
Financial Regulatory Framework Review – An update

2010

Financial Services
Consultative Consumer
Panel, Ireland

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1. Summary of the Main Points

- The Consumer Panel is satisfied that the key points of its 2009 report were taken on board and it now wants to revisit it to examine the developments within the financial services sector over the last year and to highlight any issues that it thinks still need to be addressed.
- The Consumer Panel has pointed towards threatening forces at work in the local and International scene on numerous occasions. These warnings were not heeded and the response of the Financial Regulator was deficient resulting in a substantial impact on consumers during the current financial crisis.
- There were no clear lines of responsibility in the regulatory framework between the Central Bank, Financial Regulator, the Department of Finance and the financial institutions themselves.
- It must be recognised that Capital is at the heart of the financial services industry and robust prudential supervision is essential to maintain financial stability and consequently the protection of consumers. Stronger long-term capital adequacy requirements will mean better protection for consumers; however, excessive capital requirements can also be harmful through the restriction of available credit. While this is an inevitable consequence resulting in consumers being penalised in the short-term, there needs to be very real awareness that consumers should not pay in the long-term and more robust consumer protection is required now more than ever.
- The Consumer Panel is satisfied that the Deposit Guarantee Scheme has been extended until December 2010 but is concerned as to what will happen when this time period has lapsed. The Consumer Panel was alert in its recommendations from an early juncture on this issue but, as was the case with the regulation of sub-prime lenders, the Financial Regulator stated it was not its concern but rather that of the Department of Finance and it would await developments at EU level. This demonstrated to the Consumer Panel that the Financial Regulator failed to properly understand its role in protecting the consumer.
- Consumers should not be disproportionately punished with higher fees and interest charges in order for the Banks to rebuild their balances, especially while the Government is contributing substantial sums to them.
- Right must continue to be done and the risk-based model of supervision implemented by the Head of Financial Regulation, Matthew Elderfield, must now be maintained.

Credit Review Office

- The Consumer Panel welcomes this additional appeals avenue for consumers that are adversely affected by the restriction of credit within the banking sector at present.

However, we are disheartened that the Credit Review Office has no regulatory or mandatory powers relating to the opinions it furnishes on applications.

Statutory Commission of Investigation

- While the Governor of the Central Bank may feel that the reasons for the financial crisis were set out in the Honohan Report and Regling/Watson Report, the Consumer Panel is of the view that the Statutory Commission of Investigation is of critical importance to provide answers to the consumers who are bailing out banks and that clear terms of reference needed to be outlined for the Investigation.
- The Consumer Panel is satisfied to see that the Minister for Finance has advanced this issue by appointing Mr Peter Nyberg, former Director General for Financial Services at the Finnish Ministry of Finance, to lead the Commission of Investigation into the banking sector. In addition, the requirement for the Commission to complete its report within 6 months of its establishment is an important and welcome time limit.
- The Consumer Panel is also satisfied with the referral of the policy lessons arising from the preliminary reports into the banking crisis to the Joint Oireachtas Committee on Finance and Public Service to be further considered; with it reporting back to the Dáil and Seanad by the end of October 2010.

Rules, Principles and Sanctions

- It is now known that the light-touch approach to regulation that was in use in Ireland failed, and as suggested by some, was never really properly implemented in the first place. The response of the Financial Regulator was deficient and the effects will be felt by the Irish consumer for a considerable time to come.
- Both large and small market participants must be pursued with the same vigour to prevent a re-emergence of undesirable practices that have been a major feature of the financial services industry.
- The Consumer Panel welcomes the Financial Regulator's published plans for reforming its approach to banking supervision and the *Central Bank Reform Bill, 2010*, as positive steps towards correcting the turmoil in the banking sector. It has been calling for more robust regulation since its establishment, and the new more 'intrusive' approach to be taken should not only stabilise the financial services sector but provide the protection for consumers that has been woefully inadequate to date.

Culture

- If the culture in the Irish financial services sector is to be reformed for the better, those who were at the top during the years that lead us to the current crisis must be replaced. It is only with new independent thinking that we can be sure that same mistakes are not repeated to the detriment of the Irish people.

Systemic Control – Product Regulation & Rearrangement of the Financial Architecture

- It was stated that both products and institutions should be regulated, and the Financial Regulator should not just ignore products it feels are not within its remit; especially if those products may have an effect on the stability of the financial system.
- The expression of concern in relation to a ‘negative equity’ mortgage product appears to be in conflict with the new thinking outlined in *‘Banking Supervision: our new approach’* published by the Central Bank where it is stated that under the review of the Consumer Protection Code it will consider *‘incorporating new provisions in relation to product development/design and risk, particularly in relation to the information to be provided to consumers’*.
- The Consumer Panel understands that the introduction of product regulation for existing products may be difficult but at a minimum we recommend that new products being introduced should be regulated and the Consumer Panel would suggest it take the form of a one-page cover document to outline the main points of the particular product. This could then be either approved or rejected by the Financial Regulator.
- The Consumer Panel reiterates its proposal that a special unit be established within the Financial Regulator that would scrutinise all new players and products emerging on the domestic market for systemic risk.
- The Financial Regulator must heavily regulate retail banks to prevent them from getting involved in risky practices and becoming closeted investment banks, and should also control who is allowed to access the financial markets especially if liability will fall on the shoulders of the taxpayers. The Consumer Panel is satisfied that the new Head of Financial Regulation is taking a firm hand with the banks.
- European legislation to regulate the derivatives markets will be brought forward in 2010 and will be in line with the objectives agreed at the G20 meeting of 25, held in September 2009. The European Commission further intends to cooperate with its G20 partners to ensure coherent implementation on a global scale. The Consumer Panel is in agreement that this is a positive response to an area that had a major impact during the financial crisis.

Central Bank Organisation – Hearing the Voice of the Consumer

- While the Consumer Panel welcomes the commitment to fixing the banking system, it is nonetheless concerned about where the consumer fits in the new framework.
- While the Consumer Panel is saddened that it is to be abolished, it lobbied the Minister for Finance, Brian Lenihan, to improve the structure and remit of the new Consumer Advisory Group and is grateful that he agreed with our recommendations.

- The Consumer Panel is satisfied with its improved remit but considers the wording of Section 18E, in particular, *'if the Bank so requests'*, as a fundamental weakness in the remit of the Consumer Advisory Group to be established. It raises concerns for the Consumer Panel about the place of the consumer in the new structure. There must be a focus on the challenges ahead for consumers and the new regime must work robustly on their behalf. The Consumer Panel urges the new Consumer Advisory Group to continue to advance the consumer cause into the future by developing on the sizeable work already undertaken by it and retaining its activist philosophy in ensuring the consumer is central to any financial regulation or policy development.

De Larosière Report

- The Consumer Panel is satisfied that the Financial Regulator is taking account of the new European structures while undertaking its own restructure at present as outlined in the *'Banking Supervision: our new approach'*.

Corporate Governance and Regulatory Governance

- There were a number of unsavoury practices including weak governance and risk management operating within the financial institutions, along with a failure of bank management to maintain safe and sound banking practices. These came to light in the midst of the financial crisis and resulted in consumers paying heavily to fix the mistakes that were made.
- The Consumer Panel submitted its comments on the Financial Regulator's Consultation paper on Corporate Governance Requirements in June 2010. The Consumer Panel welcomes the introduction of new standards as the first step in changing the mindset in relation to governance in our financial institutions but notes that the draft code as it stands is weak and deficient and requires significant revision.
- The Financial Regulator has stated that failure to comply with the new standards *may* be subject to sanction under the Administrative Sanctions Framework but the Consumer Panel is of the view that it is essential for the Financial Regulator to use the punitive measures available to ensure compliance and failure by the Financial Regulator to act on a serious corporate governance issue should be punishable.
- There needs to be a review of the current 'fitness and probity' standards and a robust and mandatory code of conduct should be introduced in order to further reinforce appropriate Corporate Governance standards throughout the financial services sector.
- The Consumer Panel, as previously stated, maintains the view that the Government should legislate to provide a comprehensive framework of legal protection for those who speak out to report matters of public interest in good faith.

