Introductory remarks by Deputy Governor (Financial Regulation) Cyril Roux at the Joint Committee of Inquiry into the Banking Crisis

10 June 2015

Mr Chairman, Members of the Joint Committee,

Thank you for the opportunity to share with you my experience as Deputy Governor for Financial Regulation since I joined the Central Bank of Ireland (CBI).

This Committee has been established, first, to address the reasons Ireland has experienced a systemic banking crisis and, second, to review the preventative reforms implemented in the wake of the crisis.

As regards the first theme of inquiry, I'm not close enough to the Irish experience of the previous decade to provide this knowledgeable Committee with special insight. That said, I'm well aware of the severe economic hardship brought about by the crisis. Many Irish households and Irish firms still suffer from it today. Hence all parties, including the CBI, must continue to do their utmost to prevent a replay of the banking crisis and protect the financial stability of the country. I'll share with you what I know of the reforms put in place here after the crisis before I joined, and I'll present the further European reforms that we have replaced them with in the past year and a half.

In October 2013, as I came into office, two independent, large scale exercises were in train to assess the effectiveness of the domestic framework that had been designed and put in place by my predecessor Mr Matthew Elderfield between 2010 and 2013.

The first one was the Balance Sheet Assessment of the three remaining covered banks, conducted as part of the 2013 Financial Measures Programme. It concluded with a view that the covered banks were mostly in financial working order, and required only moderate strengthening of their provisions, which they did bring into their year-end accounts, in the main.

The second large scale exercise was the IMF review of Ireland's observance of the Basel Core Principles for effective banking supervision. The IMF found that since the crisis had begun, the CBI had taken substantive steps to rebuild its functions in financial regulation and supervision, including changes in the institutional setting, changes of senior staff, increases in the quantity, albeit from a very low base, and caliber of supervisory staff. The IMF acknowledged the design and implementation of a proactive and intensive approach to supervision, the expansion of prudential requirements and improvement in enforcement powers. Overall the IMF ascribed to the CBI as of 2013 a satisfactory level of compliance with the aforementioned Basel Core Principles for effective banking supervision.

Taken together, these two reviews gave me sufficient assurance that Irish banks and Irish banking supervision, albeit not without need for further progress, had been put on a more solid footing, and that I could direct our 2014 efforts to moving towards the entry into force of the Single Supervisory Mechanism (SSM). This entailed two major lines of work.

The first line of work was internal and organisational, I will describe its outcome later.

The second line of work was the Comprehensive Assessment. Under the leadership of the ECB, we conducted, like the other national supervisory authorities, an Asset quality review and a stress test of the top 120 Eurozone banking groups. The results were published in the Comprehensive Assessment report of the ECB in October 2014. The ECB found that around one out of five Eurozone banking groups was in need of recapitalisation. Out of the four top Irish banks, only Permanent TSB was found to need supplementary capital to fully withstand an adverse stress test. PTSB subsequently raised the required capital in May of this year.

Let me now change tack and describe the overhaul of the banking regulatory framework

Domestically, between 2010 and 2013, the Oireachtas and the CBI introduced several pieces of legislation, codes and regulations which much strengthened the requirements weighing

in on commercial banks and the hand of the CBI in supervising them and enforcing against their breaches. These new requirements were additional to the prevailing European capital requirement directive.

Internationally, between 2010 and 2013, three large initiatives unfolded that are directly relevant to matters of the Inquiry.

First, in 2010, the EU adopted the European System of Financial Supervision, comprising the European Systemic Risk Board (ESRB) and the three European Supervisory Authorities including the European Banking Authority (EBA). The ESRB is tasked with macro prudential oversight in Europe, while the EBA is in charge of banking supervisory convergence and drafting secondary legislation.

Also in 2010, the Basel Committee on Banking Supervision addressed the inadequacies of its second agreement and replaced it by the third agreement (Basel III), This third agreement forms the basis of the new prudential banking regulatory framework in Europe, adopted under the Irish presidency of the EU Council, and enshrined in the fourth capital requirements directive (CRD IV) and the capital requirements regulation (CRR). They have been in force from 1 January 2014.

Finally, in 2012, the EU heads of states and governments decided on the Banking Union, which also started to come into force in 2014 as far as the SSM is concerned.

The changes have been profound. I will try to give you a flavour of the depth and breadth of this new, multifaceted regime, starting with CRD IV and CRR.

