



FINANCIAL REGULATOR
Rialtóir Airgeadais

Law Reform Commission Conference

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**Speech by Mary O’Dea,
Acting Chief Executive & Consumer Director, Financial Regulator**

Good morning chairperson, ladies and gentlemen...

I want to thank you for inviting me here today to talk about Financial Regulation in the context of personal debt and reforming the law in this area.

As you know, the Financial Regulator supports the change in the law to ensure that people will not face jail where they are willing but unable to repay loans to financial institutions and we engaged with the Law Reform Commission in its work in this area. In this regard we welcome the proposals announced last month in the Renewed Programme for Government aimed at helping people in debt by reforming the system of debt enforcement. These proposals, which were largely influenced by the Law Reform Commission’s consultation paper, include the creation of a new system of personal insolvency regulations allowing for a statutory non-court-based debt settlement system and a central Debt Enforcement Office to remove as many debt enforcement proceedings from the courts as possible.

I would like to congratulate the previous speaker, Paul Joyce, and his organisation, FLAC, on the publication of the important study *“To no one’s credit – the debtor’s experience of instalment and committal orders in the Irish legal system”*. We share your concerns regarding current debt

enforcement procedures in Ireland and in particular the possibility of those struggling with indebtedness being imprisoned as a result of failing to comply with a court order. In this regard we welcome the new Enforcement of Court Orders (Amendment) Act 2009, which amended the Enforcement of Court Orders Act 1940 and introduced:

- the end to the sentencing to imprisonment of a debtor in his/her absence,
- the requirement for a summons to provide information - such as the implications for the debtor, in ordinary language,
- the requirement for a judge to explain to the debtor that he or she is entitled to apply for legal aid; and
- the switch of the onus of proof to the creditor to show that the debtor's failure to pay is not because they can't pay but rather "is due to his or her wilful refusal or culpable neglect".

In an economic environment where many people have been hit by job losses, shorter working hours or other changes in their circumstances, and are no longer able to meet repayments on the loans they took out in better times, it is important that we work together to find solutions, especially solutions that will help people to stay in their family homes.

Earlier this year the Financial Regulator examined new and proposed measures that were under consideration or introduced in other countries such as the United States and the United Kingdom to help home owners who are in difficulties. While introducing such measures here is outside our direct remit, we have suggested that these schemes could be used as a background for developing the most appropriate or best fit solutions for Irish homeowners and the Irish market. We are ready to play our part in assisting to develop appropriate solutions.

Code of Conduct on Mortgage Arrears

Earlier this year, as the economic environment deteriorated, we introduced a statutory Mortgage Arrears Code to protect consumers of all mortgage lenders including those known as "sub-prime" lenders who found themselves in difficulties. While this Code has been criticised, and I accept it is not a panacea alone for all the issues now in the mortgage

market, it was introduced quickly to put immediate protections in place for people who were in trouble. I would like to explain some elements of this new Code before I respond to the criticisms.

As you all know any decision by a lender to make a loan must be based on the best assessment *at a point in time* of whether that particular consumer can afford the loan. That is required under our statutory Consumer Protection Code. It is, however, very difficult to predict future events that will affect an individual consumer. Changes in circumstances, such as losing a job, family issues or other life events may make it impossible to make the repayments on a loan that was once affordable. Sudden or serious changes in circumstances can very quickly leave a consumer over-indebted.

The Financial Regulator considers that responsible lending behaviour goes beyond the point of sale, particularly in the case of mortgages where the lender and the consumer enter into a long-term relationship. Additional lender responsibilities will arise if the consumer is faced with difficulties in meeting his/her repayments. In such circumstances it is the responsibility of the lender to engage with the consumer to address his/her arrears difficulties and try to come to an arrangement to overcome these difficulties. In our statutory Consumer Protection Code, introduced in 2007, we required lenders to inform a consumer when his/her account goes into arrears and to have in place a procedure for handling mortgage arrears.

