funds, large exposures and anti-money laundering. We adopt a principles-led approach to supervision, whereby the Board of Directors of a financial service provider are responsible for setting their tolerance for risk and for ensuring that management establishes a framework for assessing the various risks. Financial service providers are also required to develop a system to relate risk to their level of capital and establish a method for monitoring compliance with internal policies. Our role involves oversight of the quality of the institution's corporate governance including risk management and internal control systems, the focus being on structures and methodologies used.

Prudential Supervision of financial service providers is carried out by means of administering the provisions set out in legislation and regular interaction with institutions. This process is supported by the collection and analysis of financial information (Table 3.1 refers) and by on-site visits (Table 3.2 refers).

Analysis of Returns

In line with our risk-based approach to supervision, we require financial service providers to submit prudential returns weekly, monthly, quarterly and annually, depending on the nature of activities. Certain basic information is required to be submitted by all financial service providers irrespective of their complexity or risk. These prudential returns provide us with information on a range of risk variables which we actively monitor, such as liquidity, capital adequacy, solvency and exposure limits. For example, we collect weekly mortgage statistical data from the main mortgage lenders and prudential and large exposures data on a quarterly basis from credit institutions. We had planned to introduce quarterly and electronic reporting for all insurance companies. However, this project was delayed due to the heavy IT workload imposed by the implementation of the Capital Requirement and Markets in Financial Instruments Directives. In the case of investment firms, stockbrokers and fund service providers, we examine reports from them at least twice yearly to ensure that they are conforming to capital adequacy and regulatory reporting requirements. We examine annual reports from the investment firms' external auditors regarding general compliance and compliance with rules to safeguard client money. We also analyse and record regulatory reports in respect of Irish authorised collective investment schemes, including net asset value reports and annual audited accounts. In the case of retail investment or insurance intermediaries, we examine their financial statements once per year. In 2006, we received 60,480 returns from financial service providers (Table 3.1 refers).

Table 3.1 - Number of returns from Financial Service Providers received in 2006		
Banks and Building Societies	2005	2006
Weekly returns	198	512
Monthly returns	598	488
Quarterly returns	495	542
Annual returns (Audited Accounts)	49	47
Insurance		
Audited Annual Returns		
▶ Non Life	124	128
▶ Life	50	55
Quarterly Return		
▶ Non Life	225	226
▶ Life	82	101
Investment/Stockbroking Firms		
▶ Weekly	572	351
▶ Monthly	264	300
▶ Quarterly	372	425
▶ Semi-Annual	38	44
▶ Annual Audited Accounts	322	283
Fund Service Providers		
▶ Monthly	12	-
▶ Quarterly	24	18
▶ Semi-Annual	67	69
▶ Annual Audited Accounts	74	72
Retail Intermediaries		
▶ Semi-Annual	872	-
▶ Annual	1,107	1,117
Exchanges		
▶ Monthly	24	24
▶ Annual Audited Accounts	2	2
Funds		
Monthly Net Asset Value Returns	45,281	48,840
Annual and Interim Accounts	6,343	6,836
Total	57,195	60,480

In examining the reports received from financial service providers, we may identify issues for further discussion with them. In most cases the financial service provider clarifies these issues to our satisfaction. In a small number of cases the discussion may lead to a change in procedure or process in the financial service provider.

Box 3.1 - Regulatory Principle 9 - We expect financial service providers, when required, to produce accurate, complete and timely information

Furnishing of information by credit institutions to the Financial Regulator is provided for in Section 18 of the Central Bank Act, 1971, as amended by Section 37 and Section 8 of the Central Bank Act's, 1989 and 1998 respectively and Section 41 of the Building Societies Act, 1989. Regulatory reports, in compliance with these requirements include monthly summary reports, quarterly prudential, sectoral and large exposures returns and annual accounts. Given the importance we place on these returns as a major off-site supervision role, it is imperative that credit institutions have the resources and controls in place to ensure the returns are completed accurately and on a timely basis. It is necessary, from time to time, to verify the accuracy with which credit institutions are completing these returns and to assess the adequacy of controls and resources in place to ensure compliance with regulatory requirements.

During the course of two inspections in 2006, we looked at the organisation and staffing of the regulatory reporting functions, the systems in place to produce these returns and the quality checks being carried out within the institutions to verify the accuracy of the information submitted. Errors in reporting and lack of supporting documentation were identified and both institutions were required to address these issues. Detailed recommendations were issued to both institutions in relation to their implementation. There is a formal system in place to track the implementation of these recommendations. Further verification will form part of the next inspection of both institutions.

On-site Visits

A key supervisory tool is the on-site inspection of financial service providers. This enables us to understand fully the activities of the financial service provider, how it is organised, what type of corporate culture exists and how its systems and controls work. However, inspections are resource intensive. To be effective, thorough preparation and follow-up are required. Our experience is that all aspects of a five-day inspection will take three inspectors two to three weeks to complete. Accordingly, we carefully prioritise the use of this supervisory tool so that those financial service providers that are most likely to be inspected are those that represent the greatest risk, whether because of the complexity of their organisation or scope of activities.

On-site inspections enable us to:

- ▶ Assess the corporate governance system in place;
- ▶ Evaluate the culture of compliance evident in the running of the organisation;
- ▶ Assess the controls and risk management processes in each of the business areas of the financial service provider;
- ▶ Confirm the accuracy of financial returns and other information which has been submitted;
- ▶ Examine compliance with any regulatory requirements we may have imposed; and
- ▶ Check that anti money laundering procedures are in place.

In addition, regular review meetings also take place with financial service providers, and generally take a half-day. They are of a more general nature and cover broad compliance issues and any matters outstanding from the most recent inspection. In 2006 we carried out 426 inspections and review meetings of financial service providers (Table 3.2 refers).

Table 3.2 Number of On-Site Inspections and Review Meetings		
	2005	2006
Banks and Building Societies		
Inspections	8	13
Review Meetings	39	47
Total	47	60
Insurance		
Inspections	17	4
Review Meetings	120	195
Total	137	199
Investment/Stockbroking firms		
Inspections	11	9
Review meetings	103	78
Total	114	87
Fund Service Providers		
Inspections	4	10
Review meetings	69	66
Total	73	76
Retail Intermediaries		
Inspections	5	1
Review meetings	2	3
Total	7	4
Exchanges		
Review meetings	1	0
Total	1	0
Overall Total	379	426

Box 3.2 - Regulatory Principle 5 - We expect financial service providers to have oversight and reporting systems that allow the board and management to monitor and control all operations.

All insurance undertakings must be able to demonstrate, in accordance with Article 2(e) of the Framework Regulations (S.I. 359 of 1994), that effective control is being exercised. As a principle, we expect financial service providers to have oversight and reporting systems that allow the board and management to monitor and control all operations. In relation to Irish subsidiaries of foreign companies, this means that the firm is managed from Ireland and decision-making takes place in Ireland. In other words, the firm must have its 'heart and mind' in Ireland.

During the course of the programme of regular review meetings in 2006, we became concerned about a company with regard to its ability to exercise effective control over its operations. Following an on-site inspection of the company, we identified a number of management and control deficiencies. In aggregate, the deficiencies showed the operation lacked appropriate substance. Our concerns were:

- ▶ The 'Heart & Mind' of the company appeared to be located outside of Ireland. It was very heavily dependent on outsourced management services and lacked sufficient own staff to control the core functions of the company;
- ▶ Corporate Governance was not sufficiently robust, as the insurance company lacked appropriate management structures in terms of executive committees;
- ▶ The Compliance function was weak, as there was a lack of demonstrable controls; and
- ▶ Financial Management controls also needed to be strengthened.

We required the company to address the issues identified in the inspection. The company submitted a comprehensive remediation plan and agreed to appropriate corrective actions. As a result, the company has reorganised its internal structures, is investing in new IT systems and has recruited skilled staff.

Unlicensed Providers of Financial Products

We deal with enquiries from the public or from financial service providers regarding the regulatory status of financial service providers. Where we identify alleged instances of unauthorised activity, we investigate the matter and exercise our enforcement powers as appropriate.

Enquiries concerning unauthorised providers are generally received in one of two ways - by telephone and/or by letter - from members of the public, foreign regulators, other Irish institutions or from the Gardaí or the police in other jurisdictions. We also monitor the media in order to identify cases of unauthorised activity. In almost all instances, once we contact the financial service provider in question, it either ceases business or seeks to regularise its position. Where the financial service provider does not comply we have a number of enforcement options, including the publication of Warning Notices.

In 2006, we published four warning notices in relation to four financial service providers as follows:

- ▶ Godfrey Brooks Investment Advisory, based in Switzerland: warning notice published 12 May 2006;
- ▶ Stonewell Finance, based in Sweden: warning notice published on 22 June 2006;
- ▶ Atlantic Capital Management, based in Spain: warning notice published on 16 August 2006; and
- ▶ Jupiter Advisory, based in Switzerland: warning notice published on 1 September 2006;

Box 3.3 outlines how we dealt with the case of another unauthorised firm - Cyrus Rushwood & Associates Limited case.

Box 3.3 - Regulatory Principle 8 - We expect financial service providers to comply with any regulatory rules set down by the Financial Regulator.

In August 2006 we became aware of the website of an unauthorised investment business firm, Cyrus Rushwood & Associates Limited (Cyrus), with an address in the United States. We had concerns about the website of Cyrus as the firm was claiming to be an investment intermediary authorised by the Financial Regulator under the Investment Intermediaries Act, 1995, as amended. Cyrus is not authorised by the Financial Regulator under the Investment Intermediaries Act, 1995, as amended and holds no authorisation whatsoever from the Financial Regulator.

We issued a press release on the Financial Regulator website, warning the public of Cyrus, and confirming that Cyrus is not authorised by the Financial Regulator. The Financial Regulator had no evidence that the firm had attempted to target Irish consumers, however it was apparent that information appearing on the Cyrus website had been copied from the website of the authorised firm which had reported the matter to us, a firm which had no connection whatsoever with Cyrus.

As part of our enquiries, we wrote to the Securities and Exchange Commission (SEC) in the US seeking further information on Cyrus. We also reported Cyrus to the Garda Bureau of Fraud Investigation. The Financial Regulator is obliged to report to the Gardaí any information relevant to any person or body in relation to which it exercises functions under the designated enactments or the designated statutory instruments, that leads it to suspect that a criminal offence may have been committed by that person or body. In addition, through correspondence with the internet service provider, we had the website of Cyrus shut down.

Money Transmitters and Bureaux de Change

In 2006, we authorised 9 money transmission businesses. In assessing such applications, we seek to ensure that the shareholders, partners, directors and senior management are fit and proper persons and that the internal controls and procedures are adequate to prevent money laundering.

3.2 Regulatory Innovations

We introduced a number of innovations in 2006, the most significant of which was the implementation of a new framework of testing the probity and competence of the industry's proposed directors and managers. This together with the other improvements to our regulatory approach is outlined below.

Common Fitness & Probity Regime

Since the beginning of 2007, proposed approved persons of financial services providers are subject to a new common fit and proper test. This test, which replaces a patchwork of sectoral tests, was the subject of two consultation papers, issued in February 2005 and February 2006. The considerable input we got through the consultative process from industry, consumer representatives and interested bodies was very useful in developing final proposals that are proportionate and that should lead to greater efficiencies in the system.

The new test is set out in two documents, available on our website. One is the new Individual Questionnaire that is to be completed by all proposed approved persons. The second describes the process by which the new test will work. This process is centred on the premise that financial service providers will satisfy themselves as to the fitness and probity of those that they are proposing to appoint as Directors or Managers before submitting their applications to us. They will do this principally by embedding fitness and probity in their recruitment or selection procedures. The new process will permit us to issue faster responses to proposals from financial service providers.

Reinsurance

On 28 July 2006, we issued the first reinsurance licence pursuant to the European Communities (Reinsurance) Regulations 2006, authorising ITX Re Limited as a reinsurance undertaking. As Ireland was the first Member State to implement the EU Reinsurance Directive, ITX Re became the first company in Europe to be authorised under its terms. The regulations also provide for a single passport system within Europe for reinsurers and include specific requirements for dealing with Finite reinsurance and Special Purpose Reinsurance Vehicles.

Prior to the Regulations, Ireland was already an established location for reinsurance business. Commentators within the reinsurance industry predict the new regulations will mean considerable growth in the Irish market, as the Regulations introduce a comprehensive framework for the authorisation and supervision of reinsurance for the first time.

The implementation process of the full regulatory regime for reinsurance is designed to assist Reinsurance Undertakings in the market towards full compliance and to provide certainty in the market place. Regular constructive engagement with key stakeholders, in particular with industry representative bodies has been an essential part of this process. We also co-operate closely with regulators in other EU Member States, the USA and other third countries.

Qualifying Investor Funds

In November 2006 we engaged in discussions with representatives of the funds industry to discuss a possible change to the authorisation regime applied to specialist qualifying investor funds (QIF) aimed at institutional investors where the QIF would be authorised immediately on filing of specified documents.

Following consultation in December 2006, and consideration of the industry's submission, we introduced a new authorisation regime so that a QIF may be authorised within 24 hours on receipt of the application. We do not undertake a detailed review of the application, provided that the parties involved are approved or cleared in advance of the application and that confirmation is received in relation to the contents of the relevant documentation. The new system meets one of our commitments in the "Building on Success" document issued by the Department of An Taoiseach on the development of the financial services industry.

Authorisation timescales

The timeframe for processing applications for the authorisation of collective investment schemes is as follows:

- ▶ We issue first comments on an application within 3 weeks of filing a complete application, second and subsequent comments within 2 weeks of receipt of responses. When all queries have been resolved, the fund is authorised immediately.
- ▶ We have a fast track regime for cloned funds and sub funds. In these circumstances, first comments in respect of such funds are issued within 2 weeks and second and subsequent comments within 1 week of receipt of responses. Similarly, when all queries have been resolved, the fund is authorised immediately.

These timeframes are reviewed regularly in partnership with IFIA - Irish Funds Industry Association. We will continue to work to improve the efficiency and effectiveness of the system. However the total time for authorisation varies considerably depending on the type of institution involved.

Marketing of Irish non-UCITS funds in the Netherlands

Following negotiations with the Netherlands Government, Ireland has been designated as a state of equal supervision standard with effect from 31 October 2006. This followed a review undertaken by the Dutch Financial Markets Authority to evaluate equivalence of our authorisation process. Their review included a detailed examination of the Irish procedures.

The consequence of this designation is that non-UCITS Irish collective investment schemes do not now need a separate licence to enter the Dutch market.

Enhancements to Collective Investment Scheme policy

We continued to review our requirements in relation to the investment policies of UCITS, issuing a number of consultation papers and guidance notes and revising the existing UCITS Notices.

Following consultation we issued a revised set of UCITS Notices and related Guidance Notes in May 2006 relating to the use of financial derivative instruments and amendments to stocklending arrangements. Further improvements were introduced in November 2006 when requirements in relation to the inward marketing of UCITS were amended in accordance with the agreed Committee of European Securities Regulations (CESR) Guidelines.

In November 2006 we notified the funds industry of policy initiatives relating to investment in Professional Investor Funds (PIFs) and Qualifying Investor Funds (QIFs) by pension funds and knowledgeable employees, permitted markets for retail funds, investment by money market funds in floating rate instruments and disclosures of rebate arrangements.

We participated in the work of CESR (which issued guidance in January 2006) to clarify the assets which UCITS are permitted to invest in.

Development of Supervisory Regime for Captive Insurers

In response to the evolution of the captive insurance market in Europe and representations from the Dublin Insurance Management Association (DIMA), we reviewed the prudential requirements for captive insurance firms. The primary result of this review was a decision to ease the solvency requirements for captive insurers involved in specified, low risk business lines, to allow captive insurers to write more reinsurance business under specific conditions and, on a case-by-case basis, to allow credit for reinsurance ceded to related financial service providers.

These risk-sensitive measures are designed to streamline the supervisory framework and enhance the competitiveness of Ireland as a captive insurance centre, while at the same time maintaining the integrity of the regulatory regime.

New authorisation regime for Mortgage Intermediaries

We introduced a new authorisation regime for mortgage intermediaries in July 2006. The main feature of the new regime is an extended authorisation period. Prior to July 2006, mortgage intermediary authorisations were issued for a period of 12 months and were renewed annually. With effect from July 2006 mortgage intermediary authorisations were extended to a period of either 5 or 10 years. The 10-year authorisation is granted to firms already authorised under the Investment Intermediaries Act; other firms receive a 5-year authorisation.

Compliance Statements

Under Section 26 of the CBFSAI Act 2004, there is an existing provision whereby the Financial Regulator may require Compliance Statements from regulated financial service providers

In anticipation of implementing this provision, the Financial Regulator conducted an informal consultation during October and November 2006 to afford industry bodies and other interested parties the opportunity to comment on a Draft Consultation Paper setting out the Financial Regulator's proposed approach on the matter. While some clarity was requested on our proposed implementation of the legislation, the major issues raised by consultees related to the legislative provision itself. The most significant comments were:

- ▶ The legislation is impaired by the absence of a materiality threshold and the extent of the confirmation required. The current wording requires the regulated entity to specify whether it has complied with its relevant obligations as opposed to confirming that they have in place appropriate 'arrangements or structures' to secure material compliance;
- ▶ The Company Law Review Group (CLRG) recommendations on Section 45 of the Companies (Auditing and Accounting) Act 2003 are not reflected in the CBFSAI legislation;
- ▶ The Compliance Statement provision is not principles based and therefore inconsistent with the Financial Regulator's approach; and
- ▶ This requirements would have a negative impact on Ireland's competitiveness.

The Financial Regulator considered that these remarks called into question the practical application of the legislation. The Department of Finance has agreed that Section 26 should be reviewed as part of the Consolidation and Modernisation of Financial Services legislation project. In the meantime it is not proposed to exercise the power provided by Section 26, apart from extremely exceptional circumstances, pending the outcome of that review.

3.3 Implementation of new Prudential Requirements

Capital Requirements Directive

The major focus at EU level during 2006 was preparation for the introduction of a revised framework for the calculation of the capital adequacy of banks and investment firms - the Capital Requirements Directive (the CRD), for implementation on 1 January 2007. The new capital adequacy framework offers a menu of risk-sensitive approaches for the calculation of minimum regulatory capital and incentives for better risk management for credit institutions and investment firms. The arrival of the CRD brings with it a major change in the way supervision is conducted as well as increasing the complexity of supervision.

In December 2006, we published our requirements and guidelines for credit institutions and investment firms on inter alia:

- ▶ The application and use of approaches for the calculation of credit risk capital;
- ▶ Operational risk;
- ▶ Specialised lending;
- ▶ Internal Capital Adequacy Assessment Process (ICAAP); and
- ▶ Disclosure obligations.

In January 2007, we began the process of establishing the web based supervisory disclosure framework in accordance with the Committee of European Banking Supervisors (CEBS) guidelines. The framework is intended to make supervisory practices more transparent, facilitate the comparison of national texts that implement the CRD, and compare the ways in which Member States exercise national options and discretions available to them in the CRD.

Requirements for the Management of Liquidity Risk

We introduced new liquidity requirements for credit institutions in July 2006. The requirements seek to enhance the current qualitative requirements and amend the current quantitative requirements on liquidity. The new requirements involve a forward looking mismatch approach to liquidity management under which cash flows are assigned to relevant time bands, replacing the current stock approach. The new requirements reflect the use of improved techniques to measure and manage liquidity risk. A six-month parallel run of the existing stock approach and the proposed mismatch approach commenced in January 2007, with compliance with all of the qualitative and quantitative requirements under the new framework to commence with effect from July 2007.

Additional capital for High Loan-To-Value (LTV) mortgages

With effect from 1 May 2006, we amended the risk weighting of Irish residential mortgages so that mortgages with a loan-to-value (LTV) ratio in excess of 80 per cent will attract a 100 per cent risk weight for the portion of the loan that exceeds the 80 per cent threshold. As a result credit institutions are required to set aside additional capital in respect of these loans. This change has been made against the backdrop of the growth in mortgage lending, the profitability of the banking sector and changes in accounting and provisioning practices brought about by the International Financial Reporting Standards (IFRS). The new risk weighting will remain in place for a period of time to allow a capital reserve to accumulate and will be kept under review in the light of market developments.

UCITS III Management Companies

In 2006, we established a regime of prudential supervision for UCITS III fund management companies, which includes capital, fitness & probity, reporting and general supervisory requirements. The process involved prior consultation with the Irish Funds Industry Association regarding the procedures and processes to facilitate an efficient and timely conversion to the new requirements. Depending on the type of management company, the deadlines for conversion were either 30 April 2006 or 13 February 2007. In order to comply with these deadlines it was necessary for us to process multiple authorisations in a very short period of time.

Fund management companies which launched UCITS III funds after 13 February 2002 were required to be authorised by 30 April 2006. In this regard, we approved the conversion of 61 management companies by the 30 April 2006 deadline. Fund management companies which had not launched UCITS III funds were allowed to avail of the 'grandfathering' provisions of the Directive until 13 February 2007. In this regard, we approved the conversion of 10 management companies and 81 self managed investment companies by the 13 February 2007 deadline. The remaining firms have since converted. The Product Directive provided that UCITS existing on 13 February 2002 could be granted a period of 5 years (i.e. until 13 February 2007) within which to comply with its requirements. All 59 UCITS which existed on 13 February 2002 were compliant by the deadline of 13 February 2007.

