Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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A Guide to Consumer Protection Risk Assessment


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Purpose of this Guide

The purpose of this Guide is to set out the Central Bank of Ireland's ("the **Central Bank**") approach to carrying out Consumer Protection Risk Assessments ("**CPRAs**"). It also describes the Central Bank's expectations of regulated financial services firms in implementing or enhancing their frameworks for managing risks to consumers.

Foreword

The Central Bank has a statutory mandate to ensure that the best interests of consumers are protected. Our vision is of a well-functioning, well-managed and well-regulated financial services sector that is underpinned by a mature risk management culture, with firms and individuals within those firms acting in the best interests of their customers. This vision is backed up by comprehensive legislation, rigorous supervision, a credible threat of enforcement and powers of redress when consumers have suffered detriment.

As highlighted in the 2017 Consumer Protection Outlook Report, it is important that all regulated financial services firms understand the risks faced by their consumers, not only from the products and services they buy but also from the behaviour of the firms themselves and that of the wider market. In order to deliver the right consumer outcomes, in a consistent and sustainable way, firms need to have appropriate risk management frameworks in place. The enhancement of our Consumer Protection Risk Assessment model enables us to assess how firms are managing the risks they pose to consumers and ensure they have appropriate risk management frameworks to deliver for their consumers.

Our consumer protection objectives

We aim to deliver on our consumer protection mandate in the context of three desired consumer protection outcomes, which are:

- A positive consumer-focused culture that is embedded and demonstrated within all firms;
- A consumer protection framework that is fit for purpose and ensures that consumers' best interests are protected; and
- Regulated firms that are fully compliant with their obligations and are treating their customers, existing and new, in a fair and transparent way.

Our supervisory framework

We use the Probability Risk and Impact System ("**PRISM**") as the framework for supervision of regulated firms. PRISM facilitates our supervisors in judging the risks that a firm poses to the economy and to consumers and in mitigating those risks we consider unacceptable.

In line with PRISM, we adopt a risk and evidence-based approach to prioritising our work, which ensures that we are focusing our resources on those areas where we consider there to be a significant threat to our consumer protection objectives. To support this approach, we carry out comprehensive annual risk assessments, whereby we examine each of the retail sectors regulated by the Central Bank to identify current and emerging Consumer Protection Risks. This assessment is informed by intelligence from a number of sources, including:

- Our supervisory work and experience (both prudential and conduct), including analysis of consumer data submitted by firms;
- External and internal market research and analysis;
- Developments at a European and international level;
- Advice from the Central Bank's Consumer Advisory Group; and
- Our engagement with stakeholders, including consumer representatives and statutory consumer bodies.

We publish our assessment of the key current and emerging risks to consumers on an annual basis and we expect each regulated firm to consider and manage these and any other relevant risks in the context of its strategy and business model. The assessment also informs our own supervision priorities and work-planning.

We use thematic inspections to assess priority risks to consumers, for example, by focusing on a particular product and/or delivery channel or on a particular activity. Thematic inspections focus on a number of firms within an industry sector or across sectors. This allows us to determine whether standards, at an industry-level, are at or near the level we expect or whether there appears to be an industry-wide issue which may require policy changes, supervisory intervention or enforcement action to secure appropriate change.

Firm-specific CPRAs will form a key part of our supervisory framework for credit institutions, non-bank lenders, insurance undertakings, investment firms, large retail intermediaries, payment institutions and e-money institutions. CPRAs will allow us to assess how these firms are identifying and managing risks to consumers in the context of their strategies, business models and their internal structures and processes. These assessments will be in addition to and support our regular program of thematic inspections, which examine whether firms are complying with consumer protection requirements including our statutory codes of conduct and relevant European directives.

This introduction of CPRAs is a key element of our supervisory strategy to influence a more positive consumer-focused culture in the firms we regulate. We will also continue our bi-lateral engagements with boards and CEOs to ensure that there is a focus from the top on embedding a culture that *gets it right for consumers*.

Bernard Sheridan
Director of Consumer Protection

1. Consumer Protection Risk Assessment (CPRA)

1.1 Why the Central Bank is introducing CPRA

Under PRISM[1], '*Conduct Risk*' is defined as the risk a financial services firm poses to its customers from its direct interaction with them. To date, this risk has been assessed by supervisors through an examination of the nature and scope of a firm's products and how the firm controls the risks its products and other engagements with consumers present to them.