- It is likely that there will be a smaller number of players in the retail banking sector in the coming years. The Consumer Panel is concerned that as a result the consumer could be subjected to a plethora of additional charges with dubious legality under competition law. The Consumer Panel urges the Financial Regulator not to neglect competition issues arising in the coming years considering its reluctance to play a role in competition law in the financial services industry to date.

Appointment Process – Board, Management and Staffing Issues

- There is an obvious need for the Financial Regulator to recruit experienced staff but the emphasis must be on recruiting the right people to do the job required, while ensuring value for money.

Budget Implications for the Financial Regulator

- The Consumer Panel suggests that the budget should be under continuing review to ensure that the Financial Regulator is providing excellent value for money in line with comparable bodies in other jurisdictions, not only providing effective prudential supervision but robust consumer protection in light of the current and changing nature of the financial services industry.

Section 33AK

- It remains our position that Section 33AK needs to be amended specifically in relation to Consumer Protection Laws enforced by the Financial Regulator (as we have highlighted in a legal opinion) so it does not hide behind it when being asked questions that are in the public interest.

‘Banking Supervision: our new approach’

- The Consumer Panel notes that there is a weakness in the structure as presented on page 23 of the document. While there is a position of financial control at the lower level, there is no Chief Financial Officer at Board level. The Consumer Panel is of the view that a CFO at the executive level is of fundamental importance in the process of reforming the Central Bank and Financial Regulator.
- An Oireachtas Committee is to conduct a statutory review of the Financial Regulator but this type of review will be carried out after policy decisions have already been implemented. This is considered a weakness in the monitoring of the Financial Regulator to ensure it is effectively performing its functions.
- The Consumer Panel calls for a more detailed strategy in relation to recruitment so that it can be sure the correct level of expertise and skill is recruited to deal with the current financial crisis and any problems that may arise in the future.
- The Consumer Panel considers the establishment of a Risk Experts Panel a good proposal but care must be taken to ensure there is the correct level and depth of

expertise on the panel. The Consumer Panel is of the view that it would have been extremely beneficial if such a panel had existed prior to the current financial crisis.

- The Consumer Panel is of the view that reform is needed and remuneration policies must not allow or encourage excessive risk-taking in the future. The Consumer Panel is in agreement with the EU Commission recommendations for the introduction of a risk-focused remuneration policy. Furthermore, the Consumer Panel would like to refer to the words of Jean Claude Trichet, that financial institutions should be using profits to strengthen their capital bases rather than paying staff unwarranted bonuses.
- If financial institutions are to offer any bonus, it should be in the form of shares that cannot be sold for a 5 year period rather than cash; disclosure to relevant stakeholders should include the Department of Finance, the Financial Regulator, the financial institution shareholders and the relevant Oireachtas Committees; the Central Bank Commission should have enforcement powers and sanctions available in order to ensure that Irish financial institutions follow the remuneration policy set out by the EU Commission recommendations.
- The Consumer Panel would like to highlight the lack of a real consumer mandate running throughout the document.
- The Consumer Panel can only agree with Ben Bernanke who stated that '*A fundamental element of effective financial regulation is protecting consumers from unfair and deceptive practices. The recent crisis clearly illustrated the links between consumer protection and the safety and soundness of financial institutions*¹'. This has been the consistent view of the Consultative Consumer Panel through all of its work since its establishment in November 2004.

¹ The Board of Governors of the Federal Reserve System.
<<http://www.federalreserve.gov/newsevents/speech/bernanke20091023a.htm>> (date accessed: 14 July 2010)

2. Introduction

“The role of the Financial Regulator is to help consumers make informed decisions on their financial affairs while fostering sound dynamic financial institutions in Ireland. The role of the Consumer Panel is to monitor the performance of the Financial Regulator....The regulation of institutions is not only central to ensuring the stability of the financial system but also serves to protect consumers.”

Consumer Panel Report, May 2009. (Perspective of the Consumer Panel on the Current Financial Regulatory Framework)

It has been a year since the report on the ‘*Perspective of the Consultative Consumer Panel on the Current Financial Regulatory Framework*²’ was published. This report highlighted the concerns of the Consumer Panel in relation to a number of areas affected by the credit crisis and the deficient response of the Financial Regulator to the events that unfolded in Ireland thereafter. While the objective of the Consultative Consumer Panel is to monitor the performance of the Financial Regulator from a consumer viewpoint, it is obliged to comment on both prudential supervision and consumer protection as these aspects of financial regulation are inextricably linked. The Consumer Panel is satisfied that the key points of the Financial Regulatory Framework Report (the 2009 Report) were taken on board and it now wants to revisit this report to examine the developments within the financial sector over the last year and to highlight any issues that it thinks still need to be addressed.

The Consumer Panel has pointed towards threatening forces at work in the local and International scene on numerous occasions. These warnings were not heeded and the response of the Financial Regulator was deficient resulting in a substantial impact on consumers during the current financial crisis. The Central Bank was responsible for the financial stability of the system, while the Financial Regulator was responsible for financial services sector regulation and consumer protection. This structure and division of responsibility resulted in a lack of scrutiny for potential causes of systemic risk in the system as a whole. Furthermore, the notion that the Central Bank could not influence the Financial Regulator to act sooner was illogical as there were seven members in common on both Boards. There were no clear lines of responsibility in the regulatory framework between the

² The Financial Services Consultative Consumer Panel. *Perspective of the Consumer Panel on the Current Financial Regulatory Framework* (2009)
<<http://www.financialregulator.ie/consultative-panels/consumer/Pages/FormalSubmissions.aspx>>

Central Bank, Financial Regulator, the Department of Finance and the financial institutions themselves.

It must be recognised that Capital is at the heart of the financial services industry and robust prudential supervision is essential to maintain financial stability and consequently the protection of consumers. The Consumer Panel highlighted in the 2009 Report that the Financial Regulator failed to properly control the property market bubble or take action by requiring banks to set aside more capital for riskier products. The Consumer Panel is satisfied to see that work has been done in this area with the Financial Regulator having undertaken a review of bank capital requirements for the next three years to 2012. New capital requirements, along the lines of emerging International standards, have been set for the banks under the Government guarantee in order to ensure they withstand future losses. Matthew Elderfield, the Head of Financial Regulation stated *'it is important that our banks move to a strong capital position as soon as possible and that we draw a line under the Irish banking crisis. Sufficient capital is an essential ingredient to ensure that banks can withstand future losses. We have applied a robust, realistic and prudent capital standard informed by our own detailed analysis and by emerging best practice internationally.'*³ Stronger long-term capital adequacy requirements will mean better protection for consumers; however, excessive capital requirements can also be harmful through the restriction of available credit. While this is an inevitable consequence resulting in consumers being penalised in the short-term, there needs to be very real awareness that consumers should not pay in the long-term and more robust consumer protection is required now more than ever.

The Consumer Panel is satisfied that the Deposit Guarantee Scheme has been extended until December 2010 but is concerned as to what will happen when this time period has lapsed. The Consumer Panel had several communications with the Financial Regulator around the time of the Northern Rock run requesting the deposit scheme guarantee to be increased indefinitely, thereby harmonising it with the EU guarantee of €100k for consumers and we still maintain this position. The Consumer Panel was alert in its recommendations from an early juncture on this issue but, as was the case with the regulation of sub-prime lenders, the Financial Regulator stated it was not its concern but rather that of the Department of Finance and it would await developments at EU level. This demonstrated to the Consumer Panel that the Financial Regulator failed to properly understand its role in

³ The Financial Regulator.
<<http://www.financialregulator.ie/press-area/press-releases/Pages/FinancialRegulatorPublishesNewLevelsofCapitalRequiredforIrishBanks.aspx>>

protecting the consumer. An EU press release⁴ was recently issued on the Commission's proposals to boost consumer protection and confidence in financial services by fully amending Directive 94/19/EC⁵. The key proposals include an upgrade of cover to €100k meaning 95% of bank account holders in the EU will be covered if a bank fails, faster payouts, less red tape for cross-border account holders, and better information on the cover and functioning of guarantee schemes. The Consumer Panel welcomes these proposals and recognises the increased protection and security it offers consumers.

