Retail Banking Review

Submission to Department of Finance

Public Consultation

8 July 2022

Coimisiún um Iomaíocht agus Cosaint Tomhaltóirí

Competition and Consumer Protection Commission

Introduction

The Competition and Consumer Protection Commission (CCPC) welcomes the opportunity to respond to the Department of Finance's Retail Banking Review Public Consultation (the Consultation). The CCPC acknowledges the vital role the retail banking sector[1] plays in supporting economic development and growth in Ireland. Where a well-functioning banking system can assist households and businesses to meet their financial, economic and social needs, a poorly functioning banking system can negatively impact on costs within the economy at a broader level, curbing economic growth and social development.

Under s.10 (1) of the Competition and Consumer Protection Act 2014, the CCPC has a statutory function to promote competition and to promote and protect the interests and welfare of consumers. The CCPC has specific functions to provide information on financial services, including the associated risks and benefits, and to promote the development of financial education and capability[2]. The CCPC's response to the Consultation reflects this mandate.

In providing a response, the CCPC has considered the themes arising in the Retail Banking Review Dialogue hosted by the Department of Finance on 16 May 2022 (the Dialogue) and the comprehensive nature of the terms of reference for the Retail Banking Review. The CCPC notes the focus on competition, consumer protection and financial literacy during the Dialogue.

The CCPC is concerned by the impending increase in the concentration levels of the retail banking sector in Ireland as a result of the exits of KBC and Ulster Bank. While there has been entry at product level (e.g. mortgages and business lending) much of this is provided by non-bank lenders. The CCPC notes that there has been no entry into the market by a 'full service' provider and there are no indications that such entry is likely in the near future. This situation risks leaving certain consumer and business segments with little choice for a range of products. The CCPC notes that these exits will leave only three 'full service' or 'universal' banks in the market for consumers, and just two for businesses. This compares poorly as against other EU Member States and Ireland will be unique in having

[1] For the purpose of this response, 'retail banking sector' has the meaning given to it in the Consultation Paper.

[2] s.10 (3) (j) (i) to (ii) of the Competition and Consumer Protection Act 2014

such a low level of choice. It will therefore be vital that public policy and regulation can ensure that new entry into Ireland is facilitated and competition is effective. The CCPC is of the view that this can be done in a way that is consistent with ensuring strong prudential oversight and a high level of consumer protection.

The CCPC has made the following recommendations in this response to promote competition and the consumer interest, as set out in more detail below:

1. The Retail Banking Review should provide for a full review of the impact of higher concentration in the banking sector on consumers and MSMEs. This should be benchmarked against the international experience with full service banking.

2. The CCPC recommends:

    I. amending the mandate of the Central Bank of Ireland (the Central Bank) to include competition objectives,

    II. that the revised Consumer Protection Code should set out the Central Bank's approach to promoting fair competition in financial services,

    III. that a Regulatory Sandbox is established by the Central Bank to complement its existing Innovation Hub and to promote a well supervised approach to promoting innovation in financial services.

3. In order to promote new entry and to facilitate firms in matching their business models to the regulatory requirements in Ireland, the Central Bank should introduce a guidance note for fintechs seeking authorisation. This could be modelled on the guidance for fintechs provided by the European Central Bank.

4. Action measures identified in the *Ireland for Finance* Action Plans to further develop Ireland's international financial services sector should be broadened to include consideration of the domestic financial services market.

5. Regulation governing the Credit Union sector should be reviewed and in such a review full consideration be given, along with other relevant factors, to the

competition benefits to the retail banking sector of credit unions broadening their current product offerings.

6. An evaluation of the operation of the Bank Switching Code should be conducted to inform the forthcoming review of the Consumer Protection Code by the Central Bank.

7. The Government should engage at an early stage with the proposal for a European Digital Identity Wallet to ensure that it is designed to maximise consumer engagement in these markets while ensuring consumer protection, including data privacy.

8. The CCPC recommends that a review of the use of ‘suspended possession’ orders by the Courts be conducted as difficulties in enforcing the security of mortgage debt have been cited as a potential barrier to entry.

9. Measures to improve levels of financial literacy among SMEs, with a particular focus on MSMEs, should be prioritised as part of the ongoing work of the SME Taskforce.

10. Consideration should be given to identifying innovative options to address MSME need for relationship management in light of the reduced number of banks in Ireland.

11. The Central Bank should examine the loyalty costs arising from consumers rolling over onto higher mortgage interest rates at the expiry of a fixed term and identify measures to address this in the revised Consumer Protection Code.

12. The Government should develop a National Strategy for Financial Education and Inclusion. Such a Strategy should be led by a Government Department to ensure coordination between the various agencies with a role in supporting the development of financial literacy and education. A National Strategy should be designed to promote financial inclusion as well as broader financial education outputs.

13. The CCPC recommends that the Central Bank include consideration of the risks of digital financial exclusion as part of the review of the Consumer Protection Code.

14. The Department of Finance should consider the market impact and potential competition issues that may arise from the establishment of banking hubs.

Competition

Introduction

Competition works well in the banking sector when rival financial service providers vigorously compete to retain their existing customers and to win new customers by offering innovative products, competitive prices, and better service.

As identified in the Consultation, since the global financial crisis a number of withdrawals, mergers and acquisitions within the retail banking sector have resulted in greater concentration in retail banking services in Ireland. The announced withdrawals of KBC and Ulster Bank from the Irish banking market in 2022 will have the effect of reducing the number of retail banks with physical branch networks in Ireland to three. The CCPC notes that there has been recent entry into the retail bank market represented by Bunq, a fintech provider. There has been consolidation in the EU banking market since the global financial crisis, and it is anticipated that the Irish market will in the short term at least, become significantly more concentrated due to the acquisition of business by the remaining banks from those exiting the market.

The CCPC notes that the Terms of Reference for the Retail Banking Review mandate the Department of Finance to prepare a report which will address the size and structure of the retail banking sector in Ireland and best/recent practices in other open economies in the EU and OECD which are of similar size[3]. The CCPC recommends that, to the extent not already planned, this section of the report include a comparison of the number of full-service retail banks operating in Ireland against the number operating in other similar sized economies, in order to establish a benchmark of the level of concentration in the Irish retail banking sector relative to comparable economies.

The CCPC further recommends that the report prepared as part of the Retail Banking Review should provide for a full review of the impact of higher concentration in the banking sector on consumers and Micro, Small and Medium-Sized Enterprises (MSMEs)[4],

[3] Department of Finance, Retail Banking Review – Terms of Reference, 23 November 2021, https://www.gov.ie/en/publication/ea57f-banking-review-terms-of-reference/

[4] Micro-enterprises are defined as enterprises that employ fewer than 10 persons and whose annual turnover or annual balance sheet total does not exceed €2 million. Small enterprises are defined as enterprises that employ fewer than 50 persons and whose annual turnover or annual balance

including the availability of relationship management for businesses as only two banks will provide such a service after the exit of Ulster Bank. Such a review should also analyse the experience of any similarly concentrated comparable economies. As a general proposition, the CCPC submits that the fewer the number of competitors in a market, the greater the risk of reduced competition. As noted by the Financial Conduct Authority in the UK[5], markets with only a few suppliers can give these firms greater market power, meaning that they do not need to vigorously compete to attract and retain customers. Those firms are accordingly dis-incentivised from offering innovative products, lower prices and better service, with resulting detriment to consumers and MSMEs. Less competitive banking markets are associated with higher lending margins.

Within this context and following on from statements made by the CCPC in its Merger Announcement clearing the proposed acquisition of certain assets of Ulster Bank Ireland DAC by Allied Irish Banks p.l.c[6]., the CCPC submits that the higher concentration of banking services in Ireland is likely to have a detrimental effect on competition, leading to poorer outcomes for consumers and MSMEs.

Recommendation: The Retail Banking Review should provide for a full review of the impact of higher concentration in the banking sector on consumers and MSMEs. This should be benchmarked against the international experience with full service banking.