Reinsurance

In accordance with the implementation of the EU Directive for Reinsurance, we issued the Transitional Requirements for Non-Life Reinsurance Undertakings in 2006. Arising from this 141 Statements of Compliance and Compliance timelines were received from Non-Life Reinsurance Undertakings. These responses were reviewed and discussed with reinsurance undertakings as necessary. Further submissions are required in 2007 to ensure the Non-Life Reinsurance Undertakings will be in compliance with the relevant requirements when they take full effect on 10 December 2007. We continue to engage with the industry on the practical application of the requirements. A similar process will occur in 2007 for approximately 40 Life or Composite Reinsurance Undertakings.

In future, a Statement of Actuarial Opinion (SAO) will be required in respect of both Life and Non-Life Reinsurance Undertakings. In an SAO, a suitably experienced actuary certifies that the reserves booked by the company are at least equal to best estimate, that required solvency margin is correctly calculated, and that retrocession has been appropriately allowed for in the calculations. The SAOs were developed in conjunction with the Society of Actuaries in Ireland. The Non-Life SAO format and associated guidance were finalised in December 2006 and the Life SAO format is expected to be completed by June 2007.

We commissioned consulting actuaries to prepare reports on the development of risk based Augmented Solvency Models (ASM) for Life and Non-Life Reinsurance Undertakings. Reinsurance undertakings conducting Finite and Financial Reinsurance are required to compute their capital requirement in accordance with the ASM. Other reinsurance undertakings are requested to prepare a capital calculation in accordance with the ASM, to assist us assess the risks.

Prudential Handbooks

In July 2006, to coincide with introduction of the new Consumer Protection Code, we issued two revised prudential handbooks for (i) Investment and Stockbroking firms and (ii) Authorised Advisors & Restricted Intermediaries. These revised handbooks set out the general supervisory, reporting, and books & records requirements, that firms in the abovementioned categories are obliged to meet on an ongoing basis by virtue of their respective authorisations under the Investment Intermediaries Act 1995 and the Stock Exchange Act 1995.

It should be noted that the revised handbooks, similarly to the new Consumer Protection Code, are not applicable where a financial service provider is providing services which fall under the Markets in Financial Instruments Directive (MiFID). Such financial service providers will be covered by the provisions of the MiFID legislation from 1 November 2007.

Statutory Duty of Auditors to Report to the Financial Regulator

Under the 2004 Act, auditors must make an annual positive statement stating whether or not they have come across anything in their examination of a company's finances that would activate a duty under various existing statutory provisions to make a report to us. We worked with the Institute of Chartered Accountants in Ireland (ICAI) in the provision of guidance to its members on this statutory duty. The following guidance notes were published by them in September 2006:

- ▶ Guidance on Reporting to the Financial Regulator under the CBFSAI Act, 2004 (M46); and
- ▶ Guidance for reporting in accordance with the Client Money Requirements (M47).

Investor Compensation

In 2006, we liaised with the Investor Compensation Company Ltd on a number of issues, including a minor change to their investment policy.

3.4 Development of Prudential Policy

Markets in Financial Instruments Directive

The Markets in Financial Instruments Directive (MiFID) will come into effect on 1 November 2007. The MiFID extends the provisions of the Investment Services Directive which had regulated the provision of investment services within the internal market. It also introduces some new provisions promoting transparency in the trading of financial instruments which are admitted to trading on an EU regulated market and brings in a single set of conduct of business rules throughout the EU. The MiFID improves the "passport" for investment firms by more clearly describing how the responsibility is allocated between home and host states for passporting branches and generally clarifying some of the jurisdictional uncertainties that arose under the Investment Services Directive.

Implementation of the new Directive necessitates significant and detailed preparation. In July 2006 we established the MiFID implementation forum with industry and it has met on two occasions in 2006. This forum provides both the Financial Regulator and industry participants with an opportunity to discuss implementation issues. As part of our implementation plan thirteen separate work streams have been established and three of these have industry representatives dealing with conduct of business, transaction reporting and organisational and internal controls issues. The Committee of European Securities Regulators (CESR) also established a number of working groups to provide guidance for industry, in which we have actively participated. In 2006, we participated in the development of a number of EU consultation papers on a range of issues. As part of the preparations for MiFID implementation during 2006, we engaged directly with relevant investment and stockbroking firms and discussed the implications for the sector as a whole at the MiFID implementation forum.



Key industry representatives pictured at a MiFID implementation forum in November

Solvency II Directive

A major regulatory development for insurers and reinsurers will be the development of the Solvency II Directive, which introduces a new prudential regime to apply a more comprehensive approach to risk. The Directive will consolidate 14 Directives into one and has the following goals:

- ▶ Legislation which is as principles led as possible, but still aiming at a high level of harmonisation through its implementing measures;
- ▶ Developed in association with stakeholders and based on a regulatory impact analysis; and
- ▶ Compatible with international developments.

Although Solvency II implementation is not expected until 2010, a draft Directive is expected in the middle of 2007. The Directive is based on 3 fundamental principles or pillars:

Pillar I - Measurement of Assets, Liabilities and Capital

Pillar I is the component of the proposed Solvency II system which deals with quantitative matters, primarily the calculations which underlie technical provisions, capital requirements and measurement of available capital. During 2006, we participated actively in the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) Working Group, which is providing advice to the European Commission on quantitative issues.

The specifications for the second Quantitative Impact Study (QIS2) were prepared in the first quarter of the year and provided the insurance industry with its first opportunity to calculate the likely capital requirements under Solvency II. The next phase, to prepare the specifications for the next study (QIS3), took place from April to June 2007. We continue to raise industry awareness through direct communication, by facilitating a workshop for QIS2 participants and through a number of speaking engagements at conferences and industry fora. In particular, we concentrated our efforts on trying to ensure the maximum possible participation rate by Irish insurance and reinsurance firms in QIS3.

Pillar II - Supervisory Review Process

Pillar II deals with the qualitative requirements that will apply to insurance undertakings and also the Supervisory Review Process that is intended to evaluate the risk profile, solvency capital adequacy and the prudent management of insurance undertakings by means of convergent supervisory practices. During 2006, we assisted the CEIOPS Working Group develop papers relating to co-operation between Supervisory Authorities, on the issue of Procyclicality and how small undertakings should be regulated. We also participated in the development of advice relating to the Supervisory Evaluation Process, the Internal Risk and Capital Assessment requirements and Harmonised Supervisory Powers and Tools.

Pillar III - Disclosure Requirements

Pillar III deals with public disclosure and supervisory reporting. During 2006, we assisted the Working Group in developing the main information requirements that insurance undertakings must fulfil to enable an assessment of their solvency and financial condition.

CEIOPS Cross-Sectoral Issues Expert Group

This group is working on how insurance groups are supervised so that there is a consistent approach to regulation across sectors. In 2006, we assisted in the preparation of the advice on the identification and calculation of diversification benefits.

UCITS Derivative Investments

We participated in the work of the CESR which is considering the extent to which a financial index based on a non-eligible asset, e.g. hedge funds or commodities, could be an acceptable underlying exposure for UCITS using derivative investments. The consultation closed on 30 November 2006 and a public hearing was held in Paris in April 2007 to discuss the issues further. Work in this area is ongoing.

Eligible Assets Directive

We have participated in the development of an EU draft Directive on Eligible Assets. The Directive was published on 19 March 2007 and provides clarity in respect of certain definitions included in the UCITS Directive.

Prevention of Money Laundering and Terrorist Financing

At domestic level, we continued our preparatory work on the implementation of the 3rd Money Laundering Directive through our membership of the Money Laundering Steering Committee chaired by the Department of Finance. This implementation work included preliminary consultations with key industry stakeholders in May 2006.

In the light of the requirement for Member States to implement the EU Directive on the Prevention of the use of Financial System for purpose of Money Laundering and Terrorist Financing, the committees of CEBS, CESR and CEIOPS established a Task Force during 2006. The purpose of the Task Force, of which we are a member, is to provide a forum for the exchange of experiences between EU Supervisory Authorities and to support the convergence of supervisory practices in the application of anti-money laundering requirements in the area of Customer Due Diligence rules (Know your Customer).

Corporate Governance for Credit Institutions and Insurance Undertakings

A pre-consultation paper covering Corporate Governance Guidelines for Credit Institutions and Insurance Undertakings was issued in October 2006. Following a request from the industry, further consultation is being deferred pending the implementation of MiFID.

Assessment of Risks faced by Fund Administrators

In August 2006, we conducted a survey of all firms authorised to conduct fund administration in Ireland. The purpose of the survey was twofold. In recognition of the substantial growth of the funds industry in Ireland in recent years, we sought to gain a better understanding of the current status of the industry as a whole, and in particular of the size of the hedge fund sector, and secondly, to assess the nature and type of risks that firms are faced with within this industry on a day-to-day basis.

The results of the survey noted that total assets under administration (AUM) were now at €1.25 trillion, which was split between traditional funds of €780 billion and hedge funds €470 billion. The average growth rate of AUM over the last few years was 25%. Concerns were noted on the capacity of firms to continue to service this level of growth in the future. Total staff employed in this sector is about 6,800, which represents an increase of 17% year-on-year. Concern was also noted on the high level of staff attrition which was high in certain areas. Mitigants used by firms to manage these risks, include the establishment of new offices outside of Dublin, increased use of technology and also the outsourcing of certain processes to other parts of the Group outside of Ireland.

Investor Compensation Review

Following on from the collapse of W&R Morrogh Stockbrokers in April 2001 and the subsequent lengthy legal proceedings, the Minister for Finance established the Morrogh Working Group in March 2004 on which we were represented. The Final Report of the Working Group which was published in October 2006 made recommendations centred on legislative change in respect of compensation funding. We are providing assistance to the Department of Finance on the implementation of those recommendations relating to legislative and financial regulation issues.

Insurance Guarantee Schemes

The European Commission has appointed consultants to undertake a study of insurance guarantee schemes in the EU so as to provide comparative analysis of existing schemes, an analysis of problems and an evaluation of options and the feasibility of these options.

3.5 Markets Supervision

Our approach to securities supervision is focused on four key areas:

- ▶ Markets Governance, which deals with governance, controls and also prudential supervision of the Irish Stock Exchange and FINEX Europe;
- ▶ Regulatory Disclosures, which deal with the approval and publication of information that firms offering regulated securities are required to publish;
- ▶ Regulated Transactions, which involve building a new system to monitor trading in securities, mainly those listed on an Irish or other European regulated market; and
- ▶ Investigations, which will involve an increased role in the examination of selected transactions to see if any evidence exists of abuse of the market place.

Regulatory Disclosures - Prospectuses

We approve and publish prospectuses for a broad range of equity, debt instruments and funds (Table 3.3 refers). Box 3.4 describes the prospectus approval process. Substantial tasks in the early stages of this process are currently conducted for us by the Irish Stock Exchange (ISE). We have in place arrangements for regular meetings to manage this delegation agreement with the ISE. We also work very closely with the ISE to resolve issues of interpretation of the regulatory requirements and to ensure timely and orderly publication of prospectuses. The prospectus section of our website is now a key resource available for investors and others seeking authoritative information on the terms and conditions on which securities are offered for sale in Ireland. Among the highlights of our work during the year was the approval of the offer documents for the flotation of Aer Lingus Group plc as complying with the requirements of Prospectus law.

Table 3.3 - Performance of functions under the EU Prospectus Regulations for 2006

Number of documents approved	2,687
Number of documents/notifications published	3,940
Outward passporting notifications processed	362
Inward passporting notifications processed	340
Number of applications being scrutinised as at period end	585

The difference between the number of documents that have been approved to date and the number of documents that have been published on our website relates to (i) Registration Documents that have been approved by us but which will not be published until such time as we receive and approve accompanying Securities Notes (ii) Final Terms and Annual Information Reports (which do not require approval) that have been filed with us and published on our website and (iii) notifications in respect of prospectuses which have been approved by the Competent Authority of another Member State and which are then passported into Ireland and do not require the approval of the Financial Regulator.

Our work on prospectus approval also involves our attendance at a broad range of meetings at EU level, where we seek to resolve issues of prospectus law and practice to ensure that issuers can proceed promptly with offers on terms that comply with consistently high regulatory standards across Europe, but without any national obstacles to the selling of those securities.

Box 3.4 - Prospectus Approval Process

The Prospectus (Directive 2003/71/EC) Regulations 2005 (the Regulation) came into force on 1 July 2005. The Regulation implemented into Irish law the EU Prospectus Directive (the Directive). We have been appointed the competent authority for the purposes of the Regulation. We have chosen to exercise certain of our functions as competent authority under the Regulation by delegating certain tasks to the Irish Stock Exchange Limited (the ISE).

One of the competent authority functions we carry out is the approval of prospectus documents. From 1 July 2005 to 31 December 2006, we approved 3,573 prospectus documents as meeting the requirements of the Regulation and Commission Regulation (EC) No 809/2004 (the Prospectus Regulation). The process of approving a prospectus is set out below:

Box 3.4 - Prospectus Approval Process (contd.)

- ▶ A draft of the prospectus is submitted to the ISE by the issuer, offeror or person seeking admission to trading on a regulated market, or its agent (the relevant person).
- ▶ The ISE scrutinises the first draft of the prospectus in its entirety and reverts to the relevant person with comments. The scrutiny process is undertaken to determine whether the prospectus complies with the Regulation and the Prospectus Regulation.
- ▶ Any significant issues arising as part of the scrutiny process are brought to our attention, usually by the ISE, for adjudication. We assess and adjudicate on the issues, having made any necessary enquiries, and notify the ISE of our decision.
- ▶ As part of the scrutiny process, the ISE assesses applications for omission of information from a prospectus and communicates its assessment to us. We assess and adjudicate on the matter and notify the ISE and the relevant person of our decision.
- ▶ On completion of the scrutiny process, the ISE provides us with the final prospectus and a letter of comfort concerning compliance with the Regulation and the Prospectus Regulation.
- ▶ Having considered the request for approval, we communicate our decision to the ISE and in writing to the registered office of the relevant person.
- ▶ Following approval of the prospectus, we publish an electronic copy of the prospectus on our website. Where a relevant person does not wish to have the prospectus published on our website the relevant person must request non-publication in compliance with our Prospectus Rules.

We process certain other documents relating to approved prospectuses and, where applicable, publish these documents on our website.

An example of the kind of issue pursued by us during the year was the question of Employee Share Ownership Plans ('ESOP'). Due to an anomaly in prospectus law as currently drafted, financial service providers wishing to operate an ESOP where the firm does not have securities admitted to trading on an EU regulated market can be subject to inappropriate requirements. This is the situation even where financial service providers are admitted to trading on a non-European stock market. There are two elements to our approach to this issue. Firstly, we try to support issuers by guiding their legal advisers towards the key considerations so those legal advisers can provide the issuers with as much legal certainty as possible about their position. Secondly, we also support the officials of the Department of Finance at EU level in seeking to have the provisions amended.

Box 3.5 - International Cooperation

The Prospectus & Transparency Directive requires that a prospectus must include audited historical financial information. In the case of EU issuers of equity, retail or wholesale debt, the general principle is that such financial information must be prepared according to International Financial Reporting Standards (IFRS). This has caused a problem for third country issuers who have not yet signed up fully to IFRS - mainly in our case, issuers from the US and Japan. The European Commission has put in place a transitional arrangement to allow time for convergence of third country General Accepted Accounting Principles (GAAP) with IFRS. Similar arrangements will apply to periodic reporting under the Transparency Directive.

In 2006, we also participated in a substantial EU-wide review of how Prospectus Law has been implemented in the different EU countries. This was organised by the Committee of European Securities Regulators; the summary results will be published on their website in due course.

Transaction Monitoring

An important part of our work in the latter half of 2006, was the series of 'best practice' visits to securities markets regulators in other European countries to review how they supervise securities markets transactions. This work was essential to inform our work in 2007 with the CBFSAI Information Systems Department to build a securities market monitoring system. We also established a transaction reporting working group with the financial industry in August. This group has provided valuable feedback from industry on key decisions being taken on the form and content of the transaction report which will have to be made on each securities transaction.

Investigations - Market Abuse

We work closely with the ISE on the investigation of transactions and other matters where there is a possibility that a provision of market abuse law may have been breached. Table 3.4 refers. Most initial investigations do not unveil abuses of the market. It is often the case that there is a perfectly innocent explanation for a market anomaly which drew our attention or that of the ISE. It is also the case that the law on insider dealings has, traditionally, imposed a high standard of proof that can be difficult to meet. However, the transaction monitoring system we are at present building along with our administrative sanctions regime for securities, combined with the 2005 changes in market abuse law, will in due course provide a significant additional safeguard for investors in securities. This is particularly appropriate as the markets become more complex and provide many different ways to invest.

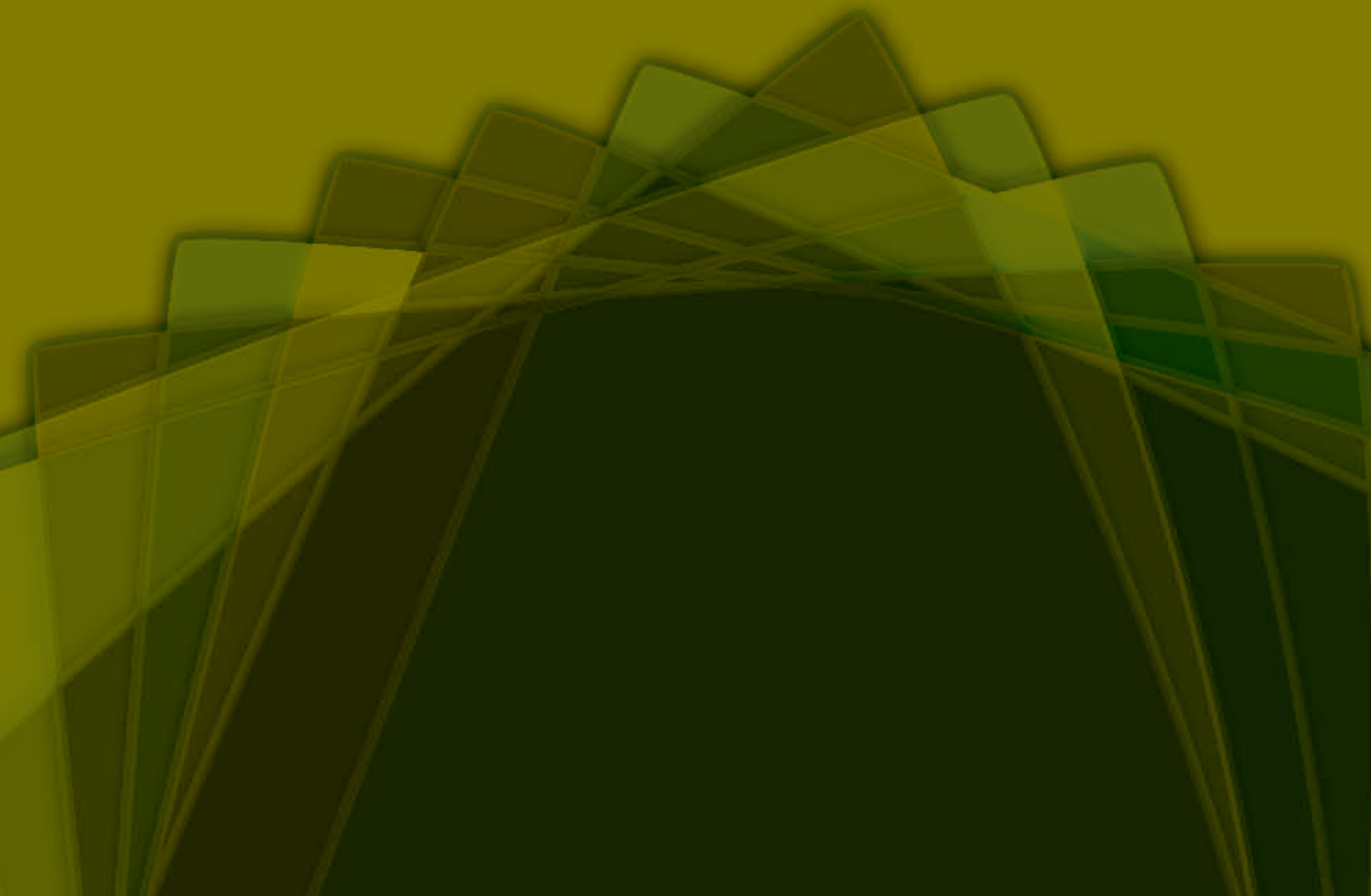
The number of queries from other regulators that need to be followed up and the range of international meetings to be attended impose heavy demands on resources. However, ultimately, international cooperation is the key to successful securities regulation in the increasingly internationalised securities markets. In this context we participated in a comprehensive EU-wide review of Market Abuse Law conducted under the imprimatur of the Committee of European Securities Regulators, the summary results of which will be published on their website in due course. We will continue to work during 2007 to develop our capacity in this area to take full advantage, in 2008, of our new transaction monitoring system, once it has been built.

