IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

CONSULTATION PROCESS

Submission of Free Legal Advice Centres Ltd

Summary of the principal points contained within this submission

- The proposed new system of consumer complaints is far from transparent with a number of newly created bodies whose respective roles are not clear.

- If responsibility for enforcing the Consumer Credit Act, 1995 is to be transferred from the Director of Consumer Affairs to the Consumer Director in the ISFRA, then it should be transferred in its entirety.

- Increased resources to oversee enforcement of the CCA, 1995 and other consumer protection legislation must be provided to the Consumer Director. The expertise of the Consumer Credit section of the Director of Consumer Affairs office should be availed of and a thorough review of the CCA,1995 should be undertaken to close off loopholes.

- The Unfair Terms in Consumer Contracts Regulations should be amended to allow the Consumer Director to refer terms in financial services contracts. These powers should be effectively used to challenge unjustified penalties and default interest charges.

- The Consumer Director should have a general role of promoting good practice and providing user friendly information for consumers in the financial services area.

- The creation of a Statutory Ombudsman in the financial services area should remove the need for any Industry Ombudsman.

- The Statutory Ombudsman should have a wider remit than the current Industry Ombudsman. For example, the new Ombudsman should be able to receive complaints in relation to the refusal to provide access to credit or conversely, irresponsible lending.

- Consumers should have a direct right of access to the Ombudsman subject to a screening process encouraging resolution of complaints at company level and the possibility of referral of complaints to mediation.

- The Consumer Director should deal with complaints in relation to breaches of Consumer Protection legislation in the financial services area, the Ombudsman with complaints in relation to financial services not covered by legislation. The Director should be allowed to avail of the Ombudsman to determine statutory complaints where a prosecution might not be appropriate.

- Proposals to regulate ‘ mortgage introducers’ and to license non-deposit taking ‘mortgage lenders’ are to be welcomed.

Organisation Profile

Free Legal Advice Centres (FLAC) is a voluntary organisation campaigning for a comprehensive scheme of civil legal aid and advice. As a human rights organisation, FLAC exists to bring about law reform, in particular in the areas of social welfare, employment and debt and to secure effective and equitable access to the legal process for the socially and economically disadvantaged.

In the immediate area the subject of this submission, FLAC has worked very closely for a number of years with the Money Advice and Budgeting Service (MABS). We provide legal training in the areas of debt and consumer credit and technical legal support to money advisors working directly with indebted clients. We also provide legal advice to members of the public through our network of voluntary centres around the country and are currently finalising a comprehensive critical research study on debt and the legal system in Ireland.

1. Introduction

This submission concerns itself principally with the proposed functions of the Consumer Director (under the CBFSA of Ireland Bill) and the Financial Services Ombudsman (under the CBFSA of Ireland (No.2) Bill) and the question of enhanced consumer protection in the area of financial services.

2. Respective roles of Consumer Director and Financial Services Ombudsman

As a preliminary observation, it is noted that the acronyms and potential roles of the proposed players are somewhat confusing. On the one hand we have the CBFSAI of which the IFSRA will be part together with the existing Central Bank. Within the IFSRA there will be a Consumer Director (a remarkably similar title to the Director of Consumer Affairs who presumably will continue her watchdog role in relation to the provision of goods and non-financial services) with responsibility for enforcing consumer protection in the financial services area. Within the IFSRA part of the CBFSAI will also be located the Financial Services Ombudsman. In turn the consultation document is not clear on whether the current industry ombudsman in relation to credit institutions and insurance should continue to operate in conjunction with the Financial Ombudsman within the IFSRA or be subsumed into it. What the hapless consumer might make of this plethora of intertwining offices is anyone's guess.

Consumer complaints in relation to financial services appear to fall into two broad categories; formal complaints that are currently regulated by statute (such as alleged breaches of the information requirements of the Consumer Credit Act in relation to credit agreements) and informal complaints in relation to, for example, the maladminstration of accounts, transaction charges or ATM errors that are not amenable to a statutory remedy outside of the law of contract and currently fall to be referred to industry ombudsman where the consumer obtains sign off on their complaint from the institution concerned.

