A Regulatory Perspective on Consumer Risk
ACOI – 10 March 2016

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What is ‘consumer risk’?

A regulatory perspective on consumer risk
  - Consumer Risk Outlook 2016

What does all this mean in practice for your firm?

Overview of Consumer Protection: Supervision Division

Update on some of our recent supervisory work
  - Contracts for Difference
  - Sale of Pension Annuities
  - Monitoring errors and overcharging
  - Retail intermediaries
  - Other supervisory actions

• Supervisory priorities 2016

Contents
What is Consumer Risk?
Central Bank’s Mission
“Safeguarding Stability, Protecting Consumers”

‘Conduct Risk’
is “the risk the firm poses to its customers through its direct interaction with them”
– PRISM Explained 2011

‘Consumer Risk’
is anything that would threaten our objective that firms treat consumers fairly and with dignity and respect
– Consumer Protection Outlook Report 2015
Consumer Risk Outlook 2016
Assessment of the current and emerging consumer environment and risks to our objectives, for full consideration by the firms we regulate in the context of our desired consumer protection outcomes.

Our desired consumer protection outcomes are:

- A positive consumer-focussed 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
- Regulated firms that are fully compliant with their obligations and are treating their customers (existing and new) in a fair and transparent way
Key existing and emerging consumer risks

- Economic environment as a driver of consumer risk
  - Policies and procedures must ensure responsible lending
  - Advertising must also promote responsible borrowing
  - Consumers must be fully informed of the risks associated with higher-risk retail products

- Business models and impact on service delivery
  - Mobile and emerging technologies
  - Reliability, safety, security
Ireland Customer Experience Report 2015

• Covers 151 financial and non-financial brands
• 37,000 Irish consumers
• Findings
  ➢ Face-to-face interaction valued by Irish consumers
  ➢ Insurance and financial services generally performed poorly
• International comparison
  ➢ 2 years behind UK market experience and 4 years behind USA
Product Governance: Getting it right from the outset
Many examples of poor product governance in public domain

Inappropriate sale of Payment Protection Insurance (PPI)

Redress schemes arising from the sale of debit and credit card protection insurance

Banks knew or ought to have known element of insurance cover was superfluous

Regulators respond with more rules!
European Supervisory Authorities published Joint Position in 2013

Guidelines are a result of failures in conduct of financial institutions resulting in consumer detriment

Provide a framework for robust and responsible product design

Extend to manufacturers and distributors

Ensure products meet the interests of the target market for which they were originally designed

Joint Position provides platform for each ESA to further develop guidelines for respective sectors

- ESMA Technical Advice on Product Governance published December 2014
- EIOPA Final Preparatory Guidelines expected Q2 2016
- EBA Guidelines effective 3 January 2017
“Developing products with the consumer’s interest, objectives and characteristics in mind from the outset is a cornerstone of ensuring good customer outcomes, and should help to re-establish and maintain confidence in retail banking.”
Culture: No.1 threat to our consumer protection objectives
What does good culture look like?

• A culture which recognises the best interests of consumers in the long-term

• Good conduct
  ➢ provides the right products and services
  ➢ to the right consumers
  ➢ in the right way
  ➢ for the right reasons

• Culture is not a ‘tick box’ exercise

• Regulators cannot change culture simply by introducing new rules

• Firms and individuals have an obligation to self-regulate
UK Banks could be facing lawsuits of up to £5 Billion
Remember ENRON?

"We treat others as we would like to be treated ourselves....

We do not tolerate abusive or disrespectful treatment.

Ruthlessness, callousness and arrogance don't belong here."
Mission Statement or Mission Impossible?

CULTURE TRUMPS ‘VISION’ EVERYTIME!
You are each ambassadors for your firm’s culture

• Boards must lead from the top
  ➢ Modelling ethical, socially responsible behaviour
  ➢ Promoting consumer risk awareness
  ➢ Embedding the right culture in middle and front-line

• Management must also lead by example
  ➢ Ensure that they understand the real drivers of behaviour and decision-making
  ➢ With that understanding, create an environment where employees are empowered to deliver fair outcomes and one where they feel safe to speak up if this is not happening in practice

• Risk and Compliance Functions
  ➢ Increasing role, and challenge, in identifying pressure points which may increase risk to consumers
Currently, as much as 84% of a company’s value may be intangible.

