



Comptroller and Auditor General

Special Report

The Financial Regulator

May 2007

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This report was prepared on the basis of information, documentation and explanations obtained from the public bodies referred to in the report. The draft report was sent to the Financial Regulator, the Central Bank and Financial Services Authority of Ireland and the Department of Finance. Where appropriate, the comments received were incorporated in the final version of the report.

Report of the Comptroller and Auditor General

The Financial Regulator

I have, in accordance with the provisions of Section 9 of the Comptroller and Auditor General (Amendment) Act, 1993, carried out an examination of the Financial Regulator.

I hereby submit my report on the above examination for presentation to Dáil Éireann pursuant to Section 11 of the said Act.

A handwritten signature in black ink, appearing to read 'John Purcell', with a stylized flourish at the end.

John Purcell
Comptroller and Auditor General

31 May 2007

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Abbreviations

BSD	Banking Supervision Department
CBFSAI	Central Bank and Financial Services Authority of Ireland
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
CSO	Central Statistics Office
EEA	European Economic Area
FATF	Financial Action Task Force
FIFA	Financial Institutions and Funds Authorisation
FR	Financial Regulator
FSAP	Financial Services Action Plan
ICAI	Institute of Chartered Accountants in Ireland
ICCL	Investor Compensation Company Limited
ICT	Information and Communications Technology
IMF	International Monetary Fund
SPS	Savings Protection Scheme (Credit Unions)

Summary of Findings

Summary of Findings

The Financial Regulator is the body charged with overseeing the regulation of most forms of financial services provision in Ireland. It was established on a statutory basis in May 2003, and forms part of the Central Bank and Financial Services Authority of Ireland. Its establishment drew together regulatory functions previously carried out by the Central Bank, the Department of Enterprise, Trade and Employment, the Registrar of Friendly Societies and the Director of Consumer Affairs.

The Financial Regulator has a two-part mandate

- a ***prudential mandate*** — under which it aims to foster sound, dynamic financial institutions in Ireland by: disseminating guidance and standards to be followed by financial services providers; controlling market entry; ongoing supervision of licensed financial services providers through analysis of periodic returns and selective reviews and inspections of financial service providers; and enforcement of standards, where necessary.
- a ***consumer mandate*** — under which it aims to help consumers to make informed financial decisions in a safe and fair market, mainly by: setting business conduct standards and checking they are adhered to; and publishing information to help consumers choose service providers and the services appropriate to their particular circumstances.

This examination looked at all the areas of activity of the Financial Regulator since its establishment. It focused in particular on

- how the Financial Regulator sets standards and provides guidance to financial service providers, particularly in relation to promulgation of EU single market measures
- the operational measures undertaken by the Financial Regulator to monitor compliance by financial service providers with standards
- how the Financial Regulator co-operates with other regulators to efficiently and effectively monitor cross-border financial service providers
- how the Financial Regulator protects and informs the users of financial services in Ireland
- the costs of regulation.

Setting Standards

In setting standards for financial services providers, the Financial Regulator tries as far as possible to follow a principles-based approach. This aims to set a limited number of high-level principles to be adhered to, focusing on the behaviour of services providers and the outcomes the Financial Regulator is trying to achieve, rather than on specifying detailed rules to be followed in all conceivable circumstances. In practice, the standards are a combination of principles, rules and guidance.

The EU Financial Services Action Plan (FSAP) was adopted in 2000 with the aim of creating EU-wide markets for wholesale and retail financial services. Implementation of FSAP measures (usually by means of EU directives) has substantially changed the standards to which financial services providers are required to adhere. The Department of Finance and the Department of Enterprise, Trade and Employment produced the statutory instruments to transpose relevant FSAP directives into Irish law. The Financial Regulator supported the Departments by providing technical expertise and advice on the development of directives and, subsequently, in providing advice on the preparation of statutory instruments to transpose the directives to Irish law.

While the FSAP is taking longer to implement across the EU than originally envisaged, the directives have generally been transposed into Irish law in a timely fashion. Following the transposition, the Financial Regulator has also generally been prompt in issuing associated rules and guidance for financial services providers.

In developing standards, regulatory policies and administrative procedures, the Financial Regulator systematically consults with stakeholders and publishes related documentation on its website. Greater transparency of the consultation process could be achieved through a simple redesign of the website. The website should also be redesigned to improve access for financial service providers to the most up-to-date information in relation to rules and guidance in operation. The Financial Regulator has identified the redesign of its websites as a key priority by the end of 2007.

Monitoring Compliance with Standards

In a value for money report on financial regulation published by the Comptroller and Auditor General in 1999, it was noted that supervision effort was not based on an assessment of the risk associated with regulated entities. Since its establishment, the Financial Regulator has devoted considerable effort to developing a formal risk rating model, and significant progress in achieving risk-based supervision has been made. The Financial Regulator ranks financial services providers based on their risk rating, taking account of both inherent risk and the impact that failure of the financial services providers would have. The risk ratings are then used to allocate the available resources.

The Financial Regulator could enhance the usefulness of the risk-rating model by formally defining risk categories and the appropriate supervisory stance for each category. This would provide the Financial Regulator with a risk-related basis for identifying the level of resources required for supervision work. As part of the process in determining the appropriate supervisory stance for the various risk categories, the Financial Regulator should commission an independent review (e.g. a peer review) of the adequacy of its current prudential processes including the target frequency and duration of inspection visits, resource level, on-site checks and follow up. It should also seek to benchmark its inspection processes against those of other regulators in the EU with a broadly similar mandate.

The Financial Regulator requires most financial services providers to submit periodic reports about their business — these are referred to as prudential returns. The frequency, type and level of detail required varies from sector to sector. This examination found that the prudential returns system is working broadly as intended, but there is scope to improve efficiency in the receipt, analysis and reporting of returns. On-line submission of returns has been established in a few sectors. Where feasible, this facility should be extended to other sectors, with built-in data validation and checking processes. The Financial Regulator plans to implement such systems by the end of 2007.

The external auditors of financial service providers are legally required to send the Financial Regulator copies of management letters sent to financial services providers at the conclusion of annual audits. Alternatively, the auditors are required to inform the Financial Regulator that no management letter was issued, where that is the case. Analysis of a sample of 80 case files in the course of the study showed that in 2005, the Financial Regulator received all the required auditors' returns only in relation to credit institutions (i.e. banks and building societies). The Financial Regulator has now updated its procedures for ensuring that auditors' returns will be received in all sectors.

Cross-border Financial Services Provision

Cross-border financial service provision is increasingly common and has been facilitated by implementation of the FSAP. Co-operation between national financial regulators is required to ensure that all financial service providers are regulated in the first instance by those best positioned to carry out that function. This should aim both to avoid duplication of regulation, and to ensure there are no gaps in supervision. Arrangements agreed at EU level define the responsibilities of regulators in relation to financial services providers operating across national borders, and guidelines and protocols providing for information sharing and collaboration are in place. The Financial Regulator applies the relevant rules and guidelines.

Consumer Protection

Provision of information to consumers is one of the primary ways that the Financial Regulator seeks to deliver on its consumer mandate. It has published a wide range of advice and guidance material for consumers of financial services, and publishes periodic price surveys on financial services (e.g. cost of personal current accounts and credit cards, cost of motor and house insurance). This information is disseminated in printed form, via a telephone Consumer Helpline, and on the Financial Regulator's website. Lists of financial services providers are also published on the website, but when it was examined in November 2006, there were gaps in the coverage and information was hard to find. Coverage has since been improved. The Financial Regulator is working to develop the consumer sections of the website to make it clearer and more user-friendly, but there have been delays in the work due to competing demands for IT resources. A revamped website is due to become operational by end-June 2007. This will include a facility for users to search for financial services providers by name and to identify the type of services they are authorised to offer.

Building on existing codes of business conduct, the Financial Regulator has developed a unified Consumer Protection Code. Following a lengthy and detailed consultation process, the Code was formally published in July 2006, and comes into effect on 1 July 2007. Most financial service providers must follow the Code in providing services to retail customers. The Code doesn't apply to credit unions, except where they are acting as authorised intermediaries or advisors. A separate code, currently issued on an interim basis, applies to moneylenders.

The Financial Regulator carries out consumer-focused inspections designed to establish that financial services providers carry out their dealings with retail customers in line with the relevant conduct of business principles. The scale of the inspection programme is determined by the available resources, rather than by an assessment of the risk that financial services providers may carry out their business in ways that could damage the interests of consumers. The Financial Regulator should develop a systematic risk-based approach to the setting of inspection targets and the selection of financial services providers to inspect. An independent assessment (e.g. a peer review) of the adequacy of the inspection process should also be carried out.

Cost of Regulation

The Financial Regulator was initially staffed by drawing personnel from a range of agencies, but it had significant new functions as well, resulting in a need for additional recruitment and associated accommodation and support services. This, together with increasing costs, is reflected in the Financial Regulator's operational expenditure, which increased by 15% between 2004 and 2005 and a further 13% in 2006. Total expenditure in 2006 was just under €46 million.

Financial service providers are required to pay annual levies to the Financial Regulator to cover part of the amount it spends on regulation. The levy scheme is subject to the approval of the Minister for Finance, who has set a target for the Financial Regulator to recover 50% of the annual cost of regulation. In order to provide a basis for the levy estimation, the Financial Regulator has developed a financial model to apportion its spending in relation to each of the financial industry sectors. In circumstances where levies are based on estimates, differences can arise between the amount collected and the appropriate share of expenditure. As a result, the amount raised through levies each year has fluctuated around the target level, but the cumulative levies in the period 2004 to 2006 are approaching 50% of expenditure.

Prior to the introduction of the levy system, the Financial Regulator indicated that individual financial services providers would be notified of the levies due each year in advance. In the period 2004 to 2006, the levy notices did not issue before July each year. Because tariff bands changed each year and the impacts of changes in the Financial Regulator's budget were uncertain, this made it difficult for financial services providers to anticipate the levies they were likely to have to pay when they are doing their own annual budgeting. The Financial Regulator should merge the levy process with its budget estimation process, to provide more timely levy notices to individual financial service providers. The Financial Regulator is working to bring forward the date when levy notices are issued and has stated in its Strategic Plan for 2007 to 2009 that it will review its finance and funding processes.

Financial regulation imposes costs on the financial services industry. In order for financial regulation to be effective it should confer benefits that outweigh the associated costs. However, quantification of the costs and, particularly, of the benefits of regulation is challenging. The Financial Regulator has been developing its capacity to assess the relative costs and benefits of new regulation where it has discretion in how legislation is to be implemented e.g. using regulatory impact assessment techniques to form a judgment on the merits of proposed regulations. This approach provides for a systematic review of costs and benefits, even if a full quantification is not achievable.

The regulatory impact assessment technique can also be used to evaluate the existing body of regulation. The Financial Regulator has invited statutory consultative panels representing financial services providers and consumers to identify and prioritise regulatory requirements that are open to amendment by the Financial Regulator for review. In parallel with that process, the Department of Finance has stated that the impact of regulation on the financial services sector will be considered as part of a process to modernise and consolidate the existing body of legislation, which the Department is currently initiating.

The Financial Regulator avails of a range of services that are shared with the Central Bank. These include information technology development and support. There is a corporate need to focus on delivering information and communications technology improvements in order to keep pace with developments in the sectors under supervision and to improve efficiency and effectiveness. The Financial Regulator has included a number of significant measures in relation to technology development in its Strategic Plan for 2007 to 2009.

The Financial Regulator

1 Introduction

1.1 The Financial Regulator is responsible for regulating most of the financial services providers operating in or based in Ireland. The scope of its mandate includes credit institutions (banks and building societies), investment firms (stockbrokers, exchanges and collective investment schemes), providers of life and non-life insurance and reinsurance, credit unions and moneylenders.

1.2 Some aspects of financial services regulation do not come within the Financial Regulator's mandate. These include occupational pension schemes, An Post savings schemes, credit intermediaries and pawnbrokers.

1.3 The Financial Regulator's mission statement describes its core objectives as being

- to foster sound dynamic financial institutions in Ireland (the prudential supervision mandate)
- to help consumers make informed financial decisions in a safe and fair market (the consumer protection mandate)

1.4 The main activities the Financial Regulator undertakes in pursuit of its mission are

- the setting of regulatory requirements (including consumer protection codes) that must be complied with by regulated financial services providers
- the authorisation of financial services providers to operate in Ireland
- supervision of financial services providers (through routine reporting by services providers, review meetings and on-site inspections) to confirm that regulatory requirements are being met
- provision of information and guidance to consumers of financial services
- monitoring of and reporting on the market for financial services, including the extent of competition.

Organisation of the Financial Regulator

1.5 The Financial Regulator was established on a statutory basis on 1 May 2003. It was assigned regulatory responsibilities which previously had been dispersed across a number of bodies. The main functions transferred to the Financial Regulator on its establishment included responsibility for regulation of

- credit institutions and investment firms, which was previously the responsibility of the Supervision Directorate of the (then) Central Bank
- insurance firms, previously regulated by a unit within the Department of Enterprise, Trade and Employment
- credit unions, which were previously the responsibility of the Registrar of Friendly Societies
- mortgage intermediaries, moneylenders and bank charges, which previously came under the remit of the Director of Consumer Affairs.

1.6 Along with assignment of the responsibility for regulation, the Financial Regulator inherited the existing structures, systems and staff from the previous supervising agencies, which had varying regulatory cultures. As a result, the development of consistent and proportionate

regulatory policies and procedures across sectors was an early challenge for the Financial Regulator. At the same time, it had to gear up to take on new areas of responsibility, especially in the consumer information and protection area.

1.7 Since its establishment, the Financial Regulator has been given additional responsibilities in the area of securities regulation that were previously carried out by the Irish Stock Exchange. It has also been assigned new responsibilities for regulation of reinsurance companies and reinsurance intermediaries, money transmission agents and the management companies of certain types of collective investment schemes.

1.8 The Financial Regulator operates as a stand-alone entity within the Central Bank and Financial Services Authority of Ireland (the CBFSAI), under the direction of the ten-member Irish Financial Services Regulatory Authority. By statute, six members of the Authority, including its Chairman and the Chief Executive of the Financial Regulator, must be members of the Board of Directors of the CBFSAI

1.9 At the end of 2006, the Financial Regulator directly employed 329 staff (full time equivalents). In addition, the Financial Regulator avails of a range of services, which are shared with the Central Bank, including human resource management and administration, accounting, internal audit, premises, statistical analysis and information technology. A committee comprised jointly of senior executives from the Financial Regulator and the Central Bank coordinate the development and implementation of management policies in respect of all organisational matters of common interest. These include planning, budgeting, resources allocation and management review processes.

1.10 The Financial Regulator spent an estimated €45.7 million in 2006 in carrying out its functions. This includes the cost of the shared services.

1.11 Government policy requires that the Financial Regulator should recover 50% of the overall annual cost of its operations by levying fees on financial services providers. The balance of the costs incurred by the Financial Regulator is provided from CBFSAI's own resources.

1.12 The Financial Regulator published a strategic plan for the period 2004 to 2006. The primary focus of the plan was to build a new regulatory structure, which included the integration of the existing regulation units into the new organisation, and the establishment of the new functions (in particular the consumer protection function) and the new industry levy process. A second strategic plan, focused on the period 2007 to 2009, was published in November 2006.

The Context for Financial Regulation

1.13 The efficient and effective functioning of the Irish economy depends on the existence of a stable, efficient and competitive market for financial services. The financial services sector in Ireland has grown rapidly, in line with the growth in the economy. The sector is profitable and generates a considerable amount of employment in the State.

1.14 Recent decades have seen major changes in the financial sector internationally, including the dismantling of traditional barriers between different financial markets and the creation of a more global financial industry. Capital now flows more easily to locations where it receives the best reward; financial services providers have easier access to foreign markets; and boundaries between different kinds of financial activity are becoming blurred. There is also an increasing complexity in the types of financial instruments and transactions on offer. Irish financial services providers are increasingly seeking business and investment opportunities abroad. At the same time, foreign financial services providers are entering the Irish market.

1.15 The International Financial Services Centre was established in Dublin in 1987, and development of the Centre was a key driver in the growth of the financial services sector in Ireland. Tax incentives were provided to companies locating in the Centre, with the aim of creating a significant financial services industry based in Ireland but providing financial services to non-residents. Over 430 international operations are currently approved to operate in the Centre.

1.16 Increasing complexity and globalisation of financial activity makes a common and coordinated approach to financial supervision more necessary. Major financial scandals have also impacted on the reputation of the financial services industry globally. In response, a number of international bodies have been established to set common frameworks and standards for financial regulation. These include the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the International Organisation of Securities Commissions¹. The Financial Regulator subscribes to the principles and standards set by the relevant international bodies. It is also responsible for implementing the principles developed by the intergovernmental Financial Action Task Force (FATF) to combat money laundering and the financing of terrorism, in so far as they relate to the operations of financial services providers.

1.17 The Financial Services Action Plan (FSAP), agreed by EU Member States in 2000, provides a framework of measures designed to create a single retail and wholesale financial market across the EU. National governments are required to implement the related EU financial supervision directives. Responsibility for putting in place the legislation and statutory regulations required to implement the FSAP in Ireland rests mainly with the Department of Finance and the Department of Enterprise, Trade and Employment. The Financial Regulator advises the relevant departments on the technical details involved in developing the regulatory principles and is represented on cross-EU committees to support consistent interpretation and implementation. It also assists departments with the preparation of legislation and regulations to implement the FSAP measures.

1.18 The Financial Regulator has stated that its involvement in implementation of the FSAP measures has been time consuming and has required a significant resource input. As the designated regulatory authority, it has also been assigned considerable additional ongoing responsibilities under a number of FSAP measures.

1.19 The key strategic challenge for the Financial Regulator is to strike an optimum balance between under-regulation and over-regulation. Under-regulation could threaten the stability of the Irish financial sector, damage Ireland's reputation as a location to carry out financial services business and damage the interests of consumers. Over-regulation could threaten the competitiveness and viability of financial businesses.

Reviews of Financial Regulation

1.20 The Comptroller and Auditor General carried out a value for money examination of how the Central Bank evaluated the effectiveness of its financial regulation functions. The resultant report was published in December 1999. The report noted areas where there was potential for improvement in the regulatory regime, including the following.

- The target frequency of on-site inspections and review meetings with individual institutions was not based on formal assessment of the risk profile of financial services providers.

¹ The principles developed by the various international bodies are similar in many respects. The main common principles are summarised in Appendix A.

- The number of on-site inspections of individual financial services providers undertaken was below the target.
- Documentation of the risk profile of credit institutions could be improved as an aid to determining the effectiveness of regulation.
- There was scope for requiring the external auditors of financial services providers to report each year to the Central Bank on whether or not matters of prudential concern had come to their attention during their audits of annual financial statements. Letters issued by the external auditors to the management of financial services providers, raising specific internal control issues, were also not routinely provided to the Central Bank.

1.21 In July 2005, the FATF conducted a review of the extent to which Ireland complies with international principles to combat money laundering and the financing of terrorism, and the effectiveness of the systems and procedures in place to deal with these issues. The FATF report, published in March 2006, noted that Ireland follows a principles-based approach to regulation and supervision, placing responsibility on the boards and management of financial institutions to implement appropriate risk management systems and effective internal controls against money laundering and the financing of terrorism; and that the fitness and probity of those who manage financial institutions is monitored closely by the Financial Regulator. Specifically in relation to regulation, supervision and monitoring, the FATF report noted that

- the Financial Regulator has a full range of supervisory powers to adequately regulate and supervise in relation to anti-money laundering and combating the funding of terrorism
- a fully implemented compliance regime for money transmission services is not yet in effect, but that the initial steps are being taken through licensing of these entities
- the Financial Regulator is unable to directly apply its range of administrative sanctions for anti-money laundering and combating the funding of terrorism breaches
- there is room for more formal increased interagency co-operation particularly between the Garda Síochána Money Laundering Investigation Unit and the Financial Regulator.

1.22 The International Monetary Fund (IMF) conducts periodic surveys to review the stability and operation of financial markets in individual countries, including compliance with the international standards set by relevant international bodies. In early 2006, the IMF carried out a survey of the Irish financial market, including a follow-up review on areas where a previous IMF survey (undertaken in 2000) identified problems in relation to compliance by Ireland with international standards. The IMF report, published in July 2006, concluded that good progress had been achieved in strengthening the regulatory and supervisory framework, in line with the recommendations of the 2000 survey. It found that the Financial Regulator's strategy of creating a unified approach to risk with common elements across different sectors where appropriate, but differentiated where necessary, was being put into practice well. However, it stated that improvements could nonetheless be made to enhance some aspects of supervision, especially as regards supervision of insurance and reinsurance.

1.23 In November 2004, separate statutory consultative panels were established to represent the views and perspectives of the main stakeholders in the Financial Regulator's activities and operations i.e. the consumers of financial services (represented by the Consultative Consumer Panel) and financial services providers (represented by the Consultative Industry Panel). In reporting on their respective activities in 2005, each of the Panels provided an overview of the performance of the Financial Regulator. The full text of the statements of the chairmen of the Panels are presented in Appendix B. The main observations they made were

- The Chair of the Consultative Consumer Panel stated that, from the consumers' point of view, the Financial Regulator had done a good job since its inception, and that the

orientation of the organisation was right. The Panel found that the Financial Regulator had got the balance about right between the need for prudent supervision and the need to protect the consumer. It found the big failing of the Financial Regulator was the slow speed at which it operates, and that it needed to show that it had the resolve to enforce the codes of business conduct. It recognised that the impact of EU legislation was also a huge challenge for the Financial Regulator, and that it needed to build its capacity to measure its own performance.