Consumers should not be disproportionately punished with higher fees and interest charges in order for the Banks to rebuild their balances, especially while the Government is contributing substantial sums to them. Vulnerable customers must be protected from the possibility of banks operating together in setting their charges. There must be confidence in the Financial Regulator that he will act fairly and watch for such undesirable practices in order to better safeguard consumers of financial institutions.

The European Central Bank has set interest rates at historically low levels to stimulate the economies that have been in depression. Yet, while the scale of the downturn in Ireland is one of the worst in the EU, many Irish consumers are now paying higher interest rates than before the crisis hit and are therefore not benefiting from the ECB stimulus. This is particularly true of the consumers who are on standard variable mortgages and who are being hit by successive interest rate hikes even though the ECB interest rate remains unchanged.

When Permanent TSB first instigated this policy the Consumer Panel asked whether the Central Bank/Financial Regulator had engaged in any sensitivity analysis to establish whether the borrowers could weather those hikes or whether the hikes would simply increase default levels. This question was asked both from a consumer protection and prudential perspective. The Consumer Panel never got an adequate response.

The banks have persisted with the policy to the point where there are now two categories of consumers - ones who are protected through their tracker mortgages and ones who are being mercilessly fleeced in order to rebuild the banks' balance sheets. The Consumer Panel is concerned that this second group of consumers are effectively being treated as

⁴ The European Union. Press Release of the European Commission. IP/10/918. 12/7/10
<<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/918&format=HTML&aged=0&language=EN&guiLanguage=en>>

⁵ Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, O.J. L135, 31.05.94. P.5-14

second class citizens who are being forced to pick up a disproportionate share of the bank rescue costs. The Consumer Panel is unclear as to who will articulate their needs in the new regulatory architecture and to what extent their voices will be heard.

In addition, the Consumer Panel questions whether allowing banks to push up interest rates despite the low rates being set by the ECB is consistent with the effective implementation of the Eurosystem's monetary policy which is supposedly one of the chief high level goals of the new Central Bank Commission as outlined on page 3 of the Central Bank's Strategic Plan for 2010 – 2012.

The unacceptable pace of investigation into how the whole financial system in Ireland came so close to collapse leaves a lot to be desired. Ireland is not alone in experiencing a financial crisis but is not on pace with other jurisdictions such as the US and Iceland in examining what went wrong. The Commission of Investigation into the Banking Crisis is of vital importance for consumers in order to better understand what happened and how it was allowed to get to such a critical point; but in the view of the Consumer Panel should have been established sooner. Furthermore, there has been very little outcome from ongoing investigations into dealings at some of our major institutions by the Gardai, Office of Director of Corporate Enforcement or the Financial Regulator.

There appeared to be very little action taken in the latter half of 2009 to deal with the financial crisis. While many were expecting a swift response, several of the measures designed to stabilise our financial system are only now coming online. There is now a new Governor of the Central Bank, and Head of Financial Supervision installed at the Central Bank and Financial Regulator Authority Ireland. We have seen the introduction of a Deposit Guarantee Scheme for consumers and a Government Bank Guarantee Scheme, both of which have been extended to December 2010; bailouts for AIB and Bank of Ireland and Irish Nationwide; the nationalisation of Anglo Irish Bank; the introduction of NAMA; the announcement of a Statutory Commission of Investigation into the banking crisis; the setting of new capital requirements by the Head of Financial Regulation Matthew Elderfield; the introduction of a Credit Review Office; Quinn Insurance put into administration by the Financial Regulator; proposals on new corporate governance rules; the *Central Bank Reform Bill, 2010*; and the publication of 'Banking Supervision: our new approach' by the CBFSAI.

The '*Perspective of the Consumer Panel on the Current Financial Regulatory Framework*' report 2009, covered a number of areas including Rules, Principles and Sanctions; Culture; Systemic Control; Central Bank Organisation; the De Larosière Report; Corporate

Governance and Regulatory Governance; Appointment process for Board of Directors/Management and Staffing Issues; Budget Implications and Section 33AK. This review proposes to comment on any changes or progress made in these areas, as well as other developments that have had an effect on the financial services sector in Ireland during the past year.

3. Credit Review Office

The establishment of a Credit Review Office was announced by the Minister for Finance in the December 2009 budget. Its mandate is to review credit applications of SME's, sole traders and farm enterprises that have been refused, reduced or withdrawn by banks participating in NAMA. It was set up under Section 210(1) (b) of the *National Asset Management Agency Act, 2009*. The Consumer Panel welcomes this additional appeals avenue for consumers that are adversely affected by the restriction of credit within the banking sector at present. However, it is disheartened that the Credit Review Office has no regulatory or mandatory powers relating to the opinions it furnishes on applications. While forcing banks to lend money is not a solution, there are many consumers who have been negatively impacted by the decisions taken since the financial crisis began. It is inevitable that there are difficulties accessing money as there is no other solution but consumers cannot continue to be penalised in terms of paying in the long-term. They require improved consumer protection now more than ever.

4. Statutory Commission of Investigation

Following the comments of the Governor of the Central Bank, Patrick Honohan, before the Joint Oireachtas Committee on Economic Regulatory Affairs, that he expected an inquiry to be authorised in order to better understand the causes of the financial crisis; the Minister for Finance stated that the *'public is entitled to a full examination of what went wrong in our banking system'*⁶. He continued *'the Government...fully agrees....on the need to engage a broad set of expertise to examine the events of recent years and to design and implement an investigation in such a way that we arrive at a deeper understanding of the root causes of the systemic failures that led to the need for extraordinary support from the State to the domestic banking system'*⁷. The Governor of the Central Bank completed his report on *'The*

⁶ Department of Finance

< <http://www.finance.gov.ie/viewdoc.asp?DocID=6166&CatID=1&StartDate=1+January+2010&m=n> >

⁷ *Ibid*

*Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008*⁸, and Klaus Regling and Max Watson completed 'A Preliminary Report on the Sources of Ireland's Banking Crisis'⁹. Both were critical of how the system worked in Ireland citing regulatory failures and Government policy as major contributors to Ireland's banking crisis. The Consumer Panel however, has been drawing attention to these failures over a number of years which was not reflected in the reports. Professor Honohan has now said he is unsure if there is a need for the Statutory Commission of Investigation into the banking crisis but the Consumer Panel would disagree with this and calls for it to proceed as stated. While the Governor of the Central Bank may feel that the reasons for the financial crisis were set out in the two reports above, the Consumer Panel is of the view that the Statutory Commission of Investigation is of critical importance to provide answers to the consumers who are bailing out banks and that clear terms of reference need to be outlined for the Investigation.

The Consumer Panel is satisfied to see that the Minister for Finance has advanced this issue by appointing Mr Peter Nyberg, former Director General for Financial Services at the Finnish Ministry of Finance, to lead the Commission of Investigation into the banking sector. The Minister also announced amended terms of reference for the Investigation to extend the period to be covered from January 2003 to 15th January 2009. This is a welcome development as the Commission will now be in a position to examine matters relating to corporate governance and risk management in each of the banks covered by the Government guarantee scheme, and most importantly the requirement for the Commission to complete its report within 6 months of its establishment is a welcome time limit. The Consumer Panel is also satisfied with the referral of the policy lessons arising from the preliminary reports into the banking crisis to the Joint Oireachtas Committee on Finance and Public Service to be further considered; with it reporting back to the Dáil and Seanad by the end of October 2010.