Comparison using companies’ market capitalisation vs tangible book value.

A firm’s culture is an essential component in driving value.

But, value aside, culture is key to restoring trust and confidence in financial services.
The way you treat your employees is the way they will treat your customers

― Richard Branson ―
What does all this mean in practice for your firm?
Like all risks, consumer risk must be effectively assessed and managed

Not just a matter for the Central Bank

Firms must consider consumer risks in the context of their own business structures and activities

Consider in context of historic and future sales

Continuously assessed and managed
Priority – Consumer Protection Risk Frameworks

- Identify consumer risks
  - Specific to each firm
- Define consumer risk strategy and appetite
  - Articulate it and embed it
- Design and implement appropriate risk architecture
  - Including adequate assurance capability
- Ensure all employees have a comprehensive understanding
  - Employees must be trained to identify consumer risks and respond appropriately in the context of their daily roles
- Take steps to ensure Risk Appetite Statement becomes a living document
  - Remember ENRON! Culture trumps vision every time....
- Develop appropriate metrics
  - Demonstrate that you are using MI effectively
  - Metrics must demonstrate clear understanding of consumer impact
Central Bank’s challenge to regulated firms

- Not enough to set tone from the top
  - Own it
  - Commit to it
  - Deliver on it

- Demonstrate how Consumer Protection Risk Frameworks and employees’ behaviours are delivering fair outcomes for consumers

- Monitoring plans must be sufficiently consumer risk-focused and more pre-emptive

- Enhanced supervisory processes – to measure firms’ progress in implementing fit-for-purpose frameworks

Outcome-focused and not just process-driven
“Laws control the lesser man, right conduct controls the greater one”

(Mark Twain)
Overview of Consumer Protection: Supervision Division
CBI Mission: “Safeguarding Stability, Protecting Consumers”

CBI Strategic Plan 2016 - 2018

**CPD’s Mission**

“Getting It Right for Consumers”

“We will work together and with others to strengthen and maintain protection for consumers so that financial services work in the best interests of all consumers, now and in the future”.

**‘5Cs’ Framework**

- Confidence
- Consumer
- Culture
- Compliance
- Challenge
How Consumer Protection delivers its mandate

**Policy**
We work to ensure the consumer protection framework is fit for purpose through developing and influencing policy and strategy at home and at European / International fora.

**Gatekeeper**
We assess applications for authorisation from individuals and firms across a number of retail sectors by applying a robust, risk based approach.
(Retail Credit Firms; Credit Servicing Firms; Home Reversion Firms; Investment, Insurance and Mortgage Intermediaries; Debt Management Firms; Payment Institutions; E-Money Institutions; Money Transmitters; Moneylenders; Bureau de Change)

**Supervision**
We monitor and investigate compliance by firms with consumer protection and prudential requirements (where relevant), taking robust supervisory action where potential or crystallised risks outside our appetite are identified.
“Getting it right for consumers”
**Annual Risk Assessments**

- We adopt a risk and evidence-based approach focussing resources where there is a significant threat to our consumer protection objectives
- Annual Consumer Risk Assessment undertaken which examines all regulated sectors
- Informed by engagement with external stakeholders including consumer groups; market research; supervisory work and experience; advice from the Consumer Advisory Group; and European and international developments
- Advises our work programme across our three pillars of Policy, Authorisations and Supervision
- Informs the content of our Consumer Protection Outlook Report
Results of some of our recent supervisory work
1. Contracts for Difference (CFDs)
We are focusing on high-risk retail investment products

- Contracts for Difference (CFDs) - First in a series of product-based themed inspections in the investment sector
- Identified as an investment product which could pose a significant threat to retail consumers
- The themed inspection covered retail clients who invested in CFDs during 2013 and 2014
- Desk-based review of all active Investment and Stockbroking firms, providing CFD products, which are authorised by the Central Bank or operating in Ireland on a branch basis (nine firms). Followed up by on-site inspections in four of these firms
**Client Profile***

### Age Profile
- 0-20: \(2.1\%\)
- 21-40: \(53\%\)
- 41-60: \(36\%\)
- 61-80: \(8.0\%\)
- 80+: \(0.3\%\)
- Corporate/Joint: \(0.6\%\)

### Gender
- Male: \(92.8\%\)
- Female: \(6.6\%\)
- Corporate/Joint: \(0.6\%\)
Irish V’s Non Irish Resident Retail Clients

- Non Irish Resident: 88%
- Irish Resident: 12%
Breakeven/Loss/Profit – Retail Clients

Breakeven: 11%
Loss: 75%
Profit: 14%
Findings

• Criteria used for assessing appropriateness varied among firms. Some firms went over the requirements, in others, the client’s knowledge and experience may have been overestimated by the firms.

