Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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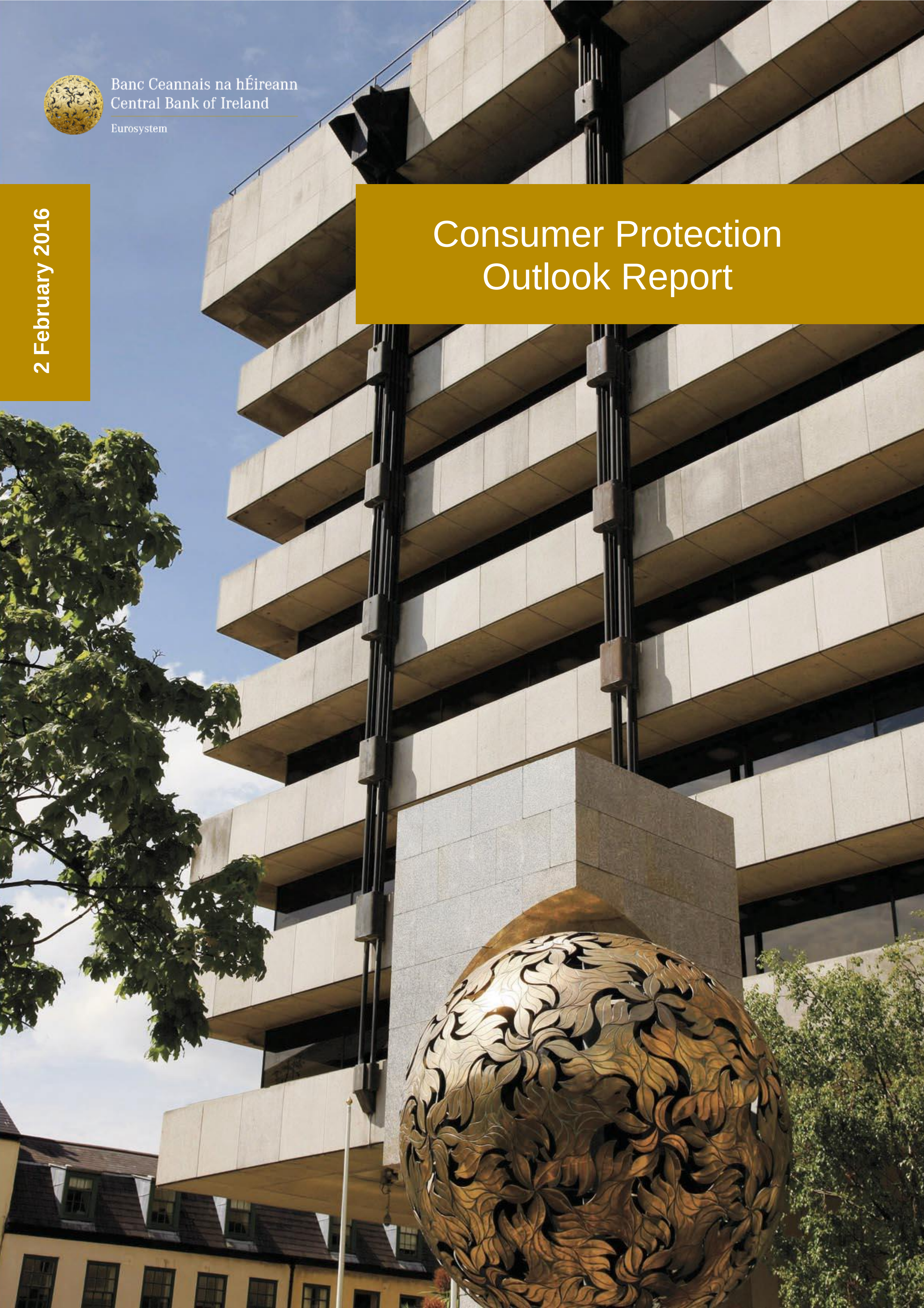
Consumer Protection Outlook Report



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Foreword

Ensuring that the interests of consumers of financial services are protected continues to be a key priority for the Central Bank as reflected in our mission statement of "Safeguarding Stability – Protecting Consumers" and in the strategic objectives of our new Strategic Plan, 2016 – 2018. The Consumer Protection Outlook Report (CPOR) is published each year within the context of our Consumer Protection Strategy "Getting It Right for Consumers" which is delivered through our overarching 5Cs consumer protection framework.