<u>Barriers to entry</u>

An effective means to promote competition in any market is by lowering the barriers to entry and exit in that market[7]. Barriers to entry can arise in a number of ways including

sheet total does not exceed €10 million. Medium-sized enterprises are defined as enterprises that employ fewer than 250 persons and either have an annual turnover that does not exceed €50 million, or an annual balance sheet not exceeding €43 million. See here: https://ec.europa.eu/growth/smes/sme-definition_en

[5] FCA: Our Approach to Competition, December 2017, https://www.fca.org.uk/publication/corporate/our-approach-competition.pdf

[6] https://www.ccpc.ie/business/wp-content/uploads/sites/3/2021/08/2022.04.28-M-21-040-Merger-Announcement-Phase-2.pdf

[7] Barriers to exit include sunk costs (i.e. an investment by a business that cannot be recovered in the event of market exit) or the costs associated with cutting short long-term contracts. In regard to the financial services sector, there are regulatory costs associated with exiting a market including wind down costs however they do not appear to act as a barrier to exit.

from regulatory requirements imposed by legislation or regulation, the behaviour of incumbent firms or a lack of contestability in a market.

Regulatory barriers

The CCPC is aware that it has been suggested that the Central Bank's macro-prudential requirements are excessively intrusive and this may be adding to the cost of financial services and potentially acting as a barrier to entry. It is difficult to establish whether this is the case as the Central Bank has imposed capital requirements that are in line with those imposed by the rest of the EU financial services competent authorities[8]. In addition, the provisions of the Capital Requirements Directive, Capital Requirements Regulation, and related guidelines, require that banks factor in the poor loan decision making of the past, among other risk factors, in the 'Internal ratings based' models used by the Irish retail banks[9] to calculate the required capital which those banks must hold[10]. To that end the capital requirements of banks, relevant to the mortgage market, are reflective of the risk profile of past decisions by the banks. This does not appear to be a regulatory barrier to entry but rather is the outworking of poor lending decisions by the banks in previous years.

Pro-competitive regulation

The CCPC notes that the regulatory role of the Central Bank is focussed on prudential and conduct supervision. Both of these sets of regulatory priorities aim to ensure that the interests of consumers are protected. However, while financial services regulation does not pursue competition policy objectives, it is recognised that ensuring a level playing field for competitors is vital to ensure competition[11]. The CCPC has a statutory function to promote competition and does this through both the enforcement of competition law and

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[8] The minimum capital requirements for all banks are set out in the Capital Requirements Directive and the Capital Requirements Regulation. The capital requirements of a bank are set as a percentage of its Risk Weighted Assets (RWA). To calculate RWA, different weights are assigned to a bank's assets which reflect their relative risk of incurring losses. The Central Bank sets additional capital requirements based on the specific risks of each bank tailored to the bank's business model and risk profile. This is done in consultation with the European Central Bank. Department of Finance 2019 'Capital Requirements and Macroprudential Policy: An Overview', available here: https://assets.gov.ie/6056/280119120125-51f2f5d31bb9471cb0ecb8c46ef5cb94.pdf

[9] With the exception of EBS, which uses a standardised model.

[10] Department of Finance 2019 'Capital Requirements and Macroprudential Policy: An Overview', available here: https://assets.gov.ie/6056/280119120125-51f2f5d31bb9471cb0ecb8c46ef5cb94.pdf

[11] https://www.centralbank.ie/news/article/competition-policy-central-banking-governor-lane

by its advocacy activities. The CCPC believes not only that competition and appropriate macro- prudential regulation can coexist comfortably, but further that active competition among firms in the banking sector, within the framework of appropriate macro-prudential regulation, is in the best interests of society, promoting a stable banking system that works in the best interests of consumers and MSMEs. Existing financial services regulation acknowledges the role competition can play by recognising the importance of a level playing field for firms to compete with each other and promote innovation[12]. In some jurisdictions, the financial services regulator has a mandate to promote competition alongside objectives such as consumer protection[13]. The balancing of multiple mandates is common to financial supervisors across the world[14].

Although there is active competition in the retail banking market at product level from newer financial service providers, those newer entrants, by focussing on a narrower range of product offerings, do not provide consumers and MSMEs with a like-for-like alternative to full service banks. There is a risk that, due to reduced competition, banks may only actively compete with each other where there is competition at product level, leaving a cohort of products for which consumers are underserved by competition and at risk of paying higher prices as a result. In order to promote a more competitive marketplace, the CCPC believes that the role of the Central Bank should evolve to include consideration of competition objectives. This can build on the existing framework which has facilitated entry to these markets, but in addition take greater consideration of the risks of concentrated markets into consideration.

At present the Central Bank is empowered under Section 117 of the Central Bank Act 1989 to have regard to (a) the interests of customers and the general public, and (b) the promotion of fair competition in financial markets in the State when drawing up codes of practice. Section 117 is relied upon by the Central Bank for its Consumer Protection Code. In the view of the CCPC, this provision provides a basis on which further consideration of

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[12] Directive (EU) 2015/2633 (the Payment Services Directive (PSD2)) revised the previous Payment Services Directive in part to ensure that certain types of competitors were no longer excluded from the market for payment services in the EU.

[13] The Financial Conduct Authority and Prudential Regulatory Authority perform such functions in the United Kingdom while the Consumer Financial Protection Bureau does so in the United States. The Polish Financial Supervision Authority also has a mandate to promote the promote the development of the financial market and its competitiveness in Poland.

[14] See Kirakul, Sasin et al (2019) 'The universe of supervisory mandates – total eclipse of the core?' *FIS Insights on policy implementation* (available here: https://www.bis.org/fsi/publ/insights30.pdf)

competition policy can be integrated into the Central Bank's approach to regulation and more specifically can provide a basis upon which the Consumer Protection Code can be amended to set out the Central Bank's approach to promoting fair competition in financial services.

Innovation Hubs and Regulatory Sandboxes are regarded as 'innovation facilitators'. The CCPC has previously advocated that the Central Bank develop a process for introducing new entrant/new product friendly initiatives in light of the development of innovation facilitators in other jurisdictions[15]. To that end, the CCPC welcomes the Innovation Hub provided by the Central Bank as a means by which fintech firms can engage with the Central Bank outside of existing formal regulator or firm engagement processes. The Innovation Hub is intended to assist fintech firms to understand their regulatory obligations when establishing new or innovative products. Regulatory Sandboxes can provide a greater degree of assistance to firms seeking to develop innovative products and services[16]. The European Supervisory Authorities (ESA)[17] issued a report in 2019 in which they carried out a comparative analysis of the existing innovation facilitators in the EU and identified best practices[18]. That report identified a set of principles for the establishment and operation of innovation facilitators. The CCPC notes the view of the Council of the European Union that Regulatory Sandboxes "can offer significant opportunities particularly to innovate and grow for all businesses, especially SMEs, including micro-enterprises as well as start-ups, in industry, services and other sectors."[19]

Recommendations:

The CCPC recommends:

I. **amending the mandate of the Central Bank to include competition objectives,**

[15] https://www.ccpc.ie/business/wp-content/uploads/sites/3/2017/06/CCPC-Mortgages-Options-Paper.pdf
[16] Regulatory Sandboxes provide a scheme to enable firms to test, pursuant to a specific testing plan agreed and monitored by a dedicated function of the competent authority, innovative financial products, financial services or business models.
[17] The ESA is composed of the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority.
[18] https://www.esma.europa.eu/press-news/esma-news/esas-publish-joint-report-regulatory-sandboxes-and-innovation-hubs
[19] https://data.consilium.europa.eu/doc/document/ST-13026-2020-INIT/en/pdf

II. **that the revised Consumer Protection Code should set out the Central Bank's approach to promoting fair competition in financial services,**

III. **that a Regulatory Sandbox is established by the Central Bank to complement its existing Innovation Hub and to promote a well supervised approach to promoting innovation in financial services.**

Authorisations

The CCPC notes that the granting of a banking licence in Ireland is governed by the terms of Section 9 of the Central Bank Act 1971 as amended. The European Union Single Supervisory Mechanism has, since 2014, required all applicants based in the European Economic Area to be granted authorisation by the European Central Bank (ECB). The process of authorisation involves an application to national competent authorities (NCA) in Member States of the European Union after which the NCA coordinates on the application with the ECB. Applications from Third Countries for a banking licence in Ireland are instead processed exclusively by the Central Bank[20].