5. Rules, Principles and Sanctions

In the 2009 Report, the Consumer Panel discussed this area and highlighted that the regulation of the financial industry should not be thought of as an 'either or' in relation to principles and rules, both have a place in the regulatory process. Principles should define

⁸ The Banking Inquiry. <http://www.bankinginquiry.gov.ie/>
<<http://www.bankinginquiry.gov.ie/The%20Irish%20Banking%20Crisis%20Regulatory%20and%20Financial%20Stability%20Policy%202003-2008.pdf>>

⁹ The Banking Inquiry. <http://www.bankinginquiry.gov.ie/>
<<http://www.bankinginquiry.gov.ie/Preliminary%20Report%20into%20Ireland's%20Banking%20Crisis%2031%20May%202010.pdf>>

the culture throughout the industry, while the rules should set the behaviour of the market participants. Furthermore, the report suggested that there should be two levels of redress with a breach of principles carrying a heavier penalty than that of a breach of rules. Along with this, there should be proper enforcement of the sanctions, with fair treatment of all regulated entities.

The Consumer Panel asked the following three questions, but failed to get answers.

- What the Regulator thinks are the most important Principles and Rules currently in force?
- What sanctions are in the Regulators armoury, irrespective of the principles and rules in force?
- We would also like to ask the Financial Regulator, Officer of Director of Corporate Enforcement, The Irish Accounting and Auditing Supervisory Authority and the Financial Services Ombudsman to review where they feel there are gaps in the regulatory framework?

It is now known that the light-touch approach to regulation that was in use in Ireland failed, and as suggested by some, was never really properly implemented in the first place. The response of the Financial Regulator was deficient and the effects will be felt by the Irish consumer for a considerable time to come. The Consumer Panel is satisfied that its comments on the need to review the light-touch approach and implement a more robust regulatory approach have been taken on board.

Measures have been taken over the last year to put in place a more stringent process to regulation, culminating in the publication of the *Central Bank Reform Bill, 2010*. While it outlines a changed structure for the Central Bank and Financial Regulator, and outlines some enforcement measures that can be taken by the Regulator, it does not go as far as to set out specific rules that would benefit the industry. It is noted that the Financial Regulator will be given the power of suspension and prohibition, both of which can amount to serious sanctions. However, this power must be met with a willingness to act on the part of the Regulator. Both large and small market participants must be pursued with the same vigour to prevent a re-emergence of undesirable practices that have been a major feature of our financial services industry.

In addition, the Financial Regulator has published its plans for reforms to the way in which it conducts banking supervision¹⁰. The Consumer Panel welcomes both this and the *Central Bank Reform Bill, 2010*, as positive steps towards correcting the turmoil in the banking sector. It has been calling for more robust regulation since its establishment, and the new more ‘intrusive’ approach to be taken should not only stabilise the financial services sector but provide the protection for consumers that has been woefully inadequate to date.

6. Culture

The 2009 Report drew attention to the culture that had been ingrained in the financial services industry due to the tight network structure that existed and the inherent risks this brought with it. It was suggested that the culture within the industry should be stimulated by the Financial Regulator and that there should be transparency in the relationships within the sector along with better and more robust regulation.

The Consumer Panel proposed that the next Regulator should be appointed from overseas in order to ensure a clear distance from the existing tight network structure and to bring independence from the current thinking within the Irish financial services sector. The Consumer Panel is satisfied to see that this suggestion was taken on board with the appointment of Matthew Elderfield as the new Head of Financial Regulation in Ireland. He took up his position in January 2010. Patrick Honohan, the new Governor of the Central Bank commented *‘He has extensive experience of financial supervision and he has the qualities that are ideally suited to this very challenging role. We look forward to working with him as we re-shape the financial regulatory system in Ireland’*¹¹. Mr Elderfield’s appointment came after a comprehensive international search to fill the position.

As stated in the 2009 report, *‘In any society or subsector of society, culture may be defined as the sum total of all the values, attitudes and behaviours of the participants and organisations.’* Despite the appointments of Patrick Honohan and Matthew Elderfield, the compositions of the boards of regulated entities and of the regulator itself have remained largely unchanged. If the culture in the Irish financial services sector is to be reformed for the better, those who were at the top during the years that lead us to the current crisis must

¹⁰ Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). <<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>>

¹¹ Business and Leadership – www.businessandleadership.com
<<http://www.businessandleadership.com/appointments/336/matthew-elderfield-central-bank/>>

be replaced. It is only with new independent thinking that we can be sure that same mistakes are not repeated to the detriment of the Irish people.

7. Systemic Control

7.1. Product Regulation

The Consumer Panel was of the view in the 2009 report that the people involved in the regulatory process should have an understanding of sophisticated products so that they can resolve systemic problems that may arise, in particular with regard to corrosive shorting of shares and currencies, and Credit Default Swaps. It was stated that both products and institutions should be regulated, and the Financial Regulator should not just ignore products it feels are not within its remit; especially if those products may have an effect on the stability of the financial system. Sub-prime lending was highlighted as an example of financial innovation that created a systemic risk and which wreaked havoc throughout the global economy. The Interest Only Mortgage was another financial product that caused substantial harm to consumers due to insufficient regulation. It allowed consumers to buy property that they could not actually afford by deferring liability. A further recent worrying development has been the talk about a new product – a ‘negative equity’ mortgage – being introduced by a number of banks onto the market. This product proposes to allow consumers to move house by taking the ‘negative equity’ portion of their existing mortgage and adding it onto the new mortgage for the new house they have purchased. While concerns have been expressed by officials at the Financial Regulator about this type of mortgage, would it not be in the best interest of consumers to have this type of product properly analysed for risk to both them and the financial system before being released on the market rather than issuing a weak expression of concern. Furthermore, the expression of concern appears to be in conflict with the new thinking outlined in ‘*Banking Supervision: our new approach*’ published by the Central Bank where it is stated that under the review of the Consumer Protection Code it will consider ‘*incorporating new provisions in relation to product development/design and risk, particularly in relation to the information to be provided to consumers*’¹²

The Consumer Panel understands that the introduction of product regulation for existing products may be difficult but at a minimum it recommends that new products being introduced should be regulated. This does not have to be an arduous undertaking whereby

¹² Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). P56

<<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>>

every aspect of a product is scrutinised. Rather, the main features could be outlined for the regulator to approve or not. If there had previously been product regulation, would the Financial Regulator have allowed such risky products as outlined above to be released on the market and offered to consumers? New players and new products must be examined and quickly brought within the remit of the Financial Regulator; this can only be achieved if the Financial Regulator is vigilant as to the activity of market participants.

It would be of great benefit to the consumer if financial products were regulated. The regulation of financial institutions could be construed as misleading in that all the products it offers could be considered sound and secure. However this is not the case, the Financial Regulator supervises the actions of the institutions rather than the individual products it offers. This may give consumers a false sense of security who believe that every product/service offered is a secure one. The Consumer Panel drew attention to the general principles of the Consumer Protection Code, that a regulated entity must ensure it *'does not recklessly, negligently or deliberately mislead a customer as to the real of perceived advantages or disadvantages of any product or service'*. It is in line with this principle that product regulation could be introduced and the Consumer Panel would suggest that it take the form of a one-page cover document to outline the main points of the particular product. This could then be either approved or rejected by the Financial Regulator.

Again, the Consumer Panel would like to draw analogy between the financial services industry and the pharmaceutical industry. Regulation in the pharmaceutical industry is fundamental, with every new product being subject to rigorous inspection before the FDA will approve it for release on the market, while the industry participants themselves are subject to heavy regulation. The Consumer Panel reiterates its proposal that a special unit be established within the Financial Regulator that would scrutinise all new players and products emerging on the domestic market for systemic risk.

There has been growing discussion and debate in the US on how best to regulate financial products, in particular OTC's. Their current Financial Reform Bill would create an independent Office of Financial Research within the Treasury Department that would collect data on transactions and exposures of financial institutions, and build the research and analytical ability in order to respond to systemic risks. It is expected that this will allow regulators better understand complex financial products, as well as the link between market participants and potential risks to the system. Lord Turner in the UK also discussed product

regulation in the Turner Review¹³, in particular mortgages as an example of retail products and CDS as an example of wholesale products. Additionally, the Financial Services Authority (FSA) published a discussion paper – Mortgage Market Review¹⁴ – in October 2009 that also examined product regulation.

The Consumer Panel strongly believes that product regulation is an area that warrants serious consideration by the Financial Regulator in the best interests of consumers.