As the mortgage landscape deteriorated for consumers in recent times, the Irish Government and the Financial Regulator felt that additional requirements had to be put in place to protect consumers by encouraging responsible behaviour by lenders seeking to repossess principal private residences.

In February 2009, the Financial Regulator put a previous industry voluntary code on Mortgage Arrears on a statutory footing, amended some of the provisions and extended it to all lenders in the market including the new regulated retail credit firms. This new statutory Code

includes a requirement that a lender must not commence enforcement of legal action on repossession of a borrower's primary residence until at least six months from the time arrears first arose. This timeframe has been extended to 12 months by the Government for recapitalised banks.

The Code increases protections for consumers experiencing difficulties in meeting their mortgage payments and comes into effect as soon as the first mortgage repayment is missed.

The main provisions of the Code require lenders to:

- communicate promptly and clearly with the borrower as soon as an arrears situation develops,
- handle genuine arrears cases positively and sympathetically,
- take into consideration the borrower's overall indebtedness in establishing his/her ability to repay. This should include full details of household income and expenditure, as advised by the borrower,
- explore various alternative repayment measures with the borrower,
- refer the borrower to the local Money Advice and Budgeting Service or alternative, where appropriate,
- desist from issuing a formal demand for the full amount due or for possession unless three repayments have been missed.

We require lenders to be flexible in their dealings with consumers in mortgage arrears. Even when legal proceedings have begun, lenders must endeavour to maintain contact with the consumer and, if an agreement can be reached, the lender must enter into repayment arrangements and put the legal proceedings on hold.

We believe this statutory Code is critical in our current environment. But there has been criticism that it does not go far enough and we welcome suggestions for improving the protections for consumers. We are preparing to review the Consumer Protection Code and we will also review the Code of Conduct on Mortgage Arrears in due course. We will consider carefully all the suggestions and issues raised to improve protections for consumers and we will make amendments where appropriate. We are currently carrying out an onsite inspection of arrears procedures and

policies and we will publish our findings which will also feed into our policies in this area.

One criticism of the Code was that it does not expressly require the regulated lender to engage constructively with a borrower, who though not actually in arrears, is aware that they are in danger of falling into arrears. I noted the suggestion in the Law Reform Commission consultation paper on Personal Debt Management and Debt Enforcement that the extension of the Code to ensure fair treatment of debtors in situations where an imminent default has not yet occurred should be considered.

Of course responsible lenders should always engage constructively with their customers, and, it is in their interests to engage where a customer brings a problem to their attention. In this regard we see as a positive development the recent statement of intent from the Irish Banking Federation whereby its members will not seek to initiate legal proceedings even after the statutory limits set out in our Code expire provided that the borrower positively engages with the lender and agrees a repayment plan which can be reviewed every 6 months. And our statutory Consumer Protection Code requires regulated firms to act honestly, fairly and professionally in the best interests of its customers and the integrity of the market.

I would like to let you know here today that the Financial Regulator has written to all lenders stating our expectations that not only should they deal with someone fairly when they are actually in arrears, but also when a borrower proactively seeks to move to prevent an arrears problem. We have made it clear that this is what we expect from regulated firms. In addition, we will re-examine this issue when we review the Code.

We noted the suggestion in your consultation paper that we should consider, in our review of the Code, the strengthening of the provision with regard to money advice for debtors in arrears by obliging mortgage lenders to refer them in all cases to money advisers. We strongly agree that referral for money advice at the earliest opportunity can prevent

unnecessary legal proceedings. We believe our Code has set a precedent and lenders will refer debtors in arrears on their mortgage for guidance to his/her local MABS service or appropriate alternative. We note the criticism of our wording regarding referral, which called for referral "where the circumstances warrant it".

I want to state clearly here that in circumstances where there are ongoing difficulties with repayment, and, in particular, if legal action is imminent, a referral to MABS is warranted and essential. No lender could reasonably claim that a case when a debtor faced court proceedings did not warrant a referral for money advice. However, we are of the view that there are circumstances where such a referral may not be warranted, such as when the consumer and the financial institution may be in a position to resolve the matter by agreement. However, we will, as I said, consider this area again in our review.