In 2016, the Central Bank enhanced its model for assessing conduct risk, recognising that risks to consumers can stem from a firm's strategy, business model, culture, governance and other internal structures, its systems and processes or the behaviours of individuals at any level within the firm ("**Consumer Protection Risk**"). The CPRA model supports supervisors in looking beyond the firm's 'direct interaction' with consumers and facilitates the Central Bank's assessment of the likelihood and impact of customer detriment crystallising or unfair consumer outcomes materialising.

Examples of significant and systemic issues of Consumer Protection Risk are well publicised both globally (for example, Payment Protection Insurance issues) and domestically (for example, tracker mortgage-related failings). These conduct and compliance failures highlight the need for firms to improve their risk management and risk behaviour and have put a spotlight on the crucial role that a firm's culture plays in ensuring fair outcomes for consumers.

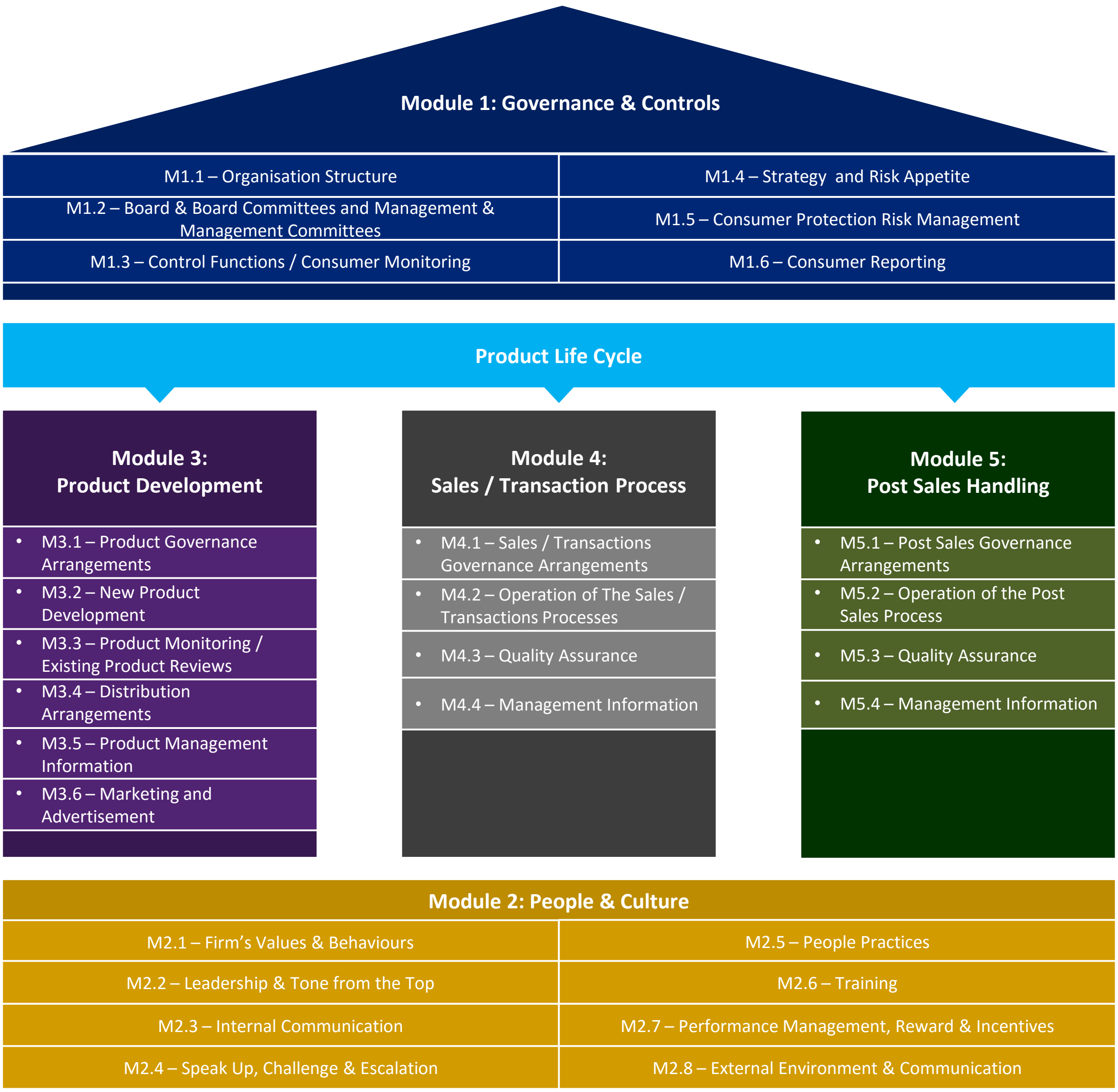
Some Consumer Protection Risks can be mitigated by implementing structural solutions, for example, through the adjustment of remuneration and incentive schemes. However, a true solution can only be achieved through a more holistic self-assessment of Consumer Protection Risk by the firm. Each regulated financial services firm must, therefore, work towards the development, implementation and embedding of a fit-for-purpose Consumer Protection Risk management framework. This framework should identify and manage the specific risks that the firm's external operating environment, strategy, business model, internal processes and procedures pose to consumer protection.