This CPOR is being published as Ireland continues to emerge from the global economic and financial crisis and moves towards recovery, stability and growth. In order to restore consumers' trust and confidence in the financial system, firms must be focused on developing and embedding a strong, sustainable consumer-centred culture from the board room to the frontline. To do this, they must understand and fully consider the needs, expectations and interests of all their customers, both existing and new, when developing their business strategy and models and in designing and selling their products and services. Firms must act in a fair, open and transparent way and continuously monitor and review their products and services to satisfy themselves that they are acting in their customers' best interest, and that they put things right when they go wrong in a timely and reasonable way.

The CPOR outlines our consumer protection objectives and our assessment of the current and emerging consumer environment and risks to those objectives, for full consideration by the firms we regulate. It sets out a number of priorities that we will be focussing on in the context of our desired consumer protection outcomes:

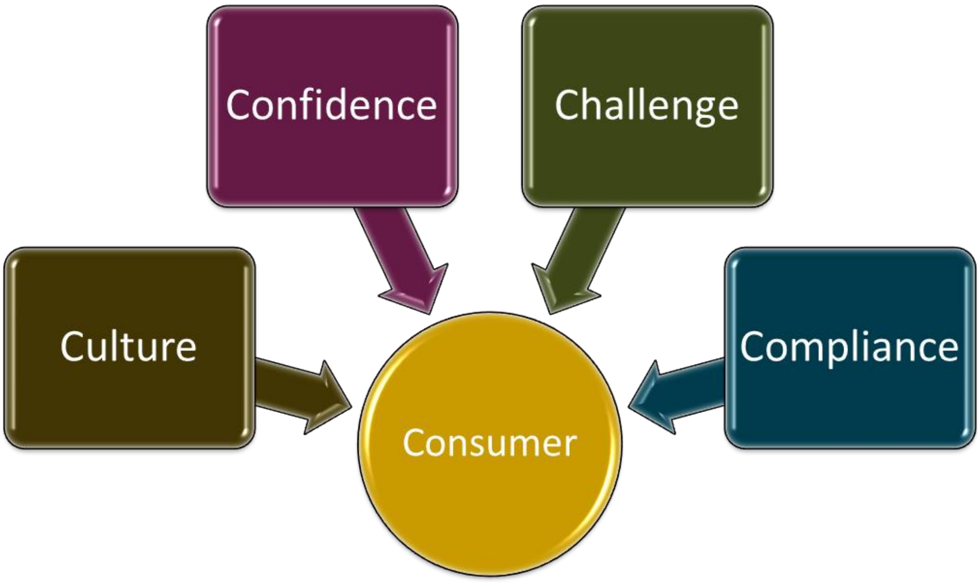
- a positive consumer-focused culture that is embedded and demonstrated within all firms;
- a consumer protection framework that is fit for purpose and ensures that consumers' best interests are protected; and
- regulated firms that are fully compliant with their obligations and are treating their customers, existing and new, in a fair and transparent way.

It is not our role to run the firms we regulate nor is it to set their strategies (including in relation to the setting of prices and rates charged) or to determine their business models. Boards and senior management are responsible for those decisions and for ensuring that they are acting in the best interests of their customers in all that they do. The Central Bank will continue to challenge firms to demonstrate to us that they are delivering their financial services to the highest consumer protection standards.

Bernard Sheridan
Director of Consumer Protection
Central Bank of Ireland

Delivering on Our Consumer Protection Objectives

There is a strong consumer protection framework in place in Ireland with the Central Bank playing an important role as regulator and supervisor of firms. Our consumer protection strategy "Getting It Right for Consumers" and 5Cs framework continue to provide a sound basis for our risk-based approach to delivering on our consumer protection objectives and the outcomes we strive to achieve.