The CCPC is aware of commentary that the pace at which authorisations are processed by the Central Bank is regarded as a barrier to entry to the Irish financial services markets, although this appears to relate to markets other than the retail banking market[21]. It is noted that Regulation 91(2) of Statutory Instrument No. 158/2014 - European Union (Capital Requirements) Regulations 2014 states that the Central Bank shall take a decision to grant or refuse a banking licence within 12 months of the receipt of the application[22]. It is recognised that the process of granting a banking licence should be comprehensive but carried out in a timely manner.

Recommendation:

In order to promote new entry and to facilitate firms in matching their business models to the regulatory requirements in Ireland, the Central Bank should introduce a guidance

[20] The CCPC notes the European Commission proposal for a Directive amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, environmental, social and governance risk which would introduce requirements for Third Country branches in the EU for the first time.
[21] https://www.irishtimes.com/business/financial-services/central-bank-commission-members-query-onerous-regulatory-hurdles-1.4856608
[22] https://www.irishstatutebook.ie/eli/2014/si/158/made/en/print

note for fintechs seeking authorisation. This could be modelled on the guidance for fintechs provided by the European Central Bank[23].

Ireland for Finance Action Plans

The Department of Finance publishes an annual Action Plan under the *Ireland for Finance* strategy, a whole of Government strategy for the further development of the international financial services sector in Ireland. The CCPC submits that, as international financial service providers constitute an important source of potential new entrants into the domestic financial services market, the *Ireland for Finance* Action Plans should be employed to promote competition in domestic financial services markets, through the inclusion of consideration of the domestic financial services market in the action measures, including those measures which are aimed at promoting Ireland as an attractive location for international financial service providers to trade.

Recommendation:

Action measures identified in the *Ireland for Finance* Action Plans to further develop Ireland's international financial services sector should be broadened to include consideration of the domestic financial services market.

The role of the Credit Unions

The CCPC notes that the Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2019 ('the 2019 Regulations') set down the currently applicable regulations regarding lending limits for credit unions[24]. There are three tiers of lending limits (referred to as 'concentration limits'[25]) under the 2019 Regulations which act to restrict the ability of a credit union to offer credit. The concentration limits apply to community loans as well as home and business loans. The regulations provide for a combined concentration limit for house and business loans of 7.5% of total assets of the credit union. Within that 7.5% limit no more than 5% of total assets may be in business loans. Larger credit unions may

[23] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201803_guide_assessment_fintech_credit_inst_licensing.en.pdf

[24] https://www.irishstatutebook.ie/eli/2019/si/642/made/en/pdf

[25] The concentration limits on lending are set by reference to the regulatory reserves held by a credit union or alternatively the assets of a credit union for loans with a maturity of periods greater than 5 years and greater than 10 years.

avail of higher concentration limits, subject to the approval of the Central Bank, of up to a 15% combined concentration limit for home and business loans.

The effect of these regulations is to facilitate greater volumes of lending by credit unions than was previously the case under the 2016 regulations, but in placing limits they continue to restrict the ability of credit unions to compete for personal loans, mortgages and MSME credit. The CCPC understands that the rationale for continuing to restrict the ability of credit unions to lend by reference to regulatory reserves and total assets arises from the prudential requirements of the Central Bank. These requirements are intended to protect borrowers from excessive risk taking by credit unions.

The CCPC notes that reform of the credit union sector is ongoing and that that the current Programme for Government includes a number of commitments in relation to the credit union sector[26]. These include enabling the credit union movement to grow as a key provider of community banking, reviewing the policy framework within which credit unions operate, and supporting credit unions in the expansion of services, to encourage community development. The CCPC understands that the legislation will include provisions enabling credit unions to invest more easily in Credit Union Service Organisations which would allow credit unions to pool their resources in delivering new loan products to their members including accessing product specific expertise. This model is used currently for credit unions who offer current accounts and the CCPC understands that it could be applied to products such as mortgages, small business loans and ATM services. It is further understood that the legislation will propose the introduction of a service level agreement between the Central Bank and the credit unions to include a timeline for a response on a product offering proposed by a credit union.

Recommendation:
Regulation governing the Credit Union sector should be reviewed and in such a review full consideration be given, along with other relevant factors, to the competition benefits to the retail banking sector of credit unions broadening their current product offerings.

[26] https://www.gov.ie/en/publication/7e05d-programme-for-government-our-shared-future/

Switching

A new entrant to the retail banking market may typically find customers via two routes. Firstly, a new entrant can generate customers by originating new business, for example by mortgage lending to first time buyers. Secondly, a new entrant can build its customer base through customers switching from their current provider to the new entrant. Low rates of switching between retail banking service providers can accordingly constitute a barrier to entry, placing new entrants at a material disadvantage to incumbent providers, as new entrants face difficulties growing their customer base and thereby generating a sustainable return on investment.

There are a number of advantages for incumbent banks in Ireland, including brand recognition, branch networks, and the scale of their activities. The CCPC notes the findings of consumer market research commissioned by the Department of Finance to inform the Retail Bank Review[27]. That survey found that 93% of consumers in Ireland held a current account with one of the five full service retail banks, that between only 2-5% of respondents had switched any type of personal finance product provided by retail banks in the past five years, and that only one in seven consumers were considering switching such financial products. The vast majority of consumers surveyed continue to avail of current accounts from full service retail banks with less than 5% holding such products with a credit union or An Post. Consumers appear to mainly avail of fintechs for specific products or services, with less than 1% using a fintech for their main current account[28].

The CCPC commissioned consumer market research in 2021 profiling the experience of consumers with products and services in regulated markets in Ireland. Our survey results showed that 3% of consumers had switched their credit card in the previous two years, while 4% had moved current account in that time. In addition, the survey found that 7% of mortgage holders had switched in that time period, despite evidence that consumers stand to make significant gains if they refinance their mortgage[29]. Taken together these

[27] https://www.gov.ie/en/organisation-information/3c122-retail-banking-review/
[28] ibid
[29] Central Bank research found that 3 in 5 consumers could save €10,000 over the lifetime of their mortgage by moving to the best available rate in the market. See here: https://www.centralbank.ie/docs/default-source/publications/economic-letters/economic-letter-12-mortgage-switching.pdf?sfvrsn=4

surveys indicate a low degree of contestability in some core retail banking product markets.

Over the past ten years there has been entry into many of the product markets in which the retail banks are active, such as current accounts, personal loans, business finance and mortgages. Such entry has emerged from credit unions, non-bank lenders[30] and from fintech lenders[31]. In addition, An Post is active in a number of these markets through its partnerships with financial services providers[32]. The CCPC notes that particularly in respect of non-bank lenders and fintech lenders that these firms generally compete in respect a limited range of products or services. To that end, the ability of such competitors to constrain incumbent banks is limited. The CCPC further notes that there has been no entry into the market by a 'full service' provider and there are no indications that such entry is likely in the near future.

The CCPC notes that the exits of KBC and Ulster Bank will lead to a significant increase in the numbers of customers, both individual consumers and business customers, that seek to switch their bank in 2022. The operation of the Central Bank's Payment Account Switching Code has been significantly tested due to this increase in switchers[33]. There are indications that the Code is underutilised by the banks with low consumer awareness of its existence, and where it is employed it is proving to be cumbersome. The code allows a consumer to complete a switching pack which enables their new provider and old provider to work together to set up a new account and close their old account. The switching code was established to encourage switching on an individual level and not on a mass scale such as is possible with the exits of KBC and Ulster Bank.