[1] See PRISM Explained, February 2016

1.2 What CPRA is

The Central Bank's CPRA model comprises five modules as outlined in Diagram 1 below. The CPRA model, in its entirety, is reflective of an appropriate Consumer Protection Risk management framework. The Central Bank's expectation is that, over time, all firms engaged in the provision of financial services will have risk management structures that are aligned to such a framework, proportionate to the nature, scale and complexity of the firm.

Diagram 1: CPRA Modules and Elements



Each module comprises a number of distinct elements, with each element attached to a specific risk in relation to consumer protection. An example from each module is set out below:

- **Module 1 Governance & Controls**: This module considers whether the organisation structure is appropriately designed to allocate roles and responsibilities in relation to the effective management of Consumer Protection Risks. Under the *Board & Board Committees and Management & Management Committees* element, supervisors will assess the risk that the board and management committee structure is not effective in identifying and managing the firm's Consumer Protection Risks; and

- **Module 2 People & Culture**: This module considers whether a firm has a truly consumer-focused culture that is underpinned with strong internal support structures that incentivise the required behaviours and hold people accountable for their behaviours. Under the *People Practices* element, supervisors will assess the risk that the firm's expected behaviours, specifically in relation to Consumer Protection Risk, are not reinforced in the key stages of the employment lifecycle, including recruitment, induction and promotion.

There are **three modules in the product life cycle** assessment and these are interlinked. These modules consider a firm's governance and controls over the design and ongoing assessment of all consumer products and services, whether the firm is a provider or distributor. An example from each module is set out below:

- **Module 3 Product Development**: under the *Marketing and Advertising* element, supervisors will assess the risk that marketing and advertisements are released that do not describe the product or service in a clear, fair and not-misleading way leading to potential misunderstanding by consumers and poor purchase decisions;

- **Module 4 Sales/Transactions Process**: under the *Management Information* element, supervisors will assess the risk that management information to monitor and track sales performance is insufficient to ensure fair consumer outcomes are being achieved; and

- **Module 5 Post Sales Handling**: under the *Operation of the Post Sales Process* element, supervisors will assess the risk that post sales systems and controls are not operating as consumers had been led to expect and/or lead to unreasonable post sale barriers resulting in unfair consumer outcomes.

1.3 How CPRA will work in practice

The purpose of the CPRA model is to provide the Central Bank with a framework to assist supervisors in carrying out an assessment of how Consumer Protection Risk is managed within regulated firms. The model has been designed to facilitate supervisors in assessing risks in respect of selected elements of the model. As elements are selected on a risk- and evidence-basis, it is not necessary to assess all modules and all elements in order to conclude on an overall risk-rating for a firm.

Scope of a CPRA

The Central Bank will, in the main, conduct targeted CPRAs, selecting specific modules and elements, which focus on priority risks. Assessments will be tailored in line with our risk-based supervisory approach to ensure they are proportionate to the nature, scale and complexity of the firm being assessed. They will also be tailored using supervisors' knowledge and experience of the firm subject to assessment.