Table 3.4 - Performance of functions under the EU Market Abuse Regulations for 2006

Enquiries initiated regarding possible contraventions	16
Suspicious Transaction Reports submitted to the Financial Regulator by persons professionally arranging transactions	4
Suspicious Transaction Reports submitted to the Financial Regulator by other EU Competent Authorities.	1
Suspicious Transaction Reports transmitted by the Financial Regulator to EU Competent Authorities.	2
Assistance rendered to other EU Competent Authorities	21
Stabilisation notifications submitted to the Financial Regulator	12

Chapter 4

Regulating Credit Unions



Registrar of Credit Unions' Statement



*Brendan Logue
Registrar of
Credit Unions*

During 2006, the credit union sector continued the steady growth pattern of recent years. Total assets at 31 December 2006 amounted to €14.4 billion, representing a growth of 11 % on 2005. Members' savings grew to €12.7 billion (including SSIAAs) at the year end. This growth is reflective of the commitment of the many volunteers who are at the heart of the movement as well as their professional staff.

Extensive and ongoing consultation and communication with the credit union representative associations continues to be an important part of our activities. The associations play an influential and active part in the life of the movement. Our contacts in this regard are mainly with the Irish League of Credit Unions (ILCU), the Credit Union Development Association (CUDA), the Credit Union Managers Association (CUMA) and the National Supervisors' Forum (NSF). We also work closely with the Credit Union Advisory Committee (CUAC), a statutory committee whose role is to advise the Minister for Finance on policy matters relevant to credit unions.

During the year considerable progress was made in developing the system for the regulation of credit unions with a view to building compliance. The new Prudential Return and Annual Return reporting systems have been further bedded in and are providing key information for regulatory purposes.

In January 2006, the board of the ILCU approved a proposal to reform the structure of the existing Savings Protection Scheme (SPS) which they are seeking to have approved in accordance with the provisions of Section 46 of the Credit Union Act 1997, as amended (the Act). We have been engaged in a series of discussions with the ILCU to establish if this will be possible and, if so, the terms and conditions that will attach thereto. We regard the creation of an SPS, which commands the support of all interests in the sector, as an important objective.

A number of significant initiatives took place in 2006. We streamlined and standardised the process for approval of additional services offered by credit unions. We updated our website so that any Guidance Notes and Newsletters we issue can be downloaded electronically. We also completed the rollout of the web-based Prudential Return to all credit unions.

An agreement was also reached with the sector, following meetings which were chaired by the Department of Finance, which will allow qualifying credit unions to extend the percentage of loans which can be issued for longer terms. This agreement followed a recommendation by CUAC in August 2006 and was approved by the Minister for Finance in February 2007.

Although progress has been made by credit unions in adapting to the more competitive financial services environment, important challenges still exist for the sector. The attraction of appropriately qualified volunteers to credit unions and the modernisation of the statutory governance structures within which they operate are topics which will need to be addressed if the movement is to continue to thrive in the future. In this regard we have, at the request of the Minister for Finance, engaged with the credit union movement to find common ground in relation to the principles that might guide reform of the regulatory framework.

In the course of 2006 two important strategy documents were published. In March the Rationalisation Committee of the ILCU published its report pointing the way forward for the rationalisation of credit unions into more efficient and cost effective groupings. In November CUDA issued its strategy "A Call to Action" which outlines the challenges facing the movement. Both documents are seminal works as they identify an agenda for modernisation of the sector and we commend both ILCU and CUDA for these initiatives.

As credit unions now hold €7.3 billion of members' funds in the form of investments we are anxious to ensure that no undue risks arise in respect of such funds. In October 2006, following an extensive period of consultation with the representative associations, the Department of Finance, and CUAC, we issued a Guidance Note on the classes of investment instruments which are suitable for credit unions to use for the investment of surplus funds. It would be our intention to further develop this Guidance Note, in due course, when its operation has been evaluated.

We are also seeking to enhance awareness among credit union boards of the need for improved governance in the lending and credit control functions. We intend to issue a Guidance Note on credit later in 2007 to assist boards and the relevant committees in operating this function to the highest possible standards.

There is general agreement among the movement's stakeholders that the technology capability of credit unions needs to be upgraded so as to provide a national platform to enhance services to members. We meet regularly with the representative associations, the Credit Union Technology Suppliers Forum and the various service providers in order to monitor the proposed initiatives on technology. We would encourage credit unions actively to support properly structured technology initiatives for the wellbeing and efficiency of their activities and to ensure their continued relevance in the modern financial services environment.

The Credit Union Act and our Strategic Plan for the years 2007-2009 set out our obligations and priorities. Central to our activities is the protection of members' interests and particularly those of savers. We remain committed to these policies so as to facilitate the continued development of credit unions in a prudent fashion.

Finally, I would like to thank the staff in the Registry of Credit Unions for their contribution and ongoing commitment to achieving our strategic objectives.



Brendan F Logue
Registrar of Credit Unions



Lordship Credit Union, Co Louth

4.1 Inspection of Credit Unions

A total of 428 credit unions were registered at the end of 2006. Of these 422 are active and submitted Annual Returns. A total of 289 credit unions were inspected or visited during the year including some unscheduled inspections (Table 4.1 refers). Specialist external accountants were appointed to investigate the affairs of 3 credit unions. Inspections are an important part of our supervisory process. We will continue to carry out a range of inspections across all credit unions in order to ensure compliance with regulatory requirements. In 2006, loan quality was a subject on which we expressed concerns. In a number of cases, we noted the requirement for additional provisions for bad and doubtful debts.

Table 4.1 - Inspections / Visits to Credit Unions		
Theme	2005	2006
Corporate Governance	-	22
Arrears and Provisioning	-	11
Credit Policy	24	-
Information Technology	24	-
Special / Unscheduled	15	8
Review Meetings	-	5
Prudential Return Development	179	243
Total	242	289

4.2 Communicating with Credit Unions

A constant line of formal and informal communication was maintained during the year with credit unions via their representative associations and executives. The details of the formal meetings are set out in Table 4.2.

Table 4.2 - Meetings with Credit Union Representative Bodies		
Association / Group	No. of meetings	
Theme	2005	2006
Irish League of Credit Unions	17	19
Credit Union Development Association	6	5
National Supervisors Forum	3	3
Credit Union Managers Association	1	1
Credit Union Advisory Committee	2	3
Total	29	31

In addition we attended the Consultative General Meeting of the ILCU and attended and addressed the Annual General Meetings of the CUDA and the NSF. We also published our Newsletter, RCU News, which keeps credit unions and their members up to date on regulatory developments.

In June 2006 we attended the Summer School in UCC for students pursuing the Diploma in Credit Union Studies and the Registrar addressed the delegates on the future direction of the credit union sector.

The Annual World Council of Credit Unions conference was held in Dublin from 27 to 30 July 2006. The Chief Executive of the Financial Regulator addressed the conference and discussed some of the challenges that lie ahead for both the Financial Regulator and credit unions. The Registrar also attended the conference and facilitated a round table discussion for international Credit Union Regulators. The success of the conference was clear in that it attracted more than 1,700 participants from over 40 countries.

We also updated our website so that any Guidance Notes and Newsletters we issue can be downloaded electronically. These are now available in the 'Credit Union' section of the Financial Regulator website under 'Publications and Relevant Legislation'. In the future we will expand this section to include other documents relevant to credit unions such as additional services application form.

4.3 New Annual Return and Prudential Return

The statutory annual reporting process for credit unions was revised for the year ended September 2005 with the launch of the credit union Annual Return. This enhancement to the reporting process was widely welcomed by the sector. We were able to measure the tangible benefits of the enhancements in 2006 by the significant reduction in the number of returns that we were required to send back to credit unions. Only 8 returns were sent back to credit unions for correction or further information in 2006 compared to 329 in 2005.

The rollout of the new web-based Prudential Return, which was initiated in 2005, was successfully completed during 2006. All credit unions were visited during this implementation process and now submit the Prudential Return to us either quarterly or bi-annually in accordance with requirements. The Prudential Return facilitates the submission of key information to us in a timely manner and is an important tool in directing our risk-based approach to the supervision of credit unions. The Prudential Return is also of benefit to credit unions in that regular and relevant financial information is available to assist boards and management in running their business, while each credit union can monitor its own compliance with regulatory requirements.

We are pleased with the level of compliance by credit unions in the submission of Prudential Returns and believe that this is due to the relative simplicity of the reporting requirements, the understanding by credit unions of the benefits of this return and the back-up support provided through the lo-call help-line.

We processed over 1,500 returns during the course of 2006 as a result of the new web-based Prudential Return and Credit Union Annual Return. Details of the Prudential Return roll out are summarised in Table 4.3

Table 4.3 - Roll out of the Prudential Return

Quarter ended	No. of active Credit Unions submitting Prudential Returns
31 March 2006	179
30 June 2006	412
30 September 2006	322
31 December 2006	422

Credit unions are required to submit the Prudential Return on a quarterly basis throughout the year. However, in accordance with our risk based approach to supervision and in order to ensure the administrative burden on credit unions and volunteers remains at a minimum, we have exempted 100 of the smaller credit unions from submitting returns at the March and September quarter ends.

4.4 Approval of Additional Services

During 2006 we continued our work in facilitating credit unions to develop the range of additional services which they may offer to their members in accordance with the provisions of Sections 48-52 of the Act. We streamlined and standardised the approval process for additional services to make it less burdensome for credit unions. In particular we worked on developing a simplified model for the approval of credit unions to provide mortgage services to their members on a tied agency basis. A standard application form and rule change have been developed in order to make it easier for credit unions to apply.

26 credit unions received a positive preliminary view in 2006 for the provision of mortgage services on a tied agency basis. In addition, credit unions need apply only to the Registrar for approval to provide mortgage services under this new model and do not need to apply to other departments within the Financial Regulator for any further authorisations.

4.5 Additional Services - Exemption for Personal Retirement Savings Accounts (PRSAs)

In March 2007, following consultation with the Registrar and other interested parties during 2006 and early 2007, the Minister for Finance signed into law a Statutory Instrument (SI) in respect of PRSAs. The SI provides credit unions with an exemption from applying to the Registrar, under the additional services provisions of the Act, if a member wishes to be introduced by the credit union to the provider of a PRSA for advice on such an investment. This exemption is subject to certain conditions.

4.6 Changes in Legislation

In August 2006, following consultation with the Registrar, the Minister for Finance increased the value of deposits that a credit union may hold from 75% of its shares to 100% of its shares. He also increased the amount any member may hold on deposit in a credit union from €26,000 to €100,000. The combined value of shares and deposits which a member may hold was also increased from €64,000 to €200,000 or 1% of the total assets of the credit union, whichever is the greater.

In October 2006, the Minister increased the prescribed limits for nominations under Section 21 whereby a member may nominate a person(s) to become entitled to their funds held in the credit union at the time of their death. The Minister also increased the limits in relation to the provision for small payments on death under Section 23 of the Act. The new regulations implement the recommendation of CUAC to increase the limits for nominations under Section 21 from €13,000 to €23,000 and for small payments on death under Section 23 from €6,400 to €15,000.

4.7 Increase in Longer Term Lending Limits

During 2006 the Minister, on the recommendation of CUAC, appointed a Review Group comprising representatives from the office of the Registrar, the ILCU and the CUDA to review the longer term lending limits as provided for by Section 35 of the Act. The Minister for Finance published the Report of this Group in February 2007.

The Group recommended that Section 35 lending limits should be increased for those credit unions that meet certain regulatory ratios and who confirm to the Registrar, by a board of directors' statement, that the credit union has the necessary controls and safeguards in place to deal appropriately with increased longer-term lending. Where we approve the board statement, individual credit unions will be authorised to lend up to new increased Section 35 lending limits, as follows:

- ▶ over five years from 20% to 40% of total loans outstanding;
- ▶ over ten years from 10% to 15% of total loans outstanding.

The outcome of the report is in line with our stated desire that any regulatory changes which allow credit unions take on greater risk must be underpinned by an appropriate prudential framework to protect members' funds. On 26 April 2007 the Minister issued a Statutory Instrument which implements the new lending limits for credit unions where written approval is received from us. In consultation with the representative bodies we are developing an explanatory note to assist credit unions that wish to apply to us for approval to lend in accordance with the new lending limits.

4.8 Guidance issued to Credit Unions

The continuing accumulation by credit unions of funds surplus to loan demand is a matter of ongoing concern for the Registrar. It can be difficult for many credit union volunteers to fully assess the complex investment products that they are being offered.

In October 2006, following extensive consultations with the credit union representative associations, the Department of Finance and other sector representatives, the Registrar issued a Guidance Note on Investments by Credit Unions. The purpose of the Guidance Note is to set out the framework within which credit unions should maintain their liquid assets and manage their surplus funds so that their obligations to members are met. Credit unions will be subject to inspection to check compliance with the Guidance Note.



This Investment Guidance Note became effective from 1 November 2006. All existing fixed-term investments held by credit unions on 31 October 2006 are permitted to run until their maturity date. The Guidance Note will be subject to review in consultation with the stakeholders in the sector and service providers.

We are anxious that there be greater consistency and transparency in the accounting and auditing practices of credit unions. We are currently engaged in discussions with the main accounting bodies with a view to reaching agreement with them on these matters.

4.9 Reform of the Savings Protection Scheme (SPS)

In January 2006 the board of the ILCU approved a proposal to reform the structure of their existing SPS which they are seeking to have approved by the Registrar as provided for under Section 46 of the Act. The Minister for Finance has requested that the potential for recognition of this reformed scheme be fully examined. Discussions between the Registrar and the ILCU are ongoing in order to clarify whether the ILCU's proposed SPS might be approved by the Financial Regulator and, if so, under what conditions.

4.10 Joint Oireachtas Committee

In September 2006 the Registrar attended a hearing of the Joint Oireachtas Committee on Finance and the Public Service. His statement provided the Committee with the background and functions of the Registrar, outlined the considerable growth in the credit union sector and identified challenges facing the credit union business model. The Registrar stated that increased regulatory oversight is required if members' interests are to be safeguarded. This session was also addressed by the President and Chief Executive of the ILCU. At a separate session, the Chief Executive of CUDA made a presentation to the Joint Oireachtas Committee.

Box 4.1 - Working in partnership with the credit union movement

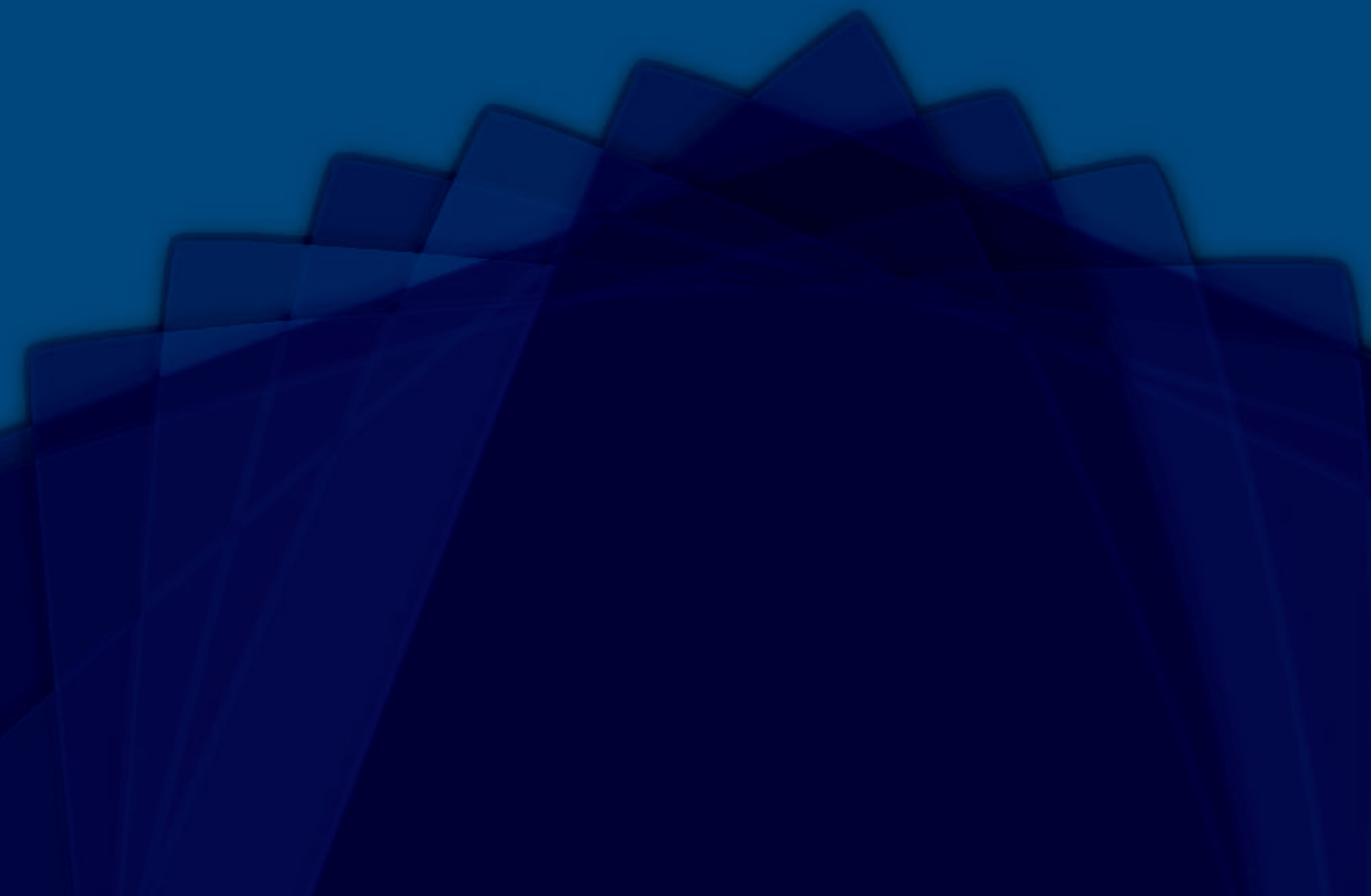
In recognition of the unique nature of credit unions and the key role and significant contribution of volunteers, we employ a considered and differentiated supervisory approach for credit unions. Since our establishment we have worked with credit unions and their representative associations in order to develop an appropriate regulatory regime. In particular we have:

- ▶ Simplified regulatory reporting for credit unions by introducing a web-based Prudential Return and a revised Annual Return;
- ▶ Improved communications with credit unions and their members through the introduction of our newsletter RCU News and the publication of relevant documents on our website;
- ▶ Supported and facilitated the reform of legislation for credit unions in relation to deposit, nomination and lending limits and additional services exemptions;
- ▶ Streamlined and standardised the additional services approval process;
- ▶ Worked with credit unions in difficulty to help them address their problems.

In developing and communicating this regulatory approach we have conducted roadshows, presented at credit union meetings and visited each credit union in the country. We also continue to meet with credit union representative associations and advisory bodies on an ongoing basis. We have found this collaborative approach of consultation and engagement successful to date and will continue to work in partnership with the movement in the future.

Chapter 5

Improving Organisational Efficiency and Effectiveness



Improving Organisational Efficiency and Effectiveness

5.1 International Benchmarking

Two international reviews of our performance were published in 2006.

Prevention of Money Laundering and Terrorist Financing

In February 2006, the Financial Action Task Force (FATF) published the findings of an examination of Ireland's system to combat money laundering and terrorist financing. The overall findings of the evaluation were largely positive. The FATF report stated the Financial Regulator:

- ▶ "applies strict licensing and supervising requirements before authorising financial institutions to become active in Ireland;
- ▶ monitors the fitness and probity of those who manage financial institutions closely; and
- ▶ is adequately structured, funded, staffed and has sufficient operational independence and autonomy to ensure freedom from undue influence or interference".

The full report is available on the FATF's website: www.fatf-gafi.org. Ireland will be required to provide an update to the FATF in February 2008 on how the findings in the evaluation report have been addressed.

Financial System Stability

In July 2006, the International Monetary Fund and the World Bank published their assessment of the stability of Ireland's Financial System. The findings of this assessment were also largely positive. In particular, the IMF stated that:

- ▶ "Good progress has been achieved in strengthening the regulatory and supervisory framework, in line with the recommendations of the assessment that was carried out in 2000; and
- ▶ The strategy of creating a unified approach to risk with common elements across different sectors where appropriate, but differentiated where necessary, is being put into practice well."

The full report is available on the IMF's website: www.imf.org/external/pubs.

International co-operation

In 2006, we hosted information and study visits from officials of the Bank of England, Banking, Finance and Insurance Commission of Belgium, Office of the Superintendent of Financial Institutions (Canada), De Nederlandsche Bank (Netherlands), Finanstilsynet (Denmark), FMA (Austria), Ministries of Finance (Czech Republic, Sweden), and the National Banks of Serbia and Slovenia. The purpose of these visits was to seek information on our approach to financial regulation, including our strategy for consumer protection and prudential supervision, our approach to implementing the Capital Requirements and Reinsurance Directives, performance reporting and the operation of our regulatory structure.

5.2 Improving Efficiency

Information Technology

During 2006 we further developed a number of systems to take account of business changes. We added functionality to our supervision systems in respect of a number of items including the 2006 levy, public enquiries, reinsurance, the Credit Union Annual return and our websites. We also upgraded our IT infrastructure and replaced a number of servers and network devices and upgraded the software to run and manage the network in order to maintain an up to date, secure environment.

We designed an electronic reporting system to be developed over the next number of years, with the first phase implemented in April 2007 to cater for returns due under the Capital Requirements Directive (CRD) from those institutions who elect to move to CRD at that stage. A project to redevelop our consumer website involved significant development work in 2006 and the new site will be launched in mid 2007.