Under the first Bill, responsibility for enforcing the bulk of consumer protection legislation in the area of financial services will pass to the newly created Consumer Director. Under the second Bill, responsibility for informal complaints appears to be passing to the newly created Financial Services Ombudsman. What is far from clear is the relationship between these two offices in

terms of demarcation of duties. Head 9 of the second Bill ‘ provides for close co-operation between them’ (and the Registrar of Credit Unions for good measure) but that is all the detail that appears to be available.

3. The role of the Consumer Director in relation to statutory complaints

The Director’s role under the Consumer Credit Act, 1995

The principal piece of legislation protecting consumers availing of financial services at present is the Consumer Credit Act, 1995. It imposes a range of obligations on creditors across a spectrum of agreements including cash loans, credit sales, credit cards, hire purchase, consumer hire, moneylending and housing loans covering the advertising of credit, the form and content of agreements, communications with consumers and default notices. It also provides for the licensing or authorisation of moneylenders, credit intermediaries and mortgage intermediaries. It is a dense and complex piece of legislation that will soon need to be overhauled following the recent published proposal for a revised directive (11.9.02 – COM (2002) 443).

At present, responsibility for enforcing the CCA lies with the Director of Consumer Affairs. Her office has the power to conduct investigations and receive complaints under the act (S.4) and her office is also responsible for furthering the prosecution of all offences under S.12 of the act (with the exception of alleged offences under the moneylending part where responsibility lies with the Gardai).

Chapter 2 of the CBFSA of Ireland Bill provides for the appointment of a Consumer Director to be appointed by the other members of the regulatory authority. S.33S provides that the Consumer Director is responsible for ‘ *managing the performance and exercise of such of the functions and powers of the Bank under the enactments and statutory instruments specified in subsection (2) as the other members of the Regulatory Authority notify to the Consumer Director in writing from time to time*’. Subsection (2) includes at point (a) ‘ *the Consumer Credit Act in so far as that Act relates to the performance or exercise of functions or powers of the Bank*’.

Our understanding is that the current powers of the Director of Consumer Affairs under the Consumer Credit Act are being transferred in their entirety to the Consumer Director in the CBFSA with the exception of the authorisation and supervision of credit intermediaries and the regulation of pawnbroking (now a practically obsolete form of credit).

Why the regulation of credit intermediaries is being retained by the Director of Consumer Affairs when the rest is being transferred is a mystery. For example, many of the currently authorised credit intermediaries are garages who direct customers to finance houses in order to avail of car finance credit facilities such as Hire Purchase or Consumer Hire agreements. The advertising, documentary requirements and general conduct of these agreements will now be regulated by the new Consumer Director but the authorisation of credit intermediaries who are primarily responsible for setting up these agreements (sometimes in a very cavalier fashion with little regard for consumer rights) will remain in Consumer Affairs. What interchange of information between these two offices is envisaged to enable effective regulation of this very prolific sector to take place?

Equally, the regulation of mortgage intermediaries is being transferred to the Consumer Director but S.144(1)(b) of the Act appears to allow a mortgage intermediary to operate as a credit intermediary without an authorisation. Who will regulate the mortgage intermediary with his/her credit intermediary's hat on? Apparently, no one.

What level of resources will be provided to carry out these functions?

Despite performing a valiant watchdog role since the CCA was commenced in May, 1996 it is our view that the Consumer Credit section of the Office of Consumer Affairs has been understaffed to deal with the wide range of responsibilities it has to shoulder, resulting in an underuse of its prosecution and referral powers. As an example, how many prosecutions have been brought by the Director against errant creditors under the CCA to demonstrate a determination to enforce its provisions? Nonetheless, a very tenacious inspection role has been performed by the section and, in addition, very valuable information and support has been provided both to the public and to agencies such as the Money Advice and Budgeting Service (MABS) in relation to the obligations of creditors and the rights of consumers under the Act.

Where is this expertise to go in the new regime? To what extent will the skills and expertise acquired by this section be utilised by the new Director? What is required is a beefed up consumer credit section to ensure that creditors adhere to their obligations under the (revised) legislation, not a watered down version. However, the signs are not promising. The fact that the current administration have ignored one of the central recommendations of the McDowell report, that a regulatory authority should operate separately from the Central Bank, does not bode well given the Central Bank's track record and lack of experience in dealing with consumer issues. Equally, the composition of the Interim Board appointed to oversee the transition to the new regulatory authority gave some clue as to the relative importance attached to consumer issues; not a single member (to our knowledge) has a background or relevant experience in the consumer area.