The CCPC has noted that, in their correspondence to consumers, many current account providers are expressing a preference for consumers to take a Do It Yourself (DIY) approach rather than encouraging consumers to avail of the switching service

[30] Non-bank lenders can be understood to be financial institutions that offer financial services but do not hold a banking licence and therefore do not accept deposits.
[31] Fintech lenders can be understood to be firms that offer digital only financial services and operate in these markets with a banking licence.
[32] The CCPC understands that An Post intends to enter the mortgage market in partnership with MoCo in 2022.
[33] Code of Conduct on the Switching of Payment Accounts with Payment Account Providers (available here: https://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/other-codes-of-conduct/45-gns-4-2-7-code-of-conduct-o.pdf)

underpinned by the code. The switching service may be of particular use to consumers who may be more vulnerable or require more assistance with switching their account. The CCPC is concerned that these consumers are not being facilitated with the extra help that they require and are being channelled into the self-service option that may not be appropriate for their needs.

The CCPC further notes that the switching code is limited in its scope to retail credit firms regulated by the Central Bank. This means that Credit Unions, An Post and fintechs do not have to follow the terms of the switching code. The CCPC does note however that many of these providers offer a switching service but it may be worth considering extending the scope of the switching code to include these current account providers.

Recommendation:

An evaluation on the operation of the Bank Switching Code should be conducted to inform the forthcoming review of the Consumer Protection Code by the Central Bank.

The CCPC notes the proposal of the European Commission for a European Digital Identity Wallet which is in part intended to facilitate easier switching of financial services[34]. Such an approach could be of significant value to consumers that are comfortable with digital financial services. It may also have significant benefits in light of the development of Open Finance to ensure that there is greater competition in the market. The CCPC notes the ambition of the European Commission to develop a common toolbox to address the technical aspects of personal digital wallets by September 2022[35].

The CCPC welcomes continued progress toward completing the Banking Union as it will strengthen the basis on which cross-border banking activities can take place in Europe thereby complementing the single market[36]. The further strengthening of the Capital Markets Union will also complement the Banking Union and provide a further basis on which MSMEs can access financial services. Ireland should continue to advocate for the

[34] https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/european-digital-identity_en

[35] https://digital-strategy.ec.europa.eu/en/news/european-digital-identity-online-consultation-platform-european-digital-identity-wallets

[36] https://www.consilium.europa.eu/en/press/press-releases/2022/06/16/eurogroup-statement-on-the-future-of-the-banking-union-of-16-june-2022/

measures necessary to complete the Banking Union, not least as increased consumer confidence in cross-border banking supervision should facilitate entry into markets which are under served by incumbent banks.

Recommendation:

The Government should engage at an early stage with the proposal for a European Digital Identity Wallet to ensure that it is designed to maximise consumer engagement in these markets while ensuring consumer protection, including data privacy.

Mortgage arrears and repossession

The CCPC published a study on the Irish mortgage market in 2017. To inform our analysis we issued a consultation paper. Nearly all of the respondents to the public consultation agreed that the prevailing level of mortgage arrears, coupled with long and uncertain repossession policies, were acting as a potential barrier to entry to the mortgage market[37].

Although there has been a decline in overall mortgage arrears[38] in recent years[39], among those consumers that are in arrears, long-term arrears of over two years are becoming an increasingly dominant sub-group, with the Central Bank's most recent data from 2021 indicating that approximately 66% of mortgage accounts in arrears for more than 90 days are in arrears for two years or over[40] (up from 64% in June 2020 and 54% in 2015[41]). Further, as of 31 December 2021, approximately 16% of mortgage accounts in arrears for

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[37] https://www.ccpc.ie/business/wp-content/uploads/sites/3/2017/06/CCPC-Mortgages-Options-Paper.pdf

[38] Defined in accordance with Section 3(a) of the Central Bank's Code of Conduct on Mortgage Arrears which states that "Arrears: arise on a mortgage loan account where a borrower has not made a full mortgage repayment, or only makes a partial mortgage repayment, in accordance with the original mortgage contract, by the scheduled due date."

[39] Central Bank of Ireland (2020) Understanding Long Term Mortgage Arrears in Ireland, https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/understanding-long-term-mortgage-arrears-in-ireland

[40] Central Bank of Ireland (2020) Understanding Long Term Mortgage Arrears in Ireland, https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/understanding-long-term-mortgage-arrears-in-ireland

[41] https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/mortgage-arrears

more than 90 days are in arrears for ten years or over[42]. The CCPC notes the recent sale of non-performing loans by AIB to a credit servicing firm[43].

Central Bank data also indicates that repossession proceedings relating to principal dwelling house accounts in arrears can be protracted in nature, with the majority in the legal system for over 2 years and just over one third of those accounts subject to court proceedings for over 5 years[44].

Non-performing loans reduce bank profits because they require higher provisions of capital, lead to lower interest income, generate expenses in their management and lead to an increase in funding costs due to the higher credit risks of such banks[45]. Potential entrants may be discouraged from entering the Irish market by the risk that, if they were to enter, their profitability will be negatively impacted by a difficulty in accessing processes which enable the timely and effective resolution of non-performing loans. This may be particularly acute where the new entrant is comparing entering the market in Ireland to entering the market in another jurisdiction(s) which data indicates has a foreclosure regime which results in shorter recovery times than Ireland[46].

In addition to the impact non-performing loans and mortgage arrears can have on competition in the market, it is important to be cognisant of the significant distress and hardship faced by borrowers in arrears, particularly those who are subject to re-possession proceedings. In its 2017 Mortgage Options Paper, the CCPC noted the value of further investigation into greater use of suspended possession orders by the courts[47],

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[42] https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/mortgage-arrears
[43] https://www.irishtimes.com/business/financial-services/2022/06/21/aib-sells-problem-loans-portfolio-to-cerberus-led-group-for-400m/
[44] https://www.centralbank.ie/docs/default-source/statistics/data-and-analysis/credit-and-banking-statistics/mortgage-arrears/2021q4_ie_mortgage_arrears_statistics.pdf?sfvrsn=7
[45] Huljak, I., Martin, R., Moccero, D. and Pancaro, C. (2020a). 'Do non-performing loans matter for bank lending and the business cycle in euro area countries'. ECB Working Paper 2411, European Central Bank, Frankfurt.
[46] For example, in benchmarking the number of years to recover in residential real estate enforcement actions across the 27 EU member states, the ECB, based on data from 2018, rates 20 EU member states ahead of Ireland in terms of shorter recovery times. See European Banking Authority (2020) Report on the Benchmarking of National Loan Enforcement Frameworks: https://www.eba.europa.eu/sites/default/documents/files/document_library/About Us/Missions and tasks/Call for Advice/2020/Report on the benchmarking of national loan enforcement frameworks/962022/Report on the benchmarking of national loan enforcement frameworks.pdf
[47] https://www.ccpc.ie/business/wp-content/uploads/sites/3/2017/06/CCPC-Mortgages-Options-Paper.pdf

as a measure which could, by giving the borrower an incentive to engage earlier and more fully with the lender, potentially bring about efficiency, transparency and predictability to re-possession proceedings and align Ireland with European norms.

The CCPC understands that suspended possession orders are utilised at an early stage of repossession proceedings in the UK[48] to suspend possession orders subject to compliance by the borrower with conditions set out in an order of the court relating to payment by the borrower of any sum secured by the mortgage or the remedy of any default.

In Ireland there is provision within Section 101 of the Land and Conveyancing Law Reform Act 2009 to allow for the suspension of a court order to take possession of a mortgaged property. In addition, an adjournment, stay, postponement or suspension may be made, subject to such terms and conditions with regard to payment by the borrower of any sum secured by the mortgage or remedying of any breach of obligation as the court thinks fit.

It is the CCPC's understanding that the current practice in Ireland in possession proceedings is for the court to adjourn proceedings in the expectation that the borrower and lender would agree to some form of settlement – rather than reaching a court mandated solution as part of a suspension.

The CCPC submits that if suspended possession orders were used more widely in Ireland at the initial stages of proceedings this could reduce delays by avoiding the need to have repeated adjournments to allow the borrower and the lender reach an agreement under the provisions in Ireland set out above.

A benefit of greater use of suspended possession orders in Ireland would also be that the arrangements made under a suspension order would be an order of court, as such with the associated transparency this could lead to greater standardisation in settlements and terms of orders, and more predictability.