Comptroller and Auditor General Value for Money examination

We co-operated in a Value for Money examination of the Financial Regulator undertaken during 2006 and into 2007 by the Comptroller and Auditor General. The examination focused primarily on the efficiency with which we carry out our functions. The issues addressed included:

- ▶ The implementation of EU Financial Services Action Plan measures, and the timeliness of their translation by us into standards and guidance for financial service providers;
- ▶ The efficiency of the work we carry out to confirm compliance by financial service providers with the relevant standards;
- ▶ The adequacy of systems in place to ensure there is efficient and effective regulation of foreign financial service providers operating in Ireland, and of Irish financial service providers operating abroad;
- ▶ The level of resources applied in regulating each sector; and
- ▶ The extent to which the potential improvements identified in the Value for Money examination in 1999 have been implemented.

The report will be published in 2007.

Internal Audit

Internal Audit services are provided on an organisation-wide basis. In 2006, internal audit work focused on the risks to the achievement of corporate strategic objectives. Exercises undertaken included audits of:

- ▶ Electronic Reporting Project;
- ▶ Supervision Database; and
- ▶ Spreadsheet Development, Use and Maintenance.

A follow-up review of the 2005 audit of arrangements for the calculation and invoicing of the funding levy was also undertaken. Our Audit and Risk Committee have considered the findings and recommendations of the internal audits and we have or are in the process of addressing them. CBFSAI-wide reviews of Training, Operational Risk and of Policy on Countering Fraud were in progress at end year.

Best Practice Visit

As part of our ongoing programme of "best practice" reviews we undertook a series of 'best practice' visits to securities markets regulators in Austria, Portugal and the United Kingdom to review how they supervise securities markets transactions. This work was essential to inform our work in 2007 in developing a securities market monitoring IT system.

Establishment of new Investment Service Providers Supervision and Markets Supervision Departments

A key part of the EU Financial Services Action Plan has been the restructuring of non-fund securities regulation. This has been achieved through four major Directives: the Prospectus and Market Abuse Directives implemented in 2005 and the Transparency and Markets in Financial Instruments Directives to be transposed in 2007.

It became clear that the scale and nature of the work on securities supervision was significantly new and different from our existing regulatory regime and therefore a reorganisation of the Financial Regulator was needed. In May 2006, the Securities and Exchanges Department was reorganised into two separate departments covering the Markets Supervision and Investment Service Providers Supervision.

The new Investment Service Providers Supervision Department is responsible for the ongoing prudential supervision of investment firms, fund service providers, UCITS III management companies, retail intermediaries and funds regulatory reporting. It also has responsibility for the implementation of the prudential aspects of the Markets in Financial Instruments Directive (MiFID) as they relate to investment firms and exercise of the relevant prudential functions of the Financial Regulator arising from implementation except those relating to the authorisation process.

The new Markets Supervision Department is responsible for the supervision of prospectus for securities admitted to trading on regulated markets or offered to the public, regulated market transactions, stock exchange and member firms and Finex. Other responsibilities of the department include implementation of Prospectus, Market Abuse and Transparency Directives and the Market in Financial Instruments Directive as it relates to regulated markets.

Establishment of Planning and Finance and Legal and Enforcement Departments

In order to align better strategic planning and budgeting it was decided to transfer the finance function to a new Department which would have responsibility for both planning and finance. The responsibilities of the Planning and Finance Department include the funding policy and collection of the levy from industry, manpower planning and budgeting, co-ordination of EU issues, public accountability, continuing the programme of organisational development and oversight of services delivery. The Department also provides secretarial support to the Consultative Consumer and Industry Panels.

Towards the end of 2006, we created the position of EU and International Co-ordinator to maintain an overview of developments from EU and International fora. Our Co-ordinator will operate across our Consumer and Prudential Directorates, whilst also working with our Consultative Industry and Consumer Panels. We welcome the Industry Panel's establishment of an EU and International Industry Advisory Group to support this important work.

The Legal and Enforcement Department concentrates on three core activities. Firstly it provides a responsive, cost effective and professional in-house legal advice resource for the Financial Regulator. Secondly it reviews, comments on and, where appropriate, assists in the drafting of legislation in co-operation with relevant Government Departments; it also drafts secondary legislation implemented directly by the Financial Regulator. Finally, the department will be pro-actively involved in Administrative Sanctions and Fitness and Probity cases and will co-ordinate our response to any relevant litigation cases.

Reorganisation of Insurance Supervision Department

In 2006, we reorganised the Insurance Supervision Department by establishing units to manage inspections, financial analysis and off-site review. A reinsurance unit has been created to deal specifically with implementing the recent Reinsurance Directive and bringing reinsurers into the supervisory net. The department is no longer divided into life and non-life divisions, but rather into insurance and reinsurance. This has facilitated the streamlining of processes and enhanced follow up of supervisory issues.

5.3 Human Resource Development

Staffing

Permanent staff numbers increased by 11 (3.1%) to reach 329 at end-December 2006. Table 5.1 below reflects the mid year restructuring of departments with four new departments - Legal and Enforcement, Planning and Finance, Markets Supervision and Investment Service Providers Supervision - being established. As our approved staff complement is 350 for 2006, the recruitment programme to fill the outstanding vacancies will continue during 2007.

Pictured are staff from the Financial Regulator receiving awards from the Association of Compliance Officers in Ireland at its graduation ceremony held in the O'Reilly Hall, UCD, with Chief Executive Patrick Neary and Prudential Director, Con Horan.



31 new staff commenced employment and 15.5 transferred from the Central Bank during 2006. In addition, 24.5 staff resigned, 5 transferred to the Central Bank, 4 took career breaks and 2 retired during the year. Staff turnover in the Financial Regulator continues to compare favourably with turnover rates in the financial services industry. In 2006, turnover of permanent staff was 8.9% compared to 18.25% in the financial services industry generally.

Table 5.1 - Staff Numbers 2005 and 2006

Department	2005	2006
Senior Management	3	3
Registrar of Credit Unions	17	19
Legal and Finance	25	-
Legal and Enforcement	-	13
Consumer Directorate		
Consumer Information	32.5	32
Consumer Protection & Codes	53	50
Planning and Project Co-Ordination Unit	5	-
Planning and Finance Department	-	15
Prudential Directorate		
Banking Supervision	45	49.5
Insurance Supervision	26	30
Financial Institutions & Funds Authorisation	65	64
Securities and Exchanges Supervision	46.5	-
Investment Services Providers Supervision	-	37
Markets Supervision	-	16.5
Overall Total	318	329

Significant progress was made in reviewing and updating a wide range of existing HR policies and procedures during the year. In 2006, the performance management system for management, administrative and professional grades was extended to include all technical and general staff across the organisation. The development of a partnership model, aimed at allowing increased staff participation in change processes will be progressed in line with the Employees (Provision of Information and Consultation) Act 2006. A range of flexible and atypical working arrangements such as job-sharing, part-time work, career break, special leave and short-term contracts are available to staff. At end 2006, there were 33 staff availing of atypical working arrangements.

Training and Development

We attach huge importance to developing an adaptable, flexible and efficient organisation with motivated and skilled staff. In 2006, we provided a wide range of staff development courses, including leadership, management and relationship development skills. Acquisition of technical skills was also a major focus of the training programme. The Academic and Professional Training Scheme continued to provide staff with the opportunity to pursue further studies. Table 5.2 refers.

Table 5.2 - Training Statistics 2006

Staff who hold 3rd level qualification	287.00
Of which, qualifications held are at degree level or higher	272.00
Staff pursuing 3rd level qualifications	32.00
Staff pursuing technical certificates	73.00
Total training hours	8,302.00
Training Hours per full time equivalent	25.20

We developed and implemented staff training programmes and organised lectures on key regulatory developments, such as the new Fitness and Probity regime. We sought to develop and enhance key management skills amongst staff through the implementation of a project management training programme. In late 2006, we initiated the development of a new modular approach to training and have engaged an external training expert to assist in the development of a curriculum based training programme for staff.

In order to broaden the knowledge and improve the skills of our staff we have arranged three staff exchanges with other financial regulators and relevant organisations. Table 5.3 gives details of these secondments.

Table 5.3 - Secondment of staff 2006

Department	Secondment to	Time Period
Banking	European Commission	2 Years
Insurance	Accountancy/Auditing firm	6 months
	Secondment from	
Consumer Information	Australian Securities and Investments Commission	1 year

5.4 Public Accountability

Strategic Planning

The principal objective of our 3-year Strategic Plan 2004 - 2006 was to develop the regulatory system for financial services. Our Strategic Plan for 2006 outlined our priorities to complete this process and specified the detailed actions we proposed to take. This Annual Report describes our performance in this regard. Overall we consider that we have made good progress towards completing this work. Appendix 5 provides details of the progress made during 2006 vis-à-vis our strategic commitments.

This plan also describes the principles which guide our regulatory approach. The Strategic Plan was developed in consultation with both the Consumer and Industry Panels.

On 16 November 2006, we published a new 3-year Strategic Plan for the period 2007-2009 and set ourselves five high level goals:

- ▶ We will set and monitor standards for financial service providers in dealing with their customers;
- ▶ We will set and monitor standards for the running of sound financial service providers and fair markets;
- ▶ We will provide relevant information to consumers;
- ▶ Our regulatory approach will facilitate innovation and competitiveness; and
- ▶ We will maximise our operational efficiency and cost effectiveness.

Oireachtas and EU hearings

During 2006, we appeared before three Oireachtas Committees and two European Parliamentary hearings. Details of these hearings are outlined in Table 5.4.

Committee	Subject	Month	Attendees
Joint Committee on Finance and the Public Service	Endowment Mortgage Survey and Equity Release	January	Chief Executive, Consumer Director.
Joint Committee on Small Business and Enterprise	Reform of the Irish Insurance Market	May	Chief Executive, Prudential Director, Deputy Head of Insurance Supervision.
Joint Committee on Finance and the Public Service	Regulation of Credit Unions	September	Registrar of Credit Unions.
EU Parliamentary Committee (Brussels)	Equitable Life	June	Consumer Director, Heads of Consumer Protection Codes and Insurance Supervision Departments.
EU Parliamentary Committee Hearing (Dublin)	Equitable Life	October	Consumer Director and Head of Insurance Supervision.

Insurance Statistical Review

The Insurance Statistical Review for 2005, which gives a detailed breakdown of insurance industry statistics, was published in August 2006. It is intended, with the continued cooperation of insurance companies, to press for earlier publication in 2007.

Official Languages Act

In March 2006, the Central Bank and Financial Services Authority of Ireland was requested by the Minister for Community, Rural and Gaeltacht Affairs to prepare a Scheme under the Official Languages Act. The primary objective of our Scheme is to ensure better availability and a higher standard of public services through Irish. The Scheme commenced on 1 December 2006 and outlines the services in Irish we have agreed to provide to the general public, over the next three years, in addition to those services we already provide in Irish.

We are committed not only to maintaining the level of services currently available through Irish and bilingually; including our signage, consumer guides and Annual Report, but also to enhancing the level of service we provide to the general public. During the lifetime of the Scheme, we will enhance our services to include Irish speaking contacts on our consumer helpline, switchboard and reception and we will increase the number of press releases published in Irish. We are also commissioning further development of our consumer website, www.itsyourmoney.ie and this planned re-development, including interactive systems, will have a bilingual capability built in with the intention of providing certain content in the Irish language within the life of the Scheme. Full details of our commitments under the Act are available in the publications area of www.financialregulator.ie.

5.5 Improving our relationship with Stakeholders

Protocol for consumer focused intermediary inspections

In conjunction with the relevant intermediary representative bodies, we drew up a protocol on the conduct of consumer focused inspections for investment / insurance and mortgage intermediary firms. This protocol, which sets out what an intermediary firm can expect from an inspection in the normal course of events, was developed in order to bring clarity to this sector on the process of how these inspections are conducted. It became effective from 1 November 2006 and is available at www.financialregulator.ie.

Stakeholder Protocol

Following consultation with the Consultative Consumer and Industry Panels and various representative bodies, we decided to develop a Stakeholder Protocol in relation to certain key interactions with the public and industry. After an initial workshop, which was held in July 2006, four themed workshops were held with representative bodies during October 2006 to develop the contents of the Stakeholder Protocol. In addition, two internal workshops were held with the staff of the Financial Regulator. Comments were also solicited from interested parties through a consultation paper and through our Regulatory Connection eZine. The Stakeholder Protocol becomes effective on 2 July 2007. This Stakeholder Protocol is a statement describing the targets which we aim to deliver to our stakeholders and which will help us achieve our purpose and high-level goals. It includes targets relating to the interactions with our organisation for authorisation, inspections, consultation and prospectus approval processes. It complements our consumer focused intermediaries inspections protocol.

Pictured at the FSI "Regulation 360" Conference which was held in November are Patrick Neary, Chief Executive of the Financial Regulator, who gave an address, are (l-r) James Deeny, Chairman of the Financial Services Consultative Industry Panel, Denis Casey, FSI Chairman & CEO of Permanent TSB, Aileen O'Donoghue, Director, Financial Services Ireland, & Dermot Gleeson S.C. Chairman of AIB.



An integral part of our approach to regulatory development is to engage with our stakeholders so that issues can be discussed with us. During the year senior executives met with representative bodies, other regulators and financial services providers. The meetings involved are detailed in Table 5.5.

Table 5.5 - Meeting with Stakeholders.		
Meetings involving the Chief Executive, Consumer and Prudential Directors	Number of Meetings	
	2005	2006
Financial Service Providers	95	64
Representative Bodies (Consumer and Industry)	84	76
Government and other Regulators	45	20
Consultative Consumer and Industry Panels	15	28
IFSC Clearing House Group	6	4
Total	245	192
Of which Conferences	11	11

Our senior executives and staff also participated in external conferences, met with the media and made presentations to industry and consumer groups on a range of regulatory issues. Presentations were also given to schools about the Financial Regulator during visits to the organisation.

Media Relations

Media interest in our work remained high in 2006 with a total of 766 queries handled, 131 interviews undertaken and 52 news items and press releases published on our website (See Table 5.6). Major communications initiatives undertaken during the year included the launch of our Strategic Plan for 2007-2009, a campaign targeted at SSIA holders commencing with the publication of the Little Black Book on SSIA's, messages on personal debt and a Motor Pack targeted at car owners. Full details of these campaigns can be found in Chapter 2.

Regulatory policy initiatives and announcements were detailed in 4 issues of our industry eZine - Regulatory Connection and 1 issue of our credit union newsletter - RCU News.

Table 5.6 - Media Contract		
Category	2005	2006
Media Queries Handled	835	766
Media Interviews	126	131
Press Releases/News items published	44	52
Total	1,005	949

Chapter 6

Financial Review



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6.1 Introduction

The Financial Regulator has systems in place for preparing the annual estimate of income and expenditure in accordance with legislative requirements and for the monitoring and reporting on actual expenditure on a regular basis. Our annual statement of estimated income and expenditure for 2006 was submitted to the Minister for Finance in accordance with the legislative requirements.

The Financial Regulator is responsible for keeping books and records that properly record and explain the Financial Regulator's transactions. We assisted the CBFSAI in the preparation of its statement of accounts and have decided to publish the further statement of our income and expenditure contained in this annual report.

6.2 Commentary on Income

The funding levy raised €21.4 million from industry in 2006. In line with our stated policy we aim to maintain the levy at approximately 50 per cent of our budget with the balance of the total annual costs being provided by the CBFSAI in accordance with Section 33(L) of the Central Bank Act, 1942 (as inserted by Section 26 of the Central Bank and Financial Services Authority of Ireland Act, 2003). In 2006, the CBFSAI, with the approval of the Minister for Finance, bore the full cost of certain securities market supervision activities carried out within the Financial Regulator. These costs totalling €1,393,835 were excluded from the Net Industry Funding levies issued in 2006.

The Regulations, detailing the levy amounts payable for 2006, were made on 24 July 2006. The 2006 levy calculations were based on an allocation of the Financial Regulator's 2006 budget, the methodology of which was subjected to an independent review by Deloitte & Touche; no issues arose from this review. Overall there was a high level of compliance with the Regulations in 2006 with the majority of regulated financial service providers paying the levy on a timely basis. An amount of €350,000 has been charged to the Income & Expenditure Account in 2006 to cover amounts written-off during the year and amounts remaining unpaid as at 31 March 2007.

6.3 Commentary on Expenditure

Total expenditure for the year ended 31 December 2006, which comprises direct and indirect costs, amounted to €45.7 million. This compares with a budgeted figure for the year of €48.6 million. Table 6.1 below analyses total expenditure of the Prudential and Consumer Directorates and the Office of the Registrar of Credit Unions.

Table 6.1 - Analysis of Expenditure by Directorate				
	Prudential Directorate	Consumer Directorate	Registrar of Credit Unions	Total
	€'000	€'000	€'000	€'000
Salaries /PRSI	12,520	5,366	1,361	19,247
Pension	1,778	762	193	2,733
Staff Expenses	14,298	6,128	1,554	21,980
Non-Pay Operating Expenses	1,300	3,631	303	5,234
Total Direct Expenses	15,598	9,759	1,857	27,214
Financial Regulator Support Departments (1)	4,026	1,777	273	6,076
Shared Services (2)	7,725	3,833	827	12,385
Total Direct Expenses & Shared Services	27,349	15,369	2,957	45,675

(1) This represents direct costs of Financial Regulator support departments of €4.255 million, together with €1.821 million of the shared services costs for services received from the CBFSAI which have been allocated to the support departments of the Financial Regulator.

(2) This represents the amount of shared services costs allocated directly to the three divisions. Total shared services costs for services received from the CBFSAI amounted to €14.206 million; the balance of €1.821 million has been allocated to Financial Regulator support departments - see note 1 above.

The process of allocating budgeted costs to each directorate takes into account the direct costs (pay, pension and non-pay) of each directorate.

Financial Regulator direct costs which cannot be directly allocated to a directorate (e.g. Financial Regulator support costs such as Legal, Planning and Finance etc) have been determined by the application of a cost allocation methodology, which has been reviewed by independent external consultants.

Total expenditure for the year ended 31 December 2006 was below budget due to staff numbers continuing to be lower than budgeted. In spite of the charge for provisions and write-offs in 2006, the total amount collected from industry was in excess of the 2006 funding requirement, because of the lower than budgeted expenditure. The 2007 levies calculation has been adjusted to take account of the excess of income over expenditure for the year ended 31 December 2006.

Non-pay operating expenses were below budget due mainly to factors such as changes in our publication policy since the budget was drawn up, which resulted in a number of documents not being published in paper format, a reduction in the number of warning notices which required publication, the outcome of more effective negotiations with publishers, lower than budgeted staff related expenses such as travel, training and office systems and a deferral of a number of consultancy projects.

Expenditure on shared services and depreciation was also below budget arising from a combination of factors including lower than budgeted staff numbers, the deferral of a number of projects by some shared service departments and refinements to the cost allocation model.

6.4 Statement of Income and Expenditure and Report of Deloitte & Touche

The following section sets out the Statement of Income and Expenditure for the Financial Regulator for the year ended 31 December 2006.

ACCOUNTING POLICIES

(a) Form of Presentation of Income and Expenditure Account

The Financial Regulator is a constituent part of the CBFSAI. It does not have either assets or liabilities of its own and accordingly it is not considered appropriate to produce either a balance sheet or cash flow statement.

The Statement of Income and Expenditure has been prepared (i) on the historical cost basis of accounting and (ii) in accordance with accounting standards generally accepted in Ireland in so far as they are applicable to the structure of the Financial Regulator. Accounting standards generally accepted in Ireland in preparing accounts giving a true and fair view are those published by the Institute of Chartered Accountants in Ireland and issued by the Accounting Standards Board.

The accounting unit is the euro.

(b) Income Recognition

The accruals concept in accounting for income and expenses has been adopted.

(c) Superannuation

The employment contracts of staff appointed by the Financial Regulator are with the CBFSAI. Under the CBFSAI's superannuation scheme permanent staff obtain the same superannuation benefits as established civil servants. The CBFSAI pays these benefits out of current income as they fall due. For the year ended 31 December 2006 the CBFSAI has adopted Financial Reporting Standard ("FRS") 17 "Retirement Benefits" in full, recognising the cost of providing pensions over the period during which it benefits from the employees services. See also Accounting Policy (d) and Note 34 of the Statement of Accounts of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2006.

Irish Financial Services Regulatory Authority			
Statement of Income and Expenditure for the year ended 31 December 2006			
	Note	2006	2005
		€000	€000
Industry Funding			
Credit Institutions		7,423	6,713
Insurance Undertakings		4,854	4,270
Intermediaries		2,888	2,954
Securities and Investment Firms		1,445	1,438
Collective Investment Schemes and Service Providers		3,529	3,963
Credit Unions		1,298	1,057
Moneylenders		158	109
Approved Professional Bodies		20	38
Exchanges		101	95
Bureau de Change/Money Transmitters		28	19
Total Funding		21,744	20,656
Less Provision/Write-offs			
		350	290
Net Industry Funding	1	21,394	20,366
Excess of Income over Expenditure c/f from prior year		2,110	1,686
Subvention from Central Bank and Financial Services Authority of Ireland	2	24,364	20,364
		47,868	42,416
Other Income	3	2,887	1,003
Total Income		50,755	43,419
Direct Expenses			
Direct Expenses	4	31,469	26,630
Shared Services	5	14,206	13,676
		45,675	40,306
Other Expenses	3	2,887	1,003
Total Expenses		48,562	41,309
Excess of Income over Expenditure for Year	6	2,193	2,110

NOTES TO THE STATEMENT OF INCOME AND EXPENDITURE

Note 1: Net Industry Funding and Provisioning

Net Industry Funding income is included in the Statement of Accounts of the CBFSAI under Other Income. This figure comprises income from levies imposed upon the above industry categories (net of appeals and adjustments) under the Central Bank Act, 1942 (Sections 33J and 33K), Regulations 2004 (as amended by the 2006 Regulations) and other income in respect of fees and charges. An amount of €350,000 in respect of provision/write-offs has been offset against total funding income to arrive at Net Industry Funding. Outstanding levy amounts are being pursued as part of the ongoing debt recovery process.