- The Chair of the Consultative Industry Panel stated that, for the Financial Regulator, the period 2003-2006 had been primarily about development and establishment, but that the Panel expected that a mature 'steady state' would be achieved soon, with a consequent levelling off of growth in expenditure by the Financial Regulator. He stated that, in seeking to achieve the right balance between under and over regulation, there was no conflict between the Financial Regulator and the financial services industry. The Panel advocated organisational changes in the Financial Regulator to recognise the differing regulatory priorities between, on the one hand, domestic and retail financial services and, on the other, the international and wholesale financial services sector. It also supported the implementation of recommendations made by the Competition Authority to improve competitiveness in the retail banking sector.

Scope of the Examination

1.24 Focusing primarily on the efficiency of the Financial Regulator in carrying out its functions, the issues addressed in this examination included

- the implementation of EU FSAP measures in Ireland, and the timeliness of their translation by the Financial Regulator into standards and guidance for financial services providers
- the efficiency of the work carried out by the Financial Regulator to confirm compliance by financial services providers with the relevant standards and in the provision of relevant information to consumers
- the adequacy of systems in place to ensure there is efficient and effective regulation of foreign financial services providers operating in Ireland, and of Irish financial services providers operating abroad
- the level of resources applied in regulating each sector.

1.25 The extent to which the potential improvements in regulation identified in the 1999 report have been implemented by the Financial Regulator was reviewed during this examination.

Methodology

1.26 The work on the examination was carried out by staff of the Office of the Comptroller and Auditor General. In addition to a review of relevant files and documents, and interviews with relevant personnel in the Financial Regulator, the work of the examination included the following.

- Case files for a sample of 80 financial services providers was selected on a random basis to examine the extent to which the key prudential supervision functions are applied in practice by the Financial Regulator (e.g. receiving and analysing returns, application of risk assessment process, on-site inspections and, where necessary, enforcement procedures).
- Case files for a random sample of 20 financial services providers subject to consumer-protection focussed inspection by the Financial Regulator were also reviewed.
- Meetings were held with representatives of the Consultative Industry and Consumer Panels.

- The Financial Regulator's budget and accounting systems were surveyed to establish how costs of regulation are arrived at and apportioned to the various sectors.
- The Financial Regulator's systems for measuring and reporting its performance were reviewed.

Structure of the Report

1.27 Chapter 2 looks at how the Financial Regulator goes about setting and disseminating standards for financial services providers. Chapter 3 examines the efficiency of the processes used by the Financial Regulator in ensuring compliance by financial services providers with the standards it has set. Chapter 4 deals with how it manages the additional complexity of supervising cross border financial services providers. Chapter 5 looks at how the Financial Regulator goes about protecting the users of financial services. Chapter 6 examines the costs of regulation, both in terms of the expenditure incurred by the Financial Regulator, and the costs imposed on financial services providers.

2 Setting Standards for Services Providers

2.1 Primary responsibility for policies, structures and legislation in relation to regulation of financial services providers rests with the Minister for Finance. Operating within the legal and organisational framework, the Financial Regulator sets the standards to be observed by financial services providers operating in Ireland. The Financial Regulator may consult financial services industry and consumer representatives in drawing up the standards. Once standards are set, they should be communicated quickly and clearly to services providers to ensure they understand what is expected of them in the conduct of their business.

2.2 This chapter looks at the progress made to date by the relevant Departments in implementing the EU FSAP measures. It then looks at how efficient the Financial Regulator has been in translating the requirements into rules, principles and guidelines for services providers. It also looks at the extent to which the Financial Regulator consults industry and consumer interests in setting standards, and how accessible the standards are to financial services providers.

Regulatory Approach

2.3 Two contrasting approaches to regulation of financial services have been defined. These are

- **Principles based regulation** — this involves the setting of a limited number of high-level principles to be adhered to by financial services providers, and which may be supplemented by guidelines to explain how the principles should work in practice. By focusing on the behaviour of services providers and the outcomes the regulators are trying to achieve, the statements of principles are intended to allow services providers a degree of discretion and freedom of action in how they conduct their business.
- **Rules based regulation** — this involves setting detailed rules to be complied with by all financial services providers, covering all relevant aspects of how they do their business and how they manage relationships with their customers/investors and with the regulator(s).

In either case, the extent to which services providers are complying with the standards has to be tested in some way, and enforcement actions may follow, if required.

2.4 In practice, in most jurisdictions, regulation of financial services providers falls between the two extremes, based on a pragmatic combination of the two approaches. Some regulatory regimes tend towards having complex sets of rules and regulations that prescribe in minute detail how services providers should act in any conceivable situation. This kind of regime may provide financial services providers with a high degree of certainty about what their regulators expect, but it may also result in high compliance costs and a loss of industry competitiveness. As a result, many financial regulators are seeking to adopt a generally less prescriptive approach.

2.5 As a relatively recently formed ‘single regulator’, the Financial Regulator has inherited a varied and sizeable body of rules, regulations and guidelines from its predecessors. Implementation of the rules and regulations required to give effect to some of the FSAP measures is adding to this. However, the Financial Regulator has stated that, to the extent that it can do so, it intends to follow a more principles based approach to regulation.

Implementing the Financial Services Action Plan

2.6 The European Council adopted the FSAP in March 2000, and set a target for implementation of the Plan by the end of 2005. The Plan consisted of a set of 42 measures intended to fill gaps and remove remaining barriers to the integration of EU financial markets.

2.7 The FSAP measures focused on a wide range of areas impacting on financial markets, including regulation of financial services providers, company law, cross border payments, and taxation of financial services. The strategic objectives of the Plan were

- to create a single EU wholesale financial market, including measures designed to enable firms to raise capital on an EU wide basis, establish a common legal framework for securities and derivatives markets, and standardise financial statements for listed companies
- to develop open and secure financial retail markets, including measures designed to equip consumers with the necessary information and safeguards to permit their active participation in the single financial market, create legal conditions in which new distribution channels and distance technologies can be put to work across national boundaries and encourage the emergence of cost-effective and secure payment systems which enable citizens to make cross border payments
- to implement ‘state-of-the-art’ prudential rules and supervision to meet the challenges in dealing with new market structures, globalisation and EU enlargement, including measures designed to eliminate gaps in the prudential framework, help develop EU supervisory structures, and enable the EU to assume a lead role in setting global standards for regulation and supervision.

2.8 Most of the FSAP measures were implemented in the form of EU directives, which have to be transposed into national law by each member state. Each directive was issued with a common EU-wide target date for completion of the transposition process. Other measures were implemented in the form of EU regulations, which apply directly in all EU member states or through non-binding EU Commission recommendations or communications.

2.9 A number of government departments were involved in the process of preparing the legislation and statutory instruments required to give effect to the FSAP measures. The Department of Finance and the Department of Enterprise, Trade and Employment were each involved in the preparation of a number of pieces of legislation and statutory instruments. Other Departments involved in the implementation of FSAP were the Department of Social and Family Affairs (on pensions legislation) and the Department of Justice, Equality and Law Reform (on anti-money laundering measures).

2.10 Where the FSAP measures relate to financial services regulation issues, the Financial Regulator provides technical assistance to the relevant departments, first in preparing and representing the Irish position during development and agreement of the Directives, and subsequently during preparation of the legislation and statutory instruments that transpose the directives into Irish law. It subsequently has a role, in relevant cases, in publishing explanations and guidelines for services providers.

2.11 Appendix C lists the measures included in the FSAP, indicating their status, the type of instrument used to give effect to the measure (i.e. regulation, directive, recommendation or communication), the relevant target dates for implementation and the dates transposition of directives was achieved or is required.

Timeliness of Transposition of EU Directives

2.12 The original target for the FSAP was that all the measures would be implemented by the end of 2005. In practice, negotiation at EU level of some of the implementation instruments took longer than planned, with the result that the original deadline has been exceeded. The current target envisages that all remaining measures will be implemented by the end of 2007.

2.13 In total, 23 FSAP-related directives had transposition dates up to and including end-January 2007². By the end of February 2007, all had been enacted into Irish law.

2.14 The dates that the individual FSAP directives were transposed into Irish law were analysed as a measure of the timeliness of the transposition process (see Figure 2.1). This indicated that 12 (52%) of the 23 directives were transposed prior to or by the target transposition date, or within one month of the target. Seven directives (31%) were transposed between one and six months after the target date, and a further four (17%) were transposed more than six months late.

Figure 2.1 Timeliness of transposition by Ireland of Financial Services Action Plan directives (position at end February 2007)

<i>Timing of transposition to Irish law</i>	Number of directives	% of total
By target transposition date	9	39%
Within 1 month of target date	3	13%
1 to 3 months after target date	3	13%
3 to 6 months after target date	4	18%
6 to 9 months after target date	1	4%
More than 9 months after target date	3	13%
All directives	23	100%

Source: Analysis by Office of the Comptroller and Auditor General

Note: Includes FSAP directives that had target transposition dates up to and including 31 January 2007 (but see footnote 2).

2.15 The EU Commission has powers to enforce the transposition of directives. In the context of the FSAP, these have been used only once against Ireland. The Market Abuse Directive³ was due to have been transposed by 12 October 2004. In July 2005, the Commission instigated infringement proceedings against Ireland and 15 other member States, issuing a Letter of Formal Notice and a Reasoned Opinion. The Directive was transposed into Irish law on the day these issued (5 July 2005), so no further action was taken by the Commission against Ireland. The Department of Enterprise, Trade and Employment was the Department responsible for implementing the legislation, and the Financial Regulator, as the competent authority, played an advisory role in the transposition. The Department has stated that the delay arose because of

- the scale of the transposition exercise
- the need to designate a new single administrative competent authority to regulate the legislation and
- the need to provide for administrative sanctions consistent with the Irish Constitution.

2 Excludes the Transparency Directive (FSAP Measure 2: see Appendix C), which was adopted in 2004 with a target transposition date of 20 January 2007. The Directive required the EU Commission to adopt implementing measures but these were not finalised until 8 March 2007, in the form of Directive 2007/14/EC. The Department of Enterprise, Trade and Employment is working on jointly transposing both directives to Irish law, and expects this to be finalised by end of June 2007.

3 Measure 4: Directive 2003/6/EC.

Convergence of Regulation in the EU

2.16 Based on the recommendations of the Lamfalussy Committee report in 2001, the EU adopted a sector-based committee system to provide advice to the EU Commission on the drafting of financial services policies and measures, and to help clarify practical issues involved in implementing the FSAP. In addition, it was envisaged that the committees would also monitor and report on the extent to which legislative provisions and implementation of financial services market rules and supervision are consistent across member states.

2.17 Separate committees — made up of representatives of the relevant financial regulator(s) in each of the member states — have been established to monitor the situation in each of the major financial services markets. These are

- **Committee of European Securities Regulators (CESR)** — established in June 2001 to act as an advisory group to assist the EU Commission in drafting implementing measures for directives in the field of securities and to ensure more convergent and timely day-to-day implementation of community legislation in member states.
- **Committee of European Banking Supervisors (CEBS)** — established in November 2003 to perform functions similar to the CESR in the area of credit institutions; its main priority has been on finalisation of common guidelines related to implementation of the Capital Adequacy Directive, which was due to be transposed in all EU member states by 31 December 2006.⁴
- **Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)** — established in November 2003 to perform functions similar to the CESR in the area of insurance and occupational pensions. The main priority of CEIOPS is the development of a directive (Solvency II), aimed at implementing a more risk-oriented and robust prudential regulation framework for insurance on the lines on the Basel Committee for banking supervision approach. It is expected that standards and guidelines will follow from these.

2.18 The CESR has issued standards on financial information, regulated markets, market conduct, trading systems, etc. In addition, it has published a country-by-country review of the application at national level of guidelines and standards in the area of securities, based on self-assessment by national financial regulators. In August 2006, the CESR decided to adopt a more active approach, involving carrying out its own examinations of convergence across the EU in the supervision of securities.

2.19 The CEBS and CEIOPS were established later than the CESR, and are still operating at the level of developing standards. They have not yet commenced formal monitoring and reporting on the convergence of supervision across the EU in their areas of operation.

Guidance on FSAP Measures

2.20 Many FSAP regulations and the transposition of FSAP directives create new legal obligations and rules (or change existing ones) in relation to how financial service providers should operate. In many cases, this requires amendments to the Financial Regulator's rules and guidance for financial services providers, and/or to its own operating procedures. EU Commission communications and recommendations, while not legally binding, also potentially have implications for how financial services providers are expected to behave or for how rules are to be

4 Directive 2006/48/EC (Measure 33) was transposed in Ireland on 19 December 2006.

interpreted. Timely translation of the various requirements into published rules and guidance is a measure of the Financial Regulator's efficiency.

2.21 A total of 22 FSAP measures dealing with financial regulation issues had been completed or formally implemented by the end of February 2007. This includes 14 measures implemented through directives, seven that involved EU Commission communications or recommendations, and in one case, a Commission report.

2.22 Progress by the Financial Regulator in relation to publishing rules and guidance based on FSAP measures was examined.⁵ This found that, at end February 2007

- The Financial Regulator had issued guidelines or rules for financial services providers in relation to eight of the 14 measures implemented through directives. Guidelines were being drafted in relation to two further directives.
- Of the eight sets of rules/guidelines that were issued, six were published (in draft or final form) at around the time the related directives were transposed. Two were issued substantially later than the relevant transposition dates.

2.23 The Financial Regulator has stated that guidance for financial services providers was not considered necessary in relation to four measures implemented by directives. These include directives on the winding up and liquidation of insurance undertakings and cross border credit institutions. The Financial Regulator considered that guidelines were not warranted in relation to measures involving EU Commission communications or recommendations. These included communications on distinguishing between sophisticated and retail investors, and business rules to facilitate cross-border provision of services; and recommendations on best practice in the provision of information to consumers.

Development of Consumer Protection Standards

2.24 The Financial Regulator is legally required, in performing its functions and exercising its powers, to promote the best interests of users of financial services. Following its establishment, it commenced a review to establish the extent and adequacy of existing rules and guidelines for financial services providers in respect of their dealings with their customers.

2.25 Codes of conduct issued by the predecessors of the Financial Regulator were in place in relation to consumers for some sectors (e.g. credit institutions, investment firms). In December 2003, the Financial Regulator issued interim codes of conduct to financial services providers in other sectors, such as insurance firms, moneylenders and mortgage intermediaries. It then commenced a detailed public consultation process aimed at developing a unified Consumer Protection Code, applicable across all sectors. The Code was published in July 2006 and will come into effect on 1 July 2007.

2.26 The new Consumer Protection Code will apply to most financial services providers offering retail services in the State. It will not apply to moneylenders or credit unions.⁶ However, following a review of the moneylending industry in 2006, a report was issued in April 2007 and the Financial Regulator commenced a review of the interim Code of Practice for Moneylenders,

5 Excludes FSAP measures that do not impact directly on the functions of the Financial Regulator e.g. measures relating to changes in company law, or to currency and cross-border payment systems.

6 The Consumer Protection Code will apply in situations where credit unions act as (authorised) mortgage or insurance intermediaries.

with a view to improving the consumer protection framework. The Financial Regulator's Strategic Plan 2007-2009 proposes consultation with credit unions on the development of an appropriate consumer protection framework for their members.

2.27 The Code comprises a number of general principles, common rules and advertising requirements that apply to all regulated financial services providers. These are supplemented by some more detailed rules for specific sectors. The Code places the onus on the principals, board and senior management of the financial services provider to ensure compliance with its requirements.

2.28 The stated objective of the Code is to ensure that consumers of financial services are treated fairly. It requires all financial services providers to gather as much information about a prospective consumer as is necessary to provide the consumer with a suitable financial product. The financial services provider must be in a position to explain why a product is suitable and if things go wrong, must handle the consumer in a fair and transparent manner. This process attempts to ensure that customers know what they are purchasing and understand the risks involved.

2.29 Based on the principle that consumers are entitled to a minimum level of professionalism and expertise from their financial advisors, the Financial Regulator also published in July 2006 a set of minimum competency requirements for personnel involved in the sale of financial services in the main sectors of the industry, or in the provision of advice to consumers about such services. The competency requirements are intended to facilitate competition between providers of financial services and to increase consumer confidence in the competence and knowledge of financial services sellers and advisors.

Consultation with Stakeholders

2.30 The Financial Regulator has, since its establishment, sought to follow a consultative approach to regulatory policy making, standard setting and administrative procedure changes. The stated policy is to undertake public consultations on all significant new regulatory requirements which the Financial Regulator proposes to introduce.⁷

2.31 Formal consultation with stakeholders by the Financial Regulator centres around the publication of consultation papers, with an open invitation to all affected parties to make recommendations on how the regulatory issues concerned should be addressed. The Financial Regulator also formally invites the statutory consultative Consumer and Industry Panels to provide comments on regulatory proposals. Depending on the scale and complexity of the issues, a period of one to three months is allowed for the submission of comments.

2.32 Up to the end of February 2007, a total of 47 consultation papers had been issued. The level of response to consultations has been variable. For example, the consultation paper on funding of the Financial Regulator drew a total of 67 responses; and the Consumer Protection Code consultation drew 61 responses. At the other extreme, a number of consultations drew just one response each.

2.33 The Financial Regulator has stated that about half of the consultation processes so far completed have resulted in amendments to administrative processes, rules or guidance notes. In

⁷ This is in addition to public consultations undertaken by the Lamfalussy committees during the development of directives.

other cases, views of industry were incorporated into final documents before formal publication. In addition, the Financial Regulator has published public responses to submissions received in relation to key issues e.g. funding of the Financial Regulator, administrative sanctions, the Consumer Protection Code, and the minimum competency requirements for directors of financial services companies.

2.34 All consultation papers issued by the Financial Regulator are published on its website. The responses received are published in a different part of the website⁸ and the outcome of the consultation process is not explicitly stated. This presentation of information makes the consultation process on any particular issue hard to follow. By comparison, the full history of each consultation process — consultation paper, submissions, response and a link to the relevant rules/guidance — is presented in one place on the Committee of European Banking Supervisors' website.

2.35 In addition to the formal consultation process, the Financial Regulator also communicates with stakeholders about its policies and processes through

- participation by staff of the Financial Regulator in conferences and seminars on financial services
- the establishment of ad-hoc implementation forums in relation to certain complex FSAP measures⁹, allowing for a more flexible and focused dialogue with the financial services industry to highlight priority areas for issuing of guidance.

2.36 A survey of financial services providers commissioned by the Industry Panel in 2006 included questions about the consultation process. Of those who responded, 48% expressed a degree of satisfaction with the process, while 30% expressed a degree of dissatisfaction. The remaining 22% were neutral on the issue.¹⁰

Access to Standards and Guidance

2.37 A pre-condition for regulation of financial services providers to operate with maximum efficiency and effectiveness is that they should, at all times, have easy access to all of the most up-to-date information about the standards they are expected to observe, and how the regulatory process operates. Internet websites potentially provide a good platform for the Financial Regulator to make the information available. If services providers are unable to access the information they need independently, they are likely to have to seek the information directly from the Financial Regulator, resulting in cost and delay.

Dissemination of Standards

2.38 The Financial Regulator does not maintain a single source or system where individual financial services providers can readily access all the rules, regulations and guidance that relate to their own area(s) of activity.

2.39 The Financial Regulator's website includes many documents that outline regulatory standards that apply in Ireland. While the amount of material on the website has been expanding

8 Responses may not be published where respondents request confidentiality for their submissions.

9 Forums have been established in relation to the Market in Financial Instruments Directive (Measure 5) and the Capital Adequacy Directive (Measure 33).

10 Consultative Industry Panel, *Survey of Regulated Entities*, July 2006

(particularly in 2006), problems remain for users of the website in accessing relevant information. When the content of the Financial Regulator's website was reviewed in December 2006, it was found that

- Not all the documents relating to the standards that apply to individual financial services sectors were located together in one part of the website.
- As part of the authorisation process, the Financial Regulator informs applicants of the current set of standards with which services providers are required to comply. Generic lists of this kind were not posted on the Financial Regulator's website, even though they would serve also as a useful reference guide for longer established services providers.
- Users were referred to other websites (e.g. the Committee of European Banking Supervisors' website) where relevant guidance is given.
- Some key documents were out of date. For example, the *Licensing and Supervision Requirements and Standards for Credit Institutions* was a 1995 Central Bank document. It had not been updated to take account of such significant developments as the euro conversion or the establishment of the Financial Regulator itself.
- The status of some documents was not clear from the site. For example, a document described as a 'regulatory document' on the requirements for the management of liquidity risk by credit institutions was published on the website in June 2006. The Financial Regulator was not implementing the requirement until 1 January 2007, and even then only on a 'parallel' basis for six months, but the effective commencement date was not clearly indicated.

Requests for Information

2.40 The Financial Regulator does not formally monitor the volume of requests from regulated services providers for information about standards, or the timeliness with which the required information is provided. Typically, these are received in the sections dealing with the regulated entities, and handled by staff who carry out ongoing supervision of the entities raising the queries.

2.41 The 2006 Industry Panel survey asked financial services providers about their level of satisfaction with their main contact in the Financial Regulator, and with the helpfulness of the guidance provided. This found that about two-thirds of respondents expressed a degree of satisfaction both with their main contact, and with the helpfulness of the guidance provided. However, over a quarter of the respondents were dissatisfied to some degree with the helpfulness of the guidance.

Conclusions

2.42 The Financial Regulator has issued guidance for financial services providers in relation to most FSAP directives impacting on its area of responsibility. In most cases where rules and guidance were published, they were provided in a timely way.

2.43 The Financial Regulator systematically consults with stakeholders in the process of developing standards, regulatory policies and administrative procedures. Documents in relation to the consultation process are published on the Financial Regulator's website.