7.2. Rearrangement of Financial Architecture

The Consumer Panel highlighted the need for a rearrangement of the financial architecture in order to minimise exposure to any future shocks in the financial system. Conflicts of interest must be avoided between borrowing and lenders; investment banks/capital markets must not own everything. There has been a move in Europe to break up the large financial institutions into more traditional banking models. The Consumer Panel would further suggest that there should be sufficient separation between capital markets and retail banks in order to insulate them from a future market crash. The Financial Regulator must heavily regulate retail banks to prevent them from getting involved in risky practices and becoming closeted investment banks, and should also control who is allowed to access the financial markets especially if liability will fall on the shoulders of the taxpayers. The Consumer Panel is satisfied that the new Head of Financial Regulation is taking a firm hand with the banks. Good work has begun in order to stabilise our banking industry and while some decisions will be severe in the short-term, the long-term benefits to consumers must be kept in mind.

The Consumer Panel also raised concerns over the lack of regulation in the Derivatives market. These sophisticated financial instruments played a significant role in the collapse of the financial services industry globally, with Credit Default Swaps being highlighted as the riskiest. It has been recognised that this is an area that warrants proper regulation and, to that end, discussions have taken place as regards legislation in this field. The European Commission set two objectives in relation to Derivatives; *‘to have concrete proposals as to how the risks from credit derivatives can be mitigated, in particular...plans for moving CDS on to central clearing facilities’* and, *‘to have a systemic look at derivatives markets in the*

¹³ The Financial Services Authority. *The Turner Review: A regulatory response to global banking crisis*. (March 2009.) P105

<http://www.fsa.gov.uk/pubs/other/turner_review.pdf>

¹⁴ The Financial Services Authority. *Mortgage Market Review*. (October 2009)

<http://www.fsa.gov.uk/pubs/discussion/dp09_03.pdf>

aftermath of the lessons learned from the crisis' ¹⁵. In October 2009, the European Commission adopted a communication - for ensuring efficient, safe and sound derivatives markets - that outlines future policy set to '*increase transparency of the derivatives market, reducing 'counterparty and operational risk in trading and' enhancing 'market integrity and oversight'*'¹⁶. Legislation to regulate the derivatives markets will be brought forward in 2010 and will be in line with the objectives agreed at the G20 meeting of 25, held in September 2009. The European Commission further intends to cooperate with its G20 partners to ensure coherent implementation on a global scale. The Consumer Panel is in agreement that this is a positive response to an area that had a major impact during the financial crisis. It was recommended in the 2009 Report that derivatives should be exchange-traded through a central clearing house in order to increase transparency, reduce fraud, and reduce risk to consumers and to the financial system as a whole. The Consumer Panel still maintains this view.

8. Central Bank Organisation – Hearing the Voice of the Consumer

8.1. Reorganisation of the Financial Regulatory Structure

The Consumer Panel acknowledged in the 2009 Report the Government's intention to restore the credit system. It specified that the role of the Central Bank of Ireland would be placed at the centre of financial supervision providing for co-ordination and full integration of supervision and stability of regulated entities with that of the whole financial system. The *Central Bank Reform Bill, 2010*, has been introduced and when it comes into force will streamline the current financial regulatory structure. The legislation will establish a single fully integrated regulatory organisation to be called the Central Bank Commission. The new Commission is to be chaired by the Governor of the Central Bank, Patrick Honohan and will be responsible for the prudential supervision of individual firms; the conduct of business, including the protection of consumer interests; and the stability of the financial system; as set out in the explanatory memorandum to the Bill¹⁷.

While the Consumer Panel welcomes the commitment to fixing the banking system, it is nonetheless concerned about where the consumer fits in the new framework, despite the inclusion of the 'protection of consumer interests' as outlined above. The functions of the Consumer Director in relation to the promotion of the interests of consumers through

¹⁵ The European Commission <http://ec.europa.eu/internal_market/financial-markets/derivatives/index_en.htm>

¹⁶ *Ibid*

¹⁷ *Central Bank of Ireland Reform Bill, 2010*. Explanatory Memorandum, p1 <<http://www.oireachtas.ie/documents/bills28/bills/2010/1210/b1210d.pdf>>

information and education have been transferred to the National Consumer Agency under the *Central Bank Reform Bill, 2010*. Furthermore, it is to abolish the Consultative Consumer Panel and replace it with an Advisory Group to advise the Central Bank on the performance of its functions and the exercise of its powers in relation to consumers of financial services.

In testimony before the Committee on Financial Services, U.S. House of Representatives, Washington D.C., the Chairman of the Federal Reserve Ben Bernanke, stated that ensuring ‘*consumers are protected from unfair and deceptive practices in their financial dealings*’¹⁸ is one of the five key elements that should be included in broad-based agenda for reform. He also stated in a speech at the Federal Reserve Bank of Boston in October 2009 that ‘*The recent crisis clearly illustrated the links between consumer protection and the safety and soundness of financial institutions. We have seen that flawed financial instruments can both harm families and impair financial stability. Strong consumer protection helps preserve household savings and to provide families access to credit on terms that are fair and well matched with their financial needs and resources. At the same time, effective consumer protection promotes healthy competition in the financial marketplace, supports sound lending practices, and increases confidence in the financial system as a whole.*’¹⁹ He highlighted that consumer protection is fundamental to reform. Yet in the Irish context the debate has revolved around macroeconomic policies such as capital adequacy levels and solvency rather than the real consequences being endured by consumers.

The existing Financial Regulator was established with consumer protection being one of its core functions and it was outlined in the 2009 Report that the response of the Government to the financial crisis is to effectively side-line consumer protection. The EU’s Consumer Policy Strategy 2007-2013 sets out the right to protection of economic interests as one of the five basic consumer rights, and this right has been fundamentally undermined during the current financial crisis. Neither the NCA nor the Consumer Advisory Group appeared to have a role to play in protecting consumers’ economic interests in the new financial regulatory framework set out in the first draft of the *Central Bank Reform Bill, 2010*. It must be remembered that the consumer should be at the centre of any financial regulation policy and not merely given reference to as in incidental. Consumers in Ireland were adversely affected by a lack of proper supervision and the recklessness of the market participants, and will end up paying to correct those mistakes in the long-term. The Consumer Panel has long held

¹⁸ The Board of Governors of the Federal Reserve System. [www.federalreserve.gov
<http://www.federalreserve.gov/newsevents/testimony/bernanke20091001a.htm>](http://www.federalreserve.gov/newsevents/testimony/bernanke20091001a.htm)

¹⁹ The Board of Governors of the Federal Reserve System. [www.federalreserve.gov
<http://www.federalreserve.gov/newsevents/speech/bernanke20091023a.htm>](http://www.federalreserve.gov/newsevents/speech/bernanke20091023a.htm)

the view that consumer protection must be a central tenet of any new financial regulatory structure.

While the Consumer Panel is saddened that it is to be abolished, it lobbied the Minister for Finance, Brian Lenihan, to improve the structure and remit of the new Consumer Advisory Group and is grateful that he agreed with our recommendations. The Consumer Advisory Group is to be established by the Central Bank which will appoint the members who are to have expertise, knowledge or experience relevant to the functions of the advisory group; determine the manner and reasons for which a member may be removed; and provide administrative services and funds it feels necessary. Its functions are set out in Section 18E (5) of the *Central Bank Reform Bill (No.2), 2010*. It states that the Consumer Advisory Group will '*advise the Bank on the exercise of the Bank's powers and the performance of the Bank's functions in relation to consumers of financial services and in particular in relation to (a) the effects of the Bank's Strategic Plan on consumers of financial services, (b) initiatives aimed at further enhancing the protection of consumer of financial services, and (c) if the Bank so requests, documents, consultation papers or other materials prepared by the Bank.*'²⁰

The Consumer Panel is satisfied with its improved remit but considers the wording of Section 18E above, in particular, '*if the Bank so requests*', as a fundamental weakness in the remit of the Consumer Advisory Group to be established. It raises concerns for the Consumer Panel about the place of the consumer in the new structure. There must be a focus on the challenges ahead for consumers and the new regime must work robustly on their behalf. The Consumer Panel urges the new Consumer Advisory Group to continue to advance the consumer cause into the future by developing on the sizeable work already undertaken by it and retaining its activist philosophy in ensuring the consumer is central to any financial regulation or policy development.