Additional Measures to Assist Consumers in Mortgage Arrears

In the current difficult economic environment, much more than a review of the Code on Mortgage Arrears is required. The repercussions of the recession mean that many consumers are facing or are already in changed circumstances, including unmanageable mortgage debt and the threat of repossession of their homes.

As I have already said, we are monitoring initiatives in other jurisdictions and earlier this year we wrote to the Department of Finance to highlight two schemes introduced by the UK and US Governments to assist mortgage holders facing difficulties through the provision of financial aid or guarantees. Generally, these schemes are aimed at helping mortgage holders retain their principal private residence and include a range of conditions like:

- limits on the size of the mortgage,
- borrowers must have sufficient income to meet new mortgage payments,
- requirements that mortgage holders receive debt counselling,

- trial periods at a new payment level before it is set for a longer period, and,
- protection for lenders against further falls in property values.

The options are generally limited to mortgage holders who can show that their incomes have fallen as a result of the current crisis to such an extent that they are in default or at high risk of default. While such policy options are outside the remit of the Financial Regulator and are a matter for decision by Government, we have suggested that these schemes could be examined to help develop appropriate measures to assist Irish mortgage holders.

In this regard we welcome the Government proposals announced in the recently published Renewed Programme for Government 10th October 2009 to *“introduce new measures to protect families having difficulties with their home mortgage payments”* with a view to expanding the options available for dealing with debt situations including *“reducing rates, the bank taking equity in the house, the bank taking ownership and leasing back to the resident with rent payments coming off the loan”* and that *“the Government will examine ways of expanding its own mortgage-support measures with reference to measures adopted in other jurisdictions”*.

We also support the recently agreed *IBF-MABS Operational Protocol – Working Together to Manage Debt* which was developed jointly by the IBF and MABS to help consumers manage all forms of debt, not just mortgage debt. The protocol enables IBF creditors and MABS advisers to work together to formulate sustainable plans to address a consumer’s debt difficulties.

However, in developing public policy on mortgage arrears, the risks of imposing a statutory bar to prohibit a mortgage lender from enforcing the security they hold against their lending must also be taken into account. This could undermine the concept of a mortgage and cause sharp downgrades in credit ratings for related mortgage backed securities which in turn could lead to higher costs for all consumers. A balance must be

struck which recognises the difficulties faced by consumers, particularly in current circumstances, and the legitimate rights of lenders where the borrowers refuses to engage with their lender to repay their debts.

Personal debt extends of course beyond mortgage debt and I would like to comment on other areas of lending and other possible changes that could be made to improve consumer protection. But before I do so I would like to set the scene by outlining some of the measures the Financial Regulator has put in place to protect and inform consumers in relation to the sale of financial services, including loans, and our ongoing work in this area:

Consumer Protection Code

Following our establishment we introduced a common set of conduct of business requirements to apply to all regulated firms in the form of a statutory Consumer Protection Code that became fully effective in July 2007. The aims of the Code are to ensure that:

- firms act in the best interests of the customer,
- consumers are given the information they need to make informed choices, and
- consumers are sold suitable products.

The protections of the Code apply to ordinary retail consumers and small businesses.

The General Principles of the Code require firms to:

- Act honestly, fairly and professionally in the best interests of its customers and the integrity of the market;
- Make full disclosure of all relevant material information, including all charges, in a way that seeks to inform the customer; and
- Not exert undue pressure or undue influence on a customer.

In relation to lending, the Code requires that:

- All loans offered to customers must be suitable for the individual customer – this would include an assessment of affordability. Furthermore, the firm must be able to demonstrate that the loan it

offered was, in fact, suitable on the basis of the borrower's circumstances.