• Most firms were in compliance with regulatory requirements on complaints handling, however some failed to maintain up-to-date records.

• Marketing material was not always constructed and presented in a sufficiently-balanced way to outline both the risks and benefits of CFDs.

• CFDs are not suitable for investors who have a low risk appetite due to the volatile nature of the CFD market, coupled with the potential for the consumer to lose more than the initial investment.
2. Sale of Pension Annuities
We recognised that:

- the purchase of pension benefits represents a significant and complex transaction for most consumers, and

- the purchase of a pension annuity is a once-off purchase, which can have a major impact on a consumer’s income in retirement

- Six of the largest annuity providers included in the desk-based review, with on-site inspections in four

- Based on data provided 92,476 annuities were held by personal consumers as at 30 June 2015
Key Findings

- Firms could be more transparent in explaining the Open Market Option
- In some cases, firms were unable to evidence that all post retirement options were fully explored
- Consumers can increase their income by over €350 a year by comparing rates from annuity providers
- Consumers could also significantly increase their income by choosing an enhanced annuity over a standard annuity, if they qualify
- 60% of customers, who chose an annuity with a guarantee period, chose a 5 year guarantee
- Although firms did explain “guaranteed payment periods” to consumers they did not always discuss the various guaranteed payment periods on offer
### Results of Straw man - €350 extra income per annum

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>Highest</th>
<th>Lowest</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Life Standard – No Guarantee</td>
<td>€187.58 per month</td>
<td>€162.03 per month</td>
<td>€25.55 per month</td>
</tr>
<tr>
<td>Single Life Standard – 5 Year Guarantee</td>
<td>€186.77 per month</td>
<td>€161.30 per month</td>
<td>€25.47 per month</td>
</tr>
<tr>
<td>Single Life Standard – 10 Year Guarantee</td>
<td>€183.91 per month</td>
<td>€158.83 per month</td>
<td>€25.08 per month</td>
</tr>
<tr>
<td>Joint Life Standard – No Guarantee</td>
<td>€162.05 per month</td>
<td>€132.48 per month</td>
<td>€29.57 per month</td>
</tr>
<tr>
<td>Joint Life Standard – 5 Year Guarantee</td>
<td>€161.63 per month</td>
<td>€132.47 per month</td>
<td>€29.16 per month</td>
</tr>
<tr>
<td>Joint Life Standard – 10 Year Guarantee</td>
<td>€160.38 per month</td>
<td>€132.34 per month</td>
<td>€28.04 per month</td>
</tr>
<tr>
<td>Single Life Enhanced – No Guarantee</td>
<td>€231.43 per month</td>
<td>€218.03 per month</td>
<td>€13.40 per month</td>
</tr>
<tr>
<td>Single Life Enhanced – 5 Year Guarantee</td>
<td>€229.10 per month</td>
<td>€216.37 per month</td>
<td>€12.73 per month</td>
</tr>
<tr>
<td>Single Life Enhanced – 10 Year Guarantee</td>
<td>€221.73 per month</td>
<td>€210.66 per month</td>
<td>€11.07 per month</td>
</tr>
</tbody>
</table>

Male, DOB 01/01/1950 Pension Fund: €50,000, Level term (i.e. no escalation), Commission rate 2%, Commencement date 06/01/2016
### Results of Straw man – Enhanced Annuity