Both the quantity and quality of capital that banks are required to hold are now much increased. Whereas up to the end of 2013, banks could operate with as little as 2 per cent of capital, they need now at least 4.5 per cent of a more tightly defined equity. Furthermore the new regulatory framework introduces the possibility for macroprudential authorities to impose several additional capital requirements, known as buffers, to all banks in their jurisdiction. The CBI has been designated as macroprudential authority for this purpose in March 2014.

From 1 January 2016, as agreed throughout Europe, all banks will have to begin building one of these buffers, the capital conservation buffer, for an additional 2.5 per cent of risk-weighted assets.

Liquidity Requirements, which were domestic until then, are now harmonised at a much tighter level under the liquidity coverage ratio. The existing CBI Liquidity Requirements which were introduced in January 2007 are being replaced by this LCR which will be fully binding in 2018.

The CRR also introduces a net stable funding obligation to enhance a bank's funding profile into the medium term and a leverage ratio requirement which caps banks assets to no more than 33 times Tier 1 capital.

Finally, the quality and granularity of banks' regulatory reporting have been also significantly enhanced from January 2014 by the CRR and subsequent standards and guidelines of the European Banking Authority, covering financial reporting, credit risk, operational risk, own funds and capital adequacy ratios.

The transformation of the regulatory framework for banks, from what it was up to the end of 2013 to what it is becoming, does not stop at prudential supervisory requirements. Lessons were also learned about the way to resolve the difficulties of banks that are failing or likely to fail. This has entailed another change in regulatory framework through the adoption of the Bank Recovery and Resolution Directive (BRRD) and the enactment of the Single Resolution Mechanism (SRM). The BRRD and the SRM aim to create a predictable framework for resolving banks that fail in the future.

The BRRD provides a toolkit for resolving banks, such as the bailing in of unsecured liabilities in lieu of the bailing out of the banks by taxpayers. The CBI has been designated as the National Resolution Authority and is already working with the banks to develop resolution plans in line with the BRRD requirements.

For larger Eurozone banks, including our own, resolution decisions will be made from January next year by the Single Resolution Board in Brussels. It will avail of the new pre-funded resolution funds in the Eurozone, which are to be gradually mutualised.

Let me know turn to the transformation of the supervision of Eurozone banks from 2014.

As I mentioned earlier, in 2012, EU heads of States and governments agreed to transfer the responsibility for supervising banks to the European level with the establishment of the SSM. Eurozone banks have come under the supervision of the ECB since November 4, 2014. The ECB directly supervises the largest European banks, including Bank of Ireland, AIB, Permanent TSB and Ulster Bank, with our assistance and that of other national supervisors. We supervise the smaller banks under the oversight of the ECB.

The revamped banking supervisory framework put in place at the CBI by Matthew Elderfield has mostly been superseded by the SSM. Our domestic supervisory engagement cycle, approval procedures, and internal supervisory guidance, enshrined in PRISM, were effective from 2011 to October 2014; they have now been replaced by the prescriptions of the SSM Supervisory Manual, which are guided by a similar, if not more, tough, intrusive and skeptical ethos. Daily supervision of the larger banks is conducted by joint supervisory teams, mostly made of CBI staff, but always headed by an ECB coordinator based in Frankfurt. These coordinators propose draft decisions drawn in consultation with us to the Supervisory Board of the ECB, where I sit. When approved, these draft decisions are submitted to the Governing Council and finally signed by the President of the ECB.

In the CBI, Banking Supervision was reorganised and further strengthened in the course of 2014. Approved headcount in Banking Supervision was brought up to 140, and actual headcount has increased to 124. We have thus reduced, albeit partially, the numerical gap with Eurozone standards. Instead of two generalist divisions, we now have three: one is dedicated to ongoing supervision, one to specialist expertise, and a wholly new third division carries out onsite inspections year round. This structure aligns the CBI with the organisational requirements of the SSM and further enhances our supervision.

Let me conclude by restating a few key messages.

In our country, the institutional arrangement of Financial Regulation, the engagement framework and practice of prudential banking supervision were overhauled during the tenure of Mr. Elderfield in the wake of our domestic banking crisis. As of 2013, much repair had been achieved. On the European stage, the lessons of the global banking crisis resulted

in an overhaul of regulation, supervision and resolution that has started unfolding at the end of 2013. While the EFSF was put in place in 2011, the CRD IV, CRR and BRRD come gradually into force from 2014 up to the end of the decade, the SSM is operational since November 2014 and the SRB will assume its functions in January 2016. These new European regulations and institutional arrangements have in the main superseded the domestic response of the 2010-2013 to our national banking crisis and are designed to address the challenges of public banking oversight and resolution at a European level, in lieu of national decision-making that prevailed until 2013.

Thank you.