The provision/write-offs are as follows:

	2006	2005
	€000	€000
Opening Provision for Unpaid Levy Notices	213	600
Less: Write-Offs 2004 Levy	68	325
Less: Write-Offs 2005 Levy	127	352
Less: Write-Offs 2006 Levy	182	-
Add: Charge to Income & Expenditure Account - Provision/Amounts Written Off	350	290
Closing Provision for Unpaid Levy Notices	186	213

Note 2: Subvention from Central Bank and Financial Services Authority of Ireland

By agreement with the Minister of Finance in April 2004, over the three-year period 2004-2006 approximately 50 per cent of the total costs of the Financial Regulator have been met by the imposition of levies on the industry. The balance of the total annual costs is provided by the CBFSAI in accordance with Section 33(L) of the Central Bank Act, 1942 (as inserted by Section 26 of the Central Bank and Financial Services Authority of Ireland Act, 2003). In 2006, the CBFSAI, with the approval of the Minister for Finance, bore the full cost of certain securities market supervision activities carried out within the Financial Regulator. These costs totalling €1,393,835 were excluded from the Net Industry Funding levies issued to the industry in 2006.

Note 3: Other Income/Other Expenses

In 2006 the Irish Stock Exchange collected €2.89 million in fees payable to the Financial Regulator in accordance with Regulation 109 of the Prospectus (Directive 2003/71/EC) Regulations 2005. In accordance with Part 17(h) of the Prospectus Directive and Market Abuse Directive, delegation agreements entered into by the Financial Regulator with the Irish Stock Exchange, the Financial Regulator confirmed to the Irish Stock Exchange that it could retain the sum of €2.89 million to put towards the costs that it had incurred in undertaking the delegated functions under the delegation agreements.

Note 4 :Direct Expenses

	2006	2005
	€000	€000
Salaries/Allowances	20,498	17,703
PRSI	1,484	1,239
	21,982	18,942
Pension Provision	3,121	2,595
Staff Expenses	25,103	21,537
Training, Recruitment & Other Staff Costs	449	313
Equipment, Stationery and Requisites	414	353
Business Travel	664	727
Publishing & Media Relations	3,016	2,563
Professional Fees	1,669	986
Miscellaneous	154	151
Non-Pay Operating Expenses	6,366	5,093
Direct Expenses	31,469	26,630

Direct expenses (excluding the pension provision of €3.121 million) are included in the Statement of Accounts of the CBFSAI as set out in Note 8 to those accounts.

- (i) Total fees paid to Members of the Financial Regulator in respect of 2006 were €172,083 (2005: €146,185).
- (ii) Auditors' fees payable to Deloitte & Touche in respect of the examination of the Statement of Income and Expenditure of the Financial Regulator amounted to €6,353 (2005: €6,050).
- (iii) Contributions towards legal costs incurred by the Financial Regulator in defending litigation during 2006, which have been received from parties to the litigation, have been set-off in arriving at the total for professional fees.
- (iv) The pension provision represents the estimated actuarial pension costs of the CBFSAI in respect of Financial Regulator staff serving in 2006. This provision does not form part of the CBFSAI's expenses for 2006.

Note 5: Shared Services

Shared services (excluding the pension provision of €1.0 million) are included in the Statement of Accounts of the CBFSAI as set out in Note 8 to those accounts.

The Financial Regulator receives various services including premises, human resources administration, accounting, internal audit, statistical and information technology services from the CBFSAI. The cost of these services in 2006 was €14.2 million (2005: €13.7 million).

The costs involved have been determined by the application of a cost allocation methodology which has previously been reviewed by independent external consultants. Allocation is based on well-recognised industry practice including occupied floor space, PC numbers and headcount (staff numbers) as appropriate. The main components of the above costs are as follows:

	2006	2005
	€000	€000
Corporate Services incl. Premises	6,802	6,173
Information Technology Services	2,655	2,844
Human Resources	2,077	2,127
Other Services	2,672	2,532
Total	14,206	13,676
Other services explained		
Other services include accounting and other administrative services (2006 : €1.3 million; 2005 : €1.1 million), statistical services (2006: €0.4 million; 2005: €0.4 million) and estimated actuarial pensions costs (2006: €1.0 million; 2005: €1.0 million) in respect of Central Bank staff engaged in the provision of services to the Financial Regulator..		

Note 6: Excess of Income over Expenditure

This represents the amount of levies collected from industry in 2006 in excess of the 2006 funding requirement. The 2006 funding requirement is the total of Direct Expenses and Shared Services (€45.675 million) expenditure less the subvention from the CBFSAI. The excess of income over expenditure has been carried forward and the calculation of the amount of industry levies for 2007 has been adjusted to take account of this excess.

Note 7: Superannuation Liabilities

Superannuation liabilities of all staff employed by the CBFSAI are dealt with in Note 34 of the Statement of Accounts of the CBFSAI for the year ended 31 December 2006.

Note 8: Post-Balance Sheet Events

There were no post-balance sheet adjusting events.

Note 9: Approval of Accounts

The Members of the Authority approved the Statement of Income and Expenditure on 30 May 2007.

INDEPENDENT AUDITOR'S STATEMENT TO THE MEMBERS OF THE IRISH FINANCIAL SERVICES REGULATORY AUTHORITY (“THE FINANCIAL REGULATOR”)

We have examined the Statement of Income and Expenditure set out in Section 6.4 of the Financial Regulator's Annual Report for the year ended 31 December 2006.

Respective Responsibilities of Members and Auditors

The Members are responsible for preparing the Statement of Income and Expenditure. Our responsibility is to report to you our opinion on the consistency of the Statement of Income and Expenditure within the Annual Report with the Statement of Income and Expenditure for the Financial Regulator disclosed in the Notes to the Accounts of the full Statement of Accounts of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2006. We also read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Statement of Income and Expenditure.

This statement, including the opinion, has been prepared for and only for the Financial Regulator's members as a body and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this statement is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

Basis of Opinion

We conducted our work in accordance with Bulletin 1999/6 “The auditors' statement on the summary financial statement” issued by the Auditing Practices Board.

Opinion

In our opinion the Statement of Income and Expenditure is consistent with the Statement of Income and Expenditure for the Financial Regulator disclosed in the Notes to the Accounts of the full Statement of Accounts of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2006.

Deloitte & Touche
Chartered Accountants & Registered Auditors
Dublin

13 June 2007

6.5 Review of Cost Allocation Model used by the Financial Regulator

This section contains an overview of the work carried out by Deloitte & Touche on the allocation of Financial Regulator 2006 costs (Outturn) to industry sectors.

This independent report is contained in section 6.6.

Review of Financial Regulator's 2006 Model

Section 33J of the 2003 Act empowers the Chief Executive of the Financial Regulator, with the agreement of the other members of the Authority, to make regulations prescribing levies to be paid by regulated entities to the Financial Regulator.

Under the current levy arrangements, the amounts levied by the Financial Regulator are set by reference to the relevant budgeted costs attributable to each industry category. These costs are determined using a Model developed by the Financial Regulator in conjunction with external consultants (the "Financial Regulator's Model"). The Financial Regulator's Model takes into account the activities involved in supervising each industry category and, in the case of costs which cannot be directly allocated to an industry category, a basis considered appropriate by the Financial Regulator has been used to allocate such costs.

In 2007 Deloitte & Touche were appointed independent reporting accountants to form an independent opinion on the logical integrity, internal consistency and arithmetical accuracy of the formulae, algorithms and calculations contained within the Financial Regulator's Model employed by the Financial Regulator to allocate costs to industry categories and on the application of the Financial Regulator's Model to 2006 actual costs (the "Financial Regulator's 2006 Actual Model") and to report that opinion to the Members of the Authority. A copy of their report, dated 13 June 2007, to the Members of the Authority is included section 6.6.

6.6 Statement of Allocation of Financial Regulator Actual Costs to Industry Sectors

1. Introduction

Section 33J of the Central Bank Act, 1942 ('the Act') as inserted by Section 26 of the Central Bank and Financial Services Authority of Ireland Act, 2003 empowers the Chief Executive of the Irish Financial Services Regulatory Authority ("Financial Regulator"), with the agreement of the other members of the Irish Financial Services Regulatory Authority, to make regulations prescribing levies to be paid by regulated entities to the Financial Regulator.

Each year the Financial Regulator sets the levy by reference to the allocation applicable to industry categories of the Financial Regulator's actual outturn costs for the previous year and the budgeted cost for the forthcoming year.

The 2006 budget model has been re-run using actual costs for 2006 in order to determine the 'actual' costs - the 'outturn'. Note 3 below, sets out the allocation of budgeted and actual costs for the year ended 31 December 2006.

The Outturn was subject to independent assessment by reporting accountants Deloitte & Touche. Their report is set out in section 4 below.

2. Notes to the Statement of allocation of actual costs for the year ended 31 December 2006.

Method of allocation

In setting the annual funding requirement any surplus or deficit from the previous year is offset against the budgeted costs. The resultant amount is allocated across industry categories. There are a total of ten industry categories. The process of allocating costs to each industry category takes into account the activities involved in supervising each industry category. In the case of costs which cannot be directly allocated to an industry category a basis considered appropriate by the Financial Regulator has been used to allocate such costs.

3. Statement of Allocation of Costs for the year to 31 December 2006

	Industry Category	Budget Allocated costs	Actual Allocated costs
		€000	€000
A	Credit Institutions	8,074	7,425
B	Insurance Undertakings	5,176	4,864
C	Intermediaries	2,905	2,514
D	Securities and Investment Firms	1,649	1,621
E	Collective Investment Schemes (“CIS”) and Providers to CIS	3,918	3,884
F	Credit Unions ¹	1,294	1,282
G	Moneylenders	144	130
H	Approved Professional Bodies	27	24
I	Exchanges	132	178
J	Bureau de Change/Money Transmitters	36	23
Total		23,355	21,945

(Category I Exchanges - includes Approved Exchanges authorised under the Stock Exchange Act, 1995 and Financial Futures and Options Exchanges authorised under the Central Bank Act, 1989)

The actual allocated costs detailed above were the result of the application of the actual costs for 2006 to the cost allocation model as described in section 2 above. These amounts, together with other information such as amounts actually collected in 2006, were then used to determine the surplus arising for each industry sector in 2006 which was offset against the 2007 levy amount to be collected.

¹ This represents the credit union funding contribution for 2006 which has been capped at 0.01 per cent of total assets

4. Independent Report by Deloitte & Touche

The Members of the Irish Financial Services Financial Regulatory Authority
("the Financial Regulator")
PO Box 9138
College Green
Dublin 2

13 June 2007

Dear Sir/Madam,

INDEPENDENT ACCOUNTANT'S REPORT TO THE MEMBERS OF THE FINANCIAL REGULATOR IN CONNECTION WITH THE OUTTURN REVIEW

We have examined the allocation of actual costs within the Financial Regulator to each of the industry categories for the purpose of calculating levies payable by regulated entities to the Financial Regulator for the year ending 31 December 2006 - "the Outturn". The Outturn has been prepared in accordance with the descriptions provided by the Financial Regulator's management to us for each of the cost centres involved in regulating financial services entities, providing services to these cost centres.

Our report is made solely to the members of the Financial Regulator in accordance with the terms of our engagement letter, dated 4 April 2007. Our work has been undertaken so that we might state to them those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Financial Regulator for our work, for our report or for the opinions we have formed.

Respective responsibilities of the Financial Regulator and Deloitte & Touche

The Financial Regulator is responsible for the preparation of the Outturn in accordance with the bases set out in the preparation note. It is our responsibility to form an independent opinion, based on our examination, on the Outturn and to report our opinion to you. Therefore we are responsible for selective testing of the allocation of actual costs as outlined below.

Work performed

We conducted our work in accordance with the terms of our engagement letter. Our work included a review of evidence relevant to the Outturn. Our work excluded audit procedures and is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit.

Our review consisted principally of the performance of the following procedures:

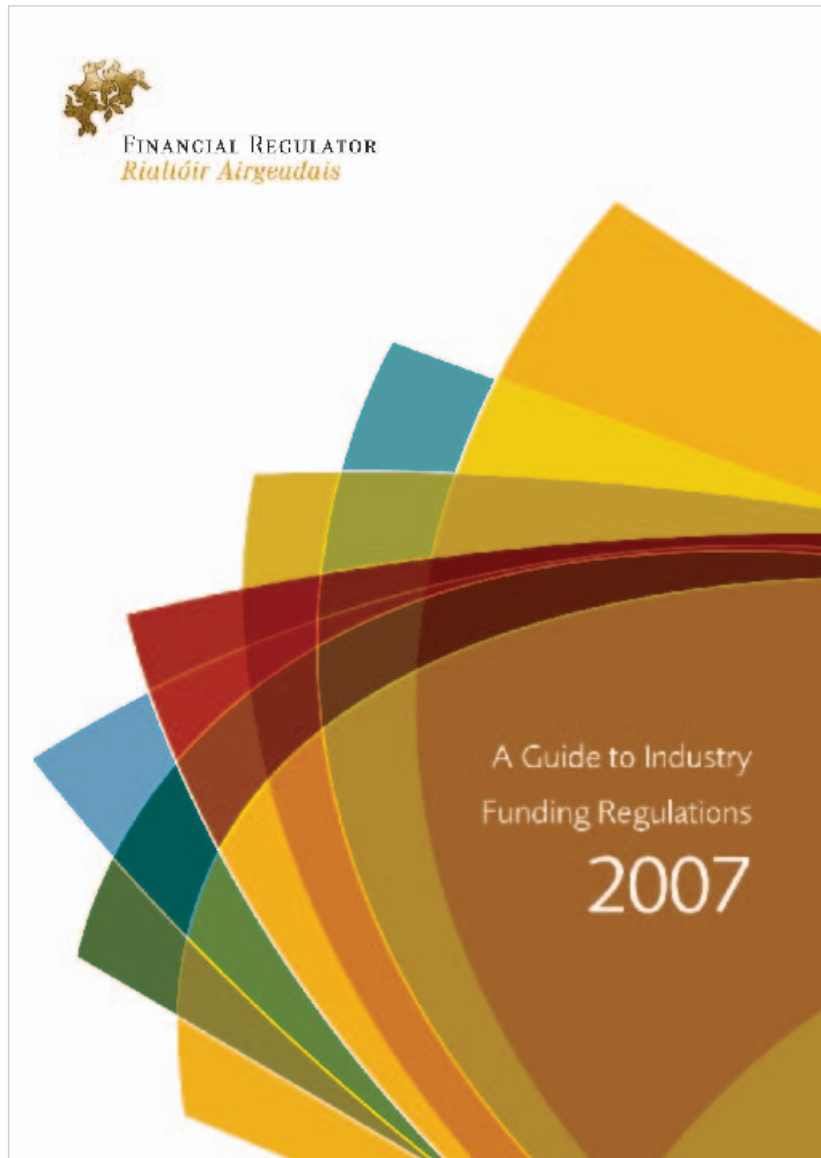
- ▶ We agreed the total population of costs in the Outturn to the Financial Regulator's management accounts for the year ended 31 December 2006 (subject to any audit adjustments thereto) presented for and subject to audit;
- ▶ We agreed the total population of costs to the accounts of the full Statement of Accounts of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2006;
- ▶ We verified that the actual costs, and only those costs, for each of the cost centres included in the budgeted model have been included in the Outturn;
- ▶ We verified that the allocation metrics used in the Outturn for each of the cost centres to be allocated, are consistent with those used in the budgeted model and have been applied correctly;
- ▶ We verified the “standing data”, used to determine the allocation metrics and used to perform the allocation of costs to industry categories, to supporting material provided by departments independent of the Financial Regulator; and
- ▶ We checked the logical integrity, the consistency and arithmetic accuracy of the formulae, algorithms and calculations in the Outturn with those in the budgeted model.

Conclusion

Based on our examination, as outlined above:

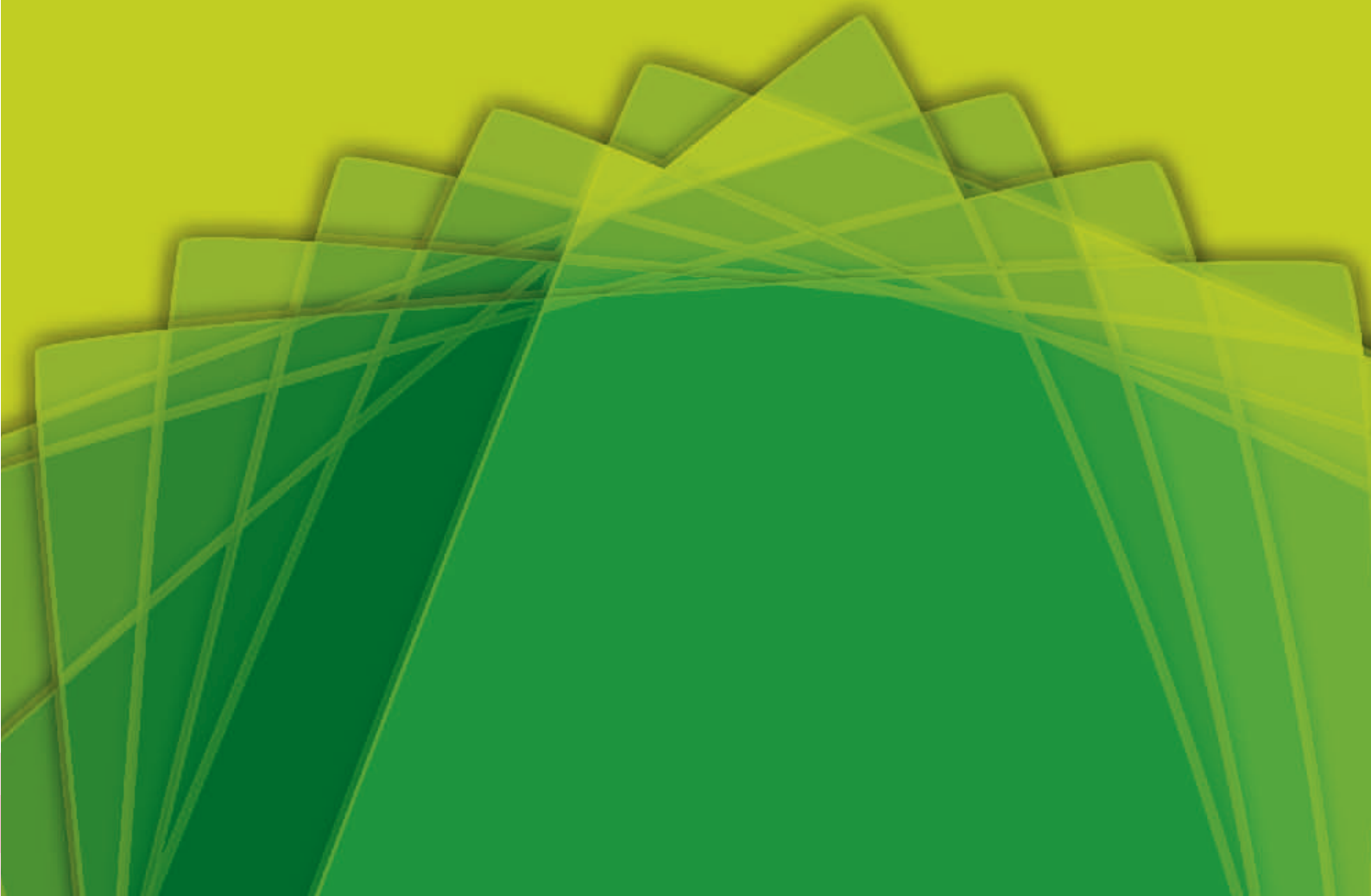
- ▶ In our opinion the Outturn has been prepared in a manner that is consistent with the budgeted model;
- ▶ Nothing came to our attention that would indicate that the Outturn has been prepared on a basis that is inconsistent with the budgeted model and/or the operations of the Financial Regulator; and
- ▶ We are not aware of any material modifications that should be made to the Outturn.

Deloitte & Touche



Chapter 7

Corporate Governance



Corporate Governance

7.1 Authority membership

The decision making power of the Financial Regulator lies generally with the members of the Authority which comprises the Chairman, Chief Executive, Consumer Director and seven other non-executive members appointed by the Minister for Finance after consultation with the Minister for Enterprise, Trade and Employment. As at 31 December 2006 the members of the Authority were as follows:

Name	Position	Date Appointed
Brian Patterson	Chairman	May 2003
Alan Ashe	Non Executive Member	May 2003
Gerard Danaher	Non Executive Member	May 2003
John Dunne	Non Executive Member	May 2003
Jim Farrell	Non Executive Member	May 2003
Alan Gray	Non Executive Member	December 2006
Mary O'Dea	Consumer Director	May 2003
Patrick Neary	Chief Executive	February 2006
Deirdre Purcell	Non Executive Member	May 2003
Dermot Quigley	Non Executive Member	May 2003
Other Attendees:		
Con Horan	Prudential Director	
Martin Moloney	Secretary	

The Chairman, Chief Executive and Consumer Director were each appointed for a term of 5 years. They may be reappointed. Liam O'Reilly retired as Chief Executive and his successor Patrick Neary was appointed on 1 February 2006 following an open competitive process. Con Horan, formerly Head of Banking Supervision, was appointed as Prudential Director in February 2006 following an open competitive process.