This framework puts the **Consumer** at its centre, where the focus of firms must be on delivering positive consumer outcomes within a regulatory framework that is fit for purpose. This can only be achieved where firms have a consumer-focused **Culture** which enables consumers to have **Confidence** in the financial decisions they are making and the firms they are dealing with. Firms need to **Challenge** themselves and be challenged by the regulator where their focus is not on those consumer outcomes. There is a need and appetite for appropriate regulatory action where **Compliance** standards are not being met.

Key Consumer Protection Risks

Financial products and services provide many benefits to consumers and are critical to both their day-to-day lives and safeguarding their future. However, they can also present threats to consumers, not only in terms of the risks inherent in the products and services themselves, but also from the firms which are providing those services, the people who run them and, indeed, from the wider market.

We adopt a risk and evidence-based approach in prioritising our work, which ensures that we are focussing our resources on those areas where we consider there to be a significant threat to our consumer protection objectives. This includes carrying out a comprehensive annual consumer risk assessment, whereby we examine each of the retail sectors regulated by the Central Bank to identify current and emerging risks. This assessment is informed by intelligence from a number of sources, including:

- our engagement with stakeholders, including consumer groups and statutory consumer bodies;
- external and internal market research and analysis;
- our supervisory work and experience, including analysis of consumer data submitted by the larger retail firms;
- advice from the Consumer Advisory Group; and
- developments at a European and international level.

Culture

The absence of a consumer-focussed culture presents the greatest threat to our objectives of achieving long-term, sustainable and positive outcomes for consumers. Globally, financial services regulators have introduced many rules and regulations to seek to influence a cultural shift in regulated firms. These rules include consumer protection codes, corporate governance codes, fitness and probity requirements, minimum competency rules and remuneration guidelines. However, we share the view of other regulators that culture cannot be changed simply by introducing rules and it remains the case that senior management must take responsibility for the behaviour and culture of their firms. Good conduct is not just about tick-box compliance with the letter of the law but about having a culture that focuses on the best interests of consumers in the short and long term.

Product Oversight and Governance

There are many examples of poor product governance spanning across both simple and more complex financial products. Through our supervisory work, consumer research, market monitoring and stakeholder engagements, we have found that consumers continue to find many financial products and services complex and difficult to understand. Product documentation can also be lengthy and confusing. Complexity also arises when firms provide different versions of similar products leading to product proliferation.

Firms must be able to demonstrate that their products are fit for purpose – this means that firms must ensure that products are fully understood by customers and are suitable for their individual needs. We therefore expect firms to conduct consumer-testing on their products (including their product literature) and to simplify them where necessary; to use plain language; and to go beyond disclosure and *caveat emptor* to ensuring consumers' general understanding of products before launch and individual consumer's understanding of the product during the sales process. They must also continuously satisfy themselves that products remain suitable for the target market.

Indebtedness and Arrears

While many people are benefitting from the economic recovery, many continue to struggle to meet repayments on mortgages and other debts. It is imperative that lenders continue to work with over-indebted consumers to try to resolve their arrears situation and to work with co-operating borrowers to achieve sustainable solutions.

Any future increases in interest rates may also present significant challenges for consumers who are already over-indebted. As the economy recovers and new lending increases, now is the time for lenders to critically assess their policies and processes to ensure that there is no re-emergence of past irresponsible lending. In this context, the objective, content and tone of all forms of marketing and advertising of credit products should be to promote responsible borrowing. Lenders must also ensure that credit products offered are appropriate for each individual consumer's needs and their ability to repay.

IT Resilience and Data Security

Firms are becoming increasingly dependent on information technology with the share of services provided on-line to consumers continuing to grow, exposing them to an increasing risk of system failures and cyber attacks. When IT and data systems fail, the business and reputation of the firm and the broader financial services sector is damaged. Consumers and businesses also suffer detriment when services are interrupted and when personal data is accessed or stolen. The Central Bank has highlighted cyber risk as one of the key emerging threats to regulated firms and sectors. In this context, all firms need to improve their knowledge and understanding of the sources of this risk to be in a position to identify, monitor and mitigate any real or perceived threat this risk poses to consumers.