Recommendation:

[48] Section 36, Administration of Justice Act 1970

The CCPC recommends that a review of the use of 'suspended possession' orders by the Courts be conducted as difficulties in enforcing the security of mortgage debt have been cited as a potential barrier to entry.

The CCPC notes the potential for Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers ('the NPL Directive') to bring about change in this area by creating a European Union wide competitive market for the sale of non-performing loans, allowing for the passporting of those services into other Member States, permitting credit institutions to process and reduce the number of non-performing loans on their balance sheets. By providing new entrants with increased opportunities to sell non-performing loans in efficient, competitive and transparent secondary markets to other operators, the NPL Directive may prove to be a mitigating factor to any perceived risk regarding difficulty resolving non-performing loans in Ireland. It is noted that the NPL Directive will not apply to loans originated by non-bank lenders which will continue to be governed by existing regulation of credit servicing firms[49], but will not be able to passport their services in the same way. The CCPC notes that a continued reduction in NPLs among the assets held by banks is expected to reduce the cost of capital to those institutions with the potential to free up more capital for productive investment.

The role of the retail banking sector in supporting MSMEs

In order to be established, prosper and grow, Micro, Small and Medium-Sized Enterprises (MSMEs) need access to effective and affordable financial services which meet their varying needs, enabling them to carry out the every-day transactions that underpin their businesses, make important business decisions and provide them with access to financing to fund investment and working capital. The cost competitiveness of MSMEs is also contingent on the cost of inputs which includes the cost of financial services and financing. High costs can curtail the ability of MSMEs to operate successfully

[49] This includes the protections extended by the Consumer Protection (Regulation of Retail Credit and Credit Servicing Firms) Act 2022: https://www.irishstatutebook.ie/eli/2022/act/5/enacted/en/print

domestically and internationally[50], which, considering the role of MSMEs as a 'critical pillar of the Irish economy'[51], can have associated negative impacts on economic prosperity and growth.

The impact of high banking costs on MSMEs competitiveness is particularly important in the context of the cost of MSME credit. As noted by the National Competitiveness and Productivity Council, 'in a post-COVID world, businesses need affordable access to credit to ensure that they can adapt their services in a changing world'[52]. As identified in the Consultation by reference to the Department of Finance's September 2021 SME Credit Demand Survey, the retail banking sector is the largest provider of finance to the MSME sector. The 2021 ECB/EC Survey on Access to Finance of Enterprises (SAFE) 2021[53] indicates that Irish SMEs preference for bank financing is likely to persist, with 60% of SMEs identifying credit lines, including bank overdrafts and credit cards, as relevant sources of financing for their enterprise. Bank loans were identified as only slightly less relevant, at 58%. In contrast, debt securities and equity capital were selected as much less relevant options, with only 6% and 14% of respondents, respectively, reporting those options as relevant.

The Central Bank recognises that non-bank lenders are playing 'a key role in funding SMEs in Ireland', providing 28% of SME financing in 2020[54] [55]. However, the Central Bank has identified that non-bank lenders tend to specialise in specific sectors or products, with 40% of such lending going to the real estate sector alone in 2020[56]. Accordingly,

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[50] NCPC (2021) Ireland's Competitiveness Challenge 2021, http://www.competitiveness.ie/publications/2021/ireland%27s%20competitiveness%20challenge%202021.pdf

[51] OECD (2019), *SME and Entrepreneurship Policy in Ireland*, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, https://doi.org/10.1787/e726f46d-en

[52] NCPC (2021) *Ireland's Competitiveness Challenge 2021*, http://www.competitiveness.ie/publications/2021/ireland%27s%20competitiveness%20challenge%202021.pdf

[53] European Commission/European Central Bank (2021) Survey of the access to finance of enterprises (SAFE), https://ec.europa.eu/growth/access-finance/data-and-surveys-safe_en

[54] Heffernan, T., McCarthy, B., McElligott, R. and C. Scollard (2021). The role of non-bank lenders in financing Irish SMEs. Central Bank of Ireland Behind the Data. Available here: https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/the-role-of-non-bank-lenders-in-financing-irish-smes

[55] CCPC notes that some sources of non-bank funding are not measured in the Central Credit Register and accordingly are not included in this figure, for example crowdfunding.

[56] Heffernan, T., McCarthy, B., McElligott, R. and C. Scollard (2021). The role of non-bank lenders in

non-bank lending is much more relevant to some SMEs than others and the ECB/EC SAFE results referred to in the previous paragraph would appear consistent with that proposition.

Therefore, although non-bank lenders are active in the market for Irish SME credit and acknowledging the steady trend of reduced demand for bank financing from SMEs[57], bank financing is still an important source of funding for SMEs and accordingly a significant contributor to the cost competitiveness of SMEs, particularly in Ireland where interest rates for businesses are higher than the European average[58]. As research draws a correlation between higher interest rates and more concentrated, less competitive banking sectors[59], the negative impact of higher interest rates on SMEs competitiveness is likely to continue to be an issue and perhaps increasingly so, in light of the withdrawal of Ulster Bank from the Irish banking sector, with the result that there will only be two full service banks in the State to serve the needs of businesses with turnover between €2 million to €250 million. Non-bank lenders tend to charge higher interest rates than banks on loans but may also be prepared to extend credit to businesses that encounter difficulties in accessing bank finance.

In addition to influencing the interest rates which SMEs may be charged if they do access credit, evidence suggests that weakened competition in bank lending is itself a key factor impeding SME access to finance[60]. Increasing the level of competition in the retail

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financing Irish SMEs. Central Bank of Ireland Behind the Data. Available here: https://www.centralbank.ie/statistics/statistical-publications/behind-the-data/the-role-of-non-bank-lenders-in-financing-irish-smes

[57] Department of Finance SME Credit Demand Survey 2021. https://www.gov.ie/en/publication/c3c54-sme-credit-demand-survey-report-april-september-2021/. The CCPC notes that in the first year the SME Credit Demand Survey was conducted in September 2011, 36% of respondents said they requested credit in the preceding six months. Only 17% responded similarly in September 2021 and this was typical of a general year on year decline in demand for credit from 2011, with the exception of a slight increase in 2012.

[58] OECD (2022) Financing SMEs and Entrepreneurs 2022, Ireland scoreboard https://www.oecd-ilibrary.org/sites/92f28ade-en/index.html?itemId=/content/component/92f28ade-en

[59] James Carroll and Fergal McCann (2016) 'Understanding SME interest rate variation across Europe' Quarterly Bulletin Articles, Central Bank of Ireland pg. 56-72, https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2016/quarterly-bulletin-no-2-2016.pdf?sfvrsn=10#page=58

[60] John Quinn (2019) 'SME access to finance in Europe: structural change and the legacy of the crisis' Research Technical Paper, Central Bank of Ireland Vol. 2019, No. 10, https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/sme-acces-to-finance-in-europe.pdf?sfvrsn=10.

banking sector is of critical importance to the ability of SMEs to compete and contribute to the prosperity of the Irish economy more broadly.

High interest rates and a weakened competitive environment are not the only factors which limit SMEs' ability to access bank credit. The high rate of demand for guarantees, particularly personal guarantees[61], is a factor which the OECD has identified as discouraging Irish businesses from seeking bank finance[62] and the CCPC suggests that this limitation is considered as part of the examination of whether retail banks are currently meeting the needs of SMEs.

Rejection rates for loans, overdrafts and credit lines are higher in Ireland than the EU average and the data also suggests that the time it takes banks to decide on credit applications is higher than EU average[63]. While a bank's decision to reject a bank financing application from an SME could be attributable to a myriad of different reasons, the European Commission has referred to lower levels of financial literacy[64] among MSMEs, particularly microenterprises, in comparison those of larger firms and lower levels of resources, as relevant to high rejection rates, positing that such firms can have difficulty in presenting credit proposals that are fitting for their banks' credit decision

[61] In a survey ran by the CSO in 2014, SMEs reported that a personal guarantee of the owner/director of the SME was requested in 53.9% of bank finance applications (Central Statistics Office Access to Finance, 2014, https://www.cso.ie/en/releasesandpubli cations/er/atf/accesstofinance2014/). More recently, 40% of SME respondents to the Department of Finance SME Credit Demand Survey, September 2021 who were successful in seeking finance said that a personal guarantee was a condition of the credit extension (Department of Finance, SME Credit Demand Survey, 2021, https://www.gov.ie/en/publication/c3c54-sme-credit-demand-survey-report-april-september-2021/).