The non-executive members of the Authority are appointed by the Minister for Finance and may hold office for an indefinite period, subject to a maximum of 15 years. Two of the appointed members must retire on the fifth anniversary of the establishment of the Financial Regulator, and on every subsequent anniversary. The retiring members are eligible for reappointment subject to the 15 year limitation. Mr Friedhelm Danz resigned as a non-executive member of the Authority in October 2006. Mr Alan Gray was appointed as a non executive member of the Authority in December 2006.

The Chairman, Chief Executive and four non-executive Authority members (Gerard Danaher, John Dunne, Alan Gray and Deirdre Purcell) are also members of the CBFSAI Board.

This chapter also contains two statements by the Chairman required to comply with various legislative codes and regulations.

7.2 Corporate Governance Compliance

Authority Procedures

The Authority meets on a monthly basis with the exception of August. The Chairman decides the Agenda for Authority meetings after consultation with the Chief Executive and the Secretary. Members are free to suggest items for inclusion. The quorum for a meeting of the Authority is a majority of the members. The Chairperson may exercise a casting vote. The Secretary maintains minutes of Authority meetings.

Each member of the Authority is provided with a handbook to assist them in carrying out their functions.

Delegation of Powers

The Authority has delegated specific responsibilities to two Authority committees described in Appendix 6. The Authority has also delegated certain operational powers and responsibilities associated with the day-to-day running of the Authority to the Chief Executive. In addition, in accordance with Section 33 S of the Central Bank Act 1942 (as inserted by the 2003 Act) the Authority has delegated certain responsibilities and powers to the Consumer Director. Under Section 33 AA of the Central Bank Act 1942, the Registrar of Credit Unions carries out the functions of the Authority in relation to the Credit Union Act 1997 under arrangements set out in the 1942 Act.

Remuneration

Total remuneration paid to the Chairman for services during the year ended 31 December 2006 for his work as Chairman of the Authority was €52,500. Total remuneration paid to the Chief Executive for service during the year ended 31 December 2006 was €237,262. Superannuation benefits attaching to the Chief Executive's salary are in accordance with the terms of the Civil Service Superannuation Scheme.

Total fees paid to other non-executive members of the Authority in the year ended 31 December 2006 amounted to €119,583. Executive members of the Authority do not receive any additional remuneration in respect of their membership of the Authority.

Ethics in Public Office Act 1995 and Standards in Public Office Act 2001

In accordance with the Ethics in Public Office Act 1995 (as amended) and the Standards in Public Office Act 2001 (as amended), Members of the Authority furnished statements of interest in respect of 2006 to the Secretary of the Authority. Copies of these statements were also provided to the Standards in Public Office Commission. These statements are requested by the Commission for completion in January in respect of the preceding year.

In addition staff of the Financial Regulator holding designated positions comply with both Acts.

Authority Code of Conduct

In January 2004 the Authority adopted a Code of Conduct for Members which records the standards of conduct and integrity expected of each member in the performance of his or her functions as a member of the Authority.

The Authority has also adopted its own internal Code of Conduct for Disclosure of Interests. This Code places certain obligations on the members of the Authority to advise the Secretary to the Authority of business interests. The Code also sets out the procedures to be followed should a material conflict of interest arise.

Staff Code of Conduct

Staff employed by the CBFSAI are assigned to the Financial Regulator in accordance with Section 6E of the Central Bank Act, 1942. The CBFSAI has a written code of conduct which applies to staff working in the Financial Regulator.

Procurement Procedures

The Financial Regulator has adopted the approach to purchasing applied generally in the CBFSAI and which the Board of the CBFSAI has approved. Procurement procedures in relation to assets did not arise.

A handwritten signature in blue ink that reads "Brian Patterson". The signature is written in a cursive style with a small number "1" above the letter "i" in "Patterson".

Brian Patterson
Chairman

7.3 Statement on the System of Internal Financial Controls

On behalf of the Authority, I acknowledge the Authority's responsibility for ensuring that the Financial Regulator maintains effective systems of internal financial control and reviews their effectiveness on an ongoing basis. Board level committee structures have been designed to ensure that the Board of the CBFSAI and the Authority work closely together to ensure that their respective obligations in relation to the control of expenditure and the management of operational risk are managed within a consistent and complete framework.

The systems of control in place provide reasonable but not absolute assurance of the maintenance of proper financial records and the reliability of the financial information provided and published. In essence, these systems are designed to manage rather than eliminate inherent financial risks.

The systems of control include:

- ▶ A clearly defined organisation structure with specified authorisation limits and reporting requirements to senior management and the Authority;
- ▶ Appropriate terms of reference for the Authority and management committees with responsibility for core policy areas;
- ▶ A comprehensive financial and budgeting management information system which incorporates:
 - ▶ Approval of annual plan and detailed expenditure budgets by the Authority;
 - ▶ Regular reporting to the Authority on financial and budgetary performance; and
 - ▶ Detailed policies and procedures relating to financial controls of the CBFSAI.

An operational risk framework has been developed for the whole organisation. Each business area is responsible for the management of risk and the implementation of appropriate controls and procedures aimed at minimising and monitoring such risks. An Operational Risk Committee which comprises senior management of the CBFSAI, including the Financial Regulator, has responsibility for the oversight of the management of operational risk. A review of operational risk was undertaken in 2006 and considered on behalf of the Authority by the Audit and Risk Management Committee. This review will take place on a regular basis. To assist departments in the ongoing assessment of risk, an operational risk database has been developed.

Our Audit and Risk Management Sub-Committee advises the Authority on the control and reporting arising from the exercise of the statutory functions of the Authority. The Chief Executive of the Financial Regulator and the Chairman of the Sub-Committee receive regular reports from the Head of Internal Audit. The Chairman of the Audit and Risk Management Sub-Committee reports to the Authority on a regular basis on significant matters on the work of the Committee.



Brian Patterson
Chairman

Appendix 1 - Public Consultations

Consultation Paper	Month Issued	Number of Submissions Received
Proposed Minimum Competency Requirements (CP14)	January	33
Transitional provisions of the amending UCITS Directives	January	1
Second Consultation on Fit and Proper Test (CP15)	February	13
Transitional Requirements for Non- Life Reinsurance Undertakings (CP16)	February	7
Collation and Publication of insurance liability claims data (CP17)	March	7
Draft amendments to Notice UCITS 10, Guidance Note 3/03, Notice UCITS 12 concerning the use of financial derivative instruments by UCITS	March	10
Corporate Governance Guidelines for Reinsurance Undertakings (revised) (CP18)	April	7
Annual management fees within authorised collective investment schemes (CP19)	June	6
Transitional Requirements for Life Reinsurance Undertakings (CP20)	September	1
Run-Off of Reinsurance Undertakings (CP21)	September	4
Implementation of Capital Requirements Directive (CP22)	October	4
Service Protocol (CP23)	October	8
UCITS Financial Indices and Structured Products and Complex Trading Strategies - Prospectus disclosure requirements (CP24)	December	7
Total		108
Responses issued by the Financial Regulator		
Minimum Competency Requirements - Public response to CP14	July	
Review of Remuneration Structures and Transparency - Public Response to CP9	November	

Appendix 2 - Regulatory Notices and Rules

Regulatory Notices and Rules	Month Issued
Consumer Protection	
Consumer Protection Code	July
Minimum Competency Requirements	July
Direction under Section 135 (1) of Consumer Credit Act, 1995 re information displayed in advertisements promoting debt consolidation housing loans	November
Collective Investment Schemes	
Transitional provisions of the amending UCITS Directives	January
Draft amendments to Notice UCITS 10, Guidance Note 3/03, Notice UCITS 12 concerning the use of financial derivative instruments by UCITS	March
Letter regarding investment by Irish authorised collective investment schemes in unit-linked insurance products	June
Notification of amendments to notice UCITS 15 - inward marketing UCITS to give effect to the CESR guidelines to simplify the notification procedure of UCITS	November
Memorandum to the Industry setting out policy changes and related matters with regard to the authorisation of collective investment schemes	November
Banks and Building Societies	
Requirements for the Management of Liquidity Risk	June
Notice on the Implementation of the Capital Requirements Directive	December
Internal Capital Adequacy Assessment Process	
Markets	
Prospectus Rules	March
Market Abuse Rules	March

Appendix 3 - Guidance Notes

Guidance Note	Date Issued
General	
Guidance Note for Regulated Financial Service Providers in Reporting Compliance Concerns to the Financial Regulator	July
Fit & Proper Requirements Instruction Paper	November
Fit & Proper Requirements Individual Questionnaire	November
Collective Investment Schemes	
Revised Guidance Note 3/03 on the use of Financial Derivative Instruments by UCITS	May
Guidance note on the provisions of the Investment Funds, Companies and Miscellaneous Provisions Act 2005	May
Revised Guidance Note 1/03 - Amalgamation of Irish authorised collective investment schemes with other collective investment schemes	November
Credit Unions	
Guidance Note on Investments by Credit Unions	October
Insurance	
Guidance on Statement of Actuarial Opinion	December
Investment Service Providers	
Prudential Handbook for Investment and Stockbroking Firms	July
Prudential Handbook of Authorised Advisors and Restricted Intermediaries	July
Investment Firms Guidelines on ICAAP Submission	November
Investment Firms ICAAP Questionnaire	December
Investment Firms ICAAP Portal	December

Appendix 4 - List of Publications

Publication Type	Date Issued
CONSUMER AWARENESS PUBLICATIONS	
Guides	
Mortgages made easy	Revised February
Pensions made easy	June
Car insurance made easy	Revised June
Mortgages made easy - Irish version	Revised July
Savings and investments made easy	Revised July
Home insurance made easy	Revised October
Fact Sheets	
Moneylenders	January
Payment protection insurance	Revised January
Money tips for students	March
How to open a bank or building society account	Revised October
Our list of publications	Revised December
How to make a complaint	Revised December
Booklets	
Managing your money	March
SSIAs - Your little black book	March - Revised in April
Your choices at retirement	June
Getting financial advice	October
Cost Surveys	
Personal Current Accounts	January
Home Insurance Cost Survey	February
Business Current Accounts	April
Motor Insurance	May and October
Stockbrokers Fees and Charges	July
Car Finance	August
Student Current Accounts	September
Credit Cards	September
Personal Loans	October
Life Insurance	December
OTHER PUBLICATIONS	
Corporate	
Financial Regulator Annual Report 2005	July
Strategic Plan 2007-2009	November
eZines and Newsletter	
Regulatory Connection - Issue 6	February
Regulatory Connection - Issue 7	May
Regulatory Connection - Issue 8	September
Regulatory Connection - Issue 9	November
RCU News	December
Funding	
Guide to Industry Funding Levy 2006	July
Industry Funding Regulations 2006	July
Insurance Statistics	
Private Motor Insurance Statistics 2003	July
Insurance Statistical Review 2005	August
Private Motor Insurance Statistics 2004	December
Publicity Notices	
Settlement Agreement with Broadstone Fund Management Ltd (in Voluntary Liquidation) and Messrs Gerard O'Neill and David Murray	July
Settlement Agreement with M.I.S. Financial Services Ltd and Mr Stephen Donnelly	December

Appendix 5 - Progress Report on 2006 Strategy

(Items in italics represent actions which were not included in the 2006 Strategic Plan but which were undertaken.)

HLG 1: Helping consumers to make informed choices through education and codes of practice in a fair financial services market.	Target Date	Updated position
Providing Information		
Develop new consumer website to better inform consumers of the costs, risks and benefits of financial services and products.	Jun 2006	Online users of www.itsyourmoney.ie increased to 325,000. Upgrade planned for 2007
Develop and implement a programme of information initiatives to communicate to consumers the elements of the new Consumer Protection Code.	Dec 2006	Deferred as full implementation of Code is in 2007.
Undertake an information initiative to coincide with the maturity of Special Savings Incentive Accounts (SSIAs).	Commence in Jan 2006	Information campaign launched - Mar 2006
Continue to develop the range of consumer publications including guides, cost surveys and fact sheets (including information on pensions for consumers).	Ongoing	Full details in Appendix 4. New publications issued on pensions, moneylenders, money tips for students, retirement, financial advice and Motor pack. 11 cost surveys published. 330,000 publications demanded and an additional 117,000 distributed.
<i>Undertake special campaign to promote awareness of the need to manage personal debt.</i>	<i>Not Specified</i>	<i>10 month campaign launched - Mar 2006.</i>
Promote awareness of our information resources on a nationwide basis, including advertising campaigns, regional awareness campaign (including on-site at various venues), new website and information centre.	Ongoing	New television campaign - Aug - Dec 2006. Radio advertisement - May, July and November 2006 28 regional information visits.
Developing Financial Planning Education		
Coordinate the implementation of an Action plan for financial planning education.	Ongoing National	Steering Group for Financial Education established - Dec 2006
Expand pilot project for transition year students.	Sep 2006	Co-operation with MABS - Ongoing A special publication 'Consumer Rights and Responsibilities' was distributed to all post-primary schools - Sep 2006.
Develop online resources for teachers and students.	Sep 2006	To be considered under the auspices of the National Steering Group for Financial Education
Fairness and Transparency		
Introduce and commence the rollout of the new Consumer Protection Code.	Jul 2006	Published July 2006. Some provisions became effective in 2006 with full implementation from July 2007. Undertake a review of the
moneylending industry including the moneylending licensing process.	Sep 2006	47 moneylenders and 333 of their customers surveyed - 2006. Report published - Apr 2007

HLG 1: Helping consumers to make informed choices through education and codes of practice in a fair financial services market.	Target Date	Updated position
Introduce and rollout standards relating to the competencies required by sales staff when dealing with customers.	Sep 2006	Published - Jul 2006 and implemented from Jan 2007.
Consider further steps to be undertaken in relation to remuneration structures for financial products and their transparency.	Dec 2006	Public Response to consultation on the review of remuneration structures and transparency published - Nov 2006.
Monitor compliance with the Consumer Protection Code through inspections and mystery shopping exercises.	Ongoing	97 on site inspections, 70 offsite meetings and 1 mystery shopping exercise was undertaken.
<i>Undertake themed inspections</i>	<i>Not specified</i>	<i>Themed inspections of Payment Protection Insurance and Special Savings Incentive Accounts undertaken.</i>
Sections 149 & 149A of the Consumer Credit Act 1995 ► Monitor compliance through inspections and mystery shopping exercises.	Ongoing	68 branches of financial service providers were visited as part of the mystery shopping exercise.
► Review the notification process and procedures.	Dec 2006	Reviewed - new procedures will be introduced in 2007
Review the process for prescribing credit institutions under Section 2 of the Consumer Credit Act 1995.	Dec 2006	Prescription process review completed in 2006 and a new procedure was introduced in 2007.
Monitor compliance of financial service providers with advertising requirements.	Ongoing	84 issues investigated during 2006.
Commence review and consultation on transparency of credit card statements.	Aug 2006	Initial assessment complete. Discussions with consumer and industry groups to commence shortly.
Continue to monitor the Irish Banking Federation's Voluntary 'Account Switching Code'.	Ongoing	Ongoing
<i>Monitor Overcharging reimbursement Programme</i>	<i>Not specified</i>	<i>Ongoing</i>
Issue Renewal of Insurance (Non Life) Regulations	Not specified	Published - Feb 2007.
Monitoring Competition		
Undertake a Regulatory Impact Analysis and public consultation on the collection of insurance claims data.	Mar 2006	Consultation Paper issued - Mar 2007 and Regulatory Impact Analysis published - Jan 2007.
Monitor competition and report on the level of competition in the market in the Annual Report.	As required by legislation	Report included in Annual Report.
Continue the implementation of the applicable recommendations of the Motor Insurance Advisory Board and Competition Authority's report on competition in the (non-investment) Banking Sector in Ireland.	Ongoing	57 recommendations fully or partially implemented, remainder under consideration and / or to be discussed with Competition Authority.

HLG 1: Helping consumers to make informed choices through education and codes of practice in a fair financial services market.	Target Date	Updated position
Publish Private Motor Insurance Statistics	Not Specified	2003 Report - Jul 2006 2004 Report - Dec 2006
Fostering access to financial services		
Co-ordinate the implementation of recommendations arising from research conducted in association with the Combat Poverty Agency.	Ongoing	Research published - Dec 2006

HLG 2: Having a regulatory system that fosters safe and sound financial institutions while operating in a competitive and expanding market of high reputation.	Target Date	Updated position
Supervisory approach and responsibilities of financial service providers		
Introduce an updated fitness and probity framework.	Sep 2006	Published - Nov 2006. Implemented with effect from Jan 2007.
Develop approach for Directors' Compliance Statements for authorised financial service providers.	2006	Informal consultation issued - Oct 2006
Introduce authorisation requirements for Reinsurance companies.	2006	Requirements introduced - Jul 2006
Introduce updated authorisation requirements for insurance and re-insurance intermediaries.	Mar 2006	Introduced - May 2006
Conversion of funds and their management companies to new supervisory regime under UCITS III Directive.	2006 / 2007	Conversion completed in accordance with EU timetable - Apr 2006 and Feb 2007
Issue policy papers on issues of prudential significance.	As required	The regulatory notices and rules issued are listed in Appendix 2.
Clarify our role in relation to innovation and product development in the financial sector.	June 2006	Published - Jul 2006
Clarify our role in relation to the regulation of wholesale and retail financial service providers.	June 2006	Published - Jul 2006
<i>Authorise new financial service providers in accordance with regulatory requirements</i>	<i>Not Specified</i>	<i>2,943 financial service providers and funds authorised.</i>
<i>Collect and analyse prudential returns</i>	<i>Not specified</i>	<i>60,480 returns received.</i>
<i>Assist ICAI with the preparation of advice for auditors</i>	<i>Not Specified</i>	<i>Published - Sept 2006.</i>
<i>Issue warning notices regarding unlicensed providers of financial products</i>	<i>Not Specified</i>	<i>4 Warning notices published. On Site Review</i>
Undertake a programme of both general and focused reviews / inspections. (Focused reviews include such areas as corporate governance, internal audit, operating risks, prevention of money laundering, actuarial assessment processes, or compliance with client asset rules.)	Ongoing	426 inspections and review meetings held. Chapter 3 refers.

HLG 2: Having a regulatory system that fosters safe and sound financial institutions while operating in a competitive and expanding market of high reputation.	Target Date	Updated position
Carry out a programme of inspections to monitor compliance with dormant accounts and unclaimed life assurance policies legislation.	Ongoing	10 inspections completed in 2005 - 2006.
Banking Supervision		
Oversee the implementation of an action plan so that credit institutions will be in a position to take on their additional responsibilities under the Capital Requirements (Basel II) Directive.	Dec 2006	Implementation forum continued its work. Provided assistance to Department of Finance on transposition of Directive - Dec 06. Implemented with effect from Jan 2007.
Update standards for corporate governance requirements for credit institutions.	2006	Pre-consultation paper covering Corporate Governance Guidelines for Credit Institutions and Insurance Undertakings - issued Oct 2006
Operate a strong "group wide" supervisory regime for complex groups, particularly those institutions with significant banking and insurance companies.	Ongoing	Ongoing
Introduce requirements for the management of liquidity risk.	Not Specified	Published - Jul 2006.
Require mortgage providers to hold additional capital for high loan-to-value mortgages	Not Specified	Requirement issued - May 2006.
Insurance Supervision		
Implement a supervisory regime for re-insurance companies.	2006 - once EU Directive has been passed.	Implemented - Jul 2006. Transitional Requirements and format of statement of Actuarial Opinion for Non-Life Reinsurance Undertakings issued - 2006.
Address the prudential issues raised by the Competition Authority in its review of the Insurance Sector in the context of the negotiations on the Solvency II Directive.	Ongoing	Ongoing
Continue to prepare for the implementation of the EU Solvency II Directive, which includes participation in EU negotiations and consultation with industry.	Ongoing	Ongoing
Introduce more frequent reporting for insurance companies.	Sep 2006	Delayed due to the implementation of CRD and MiFID
Issue guidelines on aspects of the corporate governance regime of insurance companies.	Jun 2006	Pre-consultation paper covering Corporate Governance Guidelines for Credit Institutions and Insurance Undertakings - issued Oct 2006
<i>Develop new supervisory regime for Captive Insurers.</i>	<i>Not specified</i>	<i>Developed - 2006</i>
Investment Service Providers Supervision		
Implement a supervisory regime for UCITS III management companies.	2006	Implemented - Nov 2006

HLG 2: Having a regulatory system that fosters safe and sound financial institutions while operating in a competitive and expanding market of high reputation.	Target Date	Updated position
Prepare for the implementation of the Capital Requirements (Basel II) Directive in respect of investment firms.	2007	Implementation forum continued its work. Provided assistance to Department of Finance on transposition of Directive - Dec 2006. Implemented with effect from Jan 2007.
<i>Issue revised prudential handbooks to coincide with new Consumer Protection Code</i>	<i>Not Specified</i>	<i>Published - Jul 2006.</i>
Develop a process for the examination of applications for outsourcing by fund management companies.	2006 / 2007	Ongoing
Markets Supervision		
Prepare for the implementation of the Markets in Financial Instruments Directive.	Oct 2006	Implementation forum established - Jul 2006. Provided assistance to Department of Finance on transposition of Directive - Feb 2007. Implementation rescheduled by EU to Nov 2007.
Participate in the Company Law Review Group in relation to the legislative changes to company law necessitated by Transparency Directive.	2007	Provided assistance as required.
Prepare for the implementation of the Transparency Directive.	2007	Preparations ongoing. Provided assistance to Department of Enterprise Trade and Employment on transposition of Directive - 2007.
Policy issues relating to Funds		
Implement UCITS III Management Company and Product Directives, in accordance with EU timetable.	Feb 2007	Completed - Feb 2007.
<i>Introduce new authorisation regime for qualifying investor funds.</i>	<i>Not specified</i>	<i>Consultation paper issued - Dec 2006. New regime implemented - 2007</i>
Review non-UCITS notices.	Dec 2006	Postponed due to UCITS priorities.
<i>Secure status as 'state of equal supervision' in Netherlands for non-UCITS</i>	<i>Not Specified</i>	<i>Designation received - Oct 2006</i>
Prevention of Money Laundering and Terrorist Financing		
Prepare for the implementation of the 3rd Anti-Money Laundering Directive.	2007	Preparations commenced - 2006. Due to be transposed by Dec 2007.
Review the outcome of the 2005 FATF evaluation of Ireland's anti-money laundering systems and controls and implement the necessary changes.	Dec 2006	As above. Transposition of EU Money Laundering Directive will implement main findings.