The Irish Times (September 19th) quotes the new Chairman of the Regulatory Authority, Mr Brian Patterson, as stating that the Authority would have full responsibility for prudential and consumer protection regulation and that ' *Consumer protection had been the poor relation in the financial services for too long'*. This implies clearly that consumer protection will be significantly strengthened in the new regime.

The level of resources assigned to the Consumer Director and the number of inspections and prosecutions brought under the CCA and other consumer protection legislation will be a barometer of this commitment.

The authority might usefully begin by recommending a thorough overhaul of the CCA, 1995. It will need to be reviewed in the context of the revised consumer credit directive in any case but it should also be amended to remove some of the exemptions and circumnavigation that has taken place in the past seven years. For example, the fact that mainstream credit institutions (as defined) are exempt from the provisions of Section 47 of the Act (allowing the Circuit Court to examine the excessive cost of credit in any agreement) has permitted some institutions to overcharge consumers through strategic use of business names rather than the official institutions name, in particular in the area of credit sales and hire purchase.

The use of the Unfair Terms in Consumer Contracts Regulations, 1995

It is unclear who will now have responsibility for enforcing the Unfair Terms in Consumer Contracts Regulations, 1995 under the new regime insofar as it concerns provisions in financial services contracts. At present, only the Director of Consumer Affairs has the power to refer a term to the High Court to have its fairness tested and the list of legislation in the CBFSAI Bill transferring responsibility to the new Consumer Director does not specifically include these regulations.

To our knowledge, this power has never been exercised in the financial services area by the Director of Consumer Affairs despite the fact that the regulations set out a list of potential unfair terms that include*' requiring any consumer who fails to fulfil his obligation, to pay a disproportionately high sum in compensation'* It is arguable that this term could and should be used in relation to penalties and default interest charges in housing loans and other forms of credit agreement. It is submitted that the new Director should have this power and should use it to curb the unjustified and extortionate penalties imposed by some well known institutions.. It is also suggested that these regulations be revisited to allow a broader access for consumers and consumer groups wishing to challenge alleged unfair terms. Equally, it is suggested that the choice of the High Court as the forum of referral is too intimidating and potentially costly. Perhaps there is a role for the new Ombudsman here.

Other roles for the Consumer Director

As well as its role in receiving complaints, it is imperative that the director should have an educative role extending to the promotion of good practice in the provision of financial services, the adoption of codes of conduct in specific sectors, the publication of clear and accessible leaflets and brochures for the guidance of consumers and the conduct of research into developments in consumer financial services in other countries. Again, resources to carry out these functions will be crucial.

4. The potential role of the Financial Services Ombudsman

Should the Industry Ombudsman continue?

The consultation document envisages the incorporation of the current industry ombudsman (financial services and insurance, for example) into a statutory ombudsman as an option but it comes to no conclusion that this should happen. It is apparent at this stage that the industries themselves are campaigning to retain their Ombudsman role to run parallel with the statutory one. We cannot see the sense in this apart from the pursuit of self interest. The object of any new system should be to strengthen and simplify mechanisms of consumer complaint. Several layers of similar sounding offices are likely to confuse, especially for the unsophisticated consumer for whom making a complaint is already a major challenge.

In any case, to make a complaint currently to the Ombudsman for the Credit Institutions or the Insurance Ombudsman, a consumer must show that they have exhausted existing complaints mechanisms within the institution concerned. Are the industries seriously suggesting that if a complaint is not successfully resolved at company level, that a complaint should be made to the Industry Ombudsman followed by a complaint to the Statutory Ombudsman followed by a possible right of appeal to the courts. In our view, the establishment of a Statutory Ombudsman obviates the need for industry ones.

What mandate should the Statutory Ombudsman hold?