<table>
<thead>
<tr>
<th></th>
<th>Standard</th>
<th>Enhanced</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>History of Cancer - No Guarantee Period</td>
<td>€193.29 per month</td>
<td>€236.30 per month</td>
<td>€43.01 per month</td>
</tr>
<tr>
<td>History of Cancer – 5 Year Guarantee Period</td>
<td>€192.38 per month</td>
<td>€233.76 per month</td>
<td>€41.38 per month</td>
</tr>
<tr>
<td>History of Cancer – 10 Year Guarantee Period</td>
<td>€189.19 per month</td>
<td>€225.76 per month</td>
<td>€36.57 per month</td>
</tr>
</tbody>
</table>

- Enhanced annuity assumes an individual with poor health e.g. smoker, history of heart disease and type 2 diabetes
- There are currently only 2 firms offering enhanced annuities in the Irish Market
A ‘vulnerable customer’s checklist’ in order to assess whether any additional advice or assistance, in completing the application, is required

Customers are provided with a list of the advantages/disadvantages of Annuities versus ARFs

Annuity sales documentation highlighting prominently the advantages of shopping around and “wake up packs” highlighting that the quotations provided can be used to compare retirement income

Separate ‘key contacts’ pages containing numerous sources of useful advice

Informing customers of the existence of an enhanced annuity product and where they do not offer it still making customers aware of the option

Clearly explaining the benefit of a guarantee payment period to customers and providing quotes for a five and ten year period to facilitate comparison and ultimately an informed decision
3. Monitoring Errors & Overcharging
A desk-based review of the errors resolution processes across 22 firms in the banking and insurance sectors

Findings

- All firms have governance processes in place
- Potential areas of weakness identified, lack of clarity around the level at which the governance framework is approved, when it was last approved, by whom/what party it was approved and/or what area was ultimately responsible for oversight of the governance framework
- A number of firms have no set criteria for determining escalation levels, with each business area responsible for adhering to the policy and investigating each error and resolving it
4. Retail Intermediaries
We are targeting low impact firms which are failing to meet minimum requirements

- Retail Intermediary sector as a whole consists of over 2,600 firms with c5.4m customers, generating turnover of over €4bn

- Investment, Insurance and Mortgage Intermediaries providing variety of products incl. complex and longer-term products (e.g. pensions, investments and mortgages)

- Firms range from large multinationals to sole traders (c50% of sector) to ancillary sales

- Thematic inspections on priority risk areas –
  - Professional Indemnity Insurance
  - Financial Position (Solvency)
  - Submission of Annual Returns

- Risk-based, firm-specific on-site inspections

- Annual road shows and industry newsletters to promote compliance awareness
Minimum solvency is a basic prudential and consumer safeguard as a negative financial position can lead to poor outcomes for consumers

PII provides an additional resource from which a firm can pay justified claims

Over 600 firms have been inspected for breaches of the above in the past 2 years – desk-top and on-site inspections

Most firms have rectified their positions or revoked their licences

Those which haven’t are currently subject to on-going supervisory action
Submission of Annual Returns

- In July 2011 an on-line reporting system was introduced (the ONR)
- Intermediaries are required to submit an annual return within 6 months of their financial year end
- In February 2015 we said publicly that we were focussing on firms not meeting minimum reporting requirements
- Since then well over 100 firms have been subject unannounced inspections
- Submission rates have greatly improved
- We will continue to focus on the minimum requirements - Culture
5. Other Supervisory Actions
Other Supervisory Actions

• Holding individuals to account
  ➢ Section 25 Fitness & Probity investigations – prohibition orders

• Holding firms to account
  ➢ Directions issued to cease new business / freeze bank accounts
  ➢ Involuntary revocation of licences

• Determination to invoke ICCL

• Ordered refunds of overcharged amounts

• Stopped the transfer of non-performing loans to an unregulated entity

• Introduced new on-line returns for Debt Management Firms and E-money Institutions
Other Supervisory Priorities for 2016
Supervisory work coming up ..... 

- Consumer Protection Risk Frameworks
- Engagement with Boards and CEOs on cultural change programmes
- Audits of Sales Incentives Guidelines
- Product Oversight and Governance
- Tracker Mortgage Examination
- Handling of Insurance Claims
- Health Insurance
- Structured Investment Products
- Follow-up on CCMA Themed Inspection
- Compliance with minimum standards
- Increased on-site inspections
Thank you
A Regulatory Perspective on Consumer Risk

ACOI – 11 March 2016

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