- The firm must also give the consumer a written statement of the reasons why the product(s) offered is suitable for that consumer.
- Offers to consolidate several loans into one must contain information on the extra cost involved.
- Offering pre-approved unsolicited credit is banned.
- Unsolicited increases in credit card limits are also banned - prior to the introduction of these measures an examination by the Financial Regulator found that the average number of limit increases processed automatically by credit card providers was 42,000 a month.

These are important protections for consumers who can take a complaint to the Financial Services Ombudsman if they cannot resolve their issue directly with the firm. Conscious that not all lenders were subject to our regulation, we called for a change in legislation to bring non-deposit taking mortgage lenders under our remit. As a result of this change in the law in 2008, non-deposit taking lenders, now called Retail Credit Firms which include so-called sub-prime lenders, must now comply with the Consumer Protection Code.

Consumer Protection Code for Licensed Moneylenders

In January of this year we introduced the general principles of the consumer protection code for licensed moneylenders, aimed at protecting their customers. The remaining provisions of the code came into effect in September. Licensed moneylenders often operate in a market where mainstream lenders do not, with many offering a very personal service and advancing small amounts of money for relatively short periods of time. While the funds they offer are usually expensive, some consumers value the particular niche service.

Under this Code, licensed moneylenders are now subject to many of the same provisions as other credit providers, which ensures greater

consumer protection in this sector. The code introduced some new measures which are unique to moneylenders:

- moneylenders are required to assist consumers in understanding the product including the actual repayment cost of every €100 borrowed.
- moneylenders are required to prominently disclose the high-cost nature of certain loans on all loan documentation, prior to entering into an agreement with a consumer.
- Furthermore, moneylenders are required to provide information on debt counselling services to consumers who demonstrate ongoing problems meeting their financial obligations.

Many of the requirements contained in the Consumer Protection Code in relation to disclosure, suitability, complaints handling, consumer records etc. have been included in the Consumer Protection Code for Licensed Moneylenders. This market is complicated by the presence of unlicensed or illegal moneylenders - whose customers have no protection. Illegal moneylending is a criminal matter which should be reported to the Garda. The Financial Regulator has no powers to take action against illegal moneylenders.

Redress options for Consumers:

If a consumer feels that they were given an “unsuitable” loan, they must firstly make a complaint to the relevant financial institution, who is required under the Code to have a complaints handling procedure in place.

If anyone is dissatisfied with the outcome of their complaint, they can take their complaint to the Financial Services Ombudsman. In adjudicating on complaints and considering appropriate restitution, the Ombudsman takes the provisions of both Codes into account.

Where the requirements of the Codes are breached, the firm may be subject to our Administrative Sanctions Procedures.

Debt Collection

There has been much recent discussion on the role played by debt collection agencies and whether legislation should be enacted to regulate these service providers. I note the suggestions in your consultation paper that a new regulatory regime supervised by the Financial Regulator should be put in place and, also, the proposal in the Renewed Programme for Government that debt collection agencies be regulated. The Financial Regulator agrees that debt collection agencies should be regulated.

Debt recovery services apply across a significantly wider range of activities than the recovery of money for financial products, for example for utilities, other consumer debts and also debts between businesses. As you know the law at present does not provide for debt collection firms to be regulated by any agency.

Preliminary enquiries made by the Financial Regulator suggest that most of the lending firms we regulate do not assign or sell on consumer debt. However, regulated lenders often outsource debt collection services. In such cases the lender must ensure that person contracted to collect the debt must comply with requirements of our Code. This means that the outsourced activity should uphold principles in the Code such as the requirement for firms to:

- act honestly, fairly and professionally in the best interests of customers and to act with due skill, care and diligence,
- preserve a consumer's rights, i.e., a regulated entity must not seek to exclude or restrict any legal liability or duty of care or any other duty in any agreement with a consumer,
- personal visits or phonecalls are prohibited except in certain circumstances.