It is arguable that the terms of reference, for example, of the Ombudsman for the Credit Institutions are too narrow. For example, he is precluded as we understand it from querying decisions of institutions in relation to access to credit. In other words, if a credit institution in their wisdom decide to refuse an application for a loan whatever the reason, this cannot be investigated (unless it can be argued that the refusal is discriminatory under one of the grounds set out in the Equal Status Act, 2000 in which case the Director of Equality Investigations may have a role). In a society where access to credit is so vital, it is suggested that a decision to refuse credit should be objectively justified where requested. This is not to suggest that such decisions may not be commercially justifiable according to set criteria and credit bureau information. However, the credit scoring techniques of mainstream credit institutions remain somewhat of a mystery and it is possible that unsupported and unsustainable discriminatory criteria may be used. In an age of freedom of information, should this not be subject to review?

Equally, the reverse may hold true. A decision to provide access to credit when the available or accessible information would indicate that such a loan may be unduly risky should also be open to review by the Ombudsman. A common example frequently referred to in recent times is the unilateral increase by institutions of credit card limits when the potential borrower has very limited means. 92% mortgage loans, depending on the borrowers circumstances, may be another. For sure there is irresponsible borrowing but it is arguable that the credit institution with its asset base should be made to account for irresponsible lending when default occurs.

Otherwise, the Ombudsman should have the power to deal with all complaints relating to the provision of financial services to consumers (as opposed to corporate entities with which this submission is not directly concerned) except those connected with the enforcement of statutory rights within the ambit of the Consumer Director. There is always the risk of frivolous complaints being made but these should be easily detectable by the Ombudsman's staff when a formal complaint is initially made.

The point of referral to the Ombudsman

At what point can a referral be made? Must the consumer provide sign off from the institution that the consumer's complaint has not been resolved or will there be a direct right of access once a consumer is dissatisfied with a decision or procedure of the institution?

It makes sense to first attempt to resolve the complaint at company level. However, if a consumer must first get sign off that their internal complaint has not been resolved before a complaint can be made to the Ombudsman, it may add to the risk of the complaint being

frustrated through bureaucratic obstacles being put in the consumer's way. This, in turn may lead to legitimate complaints not being pursued. Perhaps, a way of resolving this may be to suggest that there be a direct right of access if the consumer so desires, subject to the Ombudsman's staff providing a screening process for complaints and referring those considered capable of company level resolution back to the institution involved for examination. Alternatively, the complaint could be referred to mediation within the Ombudsman's service as opposed to requiring a formal determination.

Ultimately, the determinations of the Ombudsman should be legally binding subject to a right of appeal on a point of law to the High Court. Legal Aid should be available for the consumer where the matter comes before the courts.

5. Relationship between the Director and the Ombudsman

In our view, the two offices can work closely together in relation to the development of a strong consumer culture in the area of financial services. However, very clear lines of demarcation between their respective roles should be in place. The Director should have a specific watchdog role in relation to consumer protection legislation in the area of financial services including a supervision, inspection and potential prosecution role as well as a general obligation to promote high standards in consumer protection and education. The Ombudsman on the other hand should deal with complaints in relation to areas not covered by specific consumer protection legislation that arise in the course of the provision of financial services.

However, it may be that in many cases where it has been established that a breach of a statutory requirement has taken place by an institution, it would not be appropriate for the Director to initiate any proceedings. In these cases the complaint could be referred by the Director to the Ombudsman for mediation or for a determination as to how the matter might be appropriately resolved. The same considerations might apply in relation to the relationship between the Registrar of Credit Unions and the Ombudsman.

6. Consultative Panels

The composition of the consumer consultative panel should reflect as widely as possible the range of organisations in Ireland working in the area of consumer interests. An obvious case in point is the Consumers Association of Ireland (CAI) but there are other organisations who represent the interests of consumers in relation to financial services. For example, the Money Advice and Budgeting Service (MABS) is working countrywide with indebted consumers on an everyday basis providing support and assistance in negotiations with creditors. Equally, voluntary organisations such as FLAC who provide legal resources to the public and to other statutory, community and voluntary groups in this area might be considered.