The Financial Regulator's process of consultation with stakeholders could be made more transparent by a reordering of the way the documents are presented on the Financial Regulator's website.

2.44 The main format used by the Financial Regulator for publication of regulatory standards for financial services providers is through its internet website, and this is probably the best option currently available. However, there is scope for improvement in coverage and in the way in which the rules and guidance material are presented.

The Financial Regulator should make its web-based rules and guidance material more user-friendly. Apart from improving access to the material, this could also reduce the volume of direct contacts from financial service providers requesting factual information.

The Financial Regulator recognises the importance of websites as key communications tools with its stakeholders. In its Strategic Plan 2007-2009, it has identified the redesign of its website as a key priority by end 2007, and has stated that the Licensing and Supervision Requirements and Standards for Credit Institutions will be updated during the life of the Plan.

3 Ensuring Standards are Met

3.1 The main strategies adopted by the Financial Regulator to ensure that financial service providers meet all the relevant standards are

- **control of market entry** through authorisation of financial service providers before operations commence, authorisation of collective investment schemes before they are offered to investors, approval of persons acting as directors of financial service firms, and approval of proposed major changes in the nature of business and in business processes
- **supervision** of authorised service providers by requiring financial service providers to submit periodic ‘prudential returns’ which are analysed for compliance with standards, and selective on-site reviews and inspections of financial service providers operations
- **enforcement** procedures where financial service providers are found to be in breach of relevant standards and guidelines

3.2 This chapter looks at the efficiency of the Financial Regulator in carrying out these functions, including targeting of supervision resources on areas of highest risk and the timeliness and completeness of regulatory activities.

Number of Financial Service Providers

3.3 The Financial Regulator had regulatory responsibility for over 6,000 financial services providers, and almost 3,800 collective investment schemes at the end of 2005 (see Figure 3.1).

Figure 3.1 Entities regulated by the Financial Regulator, end December, 2003 to 2005

	Number of regulated entities		
	2003	2004	2005
Collective investment schemes	3,507	3,712	3,798
Financial services providers, by sector:			
Credit institutions ^a	80	80	79
Insurance companies ^b	168	177	186
Credit unions	437	437	435
Retail investment intermediaries	2,414	2,415	2,623
Insurance/reinsurance intermediaries	—	—	524
Mortgage intermediaries	1,050	1,075	1,440
Investment business firms	996	1,109	1,205
Fund service providers	230	229	230
Stockbrokers	11	12	11
Exchanges	33	41	41
Moneylenders	52	55	50
Moneybrokers	7	7	6
Bureaux de change	14	14	14

Source: Financial Regulator annual reports

Notes: a Includes credit institutions not based in Ireland but operating branches in Ireland.

b Excludes insurance companies not based in Ireland but operating branches in Ireland.

3.4 The Financial Regulator's estimates of the number of entities regulated are currently produced manually, potentially leading to an element of human error in the estimates. This is especially the case where some financial services providers (particularly intermediaries) operate in two or more financial sectors and consequently appear on two or more of the Financial Regulator's registers. Work is underway on compiling electronic registers, which should allow accurate estimates of the number of regulated entities to be compiled.

3.5 There were small changes in the number of service providers in most sectors between 2004 and 2005, and in the number of collective investments schemes regulated. More significant changes occurred in some sectors.

- The Insurance Mediation Regulations extended the remit of the Financial Regulator to include insurance and reinsurance intermediaries with effect from 2005. This increased the number of regulated entities by over 500.
- The number of mortgage intermediaries increased by 33% because of a widening of the definition of mortgage intermediaries to include mortgage 'introducer' businesses, which introduce potential mortgage customers to other mortgage intermediaries but do not arrange for a mortgage lender to provide the client with a loan.

Authorisation and Licensing

Organisation of Authorisations

3.6 The authorisation function for most financial service providers and funds is centralised within the Financial Regulator in the Financial Institutions and Funds Authorisation Department (FIFA).¹¹

3.7 Once a financial services firm has been authorised to operate, responsibility for the relationship with the firm is handed over by the FIFA Department to the relevant prudential supervision department. In addition to ongoing responsibility for prudential supervision of the entity concerned, they handle any subsequent regulatory requests or decisions, including

- applications to obtain 'approved person' status for company directors and senior managers
- applications to approve certain types of major business changes e.g. changes in ownership or shareholding, acquisitions, new products, etc.

Volume of Authorisations to Operate

3.8 The Financial Regulator issued authorisations in respect of almost 2,200 financial service providers in 2005. Over 580 collective investment schemes received authorisation. (See Figure 3.2.) In addition, over 2,600 proposed amendments to existing collective investment schemes were processed.

3.9 Most authorisations to provide financial services are issued without time limitations (but subject to continuous compliance with specified criteria). Up to 2005, licences to operate as mortgage intermediaries were valid for one year. Licences to operate as moneylenders are valid only for one year.

¹¹ Applications for authorisation of credit unions are handled by the Credit Union Department, but there have been none since the establishment of the Financial Regulator. Applications to operate as a moneylender are handled by the Consumer Directorate.

Figure 3.2 Authorisations and revocations of authorisation of financial service providers, by sector, 2005

	Newly/re- authorised	Authorisation revoked/ lapsed
Collective investment schemes	582	496
Financial services providers, by sector:		
Credit institutions	1	2
Insurance companies	10	1
Credit unions	—	2
Retail investment intermediaries	126	36
Insurance/reinsurance	525	—
Mortgage intermediaries	1,446	1,081
Investment business firms	15	9
Fund service providers	3	—
Exchanges	2	—
Moneylenders	50	55
Moneybrokers	—	—
Bureaux de change	—	—

Source: Financial Regulator

3.10 A significant part of the authorisation work in 2005 was related to issuing or renewal of authorisations for mortgage intermediaries. In part, this was due to the widening of the definition of ‘mortgage intermediary’, but three quarters of the licences issued involved renewals of previous authorisations that had a one-year duration. Arising out of a business process review in 2005, a decision was taken to extend the authorisation period for mortgage intermediaries to five years, or ten years if the mortgage intermediary holds an authorisation under the Investment Intermediaries Act. This should significantly reduce the number of authorisations to be processed each year.

3.11 There are very few formal refusals of applications for authorisation to operate as a financial services provider. Some potential applicants withdraw from, or do not proceed to, the formal authorisation process, but such cases are not formally recorded. This may be because they become aware of the full requirements for authorisation, or because of changes in business plans.

3.12 Only four applications for authorisation as mortgage intermediaries (out of a total of 1,450 applications) were refused by the Financial Regulator in 2005. In those cases, the grounds for refusal of authorisation were that the applicant had failed to provide a current Revenue tax clearance certificate, was unable to provide a completed application or was not, in the opinion of the Financial Regulator, a fit and proper person to carry out business as a mortgage intermediary.

3.13 Authorisations to provide financial services may be revoked by the Financial Regulator, either at the service provider’s request (e.g. upon retirement of a service provider) or because of infringements of the relevant regulations or licensing conditions. There were no revocations in 2005 on the grounds of breach of conditions.

Timeliness of Authorisation Process

3.14 The Financial Regulator monitors the timeliness of processing of applications for authorisation of collective investment schemes¹² for internal management information purposes. It has reported that, in 2006, the average time taken to process such applications was 21 calendar days for 'fast track' applications and 36 calendar days for other applications. These averages measure the time the application was with the Financial Regulator and exclude time taken by applicants to address issues raised by the Financial Regulator.

3.15 The Financial Regulator, in consultation with the Consultative Consumer and Industry Panels and various representative bodies, has developed a stakeholder protocol in relation to certain key interactions with the industry, which becomes effective on 2 July 2007. This includes target times for processing some types of financial service applications (see figure 3.3). Separate targets have been set for issuing first comments in response to applications, and for issuing of subsequent comments in relation to follow-up information.

Figure 3.3 Target times for processing authorisation applications

Type of application	Timeliness targets	
	Issue first comments	Issue comments on response(s) (if necessary)
Retail intermediaries	15	10
Collective investment schemes		
▪ Fast track	10	5
▪ Other	15	10
Credit institutions, insurance firms, investment services firms, funds service providers	25	Not specified

Source: Financial Regulator Stakeholder Protocol

3.16 The Financial Regulator has reviewed how it processes applications for licences and fund authorisations and has made a number of changes. For example

- Best practice reviews on collective investment schemes resulted in increased reliance, from June 2004, on certification by law firms in relation to compliance of certain fund documents with the Financial Regulator's requirements.
- Collective investment schemes that are agreed between fund managers and investors that have prior approval as qualifying on set criteria may be authorised by the Financial Regulator without a detailed review of the application document. In such cases, once the Financial Regulator receives the full documentation of the scheme, including the required confirmations and evidence that the parties are qualified as required, the scheme can be authorised on the next working day.

Approvals of Directors and Managers

3.17 An authorisation to operate as a financial services provider details the type of business for which the authorisation is granted. Any subsequent proposed change of business or proposed appointment of an additional or replacement director or senior manager requires notification to, and possible approval from the Financial Regulator. The Financial Regulator does not monitor the number and type of requests for approval of changes it receives each year, or the time taken to process them.

¹² The monitoring system is being extended to all other authorisations.

3.18 A review of the case files of a random sample of 80 of the financial services providers regulated by the Financial Regulator indicated that it processed almost a quarter of all approved persons applications received in 2005 within five working days, and about 54% within 20 working days.

3.19 The process followed by the Financial Regulator in assessing proposed directors or managers varied from sector to sector. In some sectors, the process followed permitted a response to be provided in a relatively short period. However, most of the applications were in relation to changes in personnel in investment intermediaries. In these cases, the process included carrying out checks with third parties e.g. the applicant's bank, referees, An Garda Síochána, and in some cases, foreign regulators. This gave rise to delays and reminders often had to be issued to third parties that had not replied to queries.

3.20 In order to speed up the process, the Financial Regulator introduced a new fitness and probity test to be used for all approval applications received on or after 1 January 2007. The new test requires the appointing firm to satisfy itself as to the fitness and probity of a person to be appointed to an approved position, including carrying out the necessary third party checks, before submitting their name to the Financial Regulator. From 2 July 2007, the Financial Regulator aims to provide a response to applications within 20 working days. However it reserves the right to carry out third party checks on a sample basis and with other regulators, where applicable.

Supervision of Financial Service Providers

Organisation and Staffing

3.21 The Financial Regulator has carried out or is planning substantial reorganisation of the departments that carry out the ongoing supervision of financial services providers, and of the processes they employ. In 2005, the Banking Supervision Department was reorganised on a functional basis. This included the establishment of units that specialise in carrying out inspections, financial analysis or off-site review. The Financial Regulator found that this facilitated the streamlining of processes and enhanced follow up of supervisory issues and is extending the approach to other areas of supervision. For example

- In 2006, the Insurance Supervision Department was reorganised. Traditionally divided into life and non-life divisions, the Division is now divided into divisions dealing with insurance and reinsurance. The same basic supervision methodology is now applied to all direct writers of insurance (life or non-life), and units to manage inspections, financial analysis and off-site review have been established. A reinsurance unit has been created to deal specifically with implementing the recent Reinsurance Directive and bring reinsurers into the supervisory net.
- A process of reorganising investment firm supervision is being undertaken in 2007. This will be similar to the other areas with, for instance, a dedicated inspection unit being established in April 2007.

The Financial Regulator has stated that it will continue to review its structures to address any deficiencies which arise in the supervisory process.

3.22 The Consultative Industry Panel's annual report for 2005 notes that staff turnover in the Financial Regulator has been an issue in the past as has the difficulty of recruiting experienced staff with specific skills. It supports a programme to increasingly recruit staff on a fixed-term contract basis or on a secondment basis from financial services providers or professional advisors. The annual report of the Consultative Consumer Panel has also expressed concerns about filling staffing positions that are critical for fulfilling the mandate. The Financial Regulator has stated that it is in favour of recruitment of staff on contract but has in the past found it difficult to recruit

staff on this basis. Secondment of staff from financial services providers or professional advisors also raises issues of confidentiality and impartiality.

3.23 The August 2006 report of the IMF survey of the Financial Regulator's operations recommended that it should continue to develop the necessary expertise and ensure adequate staff resources for supervising an increasingly sophisticated financial system, especially taking into account ongoing regulatory developments. It recommended that the Financial Regulator should critically review its current manpower strategy with a view to ensuring that sufficient and suitably skilled staff are recruited and retained. The Financial Regulator has stated that this recommendation is being acted on through training and development initiatives, including development of a curriculum-based training programme for staff.

Risk Assessment

3.24 The 1999 value for money examination report on financial regulation recommended that the Central Bank should develop a formal risk assessment model, in order to ensure that the level of supervision effort is proportional to the risks associated with individual service providers.

The Risk Rating Model

3.25 In response to the 1999 report recommendation, the Central Bank began a process to develop a formal risk assessment system. Building on this work, the Financial Regulator after its establishment reviewed the approaches taken by a number of other financial regulators to risk assessment, and examined the risk assessment models used by its counterparts in the UK, Australia and the Netherlands. A draft risk rating model was developed and piloted in 2004. Following some adaptations, the system was formally rolled out across all supervision departments in 2005. Figure 3.4 outlines the key elements of the model.

Figure 3.4 Basis of the Financial Regulator's Risk Rating Model

The model assesses two key exposures

- an assessment of the ***inherent risk*** of the business undertaken by the financial services provider — based on the answers to questions under a range of risk headings, including ten relating to all sectors (structure, supervisory complexity, corporate governance, business risk, operational risk, exchange risk, contagion/related party risk, capital, reputation risk and regulatory risk) and further headings related specifically to the nature of the business (e.g. credit risk, market risk or insurance trading risk)
- an ***impact assessment*** — focusing on the effect that a failure of the financial services provider would have e.g. on its customers, on the sector in which it operates and on the reputation of the Financial Regulator as supervisor.

Implementation of the Model

3.26 The successful deployment of the risk rating model depends on the availability of information to allow for coherent and consistent assessment of risk. An initial pilot run in 2004 was based on the information that the Financial Regulator had on file. However, there were gaps in the information held, resulting in a significant number of 'don't know' answers, particularly in relation to insurance firms. The Financial Regulator subsequently sought the required extra information from the services providers, through direct contact or during on-site visits. This resulted in a reduction in the number of 'don't know' answers in the 2005 assessments and shifts in the risk rating of the financial services providers. There is still a significant level of missing data in some sectors but, in the view of the Financial Regulator, this is on the periphery and does not detract to a material extent from the risk rating.

3.27 The Financial Regulator currently uses the risk rating scores to rank financial services providers in each supervision sector (e.g. the ‘top ten’, ‘next ten’ and ‘other’ services providers). Different grouping rules are used in different sectors e.g. for some sectors, institutions are grouped based on combined risk and impact scores; in others, groups are based on ‘top ten’ risk scores and ‘top ten’ impact scores. The primary purpose of this approach is to allocate available resources on a risk basis. The difficulty with this practice is that available resources, rather than exposure levels, are the primary determinant of the extent of supervisory activity.

3.28 The development and implementation of the risk rating model that has taken place to date has improved the ability of the Financial Regulator to deploy resources available for supervision work in proportion to the assessed risk/impact. The application of the model is also contributing to a deeper and more systematic understanding by the Financial Regulator of the risk profile of individual financial services providers.

3.29 However, there appears to be scope to improve the risk rating model by categorising risk based on specified threshold values. The appropriate supervisory stance associated with each status should then be defined. This potentially would permit the required level of resources for supervision to be determined based on the assessed risks and would have the additional benefit that changes in the risk rating of individual firms and of sectors could be tracked from period to period.

3.30 The Financial Regulator points out that its risk rating model is designed to be a relative system, not an absolute one, and considers that a move to specified threshold values would create difficulties.

Risk Assessment of Groups

3.31 Currently, there is no provision in the risk rating model for summarising the risk assessments of interconnected service providers. The Financial Regulator has stated that, while no scoring is conducted for groups of services providers as a whole, the risk scores for individual component entities are examined through the annual risk review process, where an overall group perspective emerges. In addition, significant developments or issues arising are communicated between supervision departments on an ongoing basis as well as through the Prudential Supervision Committee (chaired by the Prudential Director) and the Executive Board.

Capital Requirements Directive Risk Assessment

3.32 Implementation of the FSAP Capital Requirements Directive requires the introduction by the Financial Regulator of a new risk assessment model for certain large credit institutions and some categories of investment firms. The assessment required for Capital Requirements Directive purposes is much more detailed than that required by the Financial Regulator’s risk rating model. The Financial Regulator plans to apply the new risk assessment model to the relevant institutions, but continue to use the existing risk rating model for institutions not affected by the Directive.

3.33 While the development and implementation of the Capital Requirements Directive risk assessment will result in a two-tier system, the Financial Regulator can maintain a degree of proportionality in the deployment of supervision effort through appropriate definition of the supervision stances to be applied under each of the systems.

Prudential Returns

3.34 The Financial Regulator requires most of the service providers it regulates to submit formal reports and data about relevant aspects of their businesses, at specified intervals. These are referred to as ‘prudential returns’. The Financial Regulator uses the returns as a means of monitoring the operations of the service providers and their compliance with relevant standards, and to identify circumstances where it needs to intervene or seek further information.

3.35 The amount and type of information that the Financial Regulator requires to be included in the prudential returns varies considerably. Annual returns are required in all cases, with additional returns required at other periods. Appendix D summarises the main returns by sector and the main classes of information provided in each. It also shows the intervals at which service providers are required to submit returns.

Timeliness of Returns

3.36 The case files selected for this examination were reviewed to establish on a sample basis if the required returns had been submitted. In most cases, the expected returns were on file. The main exception was in relation to insurance companies. Nine of the 20 insurance companies included in the sample were due to submit quarterly returns. The review of the case files found that only six of the nine had submitted all the required quarterly returns. In the other cases, there was no record of the returns having been received, or of any action having been taken by the Financial Regulator to follow up the missing returns.

3.37 The deadlines set by the Financial Regulator for submission of prudential returns vary, depending on the sector and the type of return. For example

- Quarterly returns from credit institutions are due within 15 working days of the end of quarter; those from credit unions within 21 calendar days; and those from fund service providers within two months.
- Annual returns for credit institutions have a submission deadline of three months after year-end; the corresponding time allowed for insurance firms¹³, investment firms, stockbrokers, retail intermediaries and credit unions is six months.

3.38 Timely submission of returns is important to ensure the Financial Regulator has up to date information for regulatory analysis. In general, the Financial Regulator follows up late or incomplete returns but does not formally monitor or report on the timeliness of submission of returns.

3.39 The sample case files were examined to review the timeliness of submission of prudential returns in 2004 and 2005. Where returns were submitted in an incomplete form, or had to be resubmitted/amended due to errors, the date of submission was when the full return requirement was met. The results are presented in Figure 3.5.

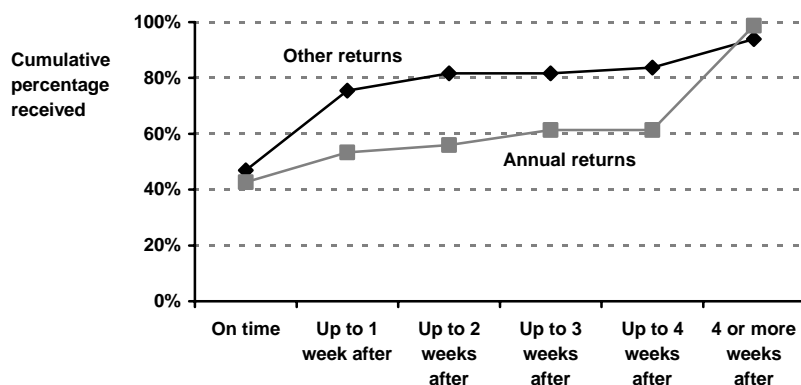
3.40 The main findings of the analysis are that

- About half of non-annual returns for 2005 were submitted on time and around 75% were submitted within one week of the reporting deadline. About 10% were more than a month late.

¹³ The legal requirement is for insurance firms to submit their annual returns within six months of the relevant year end (or within one month of the AGM for non-life insurance firms). The Financial Regulator has asked firms to submit returns within four months to give adequate time to identify errors and request their correction.

- Just over 40% of all annual returns due for submission in 2005 were submitted on time. Around 20% more were received within a month of the due date, and around 40% were more than four weeks late.
- One factor in the late submission of annual returns was incompleteness or inaccuracy in the returns when first submitted. 58% of insurance companies and 70% of credit unions had to resubmit/amend the returns due to incompleteness or inaccuracy.

Figure 3.5 Timeliness of receipt of prudential returns from a sample of financial service providers, 2005



Source: Analysis by Office of the Comptroller and Auditor General

3.41 The Financial Regulator has pointed out that it records the date when the return is first received as the date of submission. On that basis, all the insurance companies submitted their 2005 returns within the six month statutory deadline. Furthermore, it considers that the errors or omissions that occurred in the submissions from insurance firms were generally of a minor nature, affecting one or more of the forms but not the entire return. A revised format for the receipt of annual returns from credit unions increased the rate of timely first receipt of annual returns from 65% for 2004 returns to 90% for 2005 returns. There was also a reduction in the proportion of returns received that were incomplete or inaccurate from 77% to 67%. However, the type of issues that required amendment in the 2005 returns were predominantly minor in nature, and were mostly followed up by phone or fax. Only eight credit unions (2%) were required to resubmit their 2005 annual returns in full.

3.42 Although in certain cases it has the powers do so, the Financial Regulator has not imposed sanctions for late submission of returns. It has decided to use those powers where the failure is of such frequency and magnitude that it would justify the required cost and resources.