Low Interest Rate Environment

The continuing low interest rate environment has benefitted many borrowers. However, it has also had a negative impact on savers relying on returns from bank deposits, which are below inflation rates. This current low yield environment may influence consumers to take increased risks to secure the returns they need to provide for their future. Consumers may not fully understand the risks and costs involved in higher risk products. Firms producing and selling higher-risk investments directly or through intermediaries have a clear responsibility to ensure that any advice provided is suitable for the consumer and that they are fully informed of the increased risks of such products.

Service Delivery

We recognise that, in financial services as elsewhere, business models and methods of service provision are changing. In particular, mobile and emerging technologies provide clear benefits for consumers who wish to avail of those methods of delivery.

However, as with any delivery channel, firms must ensure that these services are reliable, safe and secure and that consumers are properly informed of their features and costs.

Where a new method of delivering a service involves changes to existing service delivery, firms must fully assess the impact of these changes on affected consumers prior to implementing them. This assessment must include a consideration of the specific needs of more vulnerable consumers and those especially affected by the change. Firms must also ensure that all customers are fully informed in a timely way of the proposed changes and be assisted, as appropriate and reasonable, to adopt the changes or to switch providers.

Claims Handling and Settlement

The providers of general insurance in the market are facing a number of challenges in relation to underwriting, claims and profitability. In meeting these challenges it is essential that insurers treat their customers in a fair and reasonable way up to and including claims handling and settlement. Where a firm is planning any changes to its strategy or business model, it must also assess the potential impact of such changes on consumers. Cost-cutting measures cannot be at the expense of basic customer service, especially in the field of insurance claims, where consumers have already paid for that service through their premium.

In the next section, we profile key consumer risks and priority themes for 2016 within our 5Cs framework and we describe the actions we will take to manage them. Managing consumer risk is not, of course, just a matter for the Central Bank. Each regulated firm has a responsibility to its consumers to consider the risks we have identified throughout the CPOR in the context of their own business structures and activities and to take the necessary steps to ensure that they are effectively managed and mitigated.

Consumer: the consumer protection framework

The Central Bank's 5Cs framework has the **consumer** at its centre, which reflects our primary aim to ensure that the focus of our work, as well as that of the firms we regulate, is on delivering the best outcomes for consumers. A key element of our role is ensuring that the consumer protection regulatory framework is fit for purpose and working for consumers and will continue to remain so in the face of emerging trends and products.

The influence of European level regulations on the shaping of the framework will continue to increase over the next few years with the introduction of important European directives in Ireland. Their scope will include mortgage credit, payment accounts, payment services, insurance distribution and investments. We have sought to influence the development of these regulations to shape a strong consumer protection framework as well as to protect many of the key protections already in place in Ireland.

In addition, the three European Supervisory Authorities (EBA[1], ESMA[2] and EIOPA[3]) (the 'ESAs[4]') are now playing an important role in shaping the consumer protection framework across Europe. The Central Bank is actively participating in the work of the ESAs to influence and contribute to their agendas, particularly in those areas that align with our own priority areas. The development of guidelines in relation to product oversight and governance as well as appropriate remuneration arrangements for sales staff are two particularly important areas being developed to underpin a strong consumer protection framework. However, for so long as consumer protection measures are pursued at a European level on a predominantly sectoral basis, it will continue to be a challenge for cross-sectoral consumer protection regulators such as the Central Bank to ensure a coherent cross-sectoral consumer protection framework, and we will continue to advocate on this point at a European level.

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[1] European Banking Authority
[2] European Securities and Markets Authority
[3] European Insurance and Occupational Pensions Authority
[4] European Supervisory Authorities

The Central Bank also continues to play an important role in the wider international development of consumer protection in financial services. FinCoNet, the international organisation of financial consumer protection supervisory authorities, is currently chaired by the Central Bank and it has recently published a report on how sales incentives can impact on the sale of credit products to consumers, which FinCoNet will follow up with an international public consultation on this topic.