HLG 2: Having a regulatory system that fosters safe and sound financial institutions while operating in a competitive and expanding market of high reputation.	Target Date	Updated position
Prepare for the implementation of the Information on the payer accompanying transfer of funds (Client Identification) Regulation.	2006 / 2007	Provided comments to Department of Finance on their draft proposals.
Financial Stability		
Implement procedures for close co-operation with the Central Bank.	Ongoing	Regular meetings of Financial Stability committee held.
Crisis Management		
Refine our crisis management plan in conjunction with the Central Bank.	Ongoing	

HLG3 Developing an appropriate regulatory system for credit unions	Target Date	Updated position
Supervisory approach and responsibilities of Credit Unions		
Extend the web-based reporting system for off-site analysis and risk assessment to all credit unions.	Sep 2006	Rollout completed - Aug 2006
Carry out a systematic on-site inspections programme.	Ongoing	289 credit unions inspected or visited.
Assist the Department of Finance with the development of legislation for an independent savings protection scheme.	Dec 2006	Discussions between the Registrar and the ILCU are ongoing
Providing Information		
Hold a series of meetings throughout the country to consult the credit union movement on regulatory issues and legislative developments.	Apr 2006	Meetings and visits conducted with credit unions and representative bodies throughout 2006. Chapter 4 refers.
Publish a newsletter (RCU News) to inform the movement of new developments.	Ongoing	1 issue - December 2006
Issue guidance on investment policy	Not specified	October 2006
Working with the Movement		Develop effective working
relationships with representative bodies for the movement.	Regular review meetings continuing	31 meetings with Credit Union Representative Bodies were held in 2006

HLG 4: Continuously enhancing and developing the regulatory system.	Target Date	Updated position
Legislative development		
Comment on proposed financial services legislation.	As arises	Assistance provided on consolidation and simplifications of financial services, Asset Covered Securities, Buildings Societies and Credit Union Acts. Assisted with negotiation and transposition of EU Directives.
Continue to amend our processes to incorporate relevant legislative changes.	As arises	New processes developed or being developed.
Participate in the review of EU Financial Service Action Plan.	Ongoing	Ongoing - Chapters 1 and 3 refer.
Develop and implement 'securities market' sanctions policy.	Dec 2006	Markets administrative sanctions policy framework completed - Jun 2007
Best Practice		
Undertake best practice reviews of the following functions: ▶ Banking ▶ Securities	Sep 2006 Jun 2006	Reprioritised to 2007 Transaction reporting - Completed 2006.
Facilitate the examination of Ireland's regulatory system by the International Monetary Fund.	Ongoing through 2006	IMF report published - Jul 2006
<i>Facilitate the examination of Ireland's anti money laundering system by the Financial Action Task Force.</i>	<i>Not specified</i>	<i>FATF report published - Feb 2006.</i>
Undertake review of key internal processes: ▶ Authorisation; and ▶ Administrative Sanctions.	Dec 2006 Dec 2006	New Mortgage Intermediaries authorisation regime implemented - July 2006. Reprioritised to 2008
Facilitate a programme of value for money (VFM) audits.	Dec 2006	Programme of internal audits undertaken - Chapter 5 refers.
Embed the Government's Better Regulation principles in our approach to regulation by introducing Regulatory Impact Analysis and a consistent approach to public consultation.	Apr 2006	Better Regulation actions implemented - Chapter 1 refers.
Developing and maintaining good external relationships		
Foster a sound working relationship with the Financial Services Consultative Consumer and Industry Panels and the Credit Union Advisory Committee.	Ongoing	Meetings arranged - Chapter 5 refers.
Develop an information sharing relationship with the Financial Services Ombudsman's Bureau and the Pensions Ombudsman.	Ongoing	Memorandum of Understanding agreed with Financial Services and Pensions Ombudsmen - Apr 2006

HLG 4: Continuously enhancing and developing the regulatory system.	Target Date	Updated position
Consult publicly on the following issues:		
▶ Regulatory impact of the collection of insurance claims data.	Mar 2006	Consultation Paper issued - Mar 2007 and Regulatory Impact Analysis published - Jan 2007
▶ Requirements and standards for credit institutions, relating to implementation of Capital Requirements (Basel II) Directive.	Dec 2006	Consultation Paper issued - Oct 2006 and Requirements published - Dec 2006
▶ <i>Other Consultations</i>	<i>Not Specified</i>	<i>11 other Consultation Papers published - Appendix 1 refers.</i>
Maintain a structured consultation mechanism with key industry, consumer and community groups.	Ongoing	Meetings arranged - Chapter 5 refers.
Maintain and further develop an appropriate information-sharing network with other regulators.	Ongoing	Bilateral meetings and information visits arranged - Chapters 1 and 5 refer.

HLG5: Develop an adaptable, efficient and flexible organisation with motivated and skilled staff.	Target Date	Updated position
Cohesive and Capable Organisation		
Recruit the staff necessary to carry out our existing and any additional functions assigned to us.	Ongoing	Staff numbers increased by 11 to 329 - Dec 2006.
Undertake a review of our mission, vision, values and organisation structure in preparing our Strategic Plan for the 2007 - 2009 period.	Sep 2006	Strategic Plan for 2007 - 2009 submitted to Minister for Finance - Sep 2006. Published - Nov 2006.
Examine the procedures and systems for the sharing of relevant information between regulatory departments, and make any improvements necessary.	Dec 2006	Enhancements to Supervision IT system implemented - 2006. Internal Communications action plan developed - May 2007.
Identify, assess, monitor, manage and control operational risks and put in place an effective operational risk management policy.	Ongoing	Annual review undertaken
Review our internal reporting requirements and make any necessary improvements.	Oct 2006	Reprioritised to 2007
Monitoring provision of services by Central Bank		
Undertake a review of the delivery of internal services.	Jun 2006	Reprioritised to 2007

HLG5: Develop an adaptable, efficient and flexible organisation with motivated and skilled staff.	Target Date	Updated position
Developing our technology support system		
<p>Implement Information Technology Strategy, including the following projects:</p> <ul style="list-style-type: none"> ▶ Public enquiries and tracking system; ▶ Correspondence tracking system; ▶ Cross functional legal data sharing system; ▶ Electronic reporting, processing, filing and analysis of returns; ▶ Upgrade of Supervision System; and ▶ Website enhancement and development. <p>▶ Upgrade IT infrastructure</p>	Dec 2006	<ul style="list-style-type: none"> ▶ Upgraded - 2006 ▶ Reprioritised ▶ Reprioritised ▶ First phase relating to CRD implemented - April 2007 ▶ Upgraded - 2006 ▶ Consumer website upgraded - July 2007. Project to enhance corporate website is underway ▶ Completed - 2006
Developing highly skilled and adaptable staff		
Implement a comprehensive training needs assessment and strategy to develop the skills of our staff in order to meet the needs of changing environment, such as Basel II and the EU Directive on Re-insurance.	Dec 2006	Project commenced Dec 2006. See Chapter 5.
Develop and implement a staff-training programme on the application of the administrative sanctions procedures.	2006	Training sessions organised - Jan, Mar, Apr and May 2006.
Make enhancements to the performance management system, in association with the CBFSAI.	Dec 2006	Reprioritised to 2007
Adopt a partnership approach with our staff, through consultation and internal dialogue, on key issues in the process of change and improvement.	Jun 2006	Reprioritised to 2007
Funding		
Finalise levy and collection system for 2006.	Feb 2006	Completed - Mar 2006
Submit Levy Regulations to Minister for Finance for approval.	Mar 2006	Completed - Jul 2006
Despatch invoices for 2006 to regulated financial service providers.	Jul 2006	Completed - Aug 2006
Complete standard collection process.	Oct 2006	96% collected by end December
Key Stakeholder Relationships		
<ul style="list-style-type: none"> ▶ Disseminate our plans and reports to the public; ▶ Promote our role with industry through publication of a quarterly newsletter (Regulatory Connection) and working with the various industry publications; and ▶ Provide speakers at seminars and conferences 	Ongoing	<p>Annual Report, Strategic Plan and Consumer publications distributed. 4 issues of Regulatory Connection and 1 issue of RCU News published.</p> <p>Ongoing - see Chapter 5</p>

HLG5: Develop an adaptable, efficient and flexible organisation with motivated and skilled staff.	Target Date	Updated position
In addition to developing our consumer website www.itsyourmoney.ie , we will further develop our website www.financialregulator.ie as a key communications tool, for all our stakeholders.	Dec 2006	Project reprioritised - 2007
Develop a protocol relating to service targets of the Financial Regulator and the associated responsibilities of industry in association with the Consultative Industry Panel.	Dec 2006	Intermediaries Inspection protocol launched - Nov 2006 Organisation wide Stakeholder Protocol to be launched - Jul 2007.
Develop a protocol relating to service targets of the Financial Regulator and the associated responsibilities of consumers in association with the Consultative Consumer Panel.	Dec 2006	
Public Accountability		
Prepare and publish an Annual Report for 2005.	Jun 2006	Submitted to Minister for Finance - May 2006. Published - Jul 2006
Prepare Strategic Plan for 2007 - 2009 for submission to Minister for Finance.	Sep 2006	Submitted to Minister for Finance - Sep 2006. Published - Nov 2006
Prepare Statement of Income and Expenditure for 2005.	Jun 2006	Submitted to Minister for Finance - Jun 2006. Published - Jul 2006
Prepare annual estimate of income and expenditure for 2007 and submit to Minister for Finance for approval.	Oct 2006	Submitted to Minister for Finance - Oct 2006
<i>Report to Oireachtas Committees.</i>	<i>As requested</i>	<i>3 appearances</i>
<i>Report to EU Parliament committees</i>	<i>Not specified</i>	<i>2 appearances</i>
Provide the Office of the Comptroller and Auditor General with the information required to perform its functions.	As requested	Facilitated Value for Money financial audits. C&AG VFM to be published in 2007.
Support the carrying out of independent research, in conjunction with the Consultative Consumer and Industry Panels, on our impact as Financial Regulator.	Mar 2006	Supported Consultative Industry Panel survey of regulated financial service providers. Published - July 2006

Appendix 6 - Committees, Panels & Associated Bodies

Authority Committees

Audit and Risk Management Committee

The role of the Committee is to review and advise the Authority on internal audit and efficiency matters, risk management policies and the Statement of Income and Expenditure to be included in the Financial Regulator's Annual Report.

The members of the Committee are: Alan Ashe (Chair), Deirdre Purcell and Jim Farrell.

Budget and Remuneration Committee

The key responsibilities of this Committee are to examine and make recommendations to the Authority on the annual manpower and budgetary requirements of the Authority including levies on industry; to monitor significant changes in expenditure in the course of the year; to examine and advise the Authority on the remuneration of Officers of the Authority.

The members of the Committee are: Dermot Quigley (Chair), John Dunne and Alan Ashe.

Management Committees

Executive Board

The role of the Executive Board is to advise the Chief Executive on major policy issues. Membership consists of the Chief Executive, the Consumer Director, the Prudential Director and all Heads of Function.

Consumer Committee

The role of the Committee is to review the strategic objectives, consumer project plan, current projects and wider organisational issues relating to the Consumer Directorate. It is also responsible for the development and co-ordination of policies in relation to consumer matters, future strategic objectives and personnel development and training.

The members of the Committee are:

Consumer Director (Chair), Heads and Deputy Heads of the Consumer Information, Consumer Protection and Planning and Finance departments.

Prudential Supervision Committee

The role of the Committee is to act as a forum for consideration of prudential regulatory issues (domestic and international), matters of common interest arising from the delivery of departmental work plans and interdependencies with other departments within the Financial Regulator and the Central Bank. It is involved in the development and coordination of policies in relation to areas of prudential interest including the risk rating of institutions, consultation papers and common standards, training and methods of supervision. The Committee is also involved in the oversight of prudential projects.

The members of the Committee are:

Prudential Director (Chair), Head of Financial Institutions and Funds Authorisation, Head of Banking Supervision, Head of Insurance Supervision, Head of Markets Supervision, Head of Investment Service Providers Supervision, Head of Legal and Enforcement and Registrar of Credit Unions.

Statutory Panels and Committees

Consultative Consumer Panel

The role of the Consumer Panel is to monitor our performance, to provide us with comments on the performance of the financial services industry and to provide suggestions for new initiatives which we should take. It is also charged with the responsibility of commenting on our draft budget. The Panel also comments on policy or regulatory documents we issue.

The members of the Panel are:

Brendan Burgess (Chair), Kathleen Barrington (appointed December 2006), Frances Byrne, Olive Byrne (retired November 2006), Tommy Byrne (appointed December 2006), Liam Coen (retired September 2006), Michael Connolly, Michael Culloty, James Doorley, Grainne Hannon, Eddie Hobbs (retired September 2006), Ann Hogan, Eileen Lynch (retired September 2006), John Maher, Joan Morrisson, Professor Noel Mulcahy, Fidele Mutwarasibo (appointed December 2006), Ann Owens (retired September 2006), Raymond O'Rourke, Sean O'Sullivan, Fiona Reynolds, Peter Ryan, William Ryan, Eileen Walsh (appointed December 2006). Secretary: Peter Keane

Consultative Industry Panel

The role of the Industry Panel is to comment on our proposed industry levies and fees, the impact on competitiveness of our regulatory requirements and the impact of changing trends on our functions and responsibilities. Similar to the Consumer Panel, it is also charged with the responsibility of commenting on our draft budget. It also comments on policy or regulatory documents we issue.

The members of the Industry Panel are:

James Deeny (Chair), Jim Bardon (retired May 2006), Liam Carberry, Tony Culley, Billy Doyle, Pat Farrell, Ann Fitzgerald (retired September 2006), Sarah Goddard, Jonathon Goold (appointed May 2006), Tom Healy, Pat McArdle (appointed December 2006), Robert Moynihan, John Murphy, Carmel O'Connor, Paul O'Connor (appointed December 2006), Aileen O' Donoghue, John O'Halloran, Eimer O'Rourke, Gary Palmer, Rachel Panagiodis, Sean Quirke, Robert Richardson (appointed December 2006) and Mike Ryan (retired September 2006). Secretary: Peter Keane.

Credit Union Advisory Committee

The Credit Union Advisory Committee (CUAC) acts as an advisor to the Minister on matters relating to Credit Unions. The role of the Committee is to advise the Minister on improving the management of credit unions, protecting the interests of members and creditors of credit unions and on other matters relating to credit unions as they arise.

The members of the Committee are:

Pádraig Ó'Cearbhaill, (Chair), Ken Lillis, Olive McCarthy, Donal Murphy, Michael O'Conaill, Iris White and Donal Yourell.

Secretary: Declan Cahill, Department of Finance

Closely Associated Organisations

The Financial Services Ombudsman Council

The Financial Services Ombudsman Council was established on a statutory basis under the Central Bank and Financial Services Authority of Ireland Act 2004. The main functions of the council as laid down in the Act are to:

- ▶ Appoint the Financial Services Ombudsman and each Deputy Financial Services Ombudsman;
- ▶ Prescribe guidelines under which the Ombudsman is to operate;
- ▶ Determine the levies and charges payable for the performance of services provided by the Ombudsman;
- ▶ Keep under review the efficiency and effectiveness of the Bureau and to advise the Minister on any matter relevant to the operation of the Bureau; and
- ▶ Advise the Ombudsman on any matter on which the Ombudsman seeks advice.

Joe Meade is the Financial Services Ombudsman and Caroline Gill and Gerry Murphy are the Deputy Financial Services Ombudsmen. The Council has no role regarding complaints resolution as this is the independent function of the Financial Services Ombudsman.

The members of the Council are:

Dr. Con Power (Chair), John Colgan, Crozier Deane, Dermot Jewell, Paul Joyce, Paddy Leydon, Paul Lynch, Paddy Lyons, Jim McMahon, and Caitriona Ni Charra.

Financial Services Appeals Tribunal

The Irish Financial Services Appeals Tribunal was established pursuant to the Central Bank and Financial Services Authority of Ireland Act 2003. Appeals against certain decisions made by the Financial Regulator will be heard and determined by the Appeals Tribunal. Whether the decision is appealable to the Tribunal is defined in the relevant piece of legislation from which the decision derives i.e. depending on whether it is a banking, insurance or investment matter. Administrative sanctions decisions may be affirmed, varied, substituted; remitted or set aside by the Tribunal. Decisions other than administrative sanctions may only be affirmed or remitted. An appellant dissatisfied with the final outcome may appeal a decision of the Tribunal to the High Court.

The Members are:

Francis D. Murphy (Chair), Inge Clissmann SC, John Fish, Geraldine Clarke, John Loughrey, Paulya Marrinan-Quinn SC and Liam Madden.

Investor Compensation Company Ltd (ICCL)

The ICCL was established in August 1998. The principal objective of the ICCL is to put in place arrangements (e.g. funding and payment procedures) to ensure that eligible clients of a failed firm receive compensation (within the parameters set down in the Investor Compensation Act 1998) as expeditiously as possible. The three shareholders in the company are the Central Bank and Financial Services Authority of Ireland, the Irish Stock Exchange and the Irish Association of Investment Managers.

Board of Directors:

Jim Bardon (Chair - Appointed 28 April 2006), Caitriona Murphy (Chair - Retired 28 April 2006), Dan Coveney, Inge Clissman, Ann Fitzgerald (Retired 19 May 2006), Terry Hardiman, Brian Healy, Dermott Jewell, Paul Lynch, Paul O'Donovan, Frank O'Dwyer (Appointed 12 June 2006), Gina Quin, Mark Redmond, Enda Twomey (Retired 15 January 2007), Eimer O'Rourke (Appointed 15 January 2007)

Appendix 7 - Report on a study on the Credit Card Market

Introduction

The Financial Regulator's most recent cost survey on Credit Cards, published in March 2007, shows that interest rates charged by card providers on purchases on standard credit cards range from 9.5 per cent to 18.9 per cent. In other words the most expensive card carries an interest rate almost exactly twice that of the cheapest card (the range of rates applied to cash withdrawals is even wider).

There are 13 card issuers active in the Irish market and, at first glance, a Mastercard or Visa branded card from one issuer would seem to be more or less the same as a similarly branded card from another. This begs the question as to how such a high price differential can be sustained in the market, i.e. why do consumers not cancel their high-interest cards and take out low-interest cards instead?

By way of trying to address this question we will look at some statistics in the Irish credit card market and make some comparisons with European credit card markets. We will also look at some research that has been published in relation to what consumers know about credit cards and their attitudes to credit cards, and we will report on market research that the Financial Regulator has commissioned on this issue in Ireland.

Background statistics on the Irish Credit Card Market

The Irish credit card market has grown strongly in recent years with the number of cards issued increasing year on year. As at the end of December 2006, there were approximately 2.03 million personal credit cards in circulation. The outstanding indebtedness on all personal credit cards stood at €2.607 billion at the end of 2006, and the average monthly new spending on personal credit cards in 2006 was €919 million¹. As at December 2006, total personal credit card debt was estimated to account for 15.3 per cent of all consumer credit (i.e. excluding loans for housing and investment purposes) in Ireland².

The credit card market is highly concentrated, with the three largest card issuers enjoying a market share of 78.6 per cent. These three issuers are Allied Irish Banks (34 per cent), Bank of Ireland (31 per cent), and MBNA (13.6 per cent)³. The interest rates charged by these three issuers are at the upper end of the range of rates charged in the market. 99.7 per cent of all credit cards issued are either branded Visa (59.3 per cent) or Mastercard (40.4 per cent). American Express and Diner Cards account for the remaining cards in issue⁴.