It was stated in May 2009 report that the Consumers' voice can be heard in different places throughout the system, in particular in Oireachtas Committees, the Department of Finance, Regulatory bodies and regulated firms. While the *Central Bank Reform Bill, 2010* gives various oversight functions to Oireachtas Committees, the Consumer Panel is resolute that representation for the consumer should be made during policy and regulation formulation. It is also important that the consumer is taken account of through the other channels in the

²⁰ The *Central Bank Reform Bill (No.2), 2010*.

<<http://www.oireachtas.ie/documents/bills28/bills/2010/1210/b1210d.pdf>>

<<http://www.oireachtas.ie/documents/bills28/bills/2010/1210/b1210d.pdf>>

system and must not be only considered when reviews of already implemented policies are being undertaken.

9. De Larosière Report

The Consumer Panel gave a response to the Department of Finance on the recommendations contained in the De Larosière Report during 2009. The De Larosière Report outlined the new structure to be implemented at European Level. The Panel is still of the view that not all Institutions fit neatly within the De Larosière divisions, despite the amendments to the scope of the new Authorities to be established. However, we support the new European financial supervision structure and acknowledge that it is to the benefit of the European financial industry as a whole. In September 2009, legislative proposals were put forward and have been adopted by the European Commission with the hope that the new Authorities come into being by the end of 2010.²¹ It provides not only a fresh structure but also gives the Authorities new competencies and is an integral part of preventing potential future crises. This new European framework is of fundamental importance to Ireland in stabilising its financial system and Ireland must be mindful of the new structures to ensure harmonisation of systems and to avoid regulatory shopping in the future. The Consumer Panel is satisfied that the Financial Regulator is taking account of the new structures while undertaking its own restructure at present as outlined in the '*Banking Supervision: our new approach*'.²²

10. Corporate Governance and Regulatory Governance

10.1. Corporate Governance

Under EU and National Law, directors and managers of regulated financial services entities must meet 'fit and proper' standards. It is, however, a voluntary code of conduct. It is now known that the behaviour of the management and top executives in the major banks failed to meet these standards; and that they did not adequately understand the risks taken by their institutions and the effects this would have on the wider economy. There were a number of unsavoury practices including weak governance and risk management operating within the

²¹ The European Union. European Commission Press Release
<<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1582&format=HTML&aged=0&language=EN&guiLanguage=en>>

²² Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). P71-72
<<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>>

financial institutions, along with a failure of bank management to maintain safe and sound banking practices. These came to light in the midst of the financial crisis and resulted in consumers paying heavily to fix the mistakes that were made.

The Consumer Panel expressed its dissatisfaction that the Financial Regulator was aware that non-executive directors held a number of directorships, and that these should not give rise to conflicts of interest, but did not prohibit such action. Furthermore, that several directorships were held by board members of financial institutions including some in direct conflict with their role. It was recommended that there should be a clear division between the roles of Chairman and Chief Executive so that power is not concentrated in the hands of one person, and that enhanced Corporate Governance standards needed to be applied.

The Consumer Panel is pleased to see that its recommendations - on the introduction of a binding code of conduct to end the practice of cross-directorship and a prohibition on the position of chairman and chief executive being held by the same person - have been taken on board by the Financial Regulator and that strengthening the corporate governance framework is now a priority.

There is now an opportunity to promote transparency and good governance through the Board of Directors and the management teams. The Financial Regulator has sought consultation on new Corporate Governance Standards for Banks and Insurers. It sets out clear rules in line with International regulatory plans in the area of corporate governance. The new standards limit the number of directorships which directors may hold; requires Board membership to be reviewed every 3 years; requires a clear separation between the roles of Chairman and CEO; precludes a CEO, director or senior manager from becoming Chairman; and requires an audit committee and risk committee to be established.

The Consumer Panel submitted its comments on the Financial Regulator's Consultation paper on Corporate Governance Requirements in June 2010. The Consumer Panel welcomes the introduction of new standards as the first step in changing the mindset in relation to governance in our financial institutions but notes that the draft code as it stands is weak and deficient and requires significant revision. It lacks consistency with a number of existing corporate governance codes and omits important provisions. Some provisions are vague and would prove hard to assess compliance with. The Consumer Panel welcomes the focus on director independence but is concerned about who decides on the independence. There is a growing recognition of the importance of independent voices on the Boards of companies and the Consumer Panel thinks a definition of independence is

vital. The section around Board responsibility needs to be readdressed as it is weak in its current form.

The Financial Regulator has stated that failure to comply with the new standards *may* be subject to sanction under the Administrative Sanctions Framework but the Consumer Panel is of the view that it is essential for the Financial Regulator to use the punitive measures available to ensure compliance and failure by the Financial Regulator to act on a serious corporate governance issue should be punishable.

The Consumer Panel also welcomes the new powers of suspension and investigation in relation to the fitness and probity of persons performing controlled functions available to the Regulator as outlined in the *Central Bank Reform Bill, 2010*. However, the Consumer Panel would like to highlight that there needs to be a review of the current ‘fitness and probity’ standards and that a robust and mandatory code of conduct be introduced in order to further reinforce appropriate Corporate Governance standards throughout the financial services sector. This should include a requirement that directors who are subject to serious investigations would be required to step aside from their directorships.

10.2. Watchdog/Whistleblower Information

The Consumer Panel highlighted in the 2009 Report that the Board of Directors is the guardian of a company and should – as one of its objectives – act as watchdog for any undesirable or illegal practices within the company. Additionally, there must be a willingness by the Board to act on the information received by them. If proper whistleblower protection existed it would facilitate information on such practices being passed to the top management without the fear of being exposed to personal risk.

The importance of whistleblowing in the effort to deal with wrongdoing has been increasingly recognised and, to that end, a number of Governments are considering legislation. However, as yet there is no clear or coherent EU Framework which means that the effectiveness of measures taken across the Member States will vary. The Consumer Panel, as previously stated, maintains the view that the Government should legislate to provide a comprehensive framework of legal protection for those who speak out to report matters of public interest in good faith.

Furthermore, there has been support for whistleblowers to be protected by the law in recent times with both the Governor of the Central Bank, Patrick Honohan, and the Director of the Office of Corporate Enforcement, Paul Appleby, calling for proper legislation in this area. With new directors and management teams being installed in the major regulated entities, now is the time to change the mind-set as to how information is received and dealt with by those in senior positions within our financial institutions.

10.3. Regulatory Governance

The Consumer Panel expressed its belief that Corporate Governance is not just a matter for regulated entities but also applies to the Board and management of the Financial Regulator. In the 2009 Report, the Panel suggested that policymakers needed to reflect on the impact of having directorships and Authority membership overlap, and the impact this has on the accountability for the performance of the Financial Regulator. A better balance and mix is required prospectively. To this end, it was recommended that the State's process of appointing members to Boards should move to a new level of transparency and professionalism appropriate to the responsibility commanded by these positions.

The Consumer Panel also expressed its dissatisfaction at the overlap in Board members in the Central Bank and the Financial Regulator and the absurdness of expecting consumers to believe that the Central Bank could not influence the Financial Regulator to act sooner. It was our recommendation that prudential supervision and consumer protection should not be separated but that there should be one Board with two separate divisions.

*The Central Bank Reform Bill, 2010 creates a 'single, fully-integrated, Central Bank with a unitary Board, "the Central Bank Commission" chaired by the Governor of the Central Bank. The Irish Financial Services Authority is dissolved and most of its existing functions are merged into the new structure.*²³ The Central Bank will now be responsible for the prudential supervision of individual firms; the conduct of business, including the protection of consumer interests; and the stability of the financial system overall.