Analysis and Reporting of Returns

3.43 Each area within the Financial Regulator's organisation analyses and reports on the prudential returns submitted by financial services providers in a different way. For example

- Quarterly returns from credit institutions are sent initially to the Statistics Unit of the Central Bank, where they are subjected to validation checks. They are then sent to Banking Supervision Department (BSD), where a specialist financial reporting unit analyses the data and produces a composite management report within 13 working days.
- Annual returns from credit institutions are received and analysed by the teams responsible for ongoing supervision.

- The quarterly insurance returns (where these are required) consist of a series of Excel spreadsheets submitted by email to the relevant supervision teams.
- In the case of credit unions, quarterly returns and six monthly returns may be submitted on-line. Once any validation issues have been addressed, a number of compliance and monitoring ratios are run. A final report is compiled summarising the prudential returns relating to the quarter, about five weeks after the deadline for returns submission.

3.44 Examination of the Financial Regulator's case files for a sample of financial service providers found that staff of the Financial Regulator formally raised issues or queries with about half of the financial services providers following receipt of annual returns. Similarly, issues or queries were raised formally with about 40% of the financial service providers following receipt of non-annual returns.

3.45 In cases where regulatory issues were raised formally with service providers, the average length of time taken to resolve them was around six weeks. This was normally in the form of a letter or e-mail from the service provider, giving the required explanations or undertaking to implement the action(s) sought by the Financial Regulator.

3.46 The Financial Regulator prepares a quarterly report (the 'prudential pack') which provides detailed analysis of the solvency of financial service providers and the corrective action (if any) being taken to address concerns. This report is used to assure the Authority and senior management on issues relating to the solvency and soundness of financial service providers.

3.47 Annual returns from insurance companies are used to compile the insurance statistical review, a statutory document providing published summary financial data about the insurance sector. Since its establishment, the Financial Regulator has brought forward the publication date of the review (from 19 October 2004 for the 2003 review to 30 August 2006 for the 2005 review).

Improving Efficiency in Prudential Returns

3.48 In general, the current methods of submission of prudential returns were inherited by the Financial Regulator from its predecessors, and have not been changed since its establishment. Returns from some sectors are paper based, resulting in a requirement for manual data entry and verification, while other returns are received as electronic files. The only internet-based methods developed by the Financial Regulator for submission of returns are the on-line systems for quarterly returns from credit unions, and annual returns from non-life insurance companies.

3.49 On-line submission of returns, combined with programmed analysis potentially allows for automated checking of the completeness of returns, generation of analytic reports based on the information provided and the raising of alerts about issues that require further investigation. It therefore has the potential to improve the timeliness and efficiency of the prudential returns system.

3.50 A number of FSAP directives¹⁴ require the development of electronic reporting of prudential returns. The Financial Regulator, in conjunction with the Information Systems Department of the CBFSAI, is in the process of developing a single electronic reporting platform which will be used for receiving all prudential information. A feature of the system is that data will be validated before it is submitted to the Financial Regulator, with the aim of reducing the number of errors in prudential returns.

14 The Capital Requirements Directive, the Markets in Financial Instruments Directive, Reinsurance Directive and Transparency Directive.

Auditor Reporting

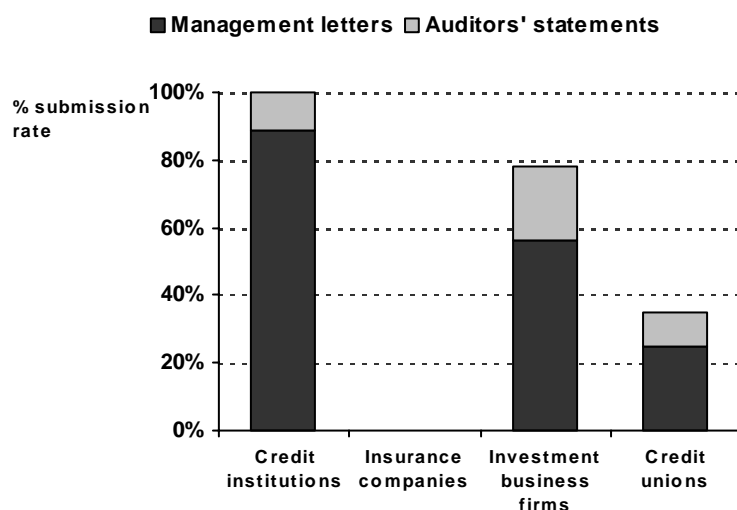
3.51 Reports of the external and internal auditors of the financial services providers are a potential source of relevant information that would help to supplement the Financial Regulator's knowledge about the services providers.

External Auditor Reporting

3.52 The external auditors of financial service providers may issue management letters where, during the course of annual audits of financial statements, they identify issues giving rise to concerns about the effectiveness of internal controls or other governance issues. Section 27C of the Central Bank and Financial Services Authority Act, 2004 requires the external auditors of regulated financial service providers to send copies of management letters to the Financial Regulator or, if no management letter was issued, a statement from the auditor to the effect that no issues that warranted being reported in a management letter were discovered during the audit.

3.53 The sample case files were reviewed to establish the extent to which external auditors' management letters or statements had been received. Figure 3.6 presents the results.

Figure 3.6 Submission of management letters or statements from external auditors, by sector, for a sample of financial service providers, 2005



Source: Analysis by Office of the Comptroller and Auditor General

3.54 Letters from the external auditors were not on file in respect of any of the insurance firms included in the sample. The Financial Regulator had not required insurance companies to notify their external auditors to provide copies of management letters (or statements) on completion of the audits. It pointed out that under the Insurance Act 1989, external auditors of insurance companies are required to report to the Financial Regulator in certain circumstances where matters of concern come to their attention and that, since 2003, directors of insurance companies are required annually to submit signed statements of internal controls, compliance with the regulatory regime, use of derivatives, etc. The policy is to seek 100% compliance for these statements.

3.55 The Financial Regulator has stated that it provided assistance to the Institute of Chartered Accountants in Ireland in the production of guidance for external auditors in relation to their Section 27C responsibilities, and that the Institute issued the guidance to its members in September 2006. The Financial Regulator understands that the ICAI have passed this guidance on to the other accountancy bodies.

3.56 In March 2007, the Financial Regulator issued an internal memo to its staff on the implications of Section 27C of the 2004 Act. This emphasizes the legal requirements on external auditors to report each year to the Financial Regulator, including the submission of management letters or statements that there were no such letters. The Financial Regulator has stated that mechanisms have been/are being put in place to monitor adherence to these requirements.

Internal Audit

3.57 The Financial Regulator has pointed out that, while receipt of internal audit reports from financial services providers is not a legal requirement, such reports are routinely collected from credit institutions by examination teams. Internal procedures for the receipt of internal audit reports from credit institutions were issued in March 2005. These procedures set minimum standards for the degree of interaction between examiners and the internal audit function of a credit institution. The number and type of internal audit reports which should be submitted to the Financial Regulator varies e.g. if less than five internal audit reports are planned each year, all reports are to be copied to the Financial Regulator; if between five and ten reports are planned, half-yearly summary reports of audit findings are to be submitted; if more than ten reports are planned, quarterly summary reports of audit findings are to be submitted.

3.58 There are no formal procedures for routine collection of internal audit reports from other kinds of financial services providers. Internal audit reports are collected from stock-broking, asset management and fund administrator firms as part of the inspection process and are followed up to ensure implementation.

On-Site Inspections

3.59 Each year, the Financial Regulator's supervision teams carry out inspections in the premises of selected financial service providers to confirm compliance with regulatory requirements, and to assess the corporate governance structures and internal controls and risk management systems in place. Inspections may be of different types

- **General inspections** — covering a range of regulatory issues, the general focus of the inspection is on a high level review of the financial services provider's systems. The visits are generally confined to the financial services provider's head office, and branch visits are rarely included. General inspections usually last three to four days and involve teams of up to four inspection staff.
- **Themed inspections** — focusing on one aspect of the management or operation of a financial services provider. The focus of the inspection is to ascertain whether the aspect under review poses any danger to the particular institution or, as part of a wider review, for institutions of that type e.g. the adequacy of the business recovery process, or of anti-money laundering measures. These inspections are typically of shorter duration than cyclical inspections.
- **Unscheduled inspections** — usually carried out where the Financial Regulator has some particular concern about a financial services provider e.g. accuracy of prudential returns or consumer protection compliance.

3.60 Figure 3.7 indicates the number of on-site inspections undertaken by staff of the Financial Regulator in 2005, for each financial services sector. It also indicates the percentage of services providers in each sector subject to inspections in 2005.

Figure 3.7 On site inspections by the Financial Regulator in 2005, by sector

Sector	Number of service providers	On site inspections		
		General	Themed	Unscheduled
Credit institutions ^a	48	8 (17%)	—	—
Insurance ^a	186	17 (9%)	7	—
Funds service providers	230	4 (2%)	—	—
Investment firms	1,205	4 (0.3%)	—	—
Stockbrokers	11	7 (64%)	1	—
Exchanges	41	—	—	—
Retail intermediaries	3,047	—	3	2
Credit unions	435	5 (1%)	48	10

Source: Financial Regulator

Notes: a Excludes Irish branches of foreign-regulated financial services providers.

3.61 The Financial Regulator's inspection manual, issued in October 2004, includes the objective of carrying out a general inspection of every financial service provider at least once over a four-year cycle. In practice, the level of general inspection in 2005 in most sectors was significantly less than the minimum 25% level implied by the four-year cyclical target. For example,

- Only 17% of credit institutions based in Ireland were subjected to on-site inspections in 2005. Two-thirds of the credit institutions for which the Financial Regulator is consolidation supervisor were inspected in 2005.
- Only 9% of insurance companies based in Ireland were subjected to on-site inspections in 2005.
- General inspections were carried out in only 1% of credit unions. More limited themed inspections, (focusing on credit policy and/or information technology) were carried out in 11% of credit unions.
- Less than 1% of investment firms were subject to general inspection.

3.62 The Financial Regulator has stated that, given the nature of their activities, their corporate structure and their holdings of client monies, all stockbroker firms are deemed to be in the high risk category. For this reason, almost two-thirds of stockbrokers were subject to inspections in 2005.

3.63 Inspection coverage relative to market size was higher. For example, the Financial Regulator has estimated that the eight credit institutions subject to inspection in 2005 (17% of the total) accounted for approximately 56% of the gross assets of the banking sector in 2005. The 10% of insurance firms subject to inspection in 2005 accounted for around 47% of the gross assets of the non-life insurance sector and 18% of the life insurance sector.

3.64 The July 2006 report on the IMF assessment of financial system stability in Ireland looked at the adequacy of on-site supervisory inspections of insurance firms and recommended that the current scope and intensity of the programme should be enhanced in the short term. However, the Financial Regulator's Strategic Plan 2007-2009 sets an annual target of ten on-site inspections of insurance and reinsurance firms — just over half the 2005 on-site inspection level. The Financial Regulator has stated that the reduced number of inspections is a consequence of the adoption of a more detailed (wider scope) and focused (intensity) inspection regime, consistent with the recommendations of the IMF.

3.65 Apart from the IMF assessment in the insurance area, no independent reviews have been undertaken of the scope or adequacy of the on-site inspections carried out by the Financial Regulator since its establishment. The Financial Regulator does not benchmark its inspection processes with other regulators.

3.66 Full implementation of the risk rating model and the formal definition of the appropriate supervisory stance associated with each risk category (including scope, frequency and duration of on-site inspection visits) should allow the Financial Regulator to determine the risk-based target number of on-site general inspections to be carried out each year in each sector, and to report on the extent to which the target is achieved.

Review Meetings

3.67 The Financial Regulator also carries out a number of review meetings each year with the managements of selected financial services providers. These meetings may be held in the premises of the financial services providers, or in the Financial Regulator's own premises. Institutions may be subject to both on-site inspection and to (one or more) review meetings in the same year.

3.68 Review meetings are generally more forward-looking than inspections, and are usually of about a half day's duration. They typically involve presentations from management of regulated entities concerning the entity's current situation, plans for the short-to-medium term, upcoming developments and/or challenges to be faced. Issues normally examined include corporate governance, financial projections, strategy and internal audit plans, as well as review of board and committee minutes. Issues raised with the institution arising from prudential returns that are still outstanding and/or follow up on recommendations arising from on-site inspections are also discussed.

3.69 Figure 3.8 shows the number of review meetings held in 2005, by sector, and the percentage of financial services providers subject to such reviews.

Figure 3.8 Review meetings with management of financial services providers in 2005, by sector

Sector	Number of services providers	Number of reviews	As percentage of services providers
Credit institutions ^a	48	39	81%
Insurance ^a	186	120	65%
Funds service providers	230	18	8%
Investment firms	1,205	56	5%
Stockbrokers	11	3	27%
Exchanges	41	1	2%
Retail intermediaries	3,047	—	—
Credit unions	435	179	41%

Source: Financial Regulator

Notes: a Excludes Irish branches of foreign-regulated financial services providers.

Enforcement

3.70 Actions taken by the Financial Regulator to enforce compliance by financial services providers with its standards or with legal requirements include

- reporting to other enforcement authorities
- administrative sanctions
- detection and prevention of unauthorised trading.

Reporting to Other Enforcement Agencies

3.71 The Financial Regulator has access to a significant amount of information concerning financial services providers which it is obliged by law to report to the relevant authorities, if it becomes suspicious that an offence may have been committed.

3.72 The review of sample case files for this examination looked for instances of enforcement activity by the Financial Regulator in 2004/2005 in relation to the cases reviewed. The findings of the review included that it sent formal notifications to the Garda Síochána in relation to anti-money laundering issues in six of the 20 credit institutions and in two of the 20 investment firms examined.

3.73 The Financial Regulator's annual report for 2005 refers to a total of 33 instances where it reported matters to other enforcement authorities, including 21 cases of suspected criminal offences, and 7 cases where the Financial Regulator concluded that the service providers had failed to adopt proper measures for the prevention and detection of money laundering and terrorist financing.

Administrative Sanctions

3.74 In August 2004, the Financial Regulator was given legal powers to hold inquiries in cases of suspected contravention of regulatory legislation, and where appropriate, to impose sanctions on financial services providers. These powers include powers to caution or reprimand, direction to refund money to customers, monetary penalties of up to €5 million on a firm or €500,000 on a person, disqualification of a person from management of a regulated financial service provider, direction to cease contravention and direction to pay costs of inquiry. Where formal enforcement inquiries are held, the Financial Regulator is required, in most cases to publish details of the inquiry findings along with the sanction details.

3.75 These powers are not retrospective and can only be applied where the relevant regulatory breach occurred on or after 1 August 2004. The Financial Regulator undertook a public consultation (November 2004) on how it should use its new powers. It subsequently developed procedures for progressing administrative sanction cases and published detailed guidance on the process in October 2005.

3.76 The February 2006 Financial Action Task Force report found that the Financial Regulator has a full range of supervisory powers to adequately regulate and supervise for anti-money laundering/counter terrorist financing matters. However, it noted that, while breaches of anti money laundering legislation are liable to criminal prosecution, the Financial Regulator is unable to use its general powers of administrative sanction for specific breaches, unless they also breach requirements subject to such sanctions (e.g. indicating a failure to have adequate systems and controls in place). Apart from being legally obliged to notify the Garda Síochána or the Revenue Commissioners about suspected money laundering, the sanctions available to the Financial Regulator in relation to anti-money laundering breaches are restricted to issuing letters to service

providers with recommendations for action or improvements to rectify breaches, or ultimately, revocation of a licence or authorisation.¹⁵

3.77 The August 2006 IMF assessment report recommended that

- the Financial Regulator should build capacity on investigations/enforcement and establish clear authority and decision-making processes under the administrative sanctions regime, particularly on deciding on the administrative route or criminal prosecutions
- the Financial Regulator should be provided with explicit legal powers to deal effectively with significant owners and key functionaries who no longer meet fit and proper requirements.

The Financial Regulator has stated that 10% of its staff have received training in relation to the administrative sanctions process.

3.78 The Financial Regulator has stated publicly that it will not hesitate to pursue sanctions where appropriate. However, its goal is to resolve issues to the benefit of consumers speedily and efficiently. Its philosophy takes account of feedback received during consultation with stakeholders about administrative sanctions, and was guided by the principles of better regulation, particularly the principles of necessity, proportionality and effectiveness. Consequently, major factors which it considers before it decides to pursue a sanctions case are

- availability of other regulatory actions
- the nature and seriousness of the contravention
- the conduct of the financial service provider after the contravention came to light
- the previous compliance record of the financial service provider

3.79 Where the Financial Regulator becomes aware of a failure of compliance with its own requirements, its usual approach is to require the directors and senior management of the firm to correct the problem. Depending on the seriousness of the problem, the Financial Regulator will often inspect to verify correction of the problem or seek an auditor's or internal auditor's report. Where a firm fails to cooperate fully or where there is a perceived need to tighten the regulatory framework, it is usually open to the Financial Regulator to issue a formal and legally binding direction to the firm. Once a potential sanctions case commences, it encourages early settlement as a more cost-effective solution rather than a full inquiry. For example, in June 2006, the Financial Regulator reached a settlement with a fund management company involving the revocation of the company's licence and suspension of named persons from involvement in management of financial service provision for a period of eighteen months.

3.80 As part of its 2007-2009 Strategy, the Financial Regulator intends to review the effectiveness of its policies, procedures and training in relation to administrative sanctions.

Unauthorised Dealing

3.81 Most of the cases of unauthorised dealing which the Financial Regulator deals with involve breaches of the requirements of the Investment Intermediaries Act, 1995. Consequently, in accordance with the provisions of that Act, the main mechanism used by the Financial Regulator against persons or firms offering financial services without an authorisation is the publication of warning notices in the national press.

¹⁵ Money laundering offences are defined in the Criminal Justice Act, 1994. This Act is not a designated enactment under the Central Bank and Financial Services Authority of Ireland Act, 2004, which provides the statutory basis for administrative sanctions imposed by the Financial Regulator.

3.82 In 2005, the Financial Regulator published two notices warning members of the public about service providers. The 2005 annual report of the Financial Regulator outlines how one of these cases was dealt with. It notes that it was apparent that the firm was committing a criminal offence under the Investment Intermediaries Act 1995 by operating as an investment business firm without the appropriate authorisation. A letter was sent to the firm who did not respond and the Financial Regulator then published a warning notice in the national newspapers. The Financial Regulator also informed the Garda Bureau of Fraud Investigation and the Securities Exchange Commission (US Regulator) about the firm.

3.83 The Financial Regulator receives around 150 to 200 queries per week from members of the public about whether particular service providers are authorised. Staff of the Financial Regulator are able to consult registers of authorised service providers to answer these queries. Some of the registers are published on the Financial Regulator's website, but others are not, and lists of licences which have been revoked are not given. Copies of warning notices published in the national press are included in the website.

Conclusions

3.84 The prudential returns systems appears to be operating broadly as intended, but there is scope to improve efficiency in the receipt, analysis and reporting of returns.

Where it is feasible, the Financial Regulator should develop electronic prudential returns systems, with automated data validation and checking processes.

The Financial Regulator has stated that it recognises the benefit of developing an electronic reporting system for receipt of prudential returns. Its Strategic Plan 2007-2009 includes a commitment to implement electronic collection, validation and analysis of returns from financial services providers by December 2007.

3.85 The Financial Regulator has developed and implemented a formal risk rating model which has improved its ability to target its available supervision resources in proportion to assessed risk and impact.

There is scope for further development of the risk rating model. In particular, the Financial Regulator should define thresholds for discrete risk categories and the appropriate supervisory stance to be followed in relation to each such category.

Definition of the appropriate supervisory stance would include the target scope, frequency and duration of on-site inspections to be carried out annually for firms in each risk category in each sector. The probability of being inspected should be proportionate to the assessed risk. For low risk groups, selection of financial services providers for inspection could be on a random basis. Ultimately, this approach would facilitate the determination of an appropriate scale of inspection coverage.

As part of the process in determining the appropriate supervisory stance for the various categories of risk, the Financial Regulator could commission an independent review (e.g. a peer review) of the adequacy of its current prudential inspection process, including the target frequency of inspections, resource level, the team composition, duration of visit, on-site checks and follow up. It should also seek to benchmark its inspection process against those of appropriate fellow regulators in the EU.

The Financial Regulator should report publicly each year on the extent to which the target inspection programme was carried out.

4 Cross Border Supervision

4.1 Large financial services providers are increasingly extending their areas of operation to more than one jurisdiction. This gives rise to new regulatory challenges and requires systems, procedures and practices to ensure cooperation and coordination between national financial regulators.

4.2 This chapter looks at how the Financial Regulator deals with cross-border provision of financial services, both by foreign financial services providers operating in Ireland, and by Irish financial services providers operating abroad.