Comparison with other European Markets

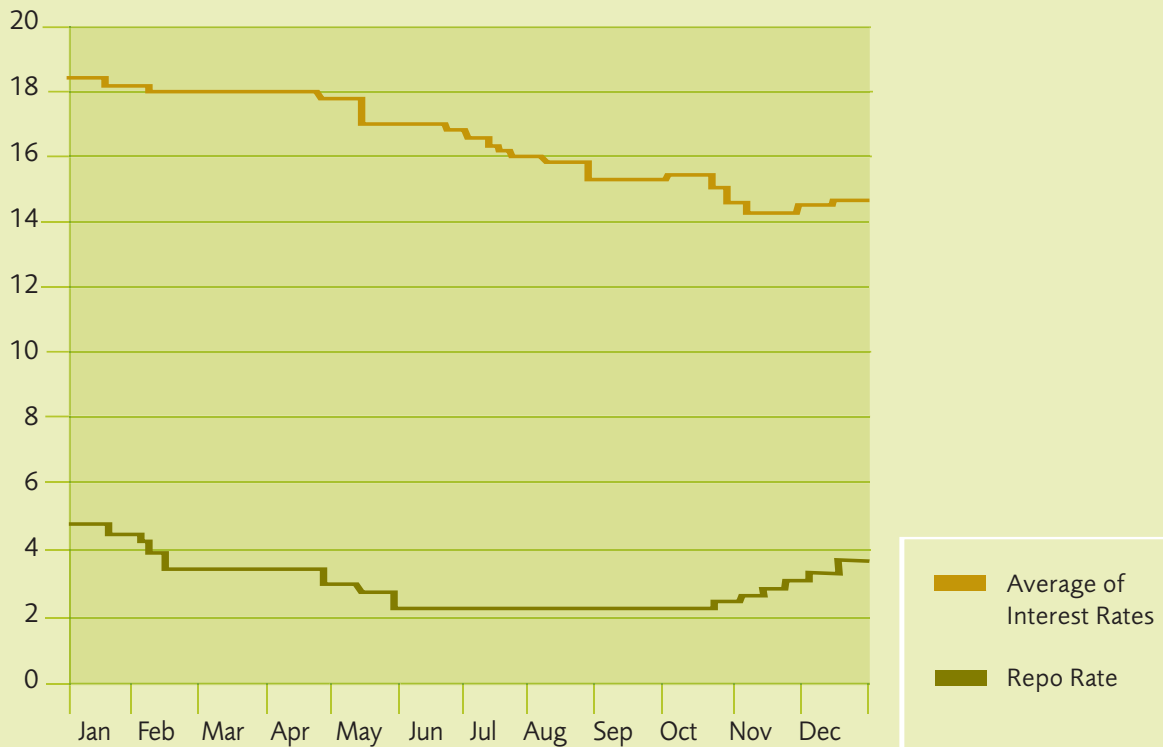
As can be seen from the following table the market share in Ireland of the three largest financial service providers is somewhat greater than that observed in a range of other European markets. The average annual growth rate in the number of issued credit cards in Ireland in the period 2001 to 2005 at 9.3 per cent is well below the average annual growth rate observed across the whole group, while the average annual growth rate in the value of transactions is closer to the norm within the group⁵.

Country	Market share of three largest issuers (2005)	Average annual growth rate in the number of cards issued (2001-2005)	Average annual growth rate in the value of transactions (2001-2005)
Austria	78.4	18.4	21.1
Belgium	63.3	16.7	17.8
Denmark	93.6	81.0	42.0
Finland	69.7	6.8	11.3
France	60.9	2.5	4.8
Germany	72.4	12.7	14.4
Greece	79.9	9.0	20.1
Ireland	78.6	9.3	17.3
Italy	35.6	22.3	20.8
Netherlands	52.7	11.9	10.3
Norway	77.3	36.5	40.4
Portugal	55.5	26.6	25.0
Spain	37.1	69.0	56.9
Sweden	85.7	40.7	45.2
Switzerland	60.7	24.6	22.7
Turkey	58.1	28.6	45.8
United Kingdom	39.9	8.8	6.3
Average	64.67	23.41	23.23

Source: Datamonitor "Western European Cards Database 2006"

Irish Credit Card Interest Rates and the cost of Funding

If consumers were sensitive to interest rates, one would expect to see a strong correlation between the interest rates charged to consumers and the cost to the issuer of funding that debt. The graph below plots a simple average of the advertised interest rates charged by card issuers active in the Irish market, on standard credit cards, over the period January 2001 to January 2007. The European Central Bank repo rate, which is generally accepted to be a proxy for the cost of funding of lenders, is also plotted. This graph builds upon data that was previously published by the Financial Regulator in a study published in July 2004⁶.



Source: Data provided to the Financial Regulator by market participants.

In our 2004 study, we noted that the relationship between changes in the cost of funding and changes in credit card interest rates was weak. The updated data continues to support this observation. One statistical measure of the strength of the relationship between two variables is the Pearson Product Moment Correlation Coefficient (PPMC). A PPMC value can range from -1 to 1. A PPMC of -1 indicates a perfect negative correlation, a PPMC of 0 indicates that no correlation exists while a PPMC of 1 indicates a perfect positive correlation.

The PPMC for the relationship between the advertised interest rates charged by credit institutions on standard credit cards and the European Central Bank repo rate over the period January 2001 until January 2007 is 0.47. In other words, there is a positive, though not very strong, correlation between the two sets of variables. By way of contrast, the PPMC for the relationship between the advertised interest rates charged by lenders for variable rate mortgages and the European Central Bank repo rate over the period 1 January 1998 until 30 June 2003 was 0.89⁷.

The conclusion we can draw from this is that interest rates on credit cards would seem to be far less responsive to changes in the cost of funding than interest rates on other banking products. It may be that consumers are exercising weak pressure on card issuers in this regard.

Some academic work in this area

An important early study on competition, consumer behaviour and credit cards was conducted by Lawrence M Ausubel in 1991⁸. The paper provides an interesting insight into consumers' usage of credit cards and their attitude towards switching in the US market. Ausubel noted that although there were 4,000 financial service providers offering credit cards in the US credit card market, and while no visible regulatory barriers existed, the market remained uncompetitive because card issuers failed to compete on interest rates. He also noted that credit card interest rates did not move in tandem with the changes in the cost of funding (Ausubel used the one-year US Treasury bill yield plus 0.75 as a proxy for the cost of funding) and found that this "stickiness" in interest rates allowed credit card companies to record large profits. In fact, he estimated that the profits generated in the credit card business persistently equalled three or more times the ordinary return on banking equity.

He suggested that competition in the credit card market was weak because lower-risk consumers are insensitive to interest rates. Moreover, he concluded that card issuers do not compete on interest rates because they fear a rate reduction might attract a disproportionate number of high-risk borrowers. Ausubel attributed the fact that consumers do not readily switch credit card providers to search costs, switching costs and irrationality.

Finally, Ausubel discovered, through comparing bank data to consumer surveys that "a sizeable proportion of consumers who borrow on credit cards are unaware of how frequently they do it or, more likely, deny (to themselves and others) that they do it". This finding is interesting in the context of the market research conducted by the Financial Regulator, and discussed below.

Calem and Mester⁹, presented empirical evidence that supported Ausubel's earlier work. They also argued that:

1. consumers who are less likely to shop around maintain higher credit card balances than consumers that do shop around; and
2. consumers with high credit card balances (especially those who represent a low default risk but who might forfeit a high credit card limit if they switched) are also less likely to shop around.

Further work¹⁰ in this area, also by Calem and Mester and with Gordy also confirmed Ausubel's findings. Research in New Zealand¹¹ has again confirmed the work in the United States, finding that consumers are insensitive to the interest rates and fees charged and that accordingly there is little incentive to card providers to reduce these charges.

In Ireland too factors such as the stickiness of credit card interest rates, inelasticity of demand for credit, the comparative profitability of the credit card sector and the fact that consumers may have misconceived ideas about their own borrowing patterns, have previously been noted¹².

Finally, in 2001, David Frank¹³ looked at the secondary market level of competition in the United States, defined to be the level where credit card issuers and commercial banks compete for each other's existing customers (rather than new customers to the market). Within this market he found that banks mainly used introductory or "teaser" rates (rather than lower ongoing rates) to attract switching customers. In Ireland, the Financial Regulator's cost survey, published on 29 March 2007, shows that in the Irish market 12 out of the 13 participants offer special low rates, for a limited period, on balances transferred.

Market Research Findings

In March 2006, the Financial Regulator commissioned market research to look at the extent to which consumers are aware of the interest rates and fees applied to their credit card accounts, the level of switching activity, and the experiences of switching in the Irish credit card market. The research shows that 54 per cent of adults own a credit card, and that 20 per cent of those who own a credit card own two or more.

Consumers were asked if they knew the interest rate applied to balances on their credit cards. 51 per cent said that they did not: however this number may be understated because a further 10 per cent of consumers said the interest rate charged on their credit card was between 1 and 5 per cent. Introductory offers aside, there are no cards in the market charging rates of between 1 and 5 per cent. In a similar survey in New Zealand, the proportion of consumers that did not know the interest rate charged on their credit card was estimated at 65 per cent¹⁴.

The research also showed that 45 per cent of consumers do not pay off their full credit card balance each month, and are as a result using their credit card as a revolving credit facility rather than as solely as a convenient transaction mechanism.

In addition, the research showed that consumers' switching activity in relation to credit cards remains very low, with only 7 per cent of consumers switching their credit card provider in the last year. Among the 93 per cent of consumers who did not switch, the reasons given included that they were happy with their current provider (48 per cent), that they thought there was too much time and effort involved in comparing different cards and in cancelling the old card (14 per cent) and that they were not concerned about offers from other card providers (7 per cent).

The sample size of those who did switch was small, and must therefore be treated with caution. Of those who switched, the main reasons given were to avail of a lower introductory interest rate (33 per cent) or a lower ongoing interest rate (29 per cent). Only 6 per cent of those who had switched said that the switching process had been difficult.

Some Conclusions

At the outset we asked the question: why do consumers not cancel their high-interest cards and take out low-interest cards instead? We can perhaps now begin to give some answers:

1. The first is that many consumers are not aware of the interest rate applied to credit card balances and consequently are not aware that better value may be had in the market. In addition, anecdotal evidence and experience suggests that many consumers have a poor understanding of what interest rates mean and how they affect the cost of a product. The Financial Regulator seeks to address this issue by raising consumers' awareness through our periodic cost surveys. We also published a revised guide to credit cards in March 2007;
2. A second reason is that the major credit card issuers in the market do not compete strongly on the ongoing interest rate charged. A simple average of the interest rates charged by the three largest firms, who together represent 78.6 per cent of the market, is 17 per cent. (the rates charged by these three firms ranged from 16.8 per cent to 17.4 per cent.). The simple average of the interest rates charged by the other firms in the market is 13.9 per cent. It is only in this latter group that one finds firms offering sub 10 per cent rates¹⁵;
3. Many consumers only use their credit cards as a convenient payment method and do not use their credit cards to borrow. For these consumers, the interest rate charged is irrelevant; and
4. Finally, consumers may overestimate the degree of difficulty involved in switching from one credit card provider to another.

Footnotes

- ¹ Table C14, Central Bank and Financial Services Authority of Ireland, Monthly Statistics, 28 February 2007.
- ² Total personal credit card debt stood at €2.607 billion at December 2006. (Table C14, Central Bank and Financial Services Authority of Ireland, Monthly Statistics, 28 February 2007). Personal debt, excluding house mortgage finance, other housing finance and finance for investment stood at EUR16.984 billion (Table C8, Central Bank and Financial Services Authority of Ireland, Quarterly Bulletin, Number 2 2007).
- ³ Datamonitor "Payment Cards in Ireland 2006"
- ⁴ Datamonitor "Payment Cards in Ireland 2006"
- ⁵ The manner in which credit card usage has evolved differs from country to country and so some caution should be exercised in interpreting this data. For a more detailed analysis of this issue see "Irish Retail Interest Rates: Why do they differ from the rest of Europe?", McElligot, R., Central Bank and Financial Services Authority of Ireland Quarterly Bulletin, Number 1 2007.
- ⁶ A Study of the Extent And Speed of Interest Rate Pass-Through on a Basket of Retail Banking Products, Financial Regulator, July 2004.
- ⁷ Based on data collected by the Financial Regulator for the study referred to at 6 above.
- ⁸ The Failure of Competition in the Credit Card market. Lawrence M Ausubel. American Economic Review, Volume 81, Number 1, March 1991
- ⁹ Consumer Behaviour and the Stickiness of Credit Card Interest Rates, Calem, P., and Mester, L. The Wharton School, University of Pennsylvania. Working Paper 94-14. January 1994.
- ¹⁰ Switching Costs and Adverse Selection in the market for Credit Cards: New Evidence. Calem, P., Gordy, M., and Mester, L., Federal Reserve Bank of Philadelphia, Working Paper No. 05-16. July 2005.
- ¹¹ Competition in the New Zealand Credit Card Market from the Consumer Perspective. Chandran, D., Matthews, C., & Tripe, D. Journal of Asia-Pacific Business, 2005 Vol 6(1), pp 59-74
- ¹² The Irish Credit Card Market - An Overview. O'Neill, J., and Reilly, A., Central Bank of Ireland Quarterly Bulletin, Autumn 2001.
- ¹³ To Switch Or Not To Switch: An Examination of Consumer Behavior in the Credit Card Industry, Frank, D., Issues in Political Economy, Volume 10, July 2001.
- ¹⁴ As 11 above.
- ¹⁵ Financial Regulator's Credit Card cost survey, published in March 2007.

Appendix 8 - Technical terms explained

Term	Abbreviation	Explanation
Annual Percentage rate	APR	The APR is the annual rate of interest charged on a loan. It takes account of all the costs involved over the term of the loan such as any set-up charges and the interest rate.
Augmented Solvency Models	ASM	A model which computes the level of capital that may be required to be held by a reinsurance undertaking.
Collective Investment Schemes	CIS	<p>A legal vehicle (e.g. unit trust, investment company, investment limited partnership, common contractual fund) which is established for the purpose of a) accepting subscriptions from the public in exchange for units/shares in the scheme, b) pooling those subscriptions and c) investing them, through professional managers, in accordance with investment objectives set out in a prospectus.</p> <p>There are two types of Collective Investment Schemes (CIS):</p> <ul style="list-style-type: none"> ▶ UCITS - Undertakings for Collective Investment in Transferable Securities which are authorised under the EC (UCITS) Regulations 2003. These CIS's can be marketed within the European Union, provided that the CIS and fund managers are registered in Ireland. ▶ Non - UCITS - Collective investment schemes authorised under the Unit Trusts Act 1990, Part XIII of the Companies Act 1990, the Investment Limited Partnerships Act 1994 and the Investment Funds, Companies and Miscellaneous Provisions Act, 2005.
Committee of European Banking Supervisors	CEBS	CEBS gives advice to the European Commission on banking policy issues and promotes co-operation and convergence of supervisory practice across the European Union.
Committee of European Insurance and Occupational Pensions Supervisors	CEIOPS	Its role involves providing advice to the European Commission in its preparation of draft implementing measures, to improve co-ordination among insurance and pension funds supervisors and to promote consistent implementation of community legislation in the Member States.
Committee of European Securities Regulators	CESR	Its role is to improve co-ordination among securities regulators and act as an advisory group to assist the EU Commission. It also works to ensure more consistent and timely day-to-day implementation of community legislation in the Member States
Employee Share Ownership Plans	ESOP	Employee share ownership plans refer to arrangements that provide for ownership of shares by employees in their own firm. Shares are held for the employees in a trust.
General Accepted Accounting Principles	GAAP	This is a general term for a set for a set of financial accounting standards and reporting guidelines used to prepare accounts in a given jurisdiction.
Internal Capital Adequacy Assessment Process	ICAAP	The Capital Requirements Directive requires that institutions should themselves have in place own processes and methods to assess their overall capital adequacy. Based on the assessment of risks and risk management, institutions determine the amount of capital required to cover their risks. This assessment is known as the Internal Capital Adequacy Assessment Process (ICAAP). The task of the Financial Regulator is to assess and review supervised financial service providers ICAAPs as a whole.
International Financial Reporting Standards	IFRS	A set of global accounting standards issued by the International Accounting Standards Board (IASB). Many of the standards forming part of the IFRS are known by the older name of International Accounting Standards (IAS)

Term	Abbreviation	Explanation
Irish Enterprise Exchange	IEX	The Irish Stock Exchange's market for small to mid-sized companies
Personal Retirement Savings Accounts	PRSA	A PRSA is a long term savings account designed to assist people to save for their retirement. A PRSA product may be either a standard PRSA product or a non-standard PRSA product. There are certain investment restrictions on Standard PRSA products and also restrictions on the amounts that a PRSA Provider can charge in respect of a Standard PRSA.
Professional Investor Funds	PIF	A professional investor scheme is a category of non-UCITS collective investment scheme authorised by the Financial Regulator for which there are less investment and borrowing restrictions imposed. A professional investor scheme has a minimum subscription requirement of €125,000.
Qualifying Investor Fund	QIF	A qualifying investor fund is a category of non-UCITS investment fund authorised by the Financial Regulator for which investment and borrowing restrictions are disapplied in full. QIFs have a minimum subscription requirement of €250,000. Investment is restricted to qualifying investors who certify that they are aware of the risks involved and the fact that they may lose the entire sum invested. A qualifying investor is defined as an individual with a minimum net worth (excluding main residence and household goods) in excess of €1.25 million or an institution, which owns or invests on a discretionary basis at least €25 million.
Quantitative Impact Study	QIS	Quantitative Impact Studies acquire insight into potential quantitative impacts of a new solvency system. A QIS invites regulated financial service providers to estimate the financial outcomes of draft versions of future regulatory requirements. In the case of the Solvency II Framework Directive for insurers and reinsurers, the results of the QISs form key input into the European Commission's Impact Assessment and the ultimate design and calibration of the future regulatory system.
Regulatory Impact Analysis	RIA	A tool used to assess the likely effects of a proposed new regulation. It involves an analysis to ascertain whether or not the new regulation would have the desired impact. It helps to identify any possible side effects or hidden cost associated with the regulation.
Savings Protection Scheme	SPS	The Credit Union Act, 1997 provides that the Registrar of Credit Unions may approve a savings protection scheme. The purpose of the scheme would be to protect members' funds in the event of a credit union becoming insolvent.
Special Purpose Reinsurance Vehicles	SPRVs	This is a once-off reinsurance company. Its sole purpose is to issue bonds and write one reinsurance contract. The funds retained in the Special Purpose Vehicle from the bond issue are equal to the limit on the reinsurance contract it writes.
Special Savings Incentive Account	SSIA	SSIAs are a five-year savings scheme in which the Exchequer tops-up, by way of a tax credit, subscriptions made by an individual to his or her SSIA. SSIAs commenced between 1 May 2001 and 30 April 2002 and matured during the period 31 May 2006 to 30 April 2007
Sub-Prime Mortgage		These mortgages are geared toward borrowers who have, or are in the process of financially recovering from, prior incidents of credit problems (e.g., a default, a recent history of arrears on a previous mortgage or other financial obligation) or who have self-declared income or a limited credit track record, and therefore cannot obtain financing in the prime lending arena. Typically, the borrower must demonstrate that his or her financial situation has improved and is stable. The lender will, to the extent possible, verify that the borrower has sufficient and stable income to comfortably meet the payment obligations on the mortgage. Furthermore, the lender will usually restrict the loan-to-value (LTV) ratio to relatively low levels and will charge relatively high interest rates to compensate for the additional risk inherent in the mortgage. The combined effect of this underwriting helps to reduce the otherwise risky nature of these mortgages.

Appendix 9 - Financial Regulator Organisation Chart

IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

Chairman: Brian Patterson

Members: Alan Ashe, Gerard Danaher, John Dunne, Jim Farrell, Alan Gray, Patrick Neary, Mary O'Dea, Deirdre Purcell and Dermot Quigley
 Other Attendees: Con Horan (Prudential Director) and Martin Moloney (Secretary)

Chief Executive

Patrick Neary

Prudential Director

Con Horan

Financial Institutions and Funds Authorisation

Michael Deasy

Fiona McMahon

Central Authorisations Function
 Policy issues relating to Funds, Auditing, Accounting and Corporate Governance
 Unauthorised Financial Service Providers

Banking Supervision

Mary Burke

Frank Brosnan
 Billy Clarke

Credit Institutions
 Complex Groups
 Financial Stability

Insurance Supervision

Patrick Brady

Andrew Mawdsley
 Mike Frazer

Life and Non Life Insurance
 Reinsurance

Investment Service Providers Supervision

Anne Troy

Tom Meade

Investment and stockbroking firms
 Fund Service Providers
 UCITS III Management companies
 Retail Intermediaries
 Bureaux de Change
 Funds Regulatory Reporting
 ICCL

Markets Supervision

Martin Moloney

Sandra Shanley

Irish Stock Exchange
 Finex Europe
 Securities trading (except funds)

Registrar of Credit Unions

Brendan Logue

Elaine Byrne
 James O'Brien

Credit Unions
 Prevention of Money Laundering

Legal and Enforcement

George Treacy

Grace O'Mahony

Enforcement Policy
 Legal Advice
 Administrative Sanctions inquiries

Planning and Finance

Patricia Moloney

Bernie Mooney

Strategic Planning
 Budgets and Funding
 Consumer and Industry Consultative Panels
 Organisation Development
 Publications
 Project co-ordination
 EU Co-ordination

Consumer Information

Sharon Donnelly

Karen A O'Leary

Consumer Communications
 Advocacy and Campaigns
 Market & Competition Monitoring
 Consumer Contacts
 Education

Consumer Protection Codes

Bernard Sheridan

Colette Drinan
 Brenda O'Neill
 Martin Sisk

Consumer Protection Code
 Bank Charges
 Consumer Credit issues
 Advertising of financial services
 Consumer compliance inspections



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