Design Review and Effectiveness Review

Supervisors' work programmes will comprise two separate assessments: a design review and an effectiveness review. As the names suggest, the design review will assess the overall design of the control in place to mitigate the risk and the effectiveness review will assess the operational effectiveness of the control.

CPRAs will be intrusive in nature. Once the design of the controls has been assessed, supervisors will then seek concrete evidence of how effectively the control operates in practice. Supervisors will review policies and procedures (including HR policies, such as recruitment, induction, performance management and reward); observe at board and key committee meetings; 'walk-through' systems; conduct substantive testing to test consistency of application of the controls and interview a selection of staff from all levels in the firm, i.e. board level, second and third line functions and front-line business units, product development, marketing and sales staff.

CPRA rating methodology

Supervisors will form judgements on the Consumer Protection Risk posed by the firm in relation to each risk category based on an assessment of the design and effectiveness of the firm's controls. Following the assessment of the firm's controls, each element included in the targeted CPRA will be rated by supervisors and this rating, together with a written rationale from supervisors will be recorded on the PRISM system.

The rating of risks and firms will facilitate the Central Bank's view of the maturity of Consumer Protection Risk management frameworks within individual firms, within peer groups and across the financial services sector. These ratings will be assessed and tracked over time to identify trends.

2. What CPRA means for your firm

The Central Bank expects boards and senior management in regulated financial services firms to fully recognise their responsibilities in relation to the governance and management of Consumer Protection Risks and to place these responsibilities among their top priorities. All regulated firms must implement Consumer Protection Risk management frameworks that are proportionate to the nature, scale and complexity of the firm and the risks they are designed to manage.

The Central Bank will assess the design and effectiveness of firms' Consumer Protection Risk management frameworks through targeted CPRAs.

2.1 How the Central Bank will engage with your firm

Each selected firm will receive a formal communication from the Central Bank in the first instance, notifying it of the planned CPRA and informing the firm of the timing and intended duration of the on-site assessment, the documentation request and other required information, as appropriate.

Prior to commencing the on-site assessment, notice will be given in relation to proposed observation by supervisors at board and/or committee meetings; proposed interviewees and timeline for interviews and relevant contact personnel in the firm, who should be available during the on-site assessment. It is possible that as a CPRA progresses, supervisors may wish to observe further meetings and/or interview further personnel.

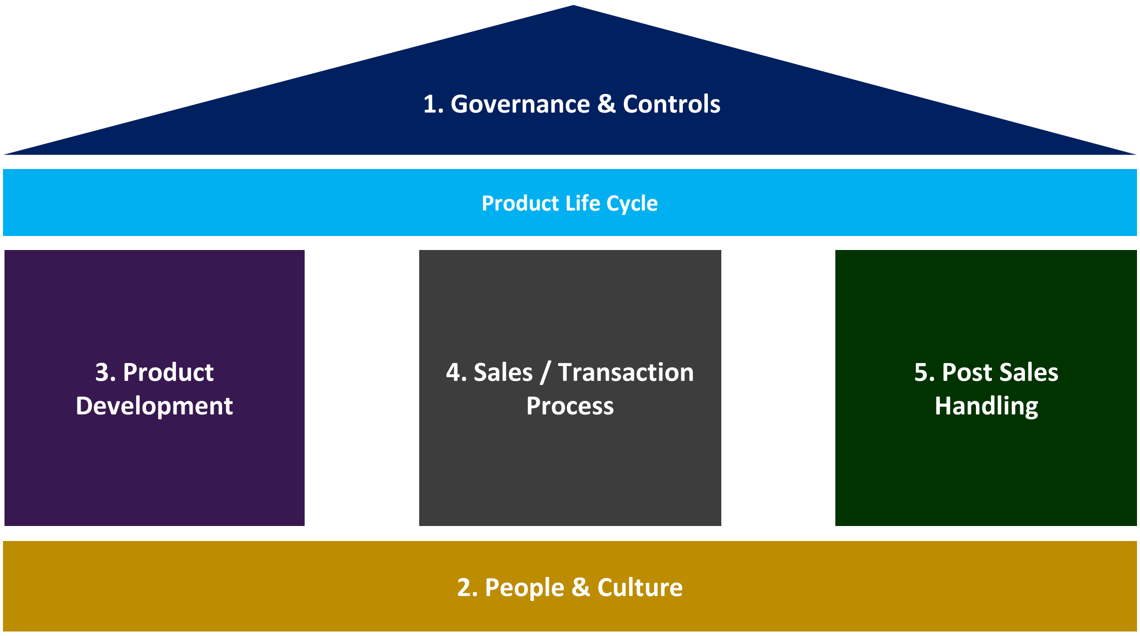
On-site assessments will typically range from two days to one week in duration, but may extend beyond this in some cases depending on the size of the firm and the breadth of the CPRA scope. At the end of the on-site assessment, the supervisors will meet with relevant personnel to discuss any outstanding issues that require clarification.