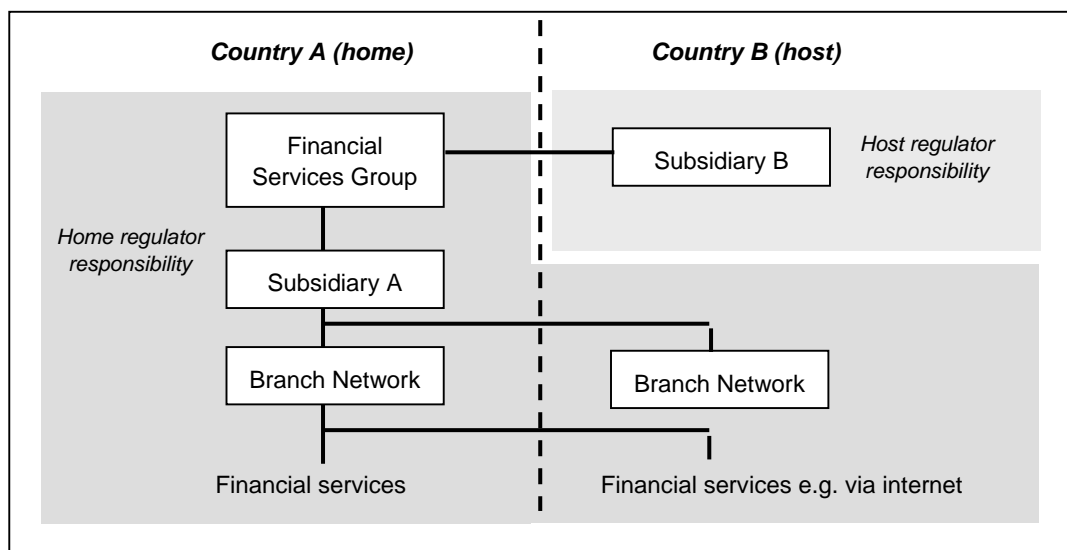
Responsibility for Regulation

4.3 The FSAP objectives include the creation of a single market across the EU for the provision of financial services. The regime that has been developed allows financial services providers authorised in one EU member state to provide financial services in another member state in three ways¹⁶

- by setting up a subsidiary company in the other member state and seeking authorisation to provide services in that jurisdiction from the relevant financial regulator
- by opening a branch operation in the other jurisdiction and/or
- by offering financial services on a cross border basis e.g. by mail or by internet.

4.4 The financial regulator in the home country of a financial services provider operating branches in another member state and/or offering services on a cross border basis has the primary responsibility for regulation of such services provision (see Figure 4.1). The home and host regulators share responsibility for ensuring that branches operating in the host country apply adequate anti-money laundering procedures.

Figure 4.1 Regulatory responsibility for EU cross border financial services providers



¹⁶ These provisions apply also to non-EU countries that are members of the European Economic Area (EEA) i.e. Norway, Iceland and Liechtenstein

4.5 Before an EU financial services provider may commence branch or cross border operations in another EU member state, the home country regulator must inform the host country regulator of what is proposed, and the host regulator may specify conditions for operation (e.g. adherence to the consumer protection code in force in the host country).

4.6 Non-EU financial services providers that wish to provide services in an EU member state are required to seek authorisation from the relevant financial regulator to establish a subsidiary company or branch in that state.

4.7 Financial regulators are responsible for regulating international financial services group companies for which they are the home regulator on a consolidated basis. In addition to providing regular prudential returns for each subsidiary operating in Ireland, group financial services providers must also provide overall prudential returns on a group basis, including subsidiaries operating abroad.

4.8 Based on the framework outlined above, the Financial Regulator has primary (home country) responsibility for

- regulation on a consolidated basis of financial services groups where the head office of the group is located in Ireland
- regulation of Irish-licensed financial services providers, including Irish subsidiaries of financial services groups which are headquartered elsewhere
- regulation of branches of Irish services providers operating in other countries
- regulation of financial services offered on a cross-border basis (e.g. internet service banking) by Irish financial services providers
- ensuring that all financial services providers offering services in Ireland adhere to the Consumer Protection Code.

The Financial Regulator shares responsibility with the relevant home country regulators for regulation of liquidity of Irish branches of credit institutions authorised elsewhere in the EU and for ensuring that such branch operations apply adequate anti-money laundering procedures.

4.9 Figure 4.2 shows the number of Irish financial services providers that were operating branches in other EU (or EEA) member states, and the number of financial services providers located in other EU states that were operating branches in Ireland, at end 2005.

Figure 4.2 Number of financial services providers operating cross border branches in or from Ireland, end 2005

Sector	Irish financial services providers with branches elsewhere	Other EU/EEA financial services providers with branches in Ireland
Credit institutions	13	31
Life insurance firms	14	13
Non-life insurance firms	16	28
Reinsurers	0	0
Fund service providers	0	0
Investment firms	0	9

Source: Financial Regulator

Supervision Activity by the Financial Regulator

Supervision of Foreign Financial Services Providers

4.10 Because the Financial Regulator is not the primary regulator of foreign financial services providers operating in Ireland on a branch basis, such branch operations are not subject to formal risk assessment.

4.11 Although the Financial Regulator has shared responsibility for supervision of liquidity of non-Irish credit institution branches operating in Ireland, it has not specified any prudential returns that such branches should make. The Financial Regulator has stated that the branches make returns in relation to the level of their business in Ireland to the Statistics Department of the Central Bank. However, the Financial Regulator does not routinely examine these returns.

4.12 Since January 2007, the Financial Regulator has removed the reporting requirement for branches of non-Irish credit institutions where both the head office of the credit institution and the relevant home regulator provide written assurances on the monitoring of branch liquidity, and that liquidity will be provided if required.

4.13 Because it has regulatory responsibility in relation to certain aspects of operation of Irish branches of EU financial services providers, the Financial Regulator has the power to make on-site inspection visits in such branches. In 2005, review meetings were held with the managers of two branch operations to discuss liquidity and anti-money laundering. The number of such review meetings increased to 14 in 2006. No on-site inspections of liquidity or anti-money laundering arrangements in branch operations were undertaken in the period 2004-2006. There was one consumer-focused inspection in 2006 of an Irish branch of a financial services provider based elsewhere in the EU.

Supervision of Irish Cross Border Financial Services Provision

4.14 The Financial Regulator's risk rating system cannot be used to carry out risk assessment of financial services groups. Where Irish headquartered groups have subsidiaries in other jurisdictions, the Financial Regulator gathers relevant information from the parent company and from regulators in the jurisdictions where the subsidiaries are authorised. It also requires credit institutions to carry out risk, internal audit and compliance reviews that encompass foreign subsidiaries. It examines the review reports and discusses the risks with the relevant credit institutions.

4.15 The Financial Regulator requires that prudential returns of Irish-authorised services providers are submitted both on an individual basis (including branches operating elsewhere) and on a group basis (i.e. including subsidiaries, wherever located).

4.16 As a principles-based regulator, the Financial Regulator's focus is on the Head Office, where the control function resides. Consequently, it carries out few visits to branches or subsidiaries of Irish-authorised financial services providers operating abroad. In 2004-2005, it carried out one on-site inspection visit to a branch operation of an Irish-authorised credit institution, and one inspection of a branch of an Irish-authorised insurance company located abroad.

Sharing of Information between Financial Regulators

4.17 EU directives provide for the exchange between financial regulators of information about financial services providers. In addition, the Financial Regulator has agreed memorandums of understanding with regulatory authorities in other jurisdictions on the respective responsibilities for supervision of cross-border financial services providers, including agreed procedures for sharing of relevant information.

4.18 Where a regulator from another EU country inspects an Irish branch or subsidiary of a financial services provider for which it has primary regulatory responsibility, the Irish Financial Regulator is informed in advance of such visits, and staff of the Financial Regulator may meet with the visiting team to discuss the situation of the services provider, or even join with the visiting team to observe the on-site inspection process.

4.19 The Financial Regulator holds bilateral (or multilateral) meetings with other EU financial regulators to discuss supervision of financial services providers operating in the relevant jurisdictions. Meetings are held each year with the UK's Financial Services Authority and with the German regulator, Bafin, and with the other national regulators on a two-year cycle. The Financial Regulator also participates in international committees of financial regulators that, among other matters, discuss issues of concern in relation to individual multi-national financial services providers in the credit and insurance areas.

4.20 Reflecting the increasing scope of operation of financial services providers, EU regulators have more recently begun to convene 'colleges of regulators' to review the arrangements for supervision of group companies that operate across multiple jurisdictions. The Financial Regulator hosted three such colleges in 2005 and attended seven others. The college process includes a mechanism whereby the subject international group financial company makes a presentation.

4.21 The CEBS issued guidelines in January 2006 for co-operation between consolidating supervisors and host supervisors in the supervision of cross-border groups. The introductory statement notes that ongoing FSAP developments make it necessary to strengthen the arrangements for cooperation on supervision of cross border financial services providers. The guidelines note that some larger financial services groups are centralising key functions and outsourcing others, and that there may no longer be a direct relationship between the legal structure and the operational structure of the group. The overriding principle of the guidelines is that consolidating and host supervisors should co-operate to ensure effective and efficient supervision of groups, both on a consolidated and individual basis, and on a risk-assessment basis.

4.22 A financial conglomerate is a financial services group that has significant banking, investment and insurance business. Since 1 January 2005, relevant financial regulators in the EU are required to determine if conglomerates operating in their jurisdictions but with parent companies based outside the EU are subject to a regulatory regime in their parent country equivalent to that applied in EU countries. If not, the EU regulators must themselves undertake supervision of the conglomerate on a group basis.

4.23 There are three such conglomerates with subsidiaries operating in Ireland, and also in other EU jurisdictions. The relevant regulatory authorities have convened and agreed in all three cases that the UK's Financial Services Authority should act as co-ordinator in relation to supervision of the conglomerates. The regulators jointly concluded that there was EU-equivalent supervision of the conglomerates in their home countries in all three cases.

Conclusions

4.24 Co-operation among regulators is the key to developing effective means of supervising the diverse activities of multi-national financial services providers. This is recognised by the Financial Regulator, which has stated in its Strategic Plan 2007-2009 that it will continue to co-operate with international regulators as required.

4.25 EU directives have defined the respective responsibilities of home and host country regulators in relation to supervision of financial services providers operating across national boundaries. In addition, guidelines for co-operation and EU protocols provide for information sharing and collaboration between regulators. The Financial Regulator has also agreed memorandums of understanding on procedures for sharing information with other regulators. This process is designed to ensure clarity of ultimate supervisory responsibility and a coordinated approach to regulation, thereby avoiding gaps in regulatory cover and inefficiencies due to duplication of supervision work.

4.26 The Financial Regulator applies the relevant rules in the area of EU cross-border supervision and participates as appropriate in the sharing of information between regulators of financial services providers that operate in more than one jurisdiction. As is the case in regulation of financial service providers operating exclusively within Ireland, the emphasis of prudential regulation in cross-border financial services providers revolves around reviewing compliance at the entity and group level.

5 Protecting Consumers of Financial Services

5.1 The legislation setting up the Financial Regulator requires the appointment of a Consumer Director to manage the consumer protection aspect of the mandate, and provides for the appointment of the Consumer Director as a statutory member of the Authority. At the end of 2006, the Consumer Director had a staff of 81 engaged in consumer-focused work.

5.2 The Financial Regulator's core objective for its consumer protection mandate is to help users of financial services to make informed financial decisions in a safe and fair market. In addition to setting consumer-focused standards (discussed in Chapter 2), its main activities in this respect are

- provision of information and guidance for consumers of financial services
- monitoring of compliance by financial services providers with codes of conduct in relation to dealing with users of services
- a requirement for potential services providers in some sectors to participate in funds protection schemes that provide a degree of compensation to persons depositing or investing funds.

The Consumer Director is also statutorily obliged to prepare an annual report, which must include information on the extent to which competition exists among providers.

5.3 This chapter reviews the timeliness, coverage and accessibility of the information provided by the Financial Regulator and how the Financial Regulator evaluates the effectiveness of the information provided. It also reviews the extent to which the Financial Regulator carries out consumer focused inspections of services providers, and the extent of funds protection.

Consumer Information

5.4 The case for the consumer protection and information mandate in financial regulation is generally based on the perception of the risk of market failure due to a mismatch in knowledge between providers selling complex financial products to consumers who may not understand the products, the costs, or may be pressured to invest in inappropriate products for their particular circumstances. Consequently, the Financial Regulator considers that informing and educating consumers about financial services is a key strategy in achieving consumer protection.

Financial Education Initiative

5.5 In December 2006, the Financial Regulator established a national steering group for financial education to oversee and co-ordinate the work of improving public education and knowledge generally on financial matters. Its long-term goal is to blend key elements of its model of financial competency with the national curriculum for both primary and secondary schools.

Register of Services Providers

5.6 Knowing who is authorised to provide financial services (and who is not) is a key starting point in helping consumers to protect their interests. The Financial Regulator estimates that it receives in the region of 150 to 200 queries per week on whether particular services providers are authorised.

5.7 At the end of November 2006, the Financial Regulator did not have a readily accessible register of all services providers for public reference purposes. Separate registers of authorised

services providers were compiled by different departments of the Financial Regulator, with varying levels of detail arising from statutory requirements or traditional administrative practice. The following gaps in register publication at end November 2006 were noted.

- The 'Regulated Firms' area of the Financial Regulator's website listed only authorised insurance companies and insurance/reinsurance intermediaries. For information about all other regulated firms, the on-line enquirer was directed to contact the Financial Regulator by email or by low-call telephone.
- Authorised credit institutions and collective investment schemes were listed on the website but in the 'Industry' area, rather than in the 'Regulated Firms' area.
- A register of moneylenders was available electronically on the website of the Office of the Director of Consumer Affairs prior to the transfer of responsibilities for the regulation of moneylenders from the Office. The Financial Regulator has stated that it did not publish an equivalent register on its own website due to information technology difficulties.

5.8 The financial regulators in the UK and the Netherlands publish on their websites full registers of all financial services providers authorised to operate in their respective jurisdictions, including branch operations of services providers headquartered elsewhere in the EU.

The Financial Regulator has stated that it now publishes separate registers of authorised services providers (with varying levels of detail) on its website. It is currently developing an integrated and 'searchable' register. The target date for the launch of the register is June 2007.

Cost Surveys and Guidance

5.9 The Financial Regulator promotes consumer information and awareness by

- carrying out periodic surveys of the cost of financial services and publishing the results
- publishing guides, booklets and fact sheets for consumers, dealing with specific aspects of insurance and personal banking services
- regional visits e.g. temporary stands in shopping malls, at wide appeal trade shows and conferences, etc.

Appendix E summarises the surveys and guidance published up to the end of February 2007 by the Financial Regulator.

5.10 The cost surveys are published at the rate of approximately one per month. Surveys of wide consumer and media interest such as motor and home insurance, personal current accounts and credit cards are produced approximately twice a year while others are less frequent. The information can be accessed on a sub-site of the Financial Regulator's website, *itsyourmoney.ie*.¹⁷ Over 67,000 cost surveys were downloaded from the website in 2005, and the findings of the surveys are regularly reported in the media.

5.11 The Financial Regulator's cost surveys focus only on services offered in Ireland. Although many companies offering services in the Irish market are part of major international groups, no international comparisons of cost have been made. The Financial Regulator has stated that comparable costs are not readily available and that such comparisons would be problematic

¹⁷ This information is also available in print form in the Financial Regulator's Information Centre in Dublin, and via its Consumer Helpline.

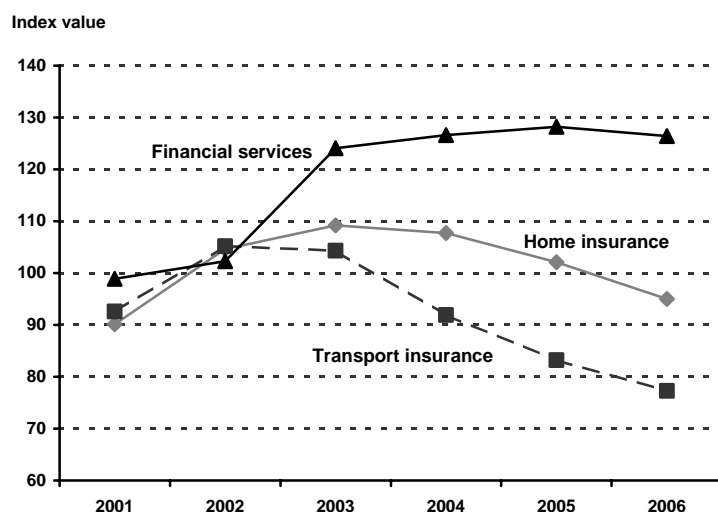
because of legal differences e.g. differences in liability under civil and common law systems, and the variety of legislative frameworks that obtain. It considers that international comparisons would not add any useful information for consumers in most cases, as the products are so different that it would be difficult to compare them. It has also stated that international comparisons are only likely to be useful when consumers are first happy to switch among domestic providers and inertia is reduced.

Impact of Cost Surveys

5.12 Widely available cost survey information has the potential to assist consumers in the search for the best value supplier of services. This should result in pressure both to reduce prices for services and to reduce the range of prices offered for similar financial services by different services providers. However, these may also be affected by forces other than the Financial Regulator's publication of information e.g. level of competition in the market place, consumer inertia, etc. Consequently, the impact of efforts by the Financial Regulator to inform consumers about price variations for the financial services they buy cannot readily be separated from other influences in the market.

5.13 The Central Statistics Office (CSO) publishes indices of the price of insurance and financial services, based on representative samples of quotations from various services providers for a constant set of consumer 'profiles'. Figure 5.1 shows how the indices moved over the period 2001 to 2006. Prices in both insurance categories increased until 2003 and fell thereafter. Prices for financial services increased rapidly until 2003, more moderately thereafter and fell in 2006. How much of the change is attributable to the impact of the Financial Regulator's information activities cannot be reliably determined.

Figure 5.1 Consumer price indices for selected financial services, 2001 to 2006, (December 2001 = 100)



Source: Central Statistics Office Consumer Price Index

Development of Information Provision

5.14 The Financial Regulator uses focus groups of consumers to evaluate the public's awareness and attitudes towards its consumer communications (publications, website and advertising/marketing campaigns). In April 2005, it commissioned a focus group evaluation of the consumer sections of its website. The evaluation group found that the members of the focus group had positive views about the information content of the website but concluded that users found the structure of the site confusing and the overall purpose of the site was not clear. The users felt there should be clear separation of financial product information/education from the Financial Regulator's corporate website, and that the navigation tools within the site were weak. Overall, they favoured a stand-alone site with a clear uncomplicated layout and easy access to product information.

5.15 Based on the negative results regarding the structure of the consumer section of the website, the Financial Regulator decided not to promote or advertise it extensively until improvements could be made. The development of the consumer information website was a high level goal in 2005, but the Financial Regulator has stated that the project was not progressed due to competing demand for IT resources. Work on development of the website by the Information Systems Department of the CBFSAI, using an outsourced supplier, commenced towards the end of 2006. The revamped website is due to become operational by the end of July 2007.

5.16 A memorandum of understanding between the offices of the Financial Regulator, Financial Services Ombudsman and Pensions Ombudsman was negotiated in 2005 and came into effect from 1 April 2006. The agreement formalised arrangements for information sharing between the bodies on recurring themes in the consumer complaints process and in relation to financial services providers that recur repeatedly in the context of complaints.

Consumer Helpline

5.17 A Consumer Helpline is operated by an agency on behalf of the Financial Regulator. In 2006, the helpline received 30,000 calls.

5.18 Performance indicators used by the Financial Regulator to monitor the level of service provided on the Helpline include call abandonment rate, first contact resolution, and waiting time. Monitoring was based on the receipt of daily reports from the agency.

5.19 In early 2005, the Financial Regulator decided to augment the quantitative indicators used to measure the performance of the Helpline by developing qualitative measures. Initiatives in this respect to date include

- Calls received by the Helpline staff were reviewed on a sample basis to verify the accuracy of information provided, assessing what was said on the phone and rating performance. Feedback was prepared and training needs identified.
- The Financial Regulator is currently working on a 'mystery shopper' quality assessment of the Helpline.
- Market research about the Helpline service commissioned by the Financial Regulator in 2005 found that 78% of respondents stated that they were very likely to recommend the Helpline and 71% stated they were very likely to use it again. 75% of queries were reported to have been resolved on the first call.

Competition in Financial Services Provision

5.20 The Financial Regulator reports annually on the extent to which competition exists among providers of financial services. Two measures are used by the Financial Regulator to indicate the level of competition (or lack of it) in the provision of financial services. These are based on the extent to which business of particular kinds (e.g. credit card provision, current account provision, etc) is concentrated in a small number of services providers or is shared across services providers.¹⁸

5.21 The latest analysis, published by the Financial Regulator in its annual report for 2005, indicates that there was a high level of concentration in the provision of some services in the banking and insurance sectors, and particularly in the provision of credit cards and current accounts. The report points out that, overall, concentration levels in the Irish banking and insurance sectors are broadly in line with the European averages.

5.22 Other agencies, in particular the Competition Authority, also have an interest in monitoring the level of competition for provision of financial services, and may take action to reduce the level of concentration. Market forces may also have an impact. Changes in the levels of competition (in either direction) cannot therefore be attributed solely to the actions of the Financial Regulator.

5.23 The Competition Authority issued a report on competition issues in the non-life insurance market in March 2005 and a report on competition in the non-investment banking sector in Ireland in September 2005. Both reports included recommendations addressed to the Financial Regulator, designed to increase competition levels in the respective markets.

- The report on the non-life insurance market focussed on motor, employer's liability and public liability insurances. The report concluded that there is little or no evidence of price co-ordination in either the motor or liability insurance markets in Ireland but also that there is evidence that competitive rivalry is not vigorous. The report included 36 recommendations addressed to the Financial Regulator, designed to increase the level of competition in the market. These included proposed changes in the areas of costs of switching between rival services providers, barriers to market entry and issues relating to intermediary conflict of interests. At end February 2007, the Financial Regulator had accepted seven of the Competition Authority's 36 recommendations. A further three had been partially accepted. The remaining 26 recommendations are to be considered and/or to be discussed with the Competition Authority.
- The Competition Authority's report on the non-investment banking sector focused on competition in personal current accounts, lending to small businesses and the payments clearing system. The report concluded that banks in Ireland did not compete aggressively for customers. While acknowledging that changes in the sector were ongoing, the report contained 25 recommendations, nine of which were directed at the Financial Regulator. The areas to which these related included: review of the arrangements for switching business between banks; provision of information on personal current account interest rate; promotion of awareness of personal current account interest rates; and preparation and publication of cost comparisons for small and medium enterprise current accounts. The Financial Regulator has accepted (fully or partially) all the recommendations, and these have been or are being implemented.