We will continue to underpin our assessment of the framework and how it is working for consumers by gathering market intelligence and insights into consumer behaviour. As well as conducting our own research, we will continue to monitor social media and other outlets for emerging issues and receive mandatory returns and other market intelligence from regulated firms as well as key stakeholders including the Competition and Consumer Protection Commission and the Financial Services Ombudsman. This information provides us with insights into existing and emerging consumer issues and allows us to better challenge and assess how firms are dealing with these issues to deliver the best outcomes for consumers.

Priority themes

- In addition to supporting the Department of Finance on its work to implement key EU directives such as the Mortgage Credit Directive and the Payment Accounts Directive into Irish law, we will continue to commit our resources to influencing and shaping the international and European agenda, including the work of the ESAs. We will continue to have a strong focus on retaining and enhancing the key protections we already have in place as these new provisions are being transposed into Irish law and advocating for a coherent cross sectoral consumer protection framework at a European level.
- On 18 December 2015, the Central Bank published new regulations for firms lending to SMEs, with which regulated lenders (other than credit unions) must comply from 1 July 2016 or, in the case of credit unions, from 1 January 2017. The regulations (which will replace the existing SME Code) aim to strengthen protections for SMEs, while also facilitating access to credit, by introducing specific requirements that regulated lenders must comply with. It will be important that

SMEs are aware of the new regulations and the potential impact on them. We plan to publish, and promote to SMEs, a guide to the new regulations in advance of the new regulations becoming effective.

- On 12 November 2015, the Central Bank published proposals to strengthen existing protections for variable rate mortgage holders by requiring enhancements to the information lenders provide to consumers about variable rate mortgages. The Central Bank is also consulting on whether more notice should be given to borrowers about increases in variable rates. Following the consultation period we will consider what amendments, if any, are needed to the existing requirements in the Consumer Protection Code 2012.
- We will continue our ongoing monitoring of market developments and will conduct consumer research to inform our work, including publishing this research and key trends we observe in the market, in order to inform the wider discussion of consumer protection issues.

Culture: developing a consumer focused culture

In our 2015 Consumer Protection Outlook Report we highlighted the importance that **culture** plays in driving the behaviour of firms and the individuals within them. The Central Bank's Strategic Plan 2016 – 2018 highlights our continuing focus on challenging the industry to develop the right culture, as part of our consumer protection mandate. We remain of the view that a cultural shift must take place, enabling staff to feel that they can serve their customers' needs in a better and fairer way.

In order to achieve this sustainable shift, the Central Bank is increasingly challenging boards not just to set the tone from the top, but to own it, commit to it and to deliver on it. We will continue to challenge firms to demonstrate to us, with concrete examples, how their consumer risk frameworks and their employees' behaviours are delivering fair outcomes for consumers. Firms must be able to demonstrate that they are outcome-focused and not just process-driven. We are enhancing our on-site supervisory processes in this area, with a view to testing and measuring firms' progress in implementing fit-for-purpose consumer risk frameworks, commencing in 2016.

Priority themes

- We will build on our engagement with firms' boards and senior management to ensure that there is a clear focus from the top on embedding and measuring the firms' own cultural change programmes. We intend to continue this programme of work to challenge boards and senior management to be able to demonstrate the outcomes being delivered for consumers.
- Cultural change must be underpinned with internal support structures within firms. We intend to monitor and challenge how firms are developing their internal consumer protection risk frameworks, including governance arrangements and implementation and monitoring of performance metrics based on a comprehensive understanding of their customers' experiences, behaviours and needs. We will assess a number of banks' and insurers' internal conduct risk frameworks to identify any gaps and best practices.
- By their very nature and intent, incentive schemes seek to drive the behaviour of individuals who are engaging with consumers and reflect the inherent culture within a firm. We intend to continue our work in this area and ensure that firms are responding appropriately to the guidelines we issued in 2014 on variable remuneration arrangements for sales staff, as well as taking a fresh look at the payment of commissions to intermediaries (as we detail below) and supporting the work of EU bodies and FinCoNet in this area.

Confidence: consumer confidence in the firms they deal with

Consumer **confidence** is directly impacted by the experience they have in their dealings with firms and their staff.