Formal feedback will be issued to the firm after the supervisors' findings and recommendations have been considered in line with Central Bank governance arrangements. Firms will be provided with the final risk ratings. Where risks are identified which are deemed unacceptable, the Central Bank will typically impose a risk mitigation programme on the firm, explaining the nature of the risk identified and requiring it to perform outcome-focused action(s) to mitigate the risk within a prescribed timeframe. However, as is the case in all of the Central Bank's supervisory work, other supervisory tools may be used such as instructing a firm to cease a practice or modify a process, or use of regulatory powers, including, for example, the imposition of directions on firms.

2.2 Aspects of an appropriate Consumer Protection Risk management framework

There is no single or one-size-fits-all framework for managing Consumer Protection Risks. However, the Central Bank is of the view that an appropriate Consumer Protection Risk management framework will include the aspects depicted in Diagram 2 below. These aspects can be further broken down, as depicted in Diagram 1 on page 8:

Diagram 2: Modules of an appropriate Consumer Protection Risk management framework



The governance and control framework should include a comprehensive risk management process, which is underpinned by the culture and behaviours within the firm. The three pillars within a firm, which manage Consumer Protection Risk on a daily basis, make up the product lifecycle, i.e. from product/service development to sales to post sales handling. To effectively manage Consumer Protection Risk, firms must ensure that relevant systems and controls are embedded across all five aspects above. There is no requirement to develop a separate and discrete framework for Consumer Protection Risk management, rather it is preferable that it is embedded throughout the firm's risk management and internal control framework.

2.3 Steps to developing an appropriate Consumer Protection Risk management framework

The following steps, at a minimum, should be considered by firms when developing or enhancing their Consumer Protection Risk management frameworks:

- Identify Consumer Protection Risks, which will be specific to each firm;
- Articulate the firm's Consumer Protection Risk appetite;
- Document the governance, systems and controls in place to manage and mitigate Consumer Protection Risks;
- Ensure Consumer Protection Risk awareness throughout the firm;
- Assign clear ownership and accountability for Consumer Protection Risks; and
- Monitor and track the risks using appropriate methodologies, metrics and management information ("**MI**").

A fundamental part of a Consumer Protection Risk management framework is to ensure appropriate systems and controls have been designed and implemented effectively. Evidence of the design of relevant controls can be embedded throughout the operational framework of a business, for example:

- A specific Consumer Protection Policy such as Management of Complaints and relevant operational procedures;
- Consumer Protection Committee or clear allocation of consumer protection responsibility embedded within another governance forum; and
- Appointment of a Head of Consumer Protection/Conduct or clear allocation of responsibility and accountability within other roles.

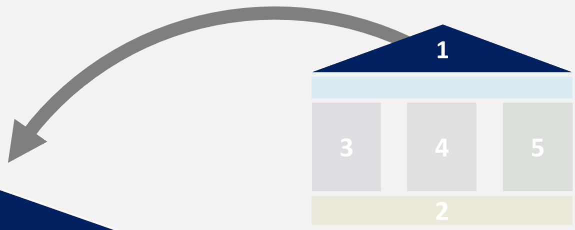
Once a firm has designed adequate controls to manage and mitigate Consumer Protection Risks, it is equally important that the firm ensures that the control is being applied in the way it was intended to and is operating effectively in practice. Effectiveness of controls can be monitored in many ways, including:

- Regular monitoring of relevant MI, such as key risk indicators or key performance indicators, specifically related to Consumer Protection Risks / issues (see **Appendix 1** for examples of Consumer Protection Risk MI);
- Ongoing monitoring of consumer outcomes; and
- Ongoing monitoring and testing of controls independently by the third line of defence (Internal Audit) and /or the second line of defence (Compliance and Risk Management functions).