The Consumer Panel is in agreement that the new structure will benefit the Irish consumer by having a more focused and integrated supervisory authority. The functions of the Consumer Director in relation to the promotion of the interests of consumers through the provision of information and financial education, is to be transferred to the National

²³ *Central Bank Reform Bill, 2010* - explanatory memorandum, p1.
<<http://www.oireachtas.ie/documents/bills28/bills/2010/1210/b1210d.pdf>>

Consumer Agency; while the Consultative Consumer Panel is to be abolished in favour of an advisory group to ‘advise it [the Financial Regulator] on the performance of its functions and the exercise of its powers in relation to consumers of financial services²⁴. The Consumer Panel is resolute that what is needed now is stronger protection so that consumers are not disproportionately penalised as banks rebuild their balances. There may have been too much focus in the past by the Financial Regulator on the education and provision of information part of the consumer mandate but by transferring it to the National Consumer Agency, it should not be forgotten that the consumer is the ultimate end user of financial products and services provided by the banks.

The Consumer Panel also believes that competition in the financial services sector can be good for consumers, but only when it is underpinned by adequate consumer protection legislation and regulation. It has been consistently highlighted by the Consumer Panel that the residential mortgage area is the only one in which there has been any degree of competition but this type of increased competition has not always served consumers well. The Financial Regulator has repeatedly informed the Consumer Panel that its competition oversight function is derived from a provision in legislation which requires commentary on the state of competition in the financial services sector ‘once a year’. The Consumer Panel has repeatedly recommended that the Financial Regulator should be far more pro-active in this area. It is likely that there will be a smaller number of players in the retail banking sector in the coming years. The Consumer Panel is concerned that as a result the consumer could be subjected to a plethora of additional charges with dubious legality under competition law. The Consumer Panel urges the Financial Regulator not to neglect competition issues arising in the coming years considering its reluctance to play a role in competition law in the financial services industry to date.

11. Appointment process – Board, Management, and Staff

The Consumer Panel outlined its concern with the practice of all senior staff in the Financial Regulator being employed exclusively from the Public Service and in particular from the Department of Finance. In this respect, it was suggested that recruitment of staff should be from a broader selection of careers, including the private sector as this would facilitate and enhance the independence of the Financial Regulator.

²⁴ *Central Bank Reform Bill, 2010* – Schedule I, item 28, Section 18E (1)
<<http://www.oireachtas.ie/documents/bills28/bills/2010/1210/b1210d.pdf>>

The Consumer Panel is satisfied that the Head of Financial Supervision, Matthew Elderfield, has been selected from an outside source. Now that this selection process has been implemented, it is important that it is followed for all future appointments in order to draw from the wealth of experience and knowledge across a range of backgrounds, and to limit any potential conflicts of interest that may arise.

It has been stated that the Financial Regulator is '*seeking to recruit a significant number of people with a range of expertise, background and experience for key priority positions*'²⁵. There was a drive early in the year to recruit 50 additional staff – including credit and market risk analysts, and legal and enforcement specialists. This was followed by reports that Mr Elderfield is aiming to increase the existing staff by 300 overall to complement the existing staff at the Financial Regulator. The Mazars Report - commissioned by the Financial Regulator on how it operates - found that it had too many administrative staff, and concluded that the Financial Regulator employed lower levels of specialist regulatory support skills than its leading International peers. The Central Bank needs to be able to redeploy staff to other positions in the public sector where their services might be better used. The Mazars Report also found that there was an over-emphasis on the finances of the organisation instead of concentrating on strategic or regulatory matters. This gives rise to concerns for the Consumer Panel as to whether or not the staff employed at the Financial Regulator was sufficiently qualified to carry out the task within its remit. There is an obvious need to recruit experienced staff but the emphasis must be on recruiting the right people to do the job required, while ensuring value for money.

Furthermore, it was outlined in the 2009 report that academic economists and outside agencies appeared to more often correctly predict what was happening in Ireland's economy, and that the Financial Regulator should listen to the messages being delivered. The Consumer Panel acknowledged that it could be difficult to place academic economists in a commercial system but is satisfied to see Patrick Honohan, who has both academic and industry experience, installed as the Governor of the Central Bank.

12. Budget Implications for the Financial Regulator

The Government has committed to the overhaul of the financial regulatory system in Ireland and to this end has introduced the new *Central Bank Reform Bill 2010*, and made a number of senior appointments within the Financial Regulatory Framework. This has significant

²⁵ The Irish Times, 19.2.2010. <<http://www.irishtimes.com/newspaper/finance/2010/0219/1224264797727.html>>

budget implications for the Financial Regulator, as does the recruitment of additional staff over the recent months with more to come as outlined by Matthew Elderfield. The Consumer Panel would like to ask how the current budget will be impacted by the slew of changes coming online in the near future. The Mazars report stated that the cost of the Financial Regulator was considerably higher in Ireland than in other countries. It found that the cost per thousand population in Ireland was €11.30 compared with the International average of €6. This represents poor value for money compared with the 16 International regulatory bodies examined in the Mazars report. The Consumer Panel suggests that the budget should be under continuing review to ensure that the Financial Regulator is providing excellent value for money in line with comparable bodies in other jurisdictions, not only providing excellent prudential supervision but robust consumer protection in light of the current and changing nature of the financial services industry.

13. Section 33AK (as inserted by Section 26 of CBFSAI Act 2003)

The Consumer Panel is still of the view that Section 33AK does not fairly represent the consumer and is excessive in its safeguards. It remains its position that it needs to be amended specifically in relation to Consumer Protection Laws enforced by the Financial Regulator (as we have highlighted in a legal opinion) so it does not hide behind it when being asked questions that are in the public interest. It is hoped that some consideration could be given to this issue and it be amended via the *Central Bank Reform Bill (No. 2), 2010*, presently being prepared by the Department of Finance for adoption in the autumn.

14. ‘Banking Supervision: our new approach’

The Central Bank and Financial Services Authority of Ireland published ‘*Banking Supervision: our new approach*’ in June 2010. As part of this review, the Consumer Panel feels it is important to consider its contents.

The new structure as outlined in the *Central Bank Reform Bill 2010* provides for a single unitary Board with a primary function to ensure that the ‘*central banking and financial regulation functions of the organisation are integrated and co-ordinated and that the powers and functions conferred on the Central Bank are properly exercised and discharged*²⁶.

²⁶ Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). P21

<<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>>

However, the Consumer Panel notes that there is a weakness in the structure as presented on page 23 of the document. While there is a position of financial control at the lower level, there is no Chief Financial Officer at Board level. The Consumer Panel is of the view that a CFO at the executive level is of fundamental importance in the process of reforming the Central Bank and Financial Regulator. There needs to be representation at Board level so that there are adequate reports to the Board on the convergence of policy strategy and financial matters of the new Central Bank Commission as a whole.

The Consumer Panel regards this as unsatisfactory as the budget of the Central Bank Commission and its strategy must be completed concurrently if it is to run efficiently and provide value for money. It must be remembered that the Central Bank Commission is a financial institution in itself and any such entity would normally have a CFO who would be fully involved in ensuring the budget and strategy are aligned. Furthermore, an Oireachtas Committee is to conduct a statutory review of the Financial Regulator but this type of review will be carried out after policy decisions have already been implemented. This is considered a weakness in the monitoring of the Financial Regulator to ensure it is effectively performing its functions.

The document reviews Resources and Skills at the Financial Regulator in Chapter 2.3²⁷. It states that '*supervision is resource intensive*²⁸'. The Consumer Panel agrees with this statement and notes that it is essential to have suitably experienced and qualified staff to monitor market developments and catch any potential risks in the system. There is a vague strategy for the recruitment outlined, such as a '*minimum of 10 supervisory staff per firm for major institutions*' and improving '*specialist expertise by recruiting staff with direct business/banking experience – credit, liquidity, treasury, market and operation risk experts*'.²⁹ The Consumer Panel queries the need to recruit 150 staff in 2010, with a further 150-200 over the following 2 years. It does not want to see more and more staff recruited with no definite plan for their use. There was an inability to transfer existing resources to deal with the issues facing the financial services industry during the current crisis and this must not happen again. Shock was expressed at the low levels of supervision that had been in place and resources must not be focused on checking layers of paperwork rather than supervising regulated entities and watching for systemic risk to the financial system. The Consumer Panel calls for a more detailed strategy in relation to recruitment so that it can be

²⁷ *Ibid* at p24

²⁸ *Ibid*

²⁹ *Ibid*

sure the correct level of expertise and skill is recruited to deal with the current financial crisis and any problems that may arise in the future.