[62] OECD (2019), SME and Entrepreneurship Policy in Ireland, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, https://doi.org/10.1787/e726f46d-en

[63] Survey data illustrates that rejection rates for bank loans, overdrafts and credit lines are higher than the EU 27 median. According to European Commission/European Central Bank (2021) Survey of the access to finance of enterprises (SAFE), https://ec.europa.eu/growth/access-finance/data-and-surveys-safe_en, the EU 27 median rejection rate for bank loans (excluding overdraft and credit lines) is 7%, where Ireland reports a 10% rejection rate. Similarly, the EU median rejection rate for credit lines, bank overdrafts or credit card overdraft is 6%, where Ireland reports a 7% interest rate. A higher proportion of credit applications were also advised as part of that survey to be designated as "still pending" in Ireland than the EU 27 median suggesting that the time it takes banks to decide on credit applications is higher than EU 27 median.

[64] Although the European Commission does not define 'financial literacy' in this report, the OECD/INFE defines the financial literacy of adults as: "a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well-being", OECD (2018), OECD/INFE Toolkit for Measuring Financial Literacy and Financial Inclusion.

systems, as these have moved from a local branch manager model to a more centralised system[65].

Financial literacy of MSMEs

While the CCPC does not have a statutory function in respect of the financial education of MSMEs, the CCPC believes that the financial literacy of MSMEs is relevant to the Review, not just in the context of credit applications, but also in respect of a firm's ability to improve their cost competitiveness by shopping around for more affordable and higher quality financial services generally and to engage with switching financial providers, if they so choose. The importance of financial literacy to Irish MSMEs more broadly is recognised by the OECD's recommendation for Ireland to develop an action plan for financial education to strengthen the financial skills and financial management of small business owners and managers[66]. The CCPC has previously drawn attention to the need to increase the financial literacy of MSME staff and management in its Public Liability Insurance Market Study[67].

Research commissioned by the Small Firms Association in 2019 illustrates low levels of financial literacy among SMEs, with 34% of respondents ranking their expertise in financial literacy as low-to-moderate and 35% of those respondents responding that they had received no financial training[68].

Recommendation:

Measures to improve levels of financial literacy among SMEs, with a particular focus on MSMEs, should be prioritised as part of the ongoing work of the SME Taskforce[69].

Relationship management

[65] European Commission (2019), SME Envoys Finance, SME access to finance situation in EU Member States, Final Report 2019, https://ec.europa.eu/docsroom/documents/39645

[66] OECD (2019), SME and Entrepreneurship Policy in Ireland, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, https://doi.org/10.1787/e726f46d-en

[67] https://www.ccpc.ie/business/research/market-studies/public-liability-insurance/

[68] The representative survey analysed responses from 132 micro, small and medium-sized businesses. Small Firms Association (2019), 'Financial Literacy amongst Irish micro, small and medium-sized businesses', https://www.ibec.ie/connect-and-learn/industries/small-business-and-startups/small-firms-association/financial-literacy-report

[69] https://enterprise.gov.ie/en/Publications/Publication-files/SME-Taskforce-National-SME-and-Entrepreneurship-Growth-Plan.pdf

The CCPC is aware that a large proportion of business customers value the relationship management services provided by full service banks. These services can include advisory services which assist MSMEs to grow and innovate. At present there is little evidence that non-bank lenders are seeking to provide similar services which may limit their ability to compete fully with retail banks for business customers.

As noted in the Dialogue hosted by the Department of Finance on 16 May 2022, gaps in the financial literacy of MSMEs may have previously been filled by the relationships developed between local bank staff and firms[70]. More generally, relationship management and a local connection in financial service provision are considered by a significant number of SMEs to be important features of financial service provision[71] [72]. The ability to avail of such advisory services can in turn significantly influence the choice of credit provider among MSMEs, and in particular where the financing needs of a business include revolving credit lines and ongoing engagement with the lender.

With the reduction in the bank branch network and increased digitalisation of business full service banking, these in-person relationships may no longer be accessible, with resulting detriment to MSMEs. As noted by industry research, there may be an opportunity for digital technology to re-conceptualise the role of relationship management[73] and the CCPC submits that further review is needed as to whether digital

[70] A further indicator of SME reliance on banks for financial advice is set out in a study of 600 SMEs from Dublin and the South East of Ireland conducted in 2005, in which the majority of SMEs agreed that meeting with bank personnel is beneficial and that they would seek the advice of the bank at the time of financial distress, Hanley, A., & O'Donohoe, S. (2009) '*Relationship Banking within the Irish SME sector and its Implication*' (No. 1553). Kiel Working Paper, accessed at: https://www.files.ethz.ch/isn/106015/kwp_1553.pdf

[71] In a 2014 survey from the CSO, 21.5% of SMEs indicated that they chose a bank because the branch was local to them and an additional 9.5% chose a bank because the bank branch was known for good client relationships. CSO (2014), Access to Finance 2014, https://www.cso.ie/en/releasesandpublications/er/atf/accesstofinance2014/

[72] As part of a survey of two hundred SMEs across Northern Ireland and the Republic of Ireland conducted by business advisors Accenture in July 2017, 23% of respondents said that lack of access to a relationship manager in their bank is a problem. As part of a global survey conducted by business advisors EY, 310 Irish SMEs were surveyed, 21% of which said they would be prepared to pay for a trusted advisor service. Accenture (2018) Irish SME Banking Survey 2018, https://www.accenture.com/_acnmedia/PDF-70/Accenture-Irish-SME-Banking-Survey-2018.pdf#zoom=50

[73] Accenture (2018) Irish SME Banking Survey 2018, https://www.accenture.com/_acnmedia/PDF-70/Accenture-Irish-SME-Banking-Survey-2018.pdf#zoom=50

and other innovative solutions may be utilised to meet the relationship banking needs of MSMEs in light of the reduction in the bank branch network.

Beyond the demand from MSMEs themselves for in-person relationships with their banks, research also indicates that the information obtained by banks through bank branch networks has a positive impact on access to credit and that larger numbers of MSMEs are discouraged from applying for credit where bank branch networks are diminished[74].

The CCPC notes the policy measures at EU level to develop a Capital Markets Union which may facilitate SMEs accessing alternative sources of funding to bank credit, including funding through equity and securities markets[75]. The recent European Commission proposal to introduce rules to level the playing field between the preferential tax treatment afforded to debt financing over that afforded to equity financing[76], is, although still in early legislative stages, a further general indicator of European policy seeking to encourage an increase in the use of equity financing. The CCPC suggests that the reduced demand for credit from Irish SMEs, coupled with higher than European average interest rates may indicate an opportunity for equity financing to play a greater role in the future of SME financing.

Recommendation:

Consideration should be given to identifying innovative options to address MSME need for relationship management in light of the reduced number of banks in Ireland.

Mortgage lending

At the time of writing there are 7 lenders offering mortgage products in the State. These lenders are AIB (including EBS and Haven), Bank of Ireland, Permanent TSB, KBC, Finance

[74] John Quinn (2019) 'SME access to finance in Europe: structural change and the legacy of the crisis' Research Technical Paper, Central Bank of Ireland Vol. 2019, No. 10, accessed at: https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/sme-acces-to-finance-in-europe.pdf?sfvrsn=10

[75] https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan_en

[76] Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, accessed at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12995-Debt-equity-bias-reduction-allowance-DEBRA-_en

Ireland, Dilosk and Avant Money. KBC have stated that they will cease accepting new applications for mortgage finance after 15th July 2022[77].