2.4 Consumer Protection Risk management in practice

Each firm must design a Consumer Protection Risk management framework that is proportionate to the nature, scale and complexity of the firm and the risks that the firm is seeking to manage. Using the modules from the framework in Diagrams 1 and 2 above, examples of practices, which may reduce the risk of unfair consumer outcomes, are set out in Diagrams 3, 4 and 5 below. These examples are for illustrative purposes only. The onus is on each firm to carry out a robust risk assessment and to develop appropriate systems and controls to mitigate its own Consumer Protection Risks.

Diagram 3: An illustrated example of Governance & Control practices that demonstrate a positive Consumer Protection Risk management framework

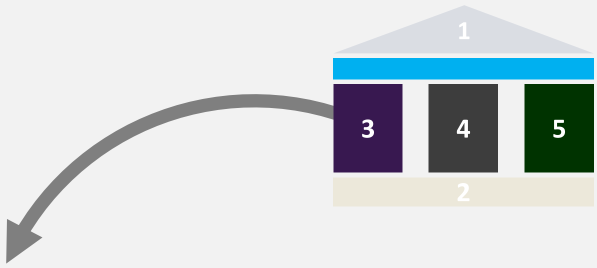


1. Governance & Controls

- Reporting lines and management responsibilities and accountabilities for Consumer Protection Risk are clear and transparent;
- Evidence of a clear understanding at board, board committees and management committees of key Consumer Protection Risks;
- Evidence of a clear understanding of individuals' responsibilities and skillset required to oversee and challenge the management of these risks;
- All aspects of strategy formation/decision-making at board level demonstrate that the consumer is central to the process and take full account of the implications of the firm's strategy on consumer protection;

- Compliance and Risk functions are involved by the firm and proactively consulted on Consumer Protection Risks with the ability to influence decisions. As a result, the firm can provide examples of where Compliance or Risk functions have prevented the firm from taking action or substantially changed the action as a result of concerns about consumer impact;
- The board can demonstrate that it has or can address Consumer Protection Risks that have been escalated to it; and
- The board tracks and monitors Consumer Protection Risks.

Diagram 4: An illustrated example of practices within the Product Life Cycle that demonstrate a positive Consumer Protection Risk management framework



Product Life Cycle

3. Product Development

- Product development committees/forums consist of an appropriate balance of members, e.g. marketing/sales, compliance, risk and consumer advocacy representation, at a senior level to consider the consumer impact;
- Products are withdrawn or not launched where concerns from a consumer perspective exist;
- Consumer research is undertaken that seeks to get a better understanding of the target market in order to establish consumers' potential needs and understanding of the product;
- Oversight and monitoring of complaints, consumer feedback and relevant distribution channels to assess ongoing ability of product design to meet consumer needs; and
- Consumer Protection Risk is tracked and monitored.

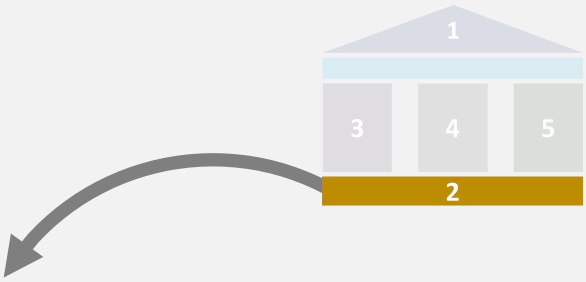
4. Sales / Transaction Process

- Consumer outcomes are recorded and tracked;
- Sales aids, training and procedural documentation support appropriate sales and are designed to ensure that sales staff clearly explain the key features for each product or service offered to ensure that consumers are able to make informed decisions;
- Sales areas (whether indirect or direct sales methods are used) are subject to regular quality assurance monitoring by external functions, e.g. internal audit and compliance;
- Seek confirmation from consumers in relation to understanding eligibility and other key product information;
- Documented process to escalate consumer detriment; and
- Consumer Protection Risk is tracked and monitored.