18 The indicators are described in summary in Appendix F, along with the results for 2005.

Consumer Focused Inspections

5.24 The Financial Regulator has identified the key risks to consumers that may arise in their dealings with financial services providers as being that the financial services provider may

- mis-sell a financial product i.e. it may not suit the individual circumstances of the consumer
- provide insufficient information to consumers about the services that they are proposing to buy
- overcharge the consumer for the services provided.

5.25 The Financial Regulator's Consumer Protection Code includes business conduct principles that are designed to counter these risks. In addition, the Financial Regulator carries out a programme of consumer focused inspections to provide assurance that the Code is being complied with by financial services providers that operate at the retail level.

Number of Inspections

5.26 The Financial Regulator carried out a total of 95 consumer-focused inspections in 2006. This was down from a total of 185 in 2004, and a total of 116 inspections in 2005. The Financial Regulator has attributed the reduction in the number of inspections in 2005 and 2006 to a range of factors, including the following.

- Experienced inspection staff were diverted from inspection activity and assigned to work on development of the Consumer Protection Code.
- 38 of the inspection visits in 2004 were preliminary visits to mortgage intermediaries, lasting about an hour each — these were carried out as a means of gathering information about the sector. In 2005, inspections of mortgage intermediaries lasted for a minimum of one day, reducing the number of inspection visits capable of being carried out.
- Issues of concern identified during inspection visits carried out in 2004 required follow-up action, which was time consuming. This was particularly the case for larger and more complex financial services providers.
- The Financial Regulator's capacity to carry out inspections was affected by a number of internal staff issues, including reorganisation of the inspection units, provision of staff training and study leave.

5.27 Figure 5.2 shows the number of inspections carried out in each sector in 2005, and the estimated inspection rates by sector. The data in the figure relate only to those financial services providers that provide services on a retail basis. A distinction is also made between inspections carried out at headquarters level in large financial institutions, and inspections carried out at branch level, where staff deal with consumers. This particularly affects retail credit institutions, which typically have large branch networks; and insurance companies which sell to consumers through networks of tied agents for which they take full responsibility.

5.28 As Figure 5.2 indicates, the Financial Regulator carried out consumer focused inspection visits at head office level to one in eight retail credit institutions and to almost one in four retail insurance institutions. The Financial Regulator carried out only one inspection of a credit institution at branch level in 2005. It carried out no inspections of tied insurance agents. Retail investment business firms and credit unions received no inspections, and inspection rates in most other sectors were below 5%.

Figure 5.2 Consumer-focused inspection of retail financial services providers, by sector, 2005

Sector	Number of retail services providers (at end year)	Number of consumer focused inspections	Inspection rate %
Credit institutions — head offices	45	6	13%
— branches	650	1	—
Insurance companies	43	10	23%
Insurance tied agents	1,413	—	—
Credit unions	435	—	—
Investment business firms	198	—	—
Multi agency intermediaries	2,068	29	1%
Mortgage intermediaries	1,440	46	3%
Authorised advisors	455	21	5%
Money lenders	50	2	4%
Bureaux de change	14	1	7%

Source: Financial Regulator

5.29 The Financial Regulator carried out inspections of eight branches of credit institutions in 2004. These followed inspection visits to the head offices of credit institutions, which concentrated on high level procedures and processes for dealing with customers. The branch inspections were carried out to establish, on a sample basis, if the procedures and processes described at head office level were being carried through at branch level; and to evaluate the level of compliance in branches with the relevant consumer standards. They found the branch inspection visits to be very useful for evaluating how procedures and processes operate in practice, and contributed to the identification of a significant problem in relation to overpayment for mortgage payment protection insurance.

5.30 The Financial Regulator allocates the staff resources available for inspection work based on consumer and market intelligence, including information coming through the Consumer Helpline, from the Financial Services Ombudsman, issues identified during inspections that could be more widespread, ‘mystery shopping’ exercises and other sources.

5.31 Formal risk rating is not used in the selection of financial services providers for consumer focused inspection. A risk rating system as elaborate as the model applied for prudential supervision would not be warranted. However, a simpler model, focused on risks to consumers could be developed. Combined with defined risk categories and clear associated inspection policies, this should provide a basis for identifying the appropriate level of inspection activity and of inspection resources.

Inspection Process

5.32 A review of the case files of a sample of retail and mortgage intermediaries that were selected for consumer-focused on-site visits in 2004 and 2005 found that

- Three to four averaged days staff time were used to carry out inspections.

- Post- inspection letters were issued within six weeks of the inspection date for eleven of the sixteen intermediary inspections reviewed. The maximum period taken to issue a post inspection letter was about six months.
- Twelve of the financial services providers were required to take action to address inspection findings. Of these, six resolved the issues within eight weeks. The remaining six did not resolve issues for an average period of about five and a half months after the post- inspection letter was issued.

5.33 There is scope for the Financial Regulator to issue post-inspection letters more quickly in the case of routine visits. The Financial Regulator accepts this. In 2006, it agreed an inspection protocol with retail intermediaries. The protocol states post-inspection letters will usually follow within 30 working days (i.e. around six weeks) after the wrap-up meeting. The Financial Regulator has stated that it will set timeliness targets for other sectors as part of the development of a service protocol outlining commitments in relation to interactions with stakeholders.

Feedback from Inspections

5.34 The Financial Regulator has used the results of themed inspections of samples of financial services providers and branches as a means of providing feedback to all institutions in the relevant sectors. For example

- A sales process review was initiated in response to a number of complaints the Financial Regulator received concerning cases of alleged mis-selling of investment products to older customers. The Financial Regulator surveyed 24 financial services providers and visited three services providers to examine samples of working papers. The review found that a significant number of the institutions surveyed did not have mechanisms in place to monitor what is actually said to the customer at the point of sale; services providers were not paying sufficient attention to matching the risk rating of their products with the risk profile of their customers; there was no clear definition of 'elderly' within the industry (the definition ranged from 60 to 80 years); and sufficient consideration was not given by services providers to whether individual complaints indicated a wider system or process problem. The Financial Regulator issued a letter in November 2006 that contained recommendations as to best practice in the sales process.
- Specific issues arising from inspection are raised first with the institution concerned. In addition, general feedback is given to industry on the main findings of the inspection programme through what the Financial Regulator refers to as 'top ten' letters. In 2006, such letters issued to the retail banking, insurance and intermediary sectors.

Letters containing feedback are not intended to create extra rules or obligations over and above the requirements in the Consumer Protection Code, but rather a framework around which financial services providers are expected to develop and improve their customer handling practices.

Enforcement of Consumer Interests

5.35 The Annual Report of the Financial Regulator for 2005 describes two instances where consumer-focused inspection work in 2004 and 2005 resulted in the identification of significant overcharging.

- Since May 2004, overcharging by 36 financial services providers identified by the Financial Regulator has resulted in the repayment of around €18 million to consumers.
- Following the issue in May 2005 of letters to services providers on feedback in relation to consumer inspection findings, the Financial Regulator was informed of 40 different instances of investment fund pricing and insurance policy errors. These resulted in refunds

of €8.2 million to 60,000 policyholders. The errors resulted from poor policy administration and breakdowns in procedures. The Financial Regulator has stated that, apart from seeking reimbursement of consumers and reviewing systems and procedures, it was not empowered to impose any sanctions on the services providers concerned as a result of the overcharging, which occurred before its power of sanction was created in August 2004.

Funds Protection

5.36 The Financial Regulator has a role in relation to funds protection schemes that are in place in a number of financial sectors.

- At the end of 2005, there were 48 credit institutions in the Deposit Protection Scheme, which is administered by the Financial Regulator. The protection scheme was established under the Central Bank Act 1989 and conforms with the European Communities (Deposit Guarantee Schemes) Regulations, 1995. Total funds held at end 2005 were €337 million. The scheme will compensate depositors up to 90% of deposits held, subject to a maximum of €20,000 (the maximum compensation figure has been unchanged since 1995). The Financial Regulator has stated that there has been no claim on the scheme since its inception.
- In 1997, the EU Investor Compensation Directive laid down basic requirements for investor compensation schemes to provide a harmonised minimum level of protection. In Ireland, the Directive was implemented by the Investor Compensation Act, 1998 which also set up the Investor Compensation Company Limited (ICCL). Staff of the CBFSAI perform the administrative functions of the ICCL, which puts arrangements in place as required to ensure eligible clients of a failed investment firm receive compensation. The Financial Regulator is the supervisory authority for the ICCL, and certain actions undertaken by the ICCL can only be carried out with the Financial Regulator's approval. Compensation is limited to 90% of the amount lost, or a maximum of €20,000. Clients dealing with an unauthorised firm are not covered under the scheme. The ICCL's website gives details of three current cases where claims are being processed. The largest of these by far is W&R Morrogh. Approximately 2,600 claims were received and, up to 12 February 2007, the administrator in that case had certified 2,182 claims and the ICCL had paid €7.2 million in compensation. The administrator had rejected 351 claims, leaving 93 cases yet to be processed.
- The Insurance Compensation Fund applies only to non-life insurance companies. The Fund operates under the jurisdiction of the President of the High Court, with the Accountant of the High Court having day-to-day responsibility for the Fund. The Financial Regulator may impose a levy on insurers (not exceeding 2% of gross premium income) in every year in which it is of the opinion that financial support is required by the Fund.

5.37 Independently of the Financial Regulator, the Irish League of Credit Unions operates a funds protection scheme called the Savings Protection Scheme (SPS), which is mandatory for the League's member credit unions. This scheme had total funds at end 2006 of €5.6 million, and may compensate individual savers up to maximum of €12,500. However, a number of credit unions not affiliated to the League are not participating in the scheme. The Financial Regulator is engaged in discussions with the League to see if agreement can be reached for recognition of a reformed version of the scheme under the provisions of the Credit Union Act 1997.

5.38 The EU established a working group to examine the need for a directive on minimum harmonisation of EU insurance guarantee schemes in 2002. The Financial Regulator has stated that the initiative was driven by an Irish proposal arising from the negative impact on many Irish

policyholders of the failure of the UK company 'Independent Insurance'. The Financial Regulator and Department of Finance have advocated a directive on this matter to address the lack of equivalent treatment and related lack of clarity as to policyholder rights in the event of the failure of a non-domestic insurance company. It has also been argued that a Directive in this area is also necessary in order to ensure a properly functioning Single Market in insurance. The EU Commission has retained consultants to undertake a study into insurance guarantee schemes in the EU and a decision by the EU on whether to proceed with a scheme is expected in 2007.

Conclusions

5.39 Since its establishment in 2003, the Financial Regulator has made significant progress in developing a programme of actions aimed at achieving greater protection for consumers of financial services. A broad range of consumer information is provided on a regular and timely basis and a principles-based code of business conduct has been published.

5.40 The scale of the Financial Regulator's consumer-focused inspection programme is determined by the available resources, rather than by an assessment of the risk that financial services providers may carry out their business in ways that could damage the interests of consumers. The Financial Regulator should develop a systematic risk-based approach to the setting of inspection targets and the selection of financial services providers to inspect. An independent assessment (e.g. a peer review) of the adequacy of the inspection process should be carried out.

5.41 The Financial Regulator needs to develop its consumer information website in order to provide easily accessible, relevant, clear and concise information on financial services.

The Financial Regulator has stated that it recognises that its website is a key tool for communicating with consumers of financial services. It plans to upgrade and redesign its consumer website by July 2007.

6 Cost Effective Regulation

6.1 Regulation is generally undertaken in an effort to achieve identified social benefits. The direct costs of regulation of financial services providers are borne in the first instance by the CBFSAI, but about half of the costs are passed on to the regulated financial services providers in the form of levies. In addition to the levies, services providers incur further costs in complying with the requirements specified by the Financial Regulator.

6.2 This chapter reviews

- the costs of regulation incurred by the Financial Regulator
- the levies imposed on financial services providers by the Financial Regulator
- the costs that regulation places on financial services providers
- how the Financial Regulator weighs up the costs and the expected benefits of regulation.

Costs of Regulation

6.3 Figure 6.1 shows the breakdown of annual spending by the Financial Regulator since its establishment in 2003.

Figure 6.1 Expenditure by the Financial Regulator 2003 – 2006

	2003 ^a	2004	2005	2006 ^b
	€000	€000	€000	€000
Salaries and allowances (including PRSI)	na	16,329	18,942	21,982
Pension provision	na	2,237	2,595	3,121
Total pay costs	11,182	18,566	21,537	25,103
Training, recruitment and other staff costs	409	278	313	449
Equipment, stationery, etc	276	358	353	414
Business travel	430	662	727	664
Publishing and media relations	374	1,715	2,563	3,016
Consultancy and other professional fees	933	869	986	1,669
Miscellaneous	72	155	151	155
Total non-pay costs	2,494	4,037	5,093	6,367
Premises and corporate services		5,556	6,173	6,803
Information technology services		2,722	2,844	2,655
Human resources services		1,810	2,127	2,055
Other services ^c		2,348	2,532	2,693
Total cost of support services	na	12,436	13,676	14,206
Total expenditure	na	35,039	40,306	45,676

Source: The Financial Regulator

Notes: a May to December 2003

b Provisional outturn

c Includes accounting and administration services, statistical services, and pension provision for support services staff

6.4 Expenditure by the Financial Regulator increased by 15% between 2004 and 2005, and by a further 13% in 2006.

6.5 Expenditure on pay costs increased by around 16% in 2005 and by a further 16.5% in 2006. In part, this reflects increases in staffing as the Financial Regulator expanded following establishment. The average number of staff increased from 298 whole time equivalents in 2004 to 312 in 2005 (an increase of 5%) and to 326 in 2006 (a further increase of 4.5%). Increases in pay rates and changes in the grading structure also contributed to the increase in spending.

6.6 The cost of shared services provided by the CBFSAI accounted for about 35% of the Financial Regulator's costs in 2004, but declined to around 31% of the total by 2006. The largest component of the cost related to corporate services (administration, security, press office, etc.) and premises expenses, which increased by 11% in 2005 and by a further 10% in 2006. A budgeted increase of over 26% in spending on IT services in 2006 did not materialise — instead, spending on IT for the Financial Regulator fell by almost 7%, relative to 2005 spending levels. The CBFSAI has stated that the drop in spending on IT reflects savings arising from the earlier than scheduled phasing out of legacy mainframe systems and somewhat slower than anticipated staff recruitment.

6.7 In both 2004 and 2005, spending by the Financial Regulator turned out to be about 10% below budget. Spending in 2006 was 6.5% under budget. The Financial Regulator has stated that the main reason for the under spending is because approved staff complements on which the budgets were based were not achieved. However, it is noted that, while average staffing in 2006 was about 7% below the budgeted level of 350, the pay budget for 2006 was used in full.

Supervision Costs by Sector

6.8 The Financial Regulator has developed a financial model to identify its spending on activities in relation to each of the financial industry sectors. The model was developed in conjunction with external consultants, as a basis for levying fees on financial services providers. Figure 6.2 presents the costs of each regulated sector for the period 2004 to 2006.

6.9 The cost of regulation of individual sectors has fluctuated significantly over the period 2004 to 2006. Variations can arise because of

- changes in the Financial Regulator's (and, indirectly, in the CBFSAI's) cost base e.g. pay increases
- changes in the level of regulatory effort by increasing the Financial Regulator's resource levels
- shifts between sectors in the deployment of the Financial Regulator's resources, which may reflect changes in the Financial Regulator's priorities and/or in the size of sectors.

6.10 Around €1.39 million of the costs of the Financial Regulator's activities in 2006 (3.1% of the total) was not allocated to the financial services sectors. Arising out of implementation of a number of FSAP directives, the Financial Regulator now carries out routine oversight of stock markets, and of entities operating in the market but not subject to authorisation by the Financial Regulator. Because the Financial Regulator had not devised a mechanism for allocating the associated costs to the relevant sectors when it was drawing up the 2006 levy scheme, the Minister for Finance agreed to a proposal that the CBFSAI would fund the full cost of market supervision for 2006 — budgeted at €1.14 million — on condition that a review would be carried out to determine to what extent that cost should be met by the relevant sectors in future years.

Figure 6.2 Cost of financial regulation activity, by financial services sector, 2004 to 2006

	2004	2005	2006 ^a
	€ 000	€ 000	€ 000
Credit institutions	10,617	13,485	14,851
Insurance	7,028	8,212	9,727
Credit unions	2,257	2,549	2,957
Intermediaries	4,582	5,252	5,029
Investment business firms	3,871	2,865	3,241
Funds and funds service providers	6,155	7,374	7,768
Moneylenders	235	242	259
Professional bodies	127	106	48
Exchanges	132	176	356
Bureaux de Change	35	46	46
Cost of regulation of all sectors	35,039	40,306	44,282
Market supervision activity ^b	—	—	1,394
Total expenditure	35,039	40,306	45,676

Source: Financial Regulator

Note: a Provisional outturn

b Costs not allocated to individual financial services sectors

Sectoral Unit Costs

6.11 Relating the cost of regulating each sector to the size of the sector is helpful in trying to understand trends in spending. However, no single measure is appropriate for establishing the size of all sectors.

6.12 In determining the annual levies to be paid by individual financial services providers, the Financial Regulator generally takes account of differences in scale of operation, so that those operating on a bigger scale pay more than smaller scale operations. Scale is measured differently in different sectors e.g. credit institutions are measured in terms of their net assets; insurance companies in terms of their total premiums; intermediaries in terms of turnover, etc.

6.13 Figure 6.3 shows the costs incurred by the Financial Regulator in regulating the main financial sectors in the period 2004 to 2006, related to the size of the sectors, based on sector aggregates for the measures used to scale fees. This suggests that, while the absolute costs of regulation of the individual sectors increased between 2004 and 2006 (as shown in Figure 6.2), the cost of regulation of credit institutions and investment funds/funds services providers has fallen when increases in the size of the sectors is taken into account.

6.14 Trends over time in the ratios for individual sectors are likely to be more relevant and informative than apparent variations between sectors. The Financial Regulator should monitor the costs of sectoral regulation in this way, and publish the outcome annually. All the major financial services sectors should be included in the analysis.

Figure 6.3 Cost of regulation relative to size of sector, selected financial services sectors, 2004 to 2006

Sector	Basis of measure of value of sector	Cost of regulation of sector per €million of valuation		
		2004	2005	2006
		€	€	€
Credit institutions	Total assets	15	14	13
Credit unions	Total assets	204	196	211
Funds/funds service providers	Net assets	14	13	11
Insurance	Total premiums	263	264	Not available

Source: Analysis by Office of the Comptroller and Auditor General

International Comparisons

6.15 Comparing the costs of regulation with the costs incurred by regulators in other jurisdictions may also provide useful perspectives on the nature of the regulatory regime.

6.16 The UK's Financial Services Authority compiled and published data in its 2005 annual report that allows international comparisons of costs to be made in relation to some sectors in selected countries. Figure 6.4 presents comparisons for the relative costs of regulation of credit institutions and insurance companies.

Figure 6.4 Comparison of costs of regulation of credit institutions and insurance companies in selected countries, 2005^a

Country	Cost of regulation of sector per €million of valuation ^b	
	Credit institutions	Insurance companies
	€	€
France	13	n.a.
Germany	7	170
Ireland	14	264
United Kingdom	10	196
Hong Kong	26	700
Singapore	28	571
United States	177	844

Source: Based on data presented in Appendix 5 of the 2005/2006 Annual Report of the UK Financial Services Authority, and in Figure 6.3 above.

Note: a Data refers to years prior to 2005 for some countries

b Valuation of credit institutions based on total banking assets, insurance companies based on total premiums

6.17 The analysis indicates that the cost of regulation of credit institutions in the EU member states for which data is available was within the range €7 to €14 per million euros of banking assets. Costs in Singapore and Hong Kong were about twice the costs in the EU countries. Costs of regulation of credit institutions in the US were relatively very high.

6.18 A similar pattern is evident in relation to the cost of regulating insurance firms, relative to the premium turnover. Costs in the UK and Germany were under €200 per million euros of premiums, and somewhat higher in Ireland at €264 per million. Costs in Hong Kong and Singapore were over twice the level in the EU countries, and were highest in the US.

6.19 International comparisons based on this measure should not be regarded as indicators of the relative cost-effectiveness of regulation of financial services sectors in the different jurisdictions. The nature and extent of the responsibilities of regulators vary significantly, and this would need to be taken into account in any assessment of relative cost-effectiveness. Economies of scale may also have an impact on the figures.

Regulatory Levies

6.20 The Act establishing the Financial Regulator¹⁹ provides for the imposition of levies on regulated bodies to fund the Financial Regulator's activities. Any shortfall in the amount raised from industry levies is met by the CBFSAL.

6.21 The regulations providing for the imposition of levies must be approved in advance by the Minister for Finance. The policy of the Minister is that 50% of the costs of regulation should be recovered through levies.

6.22 Internationally, the practice in relation to levying of regulatory fees varies. In some cases, no fees are levied on financial services providers. In other cases, levies are designed to recover the costs of regulation in full.