A Risk Experts Panel is discussed at Chapter 2.4 where it states that an external panel of risk advisors will be established comprising experienced professionals from the financial services environment. The Consumer Panel considers this a very good proposal but care must be taken to ensure there is the correct level and depth of expertise on the panel. The Consumer Panel is of the view that it would have been extremely beneficial if such a panel had existed prior to the current financial crisis as another avenue available to the Financial Regulator and its staff to acquire advice on many of the issues that arose. The Consumer Panel would also like to highlight that the work and comments of the external risk advisors panel must be taken on board by the Financial Regulator and there must be a willingness to act on the information presented.

The document continues to deal with a revised Central Bank Financial Stability Committee structure. The Consumer Panel suggests that there would be merit in having an Actuary on the Committee as it is noted that the Insurance companies did not find themselves in as much trouble as the banks, and this could be a result of a better analysis of the risks in the market by such professionals.

Governance is discussed in Chapter 5 where it is recognised that the ‘home-made’ elements of the banking crisis included weak bank governance and risk management and a failure to respond by supervisors. Responsibility for prudent banking lies with the directors and senior managers of regulated entities. The Financial Regulator announced its intention to reform and strengthen the Corporate Governance framework with the introduction of a code on ‘*corporate and internal governance together with a statutory basis for fitness and probity reviews*’.³⁰ The Consumer Panel’s views on the area of are outlined in Section 9 of this Report.

Remuneration is discussed in Chapter 5.3 of the document. It states that there was a ‘*failure to link remuneration and reward to the long-term sustainability and performance of institutions*’³¹. Short-term profits could be made without taking account of the effects of the

³⁰ Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). P39
<<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>

³¹ Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). P43

risk in the longer-term which resulted in significant losses for financial institutions but also resulted in consumers losing value in their pension and investment products. The Consumer Panel is of the view that reform is needed and remuneration policies must not allow or encourage excessive risk-taking in the future. The Consumer Panel is in agreement with the EU Commission recommendations for the introduction of a risk-focused remuneration policy. The Consumer Panel would like to refer to the words of Jean Claude Trichet, that financial institutions should be using profits to strengthen their capital bases rather than paying staff unwarranted bonuses.

The area of remuneration and bonuses throws up a dilemma for the entire financial services industry. If remuneration packages are not competitive then there will not be sufficient ability to attract experts to take up the top positions in the Irish banking industry. The Consumer Panel outlined its recommendations on remuneration in the financial services sector in a letter to the Financial Regulator on 18th December, 2009. Some of the recommendations were as follows: if financial institutions are to offer any bonus, it should be in the form of shares that cannot be sold for a 5 year period rather than cash; disclosure to relevant stakeholders should include the Department of Finance, the Financial Regulator, the financial institution shareholders and the relevant Oireachtas Committees; the Central Bank Commission should have enforcement powers and sanctions available in order to ensure that Irish financial institutions follow the remuneration policy set out by the EU Commission recommendations.

The Consumer Panel would like to highlight the lack of a real consumer mandate running throughout the document. It is acknowledged that the title is 'Banking Supervision', but a financial regulatory framework cannot side-line the consumer as they are the ultimate end user of financial products and services. It is disappointing that there are only four pages dedicated to consumer protection despite this being one of the key functions of the new Central Bank Commission. On a positive note, the Consumer Panel is satisfied that overcharging has been mentioned in the document. It has been calling for action on the way in which the handling of overcharging issues is dealt with and is satisfied that its views have been taken on board.

The document discusses Consumer Credit Limits in Chapter 6.5. The Consumer Panel notes that vulnerable consumers may need to be protected and shielded from easily

<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>

available credit but not to such an extent that their personal civil liberties are encroached. The Consumer Panel is satisfied that, currently, the Financial Regulator is only proposing to make recommendations on introducing consumer credit limits. The impact such a move would have on consumers and the wider economy must be further explored. The Consumer Panel notes that financial education is also an important component in the protection of consumers from excess credit.

Ireland has the highest personal debt level in Western Europe largely due to its highly developed consumer credit market. Ireland has a credit register but it is inadequate with reports of some loans not being entered into its records. Banks cannot make policy decisions regarding the extension of credit without proper information as to how much an individual owes to other institutions. With proper safeguards, such as confidentiality, the Consumer Panel would agree with the introduction of a comprehensive mandatory credit register to facilitate consumer protection from the reckless lending practices that were previously utilised.

Overall, the Consumer Panel notes that there are some good points outlined in the document but there is no real vision as how best to protect consumers as banks rebuild their balances. It states that *'the prudential and consumer protection frameworks work together to ensure that a holistic approach is taken to the regulation of credit institutions and other firms. This will also be reflected in our new risk-based regulatory model.'*³² However, there is no actual consumer mandate and in any financial regulatory structure the consumer must be at the centre of policy development.

The Consumer Panel can only agree with Ben Bernanke who stated that *'A fundamental element of effective financial regulation is protecting consumers from unfair and deceptive practices. The recent crisis clearly illustrated the links between consumer protection and the safety and soundness of financial institutions'*³³. This has been the consistent view of the Consultative Consumer Panel through all of its work since its establishment in November 2004.

³² Central Bank & Financial Services Authority of Ireland. *Banking Supervision: our new approach*. (Dublin: June 2010). P58

<<http://www.financialregulator.ie/press-area/press-releases/Documents/21%20June%202010%20-%20Banking%20Supervision%20-%20Our%20New%20Approach.pdf>>

³³ The Board of Governors of the Federal Reserve System.

<<http://www.federalreserve.gov/newsevents/speech/bernanke20091023a.htm>>

Appendix

Members of the Suggestions Sub-group involved in the preparation of the 2009 & 2010 Reports

Sean O’Sullivan (Chair)

Kathleen Barrington

John Maher

Professor Noel Mulcahy

Raymond O’Rourke

This report was prepared with the professional support of Leona O’Brien, B.C.L, LL.M. Financial Services Innovation Centre, University College Cork

Members of the Consumer Panel

The current members of the Panel were appointed by the Minister for Finance on 23 January 2009 for a term of 3 years.

1. **Raymond O’Rourke** is the Chairman of the Panel. He is a specialist consumer lawyer with a background in EU affairs, having worked in Brussels for the European Parliament and BEUC (European Consumers Association).
2. **Kathleen Barrington** is a freelance business journalist with a special interest in personal finance issues.
3. **Frances Byrne** is the Director of One Parent Exchange and Network (OPEN). OPEN is the national network of lone parent self-help groups that have joined together to represent the interests of lone parents living in poverty and social exclusion.
4. **Michael Culloty** is a Social Policy and Communications Officer with the Money Advice and Budgeting Service.
5. **James Doorley** is the nominee of the Consumers’ Association of Ireland (CAI), and was recently appointed Chairman of the CAI Council. He is currently Assistant Director of the National Youth Council of Ireland.

6. **John Maher** is a chartered accountant, and is a senior lecturer in Accounting and Finance at the Waterford Institute of Technology.
7. **Professor Noel Mulcahy** is former Executive Vice President of the University of Limerick. He is a former member of Seanad Eireann and Co-director of the National Centre for Work-Based Learning.
8. **Fidèle Mutwarasibo** is a Research and Integration Officer with the Immigrant Council of Ireland.
9. **Sean O’Sullivan** is Chairman of the Centre for Financial Services Innovation and is also the Managing Director of Seabrook Research Limited, a software development company, based in Cork.
10. **Fiona Reynolds** is a solicitor with Reynolds & Co in Gorey, Co Wexford.
11. **Eileen Walsh** is a senior volunteer member of the Society of St. Vincent de Paul with a particular interest in national social policy and justice issues. She is Chair of the Policy Analysis Group of the Society.

Acting Secretary: Lillian Fleming, Central Bank