Debt Advisers:

I agree with the Law Reform Commission recommendation that we should regulate debt advice services for the following reasons:

- to ensure consistency in the standards of the services provided;
- to reduce the risk of conflicts of interest;
- because Ireland is currently out of line with European standards in this area and this needs to be rectified;
- because the European Commission has recommended that in order that over-committed consumers receive consistently high quality advice and assistance, there should be systems in place for regulation and to ensure quality standards”

A Responsible Lending Test:

I would like to comment on the recommendation in the Law Reform Commission consultation paper with regard to the consideration of a possible “responsible lending” test as part of the licensing process for credit institutions.

While a specific test for “responsible lending” is not part of the current authorisation process, this process is aimed at ensuring that applicant firms have the proper resources, including appropriate expertise, business plans, systems, processes and controls to operate effectively and the suitable corporate governance structure to guide, monitor and control behaviour. It is important to note that at the authorisation stage, credit institutions undertake to comply with the Consumer Protection Code which, as I have already outlined, requires lenders to ensure that any loans offered to consumers are suitable for the individual customer.

We think it would be very difficult to clearly define “responsible lending” for inclusion as a test at the authorisation stage in that so called “irresponsible lending” may only become apparent in the light of subsequent events.

This is a complex issue and it is important in the first instance to define what we mean by responsible lending. An obvious example of

irresponsible lending would be the subprime lending in the US. But a situation where a mortgage holder is in trouble because of a fall in income and negative equity cannot be attributed to irresponsible lending and there are a range of circumstances in between these extremes.

While I think it could be very difficult to devise a workable test of “responsible lending” at the authorisation stage, the Code provision on “suitable” lending is a clear and enforceable requirement on credit institutions to act responsibly towards their customers.

At the moment, we can and do examine lending activity after authorisation when a firm is in operation and must comply with prudential requirements and with the Consumer Protection Code requirements with regard to suitability and affordability in assessing loan applications. And in the current, more intensive regulatory environment, particular attention is being paid to this area.

Debt and Access

The issue of credit and debt for low income consumers is, of course, linked to the issue of access to financial services and the Financial Regulator has been active in advocating for access for consumers. Access to credit is a more complex area. We require all lenders to act in the interests of their customers and to sell suitable products. In the new environment of less credit and tightened credit requirements, this means that in some cases a consumer’s application for credit will be refused. Equally, it is clear the borrowing will not always be the answer to a consumer’s money problems.

Information and advocacy:

In addition to the measures I have outlined, debt has been, and continues to be, the focus of many of our consumer campaigns. We have regularly highlighted the cost of credit for consumers and the risks associated with borrowing money. We have informed consumers about more expensive forms of debt, like credit cards and overdrafts and the issues associated with these forms of borrowing. We consistently highlight issues like affordability, comparing alternative options and considering the total cost of credit. We have also encouraged consumers to exercise their power and

move if they are paying more than they have to, or are not getting a deal that suits their changing circumstances. Our cost comparisons show significant variance in costs for the same products, for example the interest on credit cards currently ranges from 8.5% to 17.9%.

Our information campaigns have informed consumers about appropriate forms of credit. Personal loans are the cheapest form of credit, but people who use their credit card sometimes believe that the debt will be short term whereas in reality they carry the debt over a longer term. Forms of revolving credit, such as overdrafts can also pose problems - especially where consumers incur charges for unauthorised overdrafts. These charges can be significant, for example, an interest surcharge can be charged on top of the standard rate for overdrafts, which already vary from 5% up to 14.79%. We have a range of information and tools to help people to budget and so as to avoid and/or manage debt. We give consumers the information they need about alternative forms of credit, to help them to plan ahead to avoid potential debt problems and to get a better deal when they need and can afford credit.

Financial Capability:

Our recent financial capability study found that 6 out of every 10 people have no non-mortgage debt. But we found that those with the highest levels¹ of non-mortgage debt account for approx 11% of the population and are more likely to be between the ages of 20 and 40. We are targeting these consumers with our information campaigns and are currently dealing with over 2,600 a month who have various queries on personal finance issues.