Aligning the culture within a firm to the delivery of the right consumer outcomes is key to improving consumer confidence, as consumers should then be assured of a positive experience of being treated in a fair and transparent way. This alignment includes how staff are incentivised to deal with consumers and where products are sold through third parties, including intermediaries, consumers should also be able to have confidence that the intermediary is acting in their best interests. Many intermediaries are paid commission by product producers for selling their products, creating an inherent conflict of interest for the intermediary which can result in harm to consumers and undermine consumer confidence.

It is important that as the economy recovers, and as firms target new business, that the needs and interests of existing customers are fully considered and continue to be met. We expect firms to proactively seek and monitor feedback from their existing customers, to identify where they can provide better products and services and to enable them to respond in a more timely way to their needs, expectations and best interests.

Transparency can help consumers to have confidence that firms are treating them fairly. This includes making full disclosure of all relevant material information in a way that seeks to inform the consumer. As financial products and services can be very complex, firms have an obligation to help consumers to fully understand the associated risks and benefits before they make their decisions. Firms must move away from a reliance on legalistic terms and conditions - which contain clauses that are either unfair or just simply impossible for consumers to understand - to a structure that ensures that consumers have a clear understanding of the product or service they are buying.

Customers have a legitimate expectation of high quality, uninterrupted services, whether provided through traditional or on-line channels. All firms must have robust systems in place to deliver a reliable service to their customers, particularly at a time when on-line and mobile technology is increasingly being relied upon to undertake financial transactions. Firms need to communicate in an open, accurate and timely way when errors or incidents occur, keep consumers fully informed and provide redress where necessary. While there has been some improvement in how firms are responding to such incidents, we will continue to monitor how these incidents are being managed and assessed to prevent recurrence.

Priority themes

- A significant theme currently underway is the broader examination of tracker mortgage-related issues covering, among other things, transparency of communications with and contractual rights of tracker mortgage borrowers. Notwithstanding the considerable work undertaken by the Central Bank since 2008 to ensure consumers are appropriately protected, we remained concerned that there may be other tracker-related issues which could be impacting on consumers across the system. This warranted a broader examination of tracker-related issues, the purpose of which is to identify, and appropriately redress where relevant, any cases where:
    - customers' contractual rights under the terms of their mortgage agreements were not fully honoured; and/or
    - lenders did not fully comply with the various requirements and standards regarding disclosure and transparency for the customer.

  Lenders have been informed of our expectations in this regard, and we expect significant progress to be made by the end of 2016.
- We will commence an examination of the risks and benefits of commission payments to intermediaries. Our first step will be to publish a discussion paper on this topic in order to seek input from interested parties and ascertain next steps to ensure consumers' best interests are being protected in this area.
- We will be following up with lenders on the issues identified as part of the comprehensive themed review in 2015 of how lenders are delivering on the important consumer protections prescribed by the statutory Code of Conduct on Mortgage Arrears for borrowers in arrears and pre-arrears.
- Systems failures and errors will continue to be monitored to ensure that firms are delivering on their obligations to ensure that consumers are kept fully informed of any issues and that the impact on the consumer is dealt with in a timely and appropriate way.

Challenge: of firms and ourselves

One of the many challenges for supervisory authorities which are responsible for consumer protection, including the Central Bank, is to ensure that firms focus on acting in consumers' best interests and not just on maximising short-term shareholder return. This focus needs to be in place from the outset, when firms are first authorised and commence providing services. We have enhanced our processes for authorising retail firms in Ireland falling into our PRISM 'low impact' category for prudential purposes, to place a greater emphasis on challenging these firms to demonstrate how they will comply with the Central Bank's standards upon authorisation.

We also continue to **challenge** ourselves as regulators to ensure that we are delivering on the Central Bank's consumer protection objectives. In 2015, the outcome of a peer review of the Central Bank's consumer protection function (including our framework and strategy) by the Netherlands Authority for Financial Markets (AFM) was published. This was the first such review undertaken using the G20/OECD High-Level Principles on Financial Consumer Protection. While the AFM identified possible areas where the Central Bank can further develop the existing model and consumer protection approach overall, it found that the Central Bank has exhibited a strong commitment to consumer protection and commended a number of our regulatory and engagement intiatives as areas of good practice.