7. Miscellaneous issues in the Consultation document

Mortgage introducers

We would welcome the proposal in Head 50 of the second Bill to redefine 'mortgage intermediary' to include so called 'mortgage introducers' who are currently unregulated. One small suggestion in relation to the definition would be to clarify that the commission, payment, or consideration of any kind could be from either the consumer or mortgage lender as follows:

" any person, other than a mortgage lender or credit institution who in return for a commission, payment or consideration of any kind from either the consumer or the mortgage lender, arranges or offers to arrange……..

Licensing of Mortgage Lenders

It is apparent that some outfits have been involved in the provision of housing loans within the meaning of the Consumer Credit Act, 1995 who are not deposit taking institutions and claim not to be mortgage lenders as such. Moreover, such housing loans often involve the consolidation of a number of unsecured loans into one loan secured on the title deeds of property at high interest rates.

We would welcome the proposal in Head 45 of the second Bill that the IFSRA would license and lay down the conditions under which such institutions would operate, if at all.

Notes for meeting with IFSRA Head of Consumer Information re FLAC's concerns in relation to the provision of financial services

Introduction

We believe that there is a clear relationship between the provision of consumer credit and the occurrence of consumer debt. Consumer over-indebtedness is an increasing phenomenon in Irish society and the regulation of financial services needs to go beyond rules in relation to the provision of credit to also encompass reform and modernisation of the Irish legal system in relation to debt enforcement.

FLAC's recently published report 'An End Based On Means' contains a blueprint for reform of that system. IFSRA may consider that issues of indebtedness are outside its remit but we feel that credit and debt are inextricably linked and that effective monitoring of financial services must also involve monitoring how those with an inability to pay due to changes in their circumstances are treated by creditors and the State when a default occurs.

Consumer Credit Act 1995 – Excessive rates of charge

This Act was introduced in May 1996 so it has been in operation for seven years now without a review. The Consumer Credit directives upon which it is based have been due to be updated for some time now but this has not yet occurred. Seven years of practice have revealed loopholes, difficulties of interpretation and omissions and these should be addressed now rather than later. Some points to note are as follows:

Some loan companies are using their status as credit institutions (particularly under E.U Banking directives by virtue of the European Communities Act) to charge very high rates of interest more akin to moneylending rates. To briefly explain, a credit agreement is a moneylending agreement if the APR charged is in excess of 23%. However, a moneylending agreement can only take place between a moneylender as defined and a consumer and the definition of moneylender excludes credit institutions. So a credit institution charging over 23% APR is not involved in a moneylending agreement and does not require a moneylender's licence to operate.

Furthermore, Section 47 of the Act which allows a consumer to challenge excessive costs of credit in credit agreements also excludes credit institutions. This has led to a situation where some outfits defined as credit institutions, sometimes under the guise of business names of convenience, have charged rates as high as 29% APR for short term credit agreements.

Consumer Credit Act 1995 – Excessive penalty rates

There are no provisions in the 1995 Act relating to challenging default interest rates in consumer credit agreements. Finance Houses involved in car finance Hire Purchase agreements often charge 1.5% or 2% per month to consumers in default. We believe that this is akin to pouring oil on troubled waters and cannot be justified unless the costs sustained by the creditor are equivalent to the penalty imposed. The issue of penalty rates should be addressed in any review of the consumer credit legislation.

Debt Collection

With increasing amounts of consumer over-indebtedness and the resultant pressure being put on consumers to arrange repayments beyond their capacity, the role played by debt collectors on behalf of creditors has come into focus. In particular, it is apparent that representations are being made that are less than honest. For example, one debt collector in the recent past is on paper as threatening to report a consumer to the 'Nationwide Bureau for Default and Investigation' if they did not reach an acceptable payment of arrears, although to my knowledge, there is no such body. This kind of tactic is clearly designed to intimidate and is unacceptable. Credit and Mortgage intermediaries are licensed. It is our view that debt collectors should be similarly regulated.

Irresponsible Lending

Although the institutions argue that they use prudent lending criteria at all times when deciding to whom to offer credit, there is anecdotal evidence from MABS and others of credit being provided to persons who will clearly have a problem repaying either because of a low income or because they are already over extended. Insufficient credit checking or failure to verify details of income should involve a cost for the creditor in the event of default. In our view, the statutory Ombudsman should have the power to investigate the circumstances surrounding the granting of a loan and to recommend writing off a portion or all of the loan where appropriate.