6.23 Levies collected for 2004, 2005 and 2006 by sector are shown in Figure 6.5.

Timeliness of Levies

6.24 In the consultation paper published prior to the introduction of the levy system, the Financial Regulator indicated that regulated services providers would be charged levies annually in advance, based on the Financial Regulator's budget for the year. Levy regulations detailing the amounts or rates to be charged would be published early in the year to which the charges applied, following approval by the Minister for Finance. The Financial Regulator would issue individual levy notices as soon as practical thereafter. The Financial Regulator anticipated that, exceptionally, to allow time for development of the levy scheme, invoicing in 2004 would not occur until the middle of the year.

19 Central Bank and Financial Services Authority of Ireland Act 2003.

Figure 6.5 Levy income by sector, 2004 to 2006

Sector	2004	2005	2006
	€000	€000	€000
Credit institutions	6,022	6,713	7,423
Insurance	3,701	4,270	4,854
Credit Unions	1,005	1,057	1,298
Intermediaries	2,855	2,954	2,888
Securities	2,106	1,438	1,445
Funds / Funds Service Providers	3,678	3,963	3,529
Moneylenders	119	109	158
Professional bodies	87	38	20
Exchanges	90	95	101
Bureaux de change	19	19	28
Total	19,682	20,656	21,744

Source: Analysis by Office of the Comptroller and Auditor General

6.25 In practice, the Financial Regulator did not issue levy invoices before mid-year in any year since 2004. It has also changed the tariff bands for calculating the levy amounts each year. Combined with uncertainty about what are the Financial Regulator's overall spending plans, these factors make it difficult for financial services providers to anticipate the levies they are likely to have to pay. The Consultative Industry Panel has been strongly critical of the process for calculating the levy, describing it as cumbersome and bureaucratic. The Consultative Consumer Panel has also strongly criticised the Financial Regulator's accounting and budgeting systems.

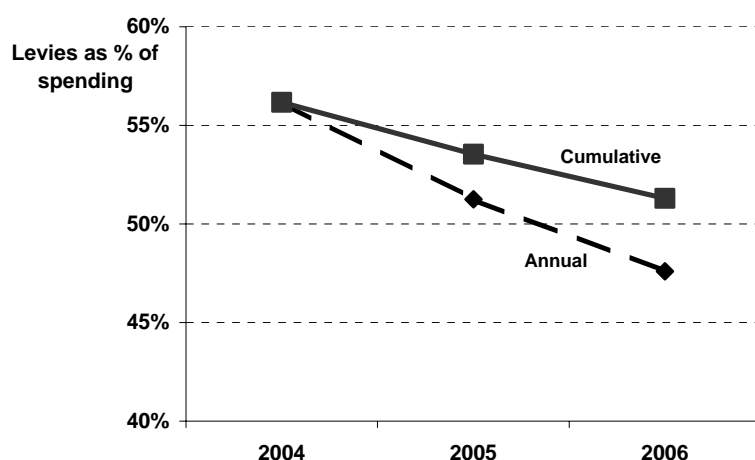
Excess Levies

6.26 Underspending by the Financial Regulator relative to its budgets in 2004 and 2005 has resulted in the collection of levy amounts that exceeded 50% of the Financial Regulator's costs in each of the years. There were excesses and losses in relation to individual sectors, and the net excess amounted to €1.69 million in 2004 and €2.11 million in 2005. The net excesses represented 9% to 10% of the total amount collected, corresponding to the amount by which budgets were underspent in the years in question.

6.27 The Financial Regulator made adjustments in the levy estimation process for 2005 and 2006, to compensate services providers in sectors where excess levies were collected in the previous years, and to recover levies where the amount collected was insufficient to meet the target 50% of the previous year's spending. The adjustments were made at industry sector level, rather than on an individual services provider basis.

6.28 Figure 6.6 indicates that the amount of levies collected each year has fluctuated significantly around the target level of 50%, ranging from 48% to 56% of annual expenditure. However, cumulatively over the period 2004 to 2006, levies collected were approaching the 50% target.

Figure 6.6 Regulatory levies as a percentage of spending by the Financial Regulator, 2004 to 2006



Source: Analysis by Office of the Comptroller and Auditor General

Uncollected Levies

6.29 The Financial Regulator wrote off invoiced fees totalling €325,000 in 2004 and €352,000 in 2005. This write off represents about 2% of total levy receipts. The Financial Regulator, and ultimately the CBFSAI, bears the cost of uncollected levies.

6.30 The write off of levies mainly relates to investment funds in liquidation or funds with no assets to meet the levy obligation. The Financial Regulator has stated that it is developing procedures to maintain and keep up to date the information on which the levy notices are issued. It expects that this will reduce the need for write offs.

Evaluating Costs and Benefits of Regulation

6.31 In general, the aim of regulation is to address some perceived market failure, in the expectation that the regulatory intervention will result in some benefit(s). The regulatory process will usually impose some costs on the producers, and ultimately, these may be passed on to consumers. To be effective, the benefits achieved through the regulatory intervention should outweigh the costs.

6.32 The Financial Regulator is obliged to implement requirements specified in domestic and EU legislation, but may have choice in the manner in which it does so. Consequently, it needs to have systems in place that allow it, to the greatest extent possible, to measure and weigh up the relative costs and benefits of the regulatory regime imposed on financial services providers.

Cost Impacts of Regulation

6.33 The costs that arise as a result of financial services regulation impact in the first instance on financial services providers. These fall mainly into the following categories.

- the *levies* imposed by the Financial Regulator on individual financial services providers

- the *administrative costs* of regulation, which arise for services providers in dealing with the Financial Regulator (e.g. resources devoted to responding to the Financial Regulator's demands by way of prudential returns, follow up queries or responding to the Financial Regulator's team during on-site inspections or reviews) or in implementing internal monitoring arrangements to ensure that the regulatory regime is complied with
- the *policy costs* of regulation, which arise when the actions sought by the Financial Regulator are implemented, including costs such as those associated with maintaining a level of liquidity specified by the Financial Regulator (over and above the level that the services provider might otherwise hold).

6.34 The administrative costs of regulations are likely to be greater at times when significant new regulations are being implemented, but should usually fall after the new systems have been adopted by financial services providers into their business practices.

6.35 Regulatory costs may differ significantly from sector to sector, reflecting differing degrees of supervision. For example, 'wholesale' financial services providers engaged exclusively in business with other firms are subject to fewer regulatory requirements, and thus lower compliance costs, than 'retail' financial services providers that sell directly to members of the public.

6.36 The 2006 survey of regulated entities commissioned by the Consultative Industry Panel found that many respondents thought the cost to the industry of compliance with regulatory requirements was heavier than it should be. Half of all firms reported their belief that the cost of compliance represents 5% or more of their total business cost; one in eight felt compliance costs represented over 15% of their overall costs.

Benefits of Regulation

6.37 There is no single agreed model that defines the benefits that regulation of financial services providers is expected to achieve, or how such benefits might be measured. As a result, the evaluation of regulations and regulatory regimes tends to focus more on quantifying the costs (to the extent that that is achievable) than on quantifying the benefits. The Financial Regulator, together with its peers internationally have been engaged in efforts to develop measures of benefits but further development is required.

6.38 A study of the benefits of financial regulation and how they might be measured was commissioned by the UK's Financial Services Authority and published in June 2006.²⁰ This identifies a wide range of potential benefits of regulation, including

- *benefits to consumers*, such as better choice (in terms of more optimal fit between what they buy and what they need); more choice in the products available; reduced losses due for example to mis-selling, or default of services providers; reduced prices; more equitable access to financial services
- *benefits to producers*, such as lower costs (e.g. by avoiding expenses needed in monitoring counterparties) and higher output (e.g. because consumers have confidence in the market and are willing to buy more); however, the study recognises that these benefits may be intermediate, ultimately being passed on (in part or in total) to consumer as a result of competitive forces

²⁰ Oxera Consulting Ltd, *A framework for assessing the benefits of financial regulation: report prepared for the Financial Services Authority*, Oxford, June 2006

- ***benefits to the wider economy***, such as higher output due to reductions in systemic risks, lower costs of financial services for businesses, higher net exports of financial services, etc.

The study points out a significant number of practical difficulties involved in measuring the extent to which benefits attributable to regulatory interventions are achieved.

Regulatory Impact Assessment

6.39 The Financial Regulator has not carried out any comprehensive review to estimate the costs of compliance generally on the financial services sector, nor is such a review planned. In this respect, it is similar to many of its counterparts in other jurisdictions.

6.40 A January 2004 Irish Government White Paper, ***Regulating Better***, set out six principles against which regulations can be assessed. These are

- the necessity for the regulation
- its effectiveness in achieving the stated objectives
- the proportionality of the costs imposed by the regulation relative to the benefits to be achieved
- transparency
- accountability
- consistency.

The Department of the Taoiseach subsequently published a guidance paper on carrying out of regulatory impact analysis in July 2005. This proposed that all new regulations being introduced by Government departments and offices should be subjected to formal regulatory impact assessment prior to their introduction.

6.41 The Financial Regulator has stated that it will apply a regulatory impact approach to all significant new regulatory proposals. While it has no set plans to conduct regulatory impact assessments or assessments of regulatory burden for the existing body of regulations, it has invited the two Consultative Panels to identify and prioritise regulatory requirements that they believe are unnecessary and open to amendment by the Financial Regulator, and to complete the associated reviews by 2009. It proposes to develop guidelines for staff over the coming months on conducting such assessments and the associated public consultations.

6.42 To date, the experience of the Financial Regulator in carrying out regulatory impact assessments has been limited.

- The draft consumer protection code was published for consultation in February 2005. Following the publication of national guidance on regulatory impact assessment in July 2005, the Financial Regulator decided to conduct and publish an assessment on the code, and sought the views of the industry, customers and consumer groups as well as the Consultative Panels. The report on the assessment, published in December 2005, noted that "...the cost exercise was conducted in an extremely tight timeframe, which only allowed a minimum of discussion on devising the cost template to be completed, and which did not allow for validation of the data. It has not therefore been possible to verify the robustness of the cost data provided.... The Financial Regulator has accepted that despite its efforts and the efforts of industry, it would not be possible to offer precise, or even reliably approximate figures describing the incremental costs to the industry of the code." In relation to the expected benefits of implementing the draft code, the report noted "... the

possibility of quantifying the benefits of the code, both to consumers and to industry, was an even more remote prospect than quantifying costs.”

- The Financial Regulator has also published a regulatory impact assessment on the collation and publication of insurance liability claims data. Based on the assessment, it decided not to pursue the publication of this data on the basis that there was sufficient data already in the market that was readily accessible in a number of ways.

6.43 In addition to regulatory impact assessments, the Financial Regulator has carried out a number of reviews of its business processes in relation to regulation of insurance firms, collective investment schemes, credit unions and consumer protection through visits to financial regulators in other jurisdictions to identify best practice. Consultation undertaken by the Financial Regulator around proposed regulations and process changes have also provided a forum for drawing attention to compliance costs.

Strategic Target Setting and Performance Measurement

6.44 In its Strategic Plan 2007-2009, the Financial Regulator has identified five high-level goals to achieve the overall prudential and consumer objectives. In general, the goals focus more on processes and activities rather than on the cost or benefit impacts that regulation might be expected to achieve.

6.45 The Plan also identifies ‘indicators of success’ in relation to the proposed strategic actions. The indicators are capable of being quantified but they generally relate to activities and outputs, rather than to measures of the impacts the Financial Regulator’s activities have on services providers or on consumers. Most of the measures are also presented without target values, estimates of the current/baseline situation or benchmarks with other regulators. Where targets are set, it is not clear in some cases to what they refer e.g. there is a target of carrying out ten on-site inspections of insurance companies each year but it is not clear whether these will be general or themed inspections.

6.46 The Financial Regulator has developed or is developing some measures of the impact of its activities. These include

- compilation of data on the solvency of financial services providers, as part of an ‘early warning system’ designed to prevent/manage the impact of serious prudential or systemic issues
- estimates of the amounts reimbursed to consumers arising from charging errors brought to light by the Financial Regulator
- measures of demand from consumers for its services (e.g. costs surveys, guides, etc)
- survey based measures of financial services providers’ perceptions of the Financial Regulator’s performance (commissioned by the Consultative Industry Panel, and paid for by the Financial Regulator)
- a planned survey, to be undertaken in 2007, of the financial capability of consumers, aimed at broadening the Financial Regulator’s knowledge of consumer behaviour, attitude and needs, and assessing the effectiveness of its consumer information programme.

The Financial Regulator recognises the importance of performance measurement, and has stated in its Strategic Plan for 2007-2009 that it is committed to developing a comprehensive set of indicators to improve the standard of public accountability it provides. It plans to carry out further work to develop performance indicators and measurement systems so as to enhance the implementation of its strategy.

Conclusions

6.47 The Financial Regulator should merge its annual levy estimation process with its budget process so as to provide earlier notice to financial services providers of their levy liabilities. The practice of waiting until end-of-year figures are available before estimating the levies for the following year is unnecessary. Since a 'prior-year' adjustment is always likely to be required in arriving at the levy amounts, earlier estimation of the levies would probably be preferable from the point of view of the services providers who pay the levies.

The Financial Regulator has stated in its Strategic Plan 2007-2009 that it will review its finance and funding processes and examine the feasibility of bringing forward the date when levy notices are issued. At the request of the Minister for Finance, the review will also examine the feasibility of outsourcing to a single agent the task of collecting funding levies on behalf of the Financial Regulator, Financial Services Ombudsman and the Investor Compensation Company Ltd.

6.48 Estimation of the impacts of financial regulation is a difficult process, but progress is being made internationally in developing appropriate models. The Financial Regulator has been developing and using a regulatory impact assessment process for proposed new regulatory requirements where it has discretion in how legislation is to be implemented. This provides for a systematic review of costs and benefits of regulation, even if full quantification is not achievable. The Financial Regulator should consider using a similar approach to reviewing the impacts of the existing body of regulation, so as to ensure as far as possible that the benefits resulting from regulation are justified by the costs imposed. The Department of Finance has stated that the impact of regulation on the financial services sector will also be considered as part of a process to modernise and consolidate the existing body of legislation, which the Department is currently initiating.

6.49 There is a corporate need to focus on delivering ICT improvements in order to keep pace with developments in the sectors under supervision. This report has identified a number of areas where development of the Financial Regulator's information and communications technology (ICT) systems could help to improve its efficiency and effectiveness. These are recognised by the Financial Regulator which has included the following measures in its Strategic Plan for 2007-2009

- carry out a review of ICT best practice in industry and other regulators in 2007 and commence implementation of recommendations of the review in 2008
- enhance the prudential supervision case management system
- publish registers of authorised financial services providers on website (by June 2007)
- redesign Financial Regulator and consumer websites (by December 2007)
- put in place infrastructure for electronic reporting to collect, validate and analyse regulatory data from financial institutions (by December 2007)
- implement a public enquiries tracking system by 2008.

Appendices

Appendix A Summary of main principles for regulation of financial services provision

The following list is based on the main principles adopted in relation to the regulation and supervision of services providers in their respective areas of expertise by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the International Organisation of Securities Commissions.

General

- The regulator should have clear responsibilities and objectives
- The regulator should have operational independence and adequate resources
- The regulator should have adequate powers including compliance powers in the exercise of its powers and functions

Licensing

- The regulator should set criteria and standards to apply to the eligibility and regulation of prospective licensees including review of ownership structure, directors and senior management, operating plan and internal controls, capital base.
- Permissible licensed activities must be clearly defined and where necessary the regulatory system should provide rules governing the legal form and structure of schemes
- The regulator should have the authority to approve or reject proposed changes in the membership of the board of directors of regulated entities and also to approve or reject major acquisitions

Regulation

- Effective regulation should consist of both on-site and off-site supervision activity
- The regulator should have comprehensive inspection, investigation, surveillance and enforcement powers
- The regulator should supervise entities both on an individual and group-wide basis
- Regulators should be satisfied that entities supervised have adequate internal controls.
- Regulators should be satisfied that there are systems in place to monitor and control market risk (and in relation to international activity, country risk and transfer risk). The regulator must be satisfied that entities have a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure and control all other material risk
- Where relevant, supervision should be on a cross-border basis with contact and information exchange with other regulators
- Supervisors must determine that entities have adequate policies, practices and procedures to promote high ethical and professional standards and to prevent the entity being used by criminal elements

Appendix B Statements of the chairmen of the consultative panels

Annual report of the consultative industry panel — 2005 Chairman's Statement

This is the first Annual Report of the Financial Services Consultative Industry Panel ('the Panel'), a body established under the Central Bank and Financial Services Authority of Ireland Act 2004. The role of the Panel is to act in an advisory capacity to the Irish Financial Services Regulatory Authority (the Financial Regulator) as it seeks to build a balanced and competitive financial services regulatory environment in Ireland.

This is a major undertaking for both the Financial Regulator and the Irish financial services industry. Established in May 2003, the Financial Regulator is one of the newest modern integrated regulatory authorities in existence. The period 2003-2006 has been primarily about development and establishment, but current expectations are that a mature "steady state" will be achieved in the near future, with a consequent leveling-off of expenditure growth.

Achieving Regulatory Balance

Building a balance between over-regulation and under-regulation across the range of financial service sectors operating in Ireland is no easy task. Over-regulation creates the potential to so anaesthetise the delivery of financial service products in Ireland that consumer choice and competition in the market is reduced. Under-regulation leads to sub-standard processes and services to the detriment of the consumer and the market. Over-regulation and under-regulation create major inherent issues for any financial services market, and in seeking to achieve the right balance in the Irish market, there is absolutely no conflict between the Financial Regulator and the financial services industry.

Balanced regulation in a principles-based competitive market cannot create a "zero failure" regime, in Ireland or in any other country. This fundamental reality requires broad, industry-wide, regulatory, and political understanding. Ireland is recognised as a well-regulated jurisdiction, but if regulations are broken, the answer is neither necessarily nor invariably extra regulation.

The Irish Market is Unique

The Financial Regulator is responsible for a financial services market that is unique in an international context. This generates particular challenges for the Financial Regulator which are not always well understood. In a domestic context, the Financial Regulator is responsible for a market that is as sophisticated as any developed European retail financial services market. However, at the same time, the Irish domestic market lacks the economies of scale that exist with larger countries, and this in itself results in particular cost-of-service pressures. The Irish domestic market also has unique features such as a Credit Union movement with a market penetration greater than any country in the world.

Wholesale Sector is World Scale

In an international context, the wholesale financial services sector in Ireland ranks in the top four in Europe. The sector is a major employer and wealth creator. For a country the size of Ireland, the sector "punches well above its weight". Regulating what is an inherently complex sector, while at the same time maintaining international competitiveness, is again a major challenge for the Financial Regulator. The view of the Panel is that the scale of the wholesale sector in Ireland

justifies the creation of the post of Wholesale Director within the Financial Regulator management structure to complement the existing positions of Consumer Director and Prudential Director.

The core role of the Wholesale Director would be to champion the appropriate regulation of the wholesale sector within the Financial Regulator, and to position risk monitoring at the centre of regulatory policy in an environment of increasingly complex financial instruments and transactions. Such a Director would interact at an early stage with industry initiatives in product innovation and development, and importantly, would be entirely consistent with the ambition of both Government and industry to grow the international wholesale sector.

The international and wholesale financial services sector contributes in excess of €1.0 billion annually to the Irish Exchequer. If we get the regulatory regime wrong, this will rapidly erode. There needs to be a fundamental recognition of the differing regulatory priorities between the domestic financial services sector, whose prosperity is directly linked to the success of the local economy, and the international organizations that operate in and from Ireland by choice. The regulatory regime is, by definition, one of the key factors in their decision to locate here. It is important to emphasise that the Panel does not advocate “soft regulation”, but rather regulation that is highly informed, responsive and pragmatic.

Competitiveness in Domestic Retail Sector

On the retail side, we need to be equally vigilant to ensure the sector is afforded a level playing field compared to other EU jurisdictions. Key initiatives now underway such as the creation of the Single European Payments Area, and planned measures to further integrate the European mortgage market means that the retail sector has the potential to become much more pan-European in focus over the next few years. This means that any barriers to innovation and competitiveness in the payments area, such as stamp duty on cards and cheques, and the provisions of Section 149 of the Consumer Credit Act 1995 requiring all non-interest fees and charges to be approved in advance by the Financial Regulator, should now be reconsidered. The Panel advocates that this be the stated position of the Financial Regulator, especially in the light of the Government’s “Better Regulation” initiatives.

The recent Competition Authority Report on the retail banking sector recognised both of these provisions as barriers to competition and recommended action on both fronts. In the emerging pan-European market, product innovation and speed-to-market will determine the winners and losers. Ireland cannot long remain the only country in the EU preparing to compete in this new environment with such competitive restrictions weighing down on the sector

In the paragraphs which follow, the Report touches on areas of real importance to the Panel, the Financial Regulator, and the financial services industry in general, and which direct the Panel’s work with the stakeholders concerned.

I thank all the members of the Panel for their enthusiastic, professional and progressive work on behalf of the Panel during 2005. The Panel could not have made the progress it has without their total commitment.

I also thank our colleagues at all levels within the Financial Regulator with whom we have built a very productive working relationship. They have well supported the work of the Panel over the last year in fulfilling our mandate.

James Deeny
Chairman
Financial Services Consultative Industry Panel

Annual report of the consumer consultative panel — 2005

Chair's statement

The orientation is right ...

From the consumer's point of view, the Financial Regulator has done a good job since its inception. There is a huge contrast between the old Central Bank which had a limited mandate for educating and protecting consumers. The Financial Regulator in general, and the Consumer Director (who is charged with promoting the best interests of users of financial services) in particular, have both put consumer protection at the head of all its activities.

One good example of this is the way in which the Financial Regulator handled individual consumer complaints while the Financial Services Ombudsman was being set up. The Financial Regulator had no official role, but took on an unofficial role onto itself which was a practical solution and was very helpful to consumers.