Our most recent research on personal debt found that 9 per cent of respondents were in serious trouble with their debts while a further 8 per cent had missed some repayments. Some 22 per cent had no debt, 21 per cent were managing to make all their repayments and some 40% were making their repayments but money was tight. [Sept 09]

¹ total outstanding debt is over 300% of monthly income

Many people have been hit badly by the downturn; no one is immune whether through reduced income, job loss or financial worries. An unfortunate outcome of the downturn is that consumers may find it harder and more expensive to purchase financial products. But even within this new environment, customers can still inform themselves about the various types of loans and the costs and risks involved and our information helps them do this.

While the focus of our current attention is quite rightly on prudential supervision, we believe it is critically important that the current level of consumer regulation is maintained. We cannot and will not neglect the important function of consumer protection, including the prevention of mis-selling. The restructuring of financial regulation must include comprehensive consumer protection regulations coupled with strong enforcement powers.

The Role of the Financial Regulator in Crisis:

Since we were set up in 2003 we have taken strong action within our remit to protect the consumers of financial services, and, I have outlined earlier some of the more important measures we have taken with regard to personal lending and borrowing. These measures include the introduction of our Consumer Protection Code, which set requirements that the firms we regulate must meet when they lend to consumers, the Mortgage Arrears Code and our regular communications with lenders.

Our strategic approach to regulation was framed in a much more benign environment and, now, with the benefit of hindsight we can say that we should have done things differently and could have taken earlier and stronger action to dampen credit growth.

Against a backdrop of historically low mortgage interest rates by Irish standards, high levels of competition in the lending market between both domestic and new foreign entrants into the market, with national and EU policies focussed on opening up the internal market to even more competition and tax advantaged construction, it is questionable whether the Financial Regulator alone could have materially prevented the growth of the property bubble.

Nevertheless, earlier and stronger action by the Financial Regulator would certainly have dampened credit growth.

Recently the Irish Banking Federation has argued that the supervision of banks was weakened by the setting up of the Financial Regulator in 2003. It maintained that too great an emphasis was placed on giving personal finance advice to consumers while monitoring the health of the banks was too low on the agenda. It is, quite frankly, extraordinary to hear the banking industry's representative body criticise our role in empowering consumers and helping them to protect themselves in an environment where this was deemed necessary because of poor sales and other practices by some in the banking industry.

The Banking Federation appears to believe that ceasing our consumer information activities would in some way have allowed us to prevent the banks from engaging in bad lending practices. This logic is clearly flawed! The IBF seems to have already forgotten the reasons why a strong statutory consumer information role was included when the Financial Regulator was set up in 2003. This was because of bad sales practices at banks. This issue is not about regulating sales practices or solvency or providing information to consumers. Rather the issue is about how to create an environment where all these elements are appropriately addressed.

Financial regulation is being strengthened worldwide in response to the financial crisis. The system of regulation in Ireland is being restructured as we build on the lessons from past events and regulation is now more intensive than it was in the past. Regulators must work to win back confidence in the regulatory system. But in rebuilding confidence in the financial system, financial institutions must also learn from their mistakes and change behaviours. For example, boards and management of these institutions, who are now heavily supported by taxpayers, must ask serious questions of themselves regarding how they conduct their businesses under such headings as governance, risk management, capital allocation, compensation incentives and the long-term strategic direction of their businesses.

Banks must now go to great lengths to win back the trust of their customers. This is not an easy task and actions will speak louder than words. Customers need to see a reformed banking system, with a sustainable model of banking.

Conclusion

Finding solutions to the debt difficulties affecting many consumers will not be easy. The Financial Regulator and the Central Bank will play its part in protecting consumers and we welcome suggestions for improvements in the measures we can put in place for consumers.

However, in the current difficult environment, we would welcome and fully support an overarching public policy initiative in this area that could draw together the relevant agencies and consider possible measures, including the recommendations in the Law Reform Commission consultation paper, to find good solutions that will work for people who are genuinely trying to address their debt problems.

I would like to once again compliment the LRC for its timely work in this area and to assure you that we will seek to progress the recommendations relevant to us in a way that leads to a better outcome.

Ends