Challenging firms at board and senior management level on their culture, practices, products and services will continue to be a key part of our engagement with them where we believe there is or may be a threat to our consumer protection objectives, both at authorisation stage and through the on-going supervision process. We have demonstrated that we are prepared to challenge firms when we see potential consumer detriment by taking regulatory actions where necessary, including consumer redress, directions and enforcement actions under our administrative sanctions procedures and in the more egregious cases, through refusal of authorisation, suspensions to business and involuntary revocations.

Priority themes

- Credit Servicing Firms, i.e. firms which service loans sold by regulated lenders to third parties, are now subject to Central Bank regulation. On 10 December 2015 the Central Bank published the Authorisation Requirements and Standards that credit servicing firms will have to meet in order to be granted an authorisation. The introduction of these requirements is another important step towards ensuring that borrowers continue to benefit from the protections of regulation when their loans are transferred to an unregulated entity. Credit servicing firms will need to demonstrate that they meet these standards, in order to obtain authorisation and to ensure that credit servicing activities are carried out in a fair and professional manner, where the best interests of consumers are protected.
- We have also developed a new Authorisation Process Model for other retail sectors including payment institutions, electronic money institutions, bureau de change, retail intermediaries, debt management firms, retail credit firms and moneylenders. This new model has been rolled out for payment institutions and e-money institutions and we will be rolling it out to other sectors during 2016, where applicants can expect greater challenge on their business models and strategies. The model also introduces a more transparent process for applicant firms in terms of information required and timelines for decisions.

Compliance: how firms are meeting and demonstrating compliance

In the 2015 Consumer Protection Outlook Report we were clear in our view that achieving **compliance** is the minimum standard and that firms need to go beyond the minimum legal requirements and move to delivering meaningful outcomes for consumers. During 2015, we carried out a number of themed reviews and inspections across the different retail sectors enabling us to identify and pursue issues with individual firms and also to provide feedback to the wider industry. It is important that all firms consider such feedback in the context of reviewing and enhancing their own practices and processes.

Considerable time and resources were expended by the Central Bank in 2015 successfully targeting firms which were not engaging appropriately with us, including firms which were failing to submit the basic information necessary for us to be able to effectively supervise them. Many of these firms are/were intermediaries acting on behalf of larger product producers. This area will remain a priority for us in 2016.

As part of our longer-term strategy for monitoring and enforcing compliance across the large number of smaller retail firms, including intermediaries, we intend to dedicate more resources to carry out proactive firm-specific inspections across these sectors. This will be in addition to carrying out thematic work on key risks identified.

We will also continue with our initiatives to help smaller firms understand their responsibilities better, including hosting road shows around the country and the publication of newsletters for a number of industry sectors.

As part of our supervisory strategy, we commenced a program of product-specific reviews in 2015, covering products traditionally offered to retail consumers and those that have not to date been specifically targeted at retail consumers. In 2015, we examined the sale of contracts for difference (CFDs) to retail clients and the sale of annuities, the findings of which have been published.

Priority themes

- We will continue our reviews of investment products focusing on the sale of structured products to retail consumers. The sale of private health insurance is also being examined, particularly in relation to compliance with the Central Bank's requirements at time of renewal. Due to the large number of variations in products available on the market, this will continue to be an area of focus for us.

- Insurance companies are required to ensure that any claim settlement offer made to a claimant is fair and to ensure that claimants are given sufficient time to accept or reject an offer. We intend to review compliance in this area to ensure that insurers are meeting their obligations, with a specific focus on motor insurance.

- We will continue to focus our supervisory work on firms that are not meeting the minimum standards in terms of complying with reporting and other obligations to the Central Bank. While many of these firms are small they can nevertheless pose a serious threat to our objectives, as non-compliance in one area can often be a sign of wider issues which can negatively impact on consumers.
- We will increase the frequency of our proactive firm-specific inspections of firms in the retail intermediary sector.