5. Post Sales Handling

- Clear policy and procedure in relation to post sales services and adequate training for staff providing such services, resulting in fair consumer outcomes;
- Clear accountability for consumer outcomes and issues identified are remediated;
- Root cause analysis of complaints, appeals, issues or other matters escalated in relation to Consumer Protection Risk and evidence that this analysis was used to mitigate future similar risks; and
- Monitoring of post sales activities to identify any potential unsuitable or unfair consumer outcomes and potential consumer detriment that could occur if there are failings in the post sales process or the quality of service and/or advice, e.g. random sampling of call centre calls, ongoing reporting of key performance and key risk indicators.

Diagram 5: An illustrated example of People and Culture practices that demonstrate a positive Consumer Protection Risk management framework



2. People & Culture	
• Clear documentation of the vision and values in the firm, specifically in relation to treatment of consumers and this is evidenced by, for example consideration of the impact of the firm's decisions on its customers; • The firm can demonstrate, with clear examples, how leadership actions and communications are encouraging a culture of consumer protection throughout the firm, from top to first line; • Clear oversight, responsibility and accountability for culture and behaviours related to consumer protection; • Remuneration structures reward consumer protection behaviours over sales volumes;	• Performance management and remuneration processes include assessment of and reinforces employee behaviours relating to Consumer Protection Risk; • Promotion process takes account of employees' behaviour, including where employees have/ have not consistently exhibited commitment to the firm's values and desired behaviours in relation to consumer protection; • Employees are aware of escalation channels with respect to consumer protection matters, and feel they are encouraged to 'raise their hand' without fear of reprisal and can provide examples of where they have done this; and • Consumer Protection Risk is tracked and monitored.

3. Conclusion

Poor business practices and behaviours can and do impact on the lives of large numbers of consumers and persistent unfair outcomes for consumers can lead to adverse consequences for firms and the sector more broadly, including the significant cost of putting things right, reputational damage, loss of trust among key stakeholders and a decline in business.

Consumer Protection Risk management, therefore, has wider social and economic benefits that go beyond the regulatory framework. Introducing or enhancing Consumer Protection Risk management frameworks is critical to the pre-emptive and proactive management of Consumer Protection Risk. An effective framework will go above and beyond minimum compliance with relevant legislation or codes of conduct, by putting consumers' interests at the heart of what the firm does.

Appendix 1

Examples of Consumer Protection Risk management information

- Number of training programmes attended by board members and senior management annually related to consumer protection risks.
- An analysis of how the firm uses MI relating to consumer outcomes. For example, what was discussed, who was present, and how decisions were reached.
- An analysis of consumer matters such as complaints, errors, claims and appeals to determine if there is sufficient discussion and challenge on the matter.
- Product root cause analysis e.g. cancellations/complaints/errors/reasons for re-submission to Product forum/committee to ensure the product is designed to meet the needs of the target market.
- The number of conflicts of interest issues with a potential consumer impact that have been escalated in the last year (both internally and, where relevant, to the Central Bank).
- The number of proposals challenged and/or turned down by the board (or its committees) for valid consumer protection risk reasons in the last year.
- An analysis of the MI and minutes which include information on consumer matters for adherence to the firm's own Consumer Protection Risk appetite.
- The percentage of risks captured on the firm's risk register which relate to Consumer Protection Risks.
- Number of new products launched without product forum/committee approval to ensure that there is no process/control breakdown which may result in unfair outcomes for consumers.
- Percentage of new/existing products escalated to committees other than the product forum/committee for a decision. This may be an indicator of an increased demand to write products not aligned to the firm's product risk appetite or challenge from the firm of the product forum/committee decisions.
- Percentage of new products rejected by the product forum/committee for consumer reasons which may indicate poor understanding by the developers of Consumer Protection Risks.

- Percentage of overdue existing product reviews as an indicator of the level to which Consumer Protection Risks within existing products may remain undetected.

- Percentage of existing products withdrawn for consumer protection reasons which may indicate that products are no longer meeting current expectations for levels of Consumer Protection Risk.

T +353 1 224 6000 **F** +353 1 224 6561 www.centralbank.ie

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Bosca PO 559, Baile Átha Cliath 1, Éire
PO. Box No 559, Dublin 1, Ireland