



The Competition Authority
An tÚdarás Iomaíochta



**Submission to the Department of Finance
Financial Services Legislation: Consultation
on Consolidation and Simplification Bill**

Submission S/04/007

December 2004

Introduction and Summary

1. The Competition Authority welcomes the overall objectives outlined in the Minister for Finance's consultation on the forthcoming financial services legislation. The pursuit of these objectives will promote effective and appropriate regulation of financial services.
2. This move to consolidate and simplify existing legislation governing the regulation of financial services is very welcome. With the introduction of the Euro and a new financial services regulator, Ireland's financial services landscape has changed significantly in recent years. The legislative landscape has been similarly altered and expanded in response to these changes, and any simplification of this area would be timely and beneficial for all stakeholders.
3. The Competition Authority is currently in the closing stages of two large-scale studies relating to the regulation of financial services:
 - The Authority's own final report on *Competition Issues in the Non-Life Insurance Market (with particular reference to motor, employers' liability and public liability insurance)* is due to be published in the New Year.¹ The report will be based on extensive research into these areas of insurance, some of which was published in three separate reports to the Authority by independent consultants in February 2004.² Though none of these reports identified any legislative deficiencies, they do highlight the generic nature of many issues which appear across a range of financial services markets.
 - The Competition Authority has received a report and recommendations regarding competition in the provision of banking services in Ireland, carried out by LECG, consultants to the Authority. Working with issues identified by the Authority, LECG has completed a detailed and important piece of work, which is intended to inform policy-makers and consumers alike. This Report represents the most substantial part of The Competition Authority's *Study of Competition in the Provision of Non-investment Banking Services in Ireland*. It will be published on 14th December 2004; the Authority intends to produce its own report and recommendations in the first part of 2005.

The Authority would be pleased to discuss any implications for the Minister's consolidation and simplification of financial services legislation arising from these two reports.

4. The remainder of this submission will address the general question of how the burden on regulated entities might be minimised while ensuring effective prudential regulation and consumer protection. In particular, we show why the Bill should lay down general regulatory principles rather than retaining the present sectoral rules approach. Such a pragmatic approach will allow a targeted and flexible response to changes in the financial service industry, and ensure an appropriate balance between legislative provisions and direct regulation. We also outline the options open to a regulator charged with ensuring that consumers are protected, and address the conflicts which may arise between consumer protection and financial stability goals.

1 This study is being conducted jointly with the Department of Enterprise, Trade and Employment.

2 See the Authority's website www.tca.ie/insurance for more information.

Better Regulation and its Benefits

5. The new legislation on financial services aims to ensure both consumer protection and financial stability. The objective of consumer protection is to enable consumers to make informed and reasoned choices. The objective of financial stability is to protect both consumers and the industry against “systemic risk”, that is, the risk associated with loss of confidence in the entire financial sector following the bankruptcy of one institution.

Better Regulation

6. One of the key objectives of the new legislation, set out in the Minister’s consultation, is to conform to the Government’s *Regulating Better* White Paper.³ The *Regulating Better* principles are: necessity, effectiveness, proportionality, transparency, consistency and accountability. Following the principles of *Regulating Better* in prescribing tasks to the Financial Services Regulatory Authority will enable the Minister to achieve all objectives in relation to the regulation of financial services.
 - (a) Legislative provisions that are proven to achieve a clearly defined objective, which no other instrument can achieve in a less costly fashion, i.e. provisions that are necessary and effective, are likely also to achieve an appropriate balance between primary legislation and more detailed regulatory requirements.
 - (b) The principle of proportionality guards against overly-burdensome regulation.
 - (c) A transparent, consistent and accountable system of regulation will facilitate the international competitiveness of the Irish financial services sector and comply with our EU obligations.

Principles-based Regulation

7. Legislation which lays down general regulatory principles, to be implemented by a regulator which operates in a transparent, consistent and accountable manner, is more likely to fulfil the *Regulating Better* principles, and the Minister’s objectives, than the present sector-based rules approach, for a number of reasons.
8. First, it is easier for unethical persons to get around the particular form of regulatory rules than the substance of the high level principles they seek to enforce. Rules can be bent, but well-defined principles are unyielding.
9. Second, the objectives of a number of regulatory interventions are not sector specific. For example, requirements and activities promoting price transparency (whether in relation to financial products or the services of intermediaries) are not specific to one particular sector, e.g. requiring the current interest rate to be printed on regular account statements should be applicable to all interest-bearing financial products.