The CCPC notes that non-bank lenders generally fund their lending in money markets, and that their expansion in residential mortgage markets has been in part attributed to the prolonged period of low interest rates in the decade or more up until 2022[78]. The correction in interest rates at the time of writing is expected to lead to a rise in the cost of providing such lending. This may reverse the competitive advantage that non-bank lenders have established in mortgage interest rates by raising their funding costs beyond those by which deposit funded institutions will rise. This may, in turn, lead to an increase in the interest rates non-bank lenders offer to new customers and expose their existing customers to interest rate hikes, particularly on the expiry of a fixed rate period.

Generally, on expiry of a fixed rate period, if a consumer does not re-start a fixed rate period or switch their mortgage to another provider, the lender will move them onto the applicable variable interest rate at the end of the fixed term. Depending on the lender and the previous fixed term rate, the variable rate could be above or below the previous rate.

The CCPC believes that the application of default interest rates in this manner can lead to unfair consumer outcomes, particularly for those who are unable to engage with their bank on expiry of a fixed rate period, for reasons which may include a lack of knowledge or understanding of the benefits of such engagement or low financial literacy, as discussed further below, as those consumers may pay more for their mortgage where their risk profile and the cost to the provider of servicing the mortgage has not changed. That additional cost to the consumer may, considering the long-term nature and high value of many mortgages, be significant.

The CCPC notes the June 2018 Addendum to the Central Bank's Consumer Protection Code for Enhanced Mortgage Switching Measures: Transparency and Switching (June 2018 Addendum) [79] sets out the requirement for mortgage lenders to engage with consumers

[77] https://www.kbc.ie/mortgages

[78] https://www.centralbank.ie/docs/default-source/publications/financial-stability-notes/non-bank-mortgage-lending-ireland-recent-developments-macroprudential-considerations.pdf?sfvrsn=4

[79] Central Bank of Ireland, Addendum to the Consumer Protection Code 2012, June 2018, https://www.centralbank.ie/docs/default-source/regulation/consumer-protection/other-codes-of-conduct/addendum-to-consumer-protection-code-2012---june-2018.pdf?sfvrsn=4

at the end of a mortgage fixed term period in a number of ways and provide them with information about the default interest rate which will apply and alternative interest rates offered by that lender.

The CCPC recommends that a revised Consumer Protection Code should mandate mortgage providers to offer the same rate or equivalent best rate to a consumer at the end of an initial fixed term. The Central Bank should also consider the differentials between offers made to new and existing customers and their appropriateness or otherwise.

Recommendation:
The Central Bank should examine the loyalty costs arising from consumers rolling over onto higher mortgage interest rates at the expiry of a fixed term and identify measures to address this in the revised Consumer Protection Code.

Financial inclusion

Financial literacy and education

The CCPC has a statutory role in financial education, laid out in the Competition and Consumer Protection Act 2014 as *"providing information in relation to financial services, including information in relation to the costs to consumers, and the risks and benefits associated with the provision of those services, and promoting the development of financial education and capability."* These activities are funded using a levy on financial services firms. The CCPC also has obligations under the Payment Accounts Regulations 2016 to provide an online comparison of personal current accounts.

In 2018, the CCPC published *Financial Capability and Well-being in Ireland in 2018* which found that most consumers in Ireland have the means to cover day-to-day costs and their current financial commitments[80]. However, financial well-being includes the ability to have financial comfort now and into the future. A significant number of consumers had little financial resilience beyond meeting current commitments and 52% of people meeting their commitments have little provision against financial shocks. In addition, while most consumers were doing reasonably well in terms of their over financial well-

[80] https://www.ccpc.ie/business/research/market-research/financial-capability-and-well-being-in-ireland/

being they had low levels of resilience for the future, including in retirement. The report found a positive effect of having received financial education as a child.

The increasing number and complexity of financial products on the market makes financial education even more important. Consumers are not just choosing between interest rates on two different bank loans or savings plans, but are rather being offered a variety of complex financial products for borrowing, saving and investing. The responsibility and risk for financial decisions can have a major impact on an individual's future life therefore, financial education is essential in assisting them make the best decisions. Digitalisation is also having a profound effect on financial services in the type of products consumers have access to, how consumers access them and how they gain information on them. Financial education, as well as digital financial literacy, plays an important role in helping consumers adapt to these changes. Covid-19 has not only accelerated the move to digital financial services, but it has also meant increased financial challenges for consumers, particularly those in vulnerable groups and women, young people and older people[81]. In addition, there have been considerable changes in the markets for consumer credit, including new types of provision such as Buy Now Pay Later, which is particularly targeted at younger consumers. Consumers should be empowered in making decisions around credit, particularly online.

International developments

The OECD recommends that countries establish and implement national strategies on financial literacy. These should be evidence-based and co-ordinated national strategies which recognise the importance of financial literacy coherently with other strategies that foster economic and social prosperity and provide a framework for co-operation among all the stakeholders. This national strategy approach was reinforced in the adoption of the OECD *Recommendation on Financial Literacy* at its Ministerial Council Meeting in October 2020[82].

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[81] See Joint European Supervisory Authorities response to the European Commission's February 2021 Call for Advice on digital finance (available here: https://www.esma.europa.eu/sites/default/files/library/esa_2022_01_esa_final_report_on_digital_finance.pdf) and G20/OECD-INFE Report on Supporting Financial Resilience and Transformation through Digital Financial Literacy (available here: https://www.oecd.org/daf/fin/financial-education/G20-OECD-INFE-report-supporting-resilience-through-digital-financial-literacy.pdf)

[82] https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0461

There has also been increased focus at a European level on financial education, particularly from the European Commission. The European Commission launched its joint financial competence framework for adults with the OECD in January 2022[83]. The European Commission is currently developing a corresponding framework for children and young people which it plans to launch in early 2023. The Capital Markets Union Action Plan also states that the European Commission will assess the possibility of introducing a requirement for Member States to promote learning measures supporting financial education, in particular in relation to responsible and long-term investing[84].

Digital financial literacy

The CCPC acknowledges that continued digitalisation of the financial services sector is essential to ensure a competitive retail banking sector that is sustainable into the future. Indeed, in addition to the competitive and commercial advantages of digitalisation, the CCPC notes that the European Commission, as part of its Digital Finance Strategy[85], is currently considering a number of legislative proposals in this area, including the introduction of an Open Finance framework[86] and, as noted above, a European Digital Identity Wallet[87] which would further promote and facilitate digitalisation in the banking sector. The European Banking Authority has also set out its strategy to ensure that the EU regulatory framework facilitates digital innovation in the interest of consumers and

[83] https://ec.europa.eu/info/publications/220111-financial-competence-framework_en
[84] https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan_en
[85] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee Of The Regions on a Digital Finance Strategy for the EU, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0591&from=EN
[86] As per the European Commission's Targeted Consultation on Open Finance Framework and Data Sharing in the Financial Sector, 'Open Finance refers to third-party service providers' access to (business and consumer) customer data held by financial sector intermediaries and other data holders for the purposes of providing a wide range of financial and information services', https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2022-open-finance-consultation-document_en.pdf. The CCPC notes the potential relevance of open finance to comments made at the Dialogue relating to the potential for centralised databases to lower cost and increase the efficiency of certain internal bank functions.
[87] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 910/2014 as regards establishing a framework for a European Digital Identity EUR-Lex - 52021PC0281 - EN - EUR-Lex (europa.eu) (the Proposal). In brief, the objective of the Proposal is that natural and legal persons will be able to digitally identify themselves and store and manage identity data and official documents in electronic format through use of a digital wallet operated on a mobile phone app and other devices. The CCPC notes in particular that the text of the Proposal expressly provides that banks should accept the use of European digital identity wallets where strong user authentication for online identification is required.

market efficiency, which includes a new mandate for the EBA in relation to digital identities[88].