The balance is about right ...

The Financial Regulator has a difficult job in maintaining an appropriate balance between the need for prudent supervision and the need to protect consumers. It also has to protect consumers within a free and competitive financial services market.

We think that the Financial Regulator has got this balance about right. It has produced a set of principles-based consumer codes. It has tackled some of the large financial scandals in a businesslike way. It has educated the consumer in a friendly and accessible way.

The speed is wrong ...

The big failing of the Financial Regulator, and the key issue which the Chief Executive must address, is the slow speed at which the Financial Regulator operates. It is slow in processing consultation papers; it is slow in processing applications for authorisation; it is slow in responding to complaints about advertising; it is slow in implementing sanctions; it is slow in producing its annual budget.

There seems to be a few reasons for this. They seem indecisive and very minor decisions may have needed approval from the top and so have to progress through many steps to get approval. They also seem to operate with undue complexity and formality probably from fear of making a mistake.

One recent example is the Endowment Mortgages controversy. Back in July 2004, the Financial Regulator identified this problem. It took 18 months before it issued any results of its survey of financial institutions. By the time the Chief Executive made a presentation to the Dáil committee looking at the subject, the information was 18 months old and out of date. Consumer problems need response times measured in weeks, not years.

The main challenge is enforcement ...

It is easier and less controversial to produce information leaflets and codes of conduct. It is more difficult to actually enforce those codes when they are transgressed. Everybody is agreed that a principles-based regulatory regime is appropriate. But the Financial Regulator will need to show that it has the resolve to enforce those principles. We have seen very little evidence in the year under review that the Financial Regulator had the resolve to stand up to some institutions and individuals who were misbehaving. It appears that this lack of resolve is due to the fear of having

its decision challenged in the courts and losing. It seems that when challenged by misbehaving institutions, the Financial Regulator simply backed down.

The impact of EU legislation is another huge challenge ...

There is a raft of new and revised legislation coming from Brussels. Those most affecting Irish consumers will be the Mortgage Directive, The Consumer Credit Directive and the MiFiD Directive. The Financial Regulator has had to devote considerable resources to discussions of this legislation to ensure that Irish legislation, which is very consumer oriented, is not watered down.

Professor Mulcahy co-ordinated the Panel's response on this issue and has interacted with the Oireachtas EU Committees. John Maher and Brendan Burgess attended separate conferences on the subject. The Panel commissioned a summary review of the Directives most affecting consumers which suggested some priority actions which could be adopted by the Panel. We submitted this to the Financial Regulator.

The Financial Regulator must measure its own performance ...

The Financial Regulator needs to develop a means to demonstrate that it has improved things for consumers. It needs to show significant gains for consumers in their understanding of the products, services, benefits, costs, prices and risks and in the manner in which complaints are handled. The Financial Regulator has made a good start in measuring its impact and needs to build on this.

The Consumer Panel's role ...

Because the Financial Regulator has done a good job overall, we have not had to make any major suggestions or criticisms. The suggestions we have made have been simple, although it is to be regretted that the Financial Regulator has ignored or rejected almost all the suggestions we made.

We have had some success in responding to Consultation Papers where some of our ideas have been taken on board by the Financial Regulator. Hopefully, this report will allow the reader assess whether the taxpayer has had good value for the €51,391 it cost them during 2005.

Brendan Burgess

Chair

Financial Services Consultative Consumer Panel

Appendix C: Implementation of Financial Services Action Plan in Ireland — position at 8 March 2007

(Note: Measures involving the Financial Regulator are shaded.)

No.	Strategic objectives of the measure	Implementation instrument(s)	Target date for implementation or transposition	Method of transposition of directives ^a	Date transposed	Guidance issued by Financial Regulator	
						Type of guidance	Date published
Raising capital on an EU wide basis							
1	Harmonise requirements for drawing up, approving and distributing prospectuses by companies	Directive 2003/71/EC Regulation (EC) 809/2004	1 Jul 2005	SI 324 of 2005 Part 5 of Investment Funds, Companies, Miscellaneous Provisions Act, 2005	1 Jul 2005	Interim prospectus rules	Jul 2005
						Final rules	Mar 2006
2	Update directive on regular reporting; set out rules for the disclosure of information about issuers of securities	Directive 2004/109/EC (Transparency Directive)	20 Jan 2007	SI being drafted to transpose both directives jointly; expected to be completed by end June 2007			
		Directive 2007/14/EC	8 March 2008				
Common legal framework for securities and derivatives markets							
3	Distinguish between sophisticated and retail investors, provide business rules conduct to facilitate cross-border provision of services	Communication (2000)722	—	—	—	No guidance deemed necessary	
4	Set out measures to combat insider dealing and market manipulation	Directive 2003/6/EC Directives 2003/124/EC, 2003/125/EC, 2004/72/EC and Regulation (EC) 2003/2273/EC	12 Oct 2004	SI 342 of 2005 Part 4 of Investment Funds, Companies and Miscellaneous Provisions Act, 2005	5 Jul 2005	Interim market abuse rules	Jul 2005
						Final market abuse rules	Mar 2006
5	Integrated and efficient market for investment services	Directive 2004/39/EC (Market in Financial Instruments Directive)	31 Jan 2007	SI 60 of 2007	15 Feb 2007	Guidelines being drafted	
A single set of financial statements for listed companies							
6	Allow fair value accounting	Directive 2001/65/EC	1 Jan 2004	SI 765 of 2004	1 Jan 2005	— Not applicable —	
7	Update EU accounting strategy – Led to introduction of international financial reporting standards for listed companies in the EU	Communication (2000) 359	—	—	—	— Not applicable —	
		Regulation (EC)1606/2002	1 Jan 2005	—	—	— Not applicable —	

No.	Strategic objectives of the measure	Implementation instrument(s)	Target date for implementation or transposition	Method of transposition of directives ^a	Date transposed	Guidance issued by Financial Regulator	
						Type of guidance	Date published
8	Modernise accounting provisions of 4 th and 7 th company law directives and modification to reflect international accounting standards	Directive 2003/51/EC	1 Jan 2005	SI 116 of 2005	1 Jan 2005	—— <i>Not applicable</i> ——	
9	Bring EU auditing practices in line with international accounting standards	Recommendation 2001/6942	—	—	—	—— <i>Not applicable</i> ——	
		Communication (2003) 286	—	—	—	—— <i>Not applicable</i> ——	
Contain systemic risk in securities settlement							
10	Make collateral arrangements easier to enter into	Directive 2002/47/EC	27 Dec 2003	SI 1 of 2004	5 Jan 2004	—— <i>Not applicable</i> ——	
Secure and transparent cross border structures							
11	Provide guidance on conduct of take over bids	Directive 2004/25/EC	20 May 2006	SI 255 of 2006	20 May 2006	—— <i>Not applicable</i> ——	
12	Agree grounds on which a company can become a European company	Directive 2001/86/EC Regulation (EC)2157/2001	8 Oct 2004	SI 623 of 2006	14 Dec 2006	—— <i>Not applicable</i> ——	
13	Review of EU corporate governance to identify wider conditions for an optimal single financial market	Communication (2003) 284	—	—	—	—— <i>Not applicable</i> ——	
14	Create the possibility for companies to conduct cross border mergers	Directive 2005/56/EC	15 Dec 2007			—— <i>Not applicable</i> ——	
15	Allow limited companies to transfer their registered office to another member state	EU measure not yet published					
Single market for investors							
16	Establish framework for protection of beneficiaries of funded pension schemes	Communication (1999) 134	—	—	—	—— <i>Not applicable</i> ——	
17	Provide a European passport for management companies, and widen the activities which they are allowed to undertake	Directive 2001/107/EC (UCITS Directive)	13 Aug 2003	SI 497 of 2003	21 Oct 2003	Draft guidelines	Mar 2004
						Guidance note 1/05	Mar 2005

No.	Strategic objectives of the measure	Implementation instrument(s)	Target date for implementation or transposition	Method of transposition of directives ^a	Date transposed	Guidance issued by Financial Regulator	
						Type of guidance	Date published
	Remove barriers to cross border marketing of units of collective investment by widening assets in which funds can invest	Directive 2001/108/EC	13 Aug 2003	SI 212 of 2003	29 May 2003	Notices and guidance notes	Dec 2003
18	Increase security of returns for schemes by better prudential supervision of pensions funds	Directive 2003/41/EC	23 Sep 2005	Social Welfare and Pensions Act 2005	14 Mar 2005	—— <i>Not applicable</i> ——	
Open and Secure Retail Markets							
19	Coordinate laws, regulations and provisions for distance selling of financial services	Directive 2002/65/EC	9 Oct 2004	SI 853 of 2004 SI 63 of 2005	15 Feb 2005	Distance Marketing Regulations	17 Dec 2004
20	Provide clear and comprehensible information for purchasers of financial services	Communication (2001) 66	—	—	—	<i>No guidance deemed necessary</i>	
21	Report on an e-commerce policy for financial services						
22	Support best practice in respect of information provision about mortgage credit	Recommendation 2001/193 Communication (2001) 447	—	—	—	<i>No guidance deemed necessary</i>	
23	Report on different national arrangements for consumer- business transactions; needs of viable internal market by way of marketing rules and removal of barriers to internal market	Report published 20 March 2000 <i>(Retail financial services: overcoming remaining barriers- a legal analysis)</i>	—	—	—	<i>No guidance deemed necessary</i>	
24	Interpret freedom to provide services and the general good in insurance	Communication (1999) 5046	—	—	—	<i>No guidance deemed necessary</i>	
25	Set rules for insurance and reinsurance mediation	Directive 2002/92/EC (Insurance Mediation Directive)	15 Jan 2005	SI 13 of 2005	14 Jan 2005	Insurance mediation rules	Jan 2005
26	Establish a single market for payments and regulate cross border payments in Euro	Communication (2000) 36 Communication (2003) 718 Regulation 2560/2001	— 31 Dec 2001	—	—	—— <i>Not applicable</i> ——	
27	Prevent fraud and counterfeiting in payments systems	Communication (2001) 11	—	—	—	—— <i>Not applicable</i> ——	

No.	Strategic objectives of the measure	Implementation instrument(s)	Target date for implementation or transposition	Method of transposition of directives ^a	Date transposed	Guidance issued by Financial Regulator	
						Type of guidance	Date published
State of the art prudential rules and supervision							
28	Adopt framework and process for winding up of insurance undertakings	Directive 2001/17/EC	20 Apr 2003	SI 168 of 2003	29 Apr 2003	No guidance deemed necessary	
29	Adopt framework process for reorganisation and winding up of credit institutions that have branches in more than one Member State	Directive 2001/24/EC	5 May 2004	SI 198 of 2004	5 May 2004	No guidance deemed necessary	
30	Establish a new prudential supervisory regime for electronic money institutions	Directive 2000/46/EC (Electronic Money Directive)	27 Apr 2002	SI 221of 2002	29 May 2002	Guidance note	Feb 2003
31	Combat money laundering	Directive 2001/97/EC (2 nd Anti Money Laundering Directive)	15 Jun 2003	SI 242 of 2003	15 Sep 2003	Various guidance notes issued	May 2003 Jun 2003 Feb 2004 Mar 2005
		Directive 2005/60/EC (3 rd Anti Money Laundering Directive)	15 Dec 2007				
32	Define information on financial instruments to be disclosed by banks and institutions	Recommendation 2000/408	—	—	—	No guidance deemed necessary	
33	Revise capital adequacy requirements	Directive 2006/48/EC (Capital Adequacy Directive)	31 Dec 2006	SI 660 of 2006 SI 661 of 2006	19 Dec 2006	Requirements and Guidance note issued	Dec 2006
34	Augment solvency requirements for insurance undertakings to protect consumers	Directive 2002/83/EC	19 June 2004	SI 727 of 2004	19 Nov 2004	No guidance deemed necessary	
		Directive 2002/13/EC	20 Sept 2003	SI 729 of 2004	19 Nov 2004		
35	Permit sharing of information about insurance companies and securities	Directive 200/64/EC	17 Nov 2002	Not transposed: relevant provisions already covered by domestic legislation		No guidance deemed necessary; legislation not amended	
36	Develop prudential rules for financial conglomerates	Directive 2002/87/EC	11 Aug 2004	SI 731 of 2004 SI 732 of 2004 SI 733 of 2004	19 Nov 2004	Guidelines being drafted	

No.	Strategic objectives of the measure	Implementation instrument(s)	Target date for implementation or transposition	Method of transposition of directives ^a	Date transposed	Guidance issued by Financial Regulator	
						Type of guidance	Date published
37	Create a Securities Committee	Decision 2001/528/EC Decision 2001/527/EC	—	—	—	<i>No guidance deemed necessary</i>	

Wider Conditions for optimal single market

38	Adopt rules on effective taxation of interest received	Directive 2003/48/EC	1 Jan 2004	SI 717 of 2003	19 Dec 2003	— <i>Not applicable</i> —	
39	Counter harmful tax competition	Ecofin Council 1 December 1997 (ref. 98/C2/01) Implemented as code of conduct on business taxation	—	—	—	— <i>Not applicable</i> —	
40	Review of taxation of financial service products	None	—	—	—	— <i>Not applicable</i> —	
41	Co-ordinate tax arrangements governing supplementary pensions	Communication (2001) 214	—	—	—	— <i>Not applicable</i> —	
42	Review corporate governance practices	Communication (2003) 284	—	—	—	— <i>Not applicable</i> —	

Source: Analysis by Office of the Comptroller and Auditor General

Note: a Main method of transposition is by statutory instrument (SI).

Appendix D Prudential return requirements at end 2006

Figure D.1 Frequency of prudential returns by sector, end 2006

Sector	Weekly	Monthly	Quarterly	Six monthly	Annual
Credit institutions		●	●		●
Insurance			○		●
Credit unions			○	○	●
Retail intermediaries					●
Mortgage intermediaries					
Insurance/reinsurance intermediaries					
Investment firms		○	○	●	●
Funds service providers			○	●	●
Stockbrokers	●	●	●		●
Moneybrokers			○	●	●
Moneylenders					●

Source: Financial Regulator

Notes: ● Applies to all service providers; ○ Applies only to some service providers

Figure D.2 Type and content of prudential returns, end 2006

Institution type	Length (pages)	Contents/issues
Credit institutions		
Monthly summary prudential ratios	1	Liquidity/solvency/Tier 1 ratios
Quarterly prudential ratios	52	Summary sheet: asset analysis, funding, capital adequacy, capital for large exposures, residential mortgages, own funds. Other schedules: underwriting, balance sheet explanation, commodities, intragroup transactions, hedging and investments. There are sections on financial analysis, prudential analysis, banking book risk, trading book risk, currency risk, summary of capital adequacy
Quarterly large exposure report	9	Reports on: banking book exposure; trading book exposure; exposures to government organisations/banks and investment firms/clients; exposure to directors and businesses in which director has a majority interest; exposures to shareholdings in which a shareholder has a majority interest.
Quarterly retail lending and deposits report	3	Lending to various business sectors by risk assets and % of total capital
Annual return	Varies	Annual accounts and their reconciliation to the prudential returns, management letter, annual positive statement from auditors, directors' declaration confirming authorisation details and advising of relevant changes during the year. Banking division form BSD-AL with background information on corporate government and business e.g. directors, committees, employees etc.
Weekly	1	Summary information from mortgage lenders on approval and drawdown data on 100% residential mortgages (since 2005)
Life insurance firms		
Quarterly returns	8	Seven forms addressing: revenue accounts; expenses analysis; asset analysis; statement of net assets, liabilities and margins; other income and expenditure; solvency
Annual return	32	Include details of claims, revenue account, new business analysis, asset analysis, employment statistics, valuation of linked and non-linked contracts, analysis of investment in property and UCITS, unit trusts, required minimum solvency. The return includes certificates by the auditors, directors and actuaries
Non-life insurance firms		
Quarterly prudential	13	Underwriting revenue account, profit and loss account, balance sheet, required minimum solvency
Annual return	25	Underwriting revenue account by business class, EU business, asset analysis, currency matching, claims settlement, profit and loss, balance sheet, employment statistics, solvency margin, reinsurance treaties, facultative reinsurance. The return includes certificates from auditors, directors and actuaries

Institution type	Length (pages)	Contents/issues
Credit unions		
Quarterly prudential	6	Income and expenditure account, balance sheet, loans analysis, savings and investment analysis, off balance sheet assets
Annual return	23	Corporate governance details, analysis of gross loans, provision for bad debts, deposits and investments, officers loans. The annual accounts include cash flow statement, auditors report to members, directors report. Management letter or letter confirming none was issued to be sent by external auditors separately
Retail intermediaries		
Semi annual return (for authorised advisors only)	Varies	Interim profit and loss, balance sheet, and statement of capital position
Annual return	Varies	Annual accounts, statement of solvency if sole trader or partnership, schedule of commissions received, schedule of payments made to authorised product intermediaries in preceding year (authorised advisors)
Fund service providers		
Quarterly return	12	Includes profit and loss, balance sheet, client money schedule, capital adequacy schedule
Semi annual return	Varies	Statement of compliance with minimum capital requirements, bank statements confirming minimum capital funding, profit and loss, balance sheet
Annual return	Varies	Statement of compliance with minimum capital requirements, bank statement confirming minimum capital funding, annual accounts, management letter incorporating service provider's response
Investment firms and stockbroking firms		
Weekly (stockbrokers)	2	Client money account balances, exposures, debtors, cashflows
Monthly	1	Schedule 4 of capital adequacy return
Quarterly	12	Capital adequacy return includes profit and loss, balance sheet, client money schedule, capital adequacy schedule
Semi annual	12	As above
Annual returns	Varies	Annual accounts, backup information for significant changes to accounts, management letter incorporating management response or confirmation that no letter issued.

Appendix E Guidance for consumers

Figure E1 Frequency of publication of cost surveys, 2004-2006

	2004				2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Personal Finance												
Personal current account		●			●		●		●			
Business current account										●		
Credit card		●		●		●		●			●	
Personal loans			●				●					●
Student current account							●				●	
Student credit card							●					
Hire purchase						●						
Car finance											●	
Stockbroker costs											●	
Insurance												
Motor insurance	●	●		●		●		●		●		●
Home insurance			●		●		●		●			
Life insurance				●		●			●			

Figure E2 Other guidance published on Financial Regulator website, at end 2006

Date	Publication
<i>Independent Consumer Guides</i>	
31 Oct 2006	Home insurance made easy
3 Aug 2006	Savings and investments made easy
1 Aug 2006	Pensions made easy
30 Mar 2006	SSIAs: your little black book
6 Jun 2006	Car insurance made easy
17 May 2006	Mortgages made easy
9 Dec 2005	Employer liability and public liability insurance for small businesses
11 Jan 2005	Independent consumer guide to life insurance
31 May 2004	Independent consumer guide to personal loans and credit
<i>Information Booklets</i>	
31 Oct 2006	Getting financial advice
22 Jun 2006	Your choices at retirement
28 Mar 2006	Managing your money
14 Dec 2004	Hire purchase agreements
8 Nov 2004	Serious illness insurance
8 Nov 2004	Income protection insurance
<i>Fact Sheets</i>	
16 Aug 2006	Information on using your money and cards on holidays
8 May 2006	Money tips for students
10 Feb 2006	Moneylenders
10 Feb 2006	Payment protection insurance
18 Jan 2006	Financial Regulator: About us
12 Dec 2005	How to make a complaint
12 Dec 2005	You and your credit rating
18 May 2005	How to open a bank or building society account
29 Nov 2004	Chip and PIN: what's it all about (on-line only)
1 Jun 2004	Fraud: how can you protect yourself (on-line only)
1 Apr 2004	Boiler rooms factsheet

Appendix F Concentration ratios in the credit and insurance markets

The Consumer Director reports annually on the extent to which competition exists among providers of financial services. Two measures are used.

- The ‘five firm’ concentration ratio measures the percentage of the market share held by the five largest firms. A concentration of 80 to 100 percent is viewed as highly concentrated.
- The Herfindahl-Hirschman index (HHI) is calculated by squaring the percentage market share of each participant and summing the results. In the HHI model, markets between 1000 and 1800 points are considered moderately concentrated and those over 1800 are considered concentrated.

Indices of Concentration in the Credit Market

Service	2000	2001	2002	2003	2004	2005
<i>Measured using the ‘five firm’ ratio</i>						
Credit cards	na	na	94	95	95	95
Term/revolving loans	77	75	74	77	78	80
Residential mortgages	66	73	73	72	68	67
Current accounts	89	87	90	89	91	88
<i>Measured using the HHI</i>						
Credit cards	2,700	2,700	2,600	2,500	2,500	2,500
Term/revolving loans	1,500	1,400	1,300	1,500	1,700	1,700
Residential mortgages	1,100	1,300	1,300	1,300	1,200	1,100
Current accounts	2,700	2,500	2,700	2,700	2,800	2,200

Source: Annual Report of Financial Regulator, 2005

Indices of Concentration in the Insurance Market

Service	2000	2001	2002	2003	2004	2005
<i>Measured using the ‘five firm’ ratio</i>						
Motor insurance	70	77	74	81	82	—
Property insurance	78	88	79	78	79	—
Liability insurance	62	66	63	64	65	—
Life insurance	65	61	70	72	75	—
<i>Measured using the HHI</i>						
Motor insurance	1,400	1,700	1,700	1,700	1,700	—
Property insurance	1,700	1,700	1,600	1,500	1,500	—
Liability insurance	1,100	1,100	1,100	1,100	1,100	—
Life insurance	1,400	1,100	1,400	1,400	1,900	—

Source: Annual Report of the Financial Regulator, 2005