³ <http://www.betterregulation.ie/index.asp?locID=22&docID=-1>

10. Third, regulation needs to be targeted and flexible to respond to new products, or innovation in the distribution of financial products. This is difficult to achieve if legislation defines what is and is not allowed, on a sectoral basis.
11. A principles-based approach does not imply that there would be *no* hard and fast rules applied to the financial services sector; rather it ensures that there is certainty regarding what the legislation is designed to achieve (which aids the regulator and the courts in their work) and that prescriptive rules are used only where they actually provide certainty in a less burdensome manner. For example, a principle of prudential regulation may be enforced through a detailed case-by-case examination by the regulator of each entity's books or hard rules regarding certain ratios – the latter “one-size fits all” may be less flexible and adaptable to different types of financial service provider (with the ensuing costs) but it may be less onerous in terms of time and resources spent dealing with the regulator – on balance a hard rule may be preferable to all. The important point is that clear, consistent and unambiguous principles should be defined so that they may provide sufficient guidance to set rules. Rules may then be applied where they are necessary, effective and proportionate.

Regulatory Impact Assessment

12. To implement the *Regulating Better* principles, all possible State interventions have to be considered. Regulatory Impact Analysis is a practical way to ensure the selection of the most effective, yet proportionate, regulatory instrument.
13. Regulatory Impact Analysis (RIA) provides a methodology for measuring the proportionality of the cost of compliance and enforcement, compared to the importance of the regulatory instrument. Provided that the regulation is necessary and effective, the regulatory burden should be kept to a minimum to reduce its cost to financial service providers – a cost, ultimately, borne by the consumers of financial services.
14. Any changes to the current system which the Minister may consider in the light of this consultation exercise should therefore be subject to RIA in advance of implementation.
15. Cost effective and proportionate regulation will create a market where firms' performances are determined by their ability to offer their customers, both in Ireland and further afield, a wide range of products at a competitive price. Ultimately, such a regulatory environment will boost the reputation of the Irish financial sector and ensure its long-term competitiveness.

Consumer Protection

16. Regarding consumer protection, there are two types of regulatory intervention:
- (a) **Ex-ante regulation** involves self-regulation⁴ or regulation containing pre-emptive provisions such as detailed codes, compulsory registration systems, compulsory disclosure of information regarding prices, bans on misleading advertising, etc.
 - (b) **Ex-post regulation** involves the provision of redress for consumers and the punishment of suppliers indulging in outlawed practices either through the consumer's right to seek private redress and/or public enforcement of the regulations.

In addition, these interventions should be complemented by wider advocacy of consumer interest to promote awareness of consumers' rights and how to exercise them.⁵

17. *Ex-ante* regulatory intervention too often results in unnecessarily high barriers to entering a market and a dampening of rivalry between suppliers. For example, excessive educational qualification requirements can lead to a shortage of suitable providers of a service. *Ex-post* measures, supplemented with enforcement by a public body, are more targeted regulatory instruments.⁶ In the UK, the consumer protection provisions of the Enterprise Act, 2002 promote the latter approach.⁷ Principles-based legislation would facilitate the adoption of an appropriate balance of *ex-ante* and *ex-post* regulatory intervention in evolving market places. That is, principles based legislation would allow IFSRA to achieve an appropriate balance between *ex-ante* registration systems etc. and *ex-post* punishment of suppliers for each area under its remit.

Mitigating Conflicts with Prudential Regulation

18. The pursuit of financial stability may result in provisions that inhibit competition, and thus have negative effects on consumers, where regulation becomes overly-focussed on protecting the profitability of financial institutions. Subjecting both consumer protection regulation and financial stability regulation to the proportionality test will limit instances where requirements relating to financial stability unduly restrict entry into, or rivalry within, markets for financial services.
19. To mitigate further potential conflicts between financial stability and consumer protection, consumer protection regulation should be formulated and enforced independently of other considerations, as prudential regulation instruments should be sufficient to maintain financial stability.

⁴ Self-regulation should be "competition proofed" to ensure that the regulation does not restrict entry or rivalry in the market.

⁵ Vickers J. (2003) "The new way ahead for consumer policy enforcement"–.

⁶ A good paper on the respective role of *ex-ante* regulation and *ex-post* regulation is Fletcher A. (2004) "The liberal profession – Getting the regulatory balance right"

⁷ Office of Fair Trading (2002), "Enforcement of consumer protection legislation"
<http://www.crw.gov.uk/resources/EA02%20Part%208%20Guidance.pdf>