An increased digital offering in financial services can, potentially, offer many benefits, including:

- developing financial products that better meet the needs of consumers, including for people currently unable to access financial services[89];
- providing consumers and SMEs with ease of access to financial products and financial data analysis, which, in Ireland is particularly important in the context of reduced branch networks;
- unlocking new ways of channelling funding to SMEs[90];
- streamlining applications processes[91];
- reducing operational costs for financial service providers, the benefit of which should be passed on to their customers in the form of lower costs; and
- making it easier for consumers to switch financial service provider and making onboarding processes including customer due diligence checks more efficient[92].

Whether consumers and SMEs can meaningfully experience the benefits of digitalisation, including the benefit of any legislative intervention by the European Commission or

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[88] https://www.eba.europa.eu/financial-innovation-and-fintech

[89] As identified on page 3 of the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee Of The Regions on a Digital Finance Strategy for the EU, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0591&from=EN

[90] As identified on page 3 of the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee Of The Regions on a Digital Finance Strategy for the EU, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0591&from=EN

[91] For example, the CCPC notes the European Commission's website relating to the European digital identity gives an example of the efficiencies which could be brought about by use of the digital identity in bank loan applications, European Digital Identity | European Commission (europa.eu).

[92] For example, the potential for an open finance framework to be utilised to improve the ease of switching and ease of onboarding is reflected in questions four and five of the European Commission's Targeted Consultation on Open Finance Framework and Data Sharing in the Financial Sector, https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2022-open-finance-consultation-document_en.pdf .

otherwise in this area, depends to a large extent on the manner in which digitalisation is implemented and used. Financial service providers must ensure digital innovations:

- provide high levels of assurance in respect of cybersecurity[93], financial crime and data abuse;
- are designed to treat consumers fairly[94]; and
- are designed in a consumer centric manner, avoiding adding complexity which may exacerbate the difficulties faced by those with low levels of financial literacy, as discussed further below, and ensuring a level of inter-operability with the systems of non-financial service providers which consumers and SMEs need to engage with on a daily basis, e.g. utility providers.

Financial inclusion

Although digitalisation can be beneficial for some consumers and SMEs, an over-reliance on digitalisation presents the risk that a cohort of the population will, by virtue of digital exclusion, be unable to or face difficulties in obtaining financial services. The ESA response to the call for evidence on digital finance highlighted the need to prevent financial exclusion and to promote further a higher level of digital and financial literacy to help consumers make effective use of financial services provided via digital means and responsible choices that meet their expectations, raising confidence and trust in the digital financial system as well as their personal financial outlook[95]. Consumers at risk of digital

[93] The CCPC notes the inclusion of financial services firms in the scope of the Network and Information Security (NIS) Directive. The CCPC also notes the proposal for a Digital Operational Resilience Act (DORA) which is intended to promote operational resilience in the European digital finance sector. In addition to large financial firms, such as retail banks, third country ICT providers will also fall within the remit of DORA. This reflects the growing impact that fintechs now have in the sector, and how consumers are engaging with digital financial services.

[94] To provide an example of unfair uses of digitalisation, the European Securities and Markets Authority has, in response to the European Commission's consultation on the digital finance strategy, pointed to the potential for increased digitalisation to lead to detrimental price optimisation/discrimination and harmful sales practices, for example where consumer data is used to systematically exploit consumers' biases or constraints such as limited time or (lower) financial knowledge, or making access to financial products contingent on purchasing another product from the financial services provider. European Securities and Markets Authority (2020) ESMA's response to the European Commission's Consultation on a New Digital Finance Strategy for Europe, esma50-164-3463_esma_dfs_response.pdf (europa.eu)

[95] See Recommendation 3: https://www.esma.europa.eu/sites/default/files/library/esa_2022_01_esa_final_report_on_digital_finance.pdf)

exclusion may not have acquired the digital skills or confidence needed to navigate digital processes[96]. The risk of digital exclusion is exacerbated in the scenario noted in the Consultation whereby the bank branch network in Ireland is diminishing, as persons at risk of digital exclusion may no longer be able to rely on in-person banking services as an alternative to digital banking.

Recommendation:

Government should develop a National Strategy for Financial Education and Inclusion. Such a Strategy should be led by a Government Department to ensure coordination between the various agencies with a role in supporting the development of financial literacy and education. A National Strategy should be designed to promote financial inclusion as well as broader financial education outputs.

To ensure a high level of consumer protection, regulation must adequately consider the risk of digital exclusion. In this regard the CCPC notes the proposed right of a consumer to request human intervention when interacting with a trader online in the European Commission's proposed amendment of the law relating to distance marketing of financial service contracts[97], thus ensuring the possibility for the consumer to interact with a human being representing the trader. The CCPC further notes that the Central Bank has indicated that it will conduct a review of the Consumer Protection Code in 2022[98].

Recommendation:

The CCPC recommends that the Central Bank include consideration of the risks of digital financial exclusion as part of the review of the Consumer Protection Code.

[96] As noted in 'Adult Literacy for Life', the Government's 10 year adult literacy, numeracy and digital literacy strategy, 47% of adults in Ireland lack basic digital skills (available here: https://www.adultliteracyforlife.ie/f/120607/x/133e8d1481/15607_all_strategy_web.pdf).

[97] See Article 16D of a Proposal for a Directive of the European Parliament and of the Council amending Directive 2011/83/EU concerning financial services contracts concluded at a distance and repealing Directive 2002/65/EC, https://ec.europa.eu/info/sites/default/files/1_1_189477_prop_dis_en.pdf

[98] https://www.centralbank.ie/docs/default-source/regulation/consumer-protection/consumer-protection-outlook-report/consumer-protection-outlook-report-2022.pdf?sfvrsn=6

Access to cash

The CCPC notes the findings of the consumer survey commissioned to accompany the Retail Bank Review Consultation. That survey found that there is a high degree of confidence among consumers in using most automated branch services and online banking services. However, those aged over 55 and in particular those aged over 65 or from the C2DE socio-economic groups are less confident in doing so. The survey found that one in five adults expressed a preference for cash and this is in turn higher among those aged over 55. One in six consumers access cash in branch. The CCPC notes the findings of the Euro Retail Payment Board report on access to cash and acceptance of cash[99]. That report found that although access to cash is not yet a major issue in most countries, there are increasingly voiced concerns that access to cash and banks' cash service levels is generally deteriorating.

There has been a reduction in the number of branches in Ireland in recent years. Central Statistics Office (CSO) data published in 2020 showed that just over 43% of the population lived less than 2km from a bank with cashier services[100]. This percentage increased to over 86% for people living in Dublin City. One in five people lived 10km or more from a bank in 2016. Just 1.5% of people in Ireland resided 10km or more from their nearest post office. The CSO data shows that there is considerable variation in the distances to cash services in Ireland, particularly in some rural areas.

The CCPC recognises the importance of continued access to cash services, particularly for those consumers at risk of financial exclusion or those who are less able to engage with services online. An Post provides significant access to cash services through its partnerships with AIB, Bank of Ireland and Ulster Bank. The CCPC also notes the recommendation of the Indecon report 'Evaluation of Concept of Community Banking in Ireland' that Retail Banks 'should consider the establishment of an increased number of Community Banking Hubs or provide alternative methods of banking services delivery in areas where branch closures may have hindered access to banks.' The CCPC is of the

[99] https://www.ecb.europa.eu/paym/groups/erpb/shared/pdf/16th-ERPB-meeting/Report_from_the_ERPB_working_group_on_access_to_and_acceptance_of_cash.pdf
[100] https://www.cso.ie/en/releasesandpublications/ep/p-sdg8/irelandsunsdgs-goal8decentworkandeconomicgrowth2021/infrastructure/

view that the concept of Community Banking Hubs has merit in situations where there is a risk of further reduction of banking services.

Recommendation:

The CCPC recommends that the Department of Finance consider the market impact and potential competition issues that may arise from the establishment of banking hubs.

Conclusion

The CCPC believes that there is considerable scope to reform the operation of the retail banking sector in Ireland. We have set out a number of recommendations in this submission which, if implemented, are intended to promote competition, consumer welfare and financial literacy. A more competitive retail banking sector can contribute significantly to economic and social development in Ireland by meeting the needs of consumers and businesses for financial products and by maintaining access to important services in all areas of the country.