TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

Central Bank
CB: Core Book 8

January 2016

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THEME: R1

Effectiveness of the regulatory, supervisory and governmental regime structure

LINE OF INQUIRY: R1a

Appropriateness of the regulatory regime

IMPLEMENTATION GROUP FOR REFORM OF REGULATORY STRUCTURES (IG)

DRAFT MINUTES OF 1ST MEETING HELD ON 24 JUNE 2009

Present:

Department of Finance : W. Beausang

Central Bank : T. Grimes
M. O'Dea
B. Halpin
C. Horan
A. M. McKiernan (Secretary)

1. The **Agenda** was adopted.

2. Introductory Issues

It was agreed that the Department of Finance will be charged with chairing the IG, although effectively a joint-Chairmanship approach can be used on many issues given the predominance of topics specifically of relevance to the Central Bank.

3. Government Decision (see Annex) – Issues Arising

The decision of Government on the reform of institutional structures for financial regulation in Ireland was set out in a Press Release of 18 June. Clarification was sought on

(i) Reference in Press Release to "introduction of a Voluntary Early Retirement Scheme" (VERS) in the Central Bank. It was confirmed by the Dept that the intention here is to give maximum flexibility to the new organisation, to enable it to refresh where necessary its staff complement to have the appropriate skills set for its new responsibilities. This is not meant to commit the organisation to introducing a VERS, or to replicate the terms of the public sector system. It was agreed that, while no VERS is under consideration at present, the organisation should retain this option for added flexibility.

(ii) Whether the Consumer Director position is likely to be part of the new CBI organisation structure. The Dept does not expect the Consumer Director post to be in the CBI, but confirmation will be sought.

(iii) The reference to "A specific differentiated regulatory focus.... (for) International Financial Services located in Ireland". The Central Bank's concerns are that this might be perceived in the market as suggesting a "lighter touch" regulatory approach to IFSC entities than to domestic entities, which could have negative reputational consequences for the new structures. It was confirmed that more discussion is needed, both within the Department and by the IG, on clarifying 1. the scope and scale of regulation of the IFSC sector and 2. how this role fits in with the evolving EU approach and structures on financial regulation.

(iv) What is intended regarding industry funding of financial regulation? This issue was due for review under the original arrangements and this review will now be part of the work of the IG. It was noted that the trend internationally appears to be moving closer to full funding of this role by industry, notwithstanding concerns regarding regulatory capture.

(v) Whether there is any additional information from the Department's side on the transfer of consumer functions to the National Consumer Agency? It was clarified that the Department of Finance intends to meet the Department of Enterprise, Trade & Employment on this issue, when there is some clarity about what the draft legislation covers. The Department were also asked for any views which they may have on possible approaches to movement of staff to the NCA, to ensure these can be dealt with at an early stage.

4. Legal Issues

The IG discussed the issue of the legislative amendments necessary to underpin the new structures and responsibilities. On the one hand, it would be appropriate to incorporate the necessary amendments into an extensive review of the Central Bank Act, 1942, which is due for consolidation, but on the other time pressures may merit a quicker and less extensive approach to legislative change. An essential input into this decision would be clarification of any proposed changes to oversight of the new structures by the Oireachtais. Different models of reporting by the organisation to external oversight bodies was discussed (e.g. public v. private reporting, confidentiality v. transparency considerations).

Regarding securities regulation, the Department has written to the EU Commission to indicate that this work will come under the aegis of the CBI, including arrangements for prospectus review currently delegation to the Irish Stock Exchange, when the delegation expires at end-2010.

5. Scope of work of the IG

It was clarified that it is not intended that the IG will deal with matters relating to the internal organisation of functions in the CBI, but rather the policies and decisions needed to ensure the new structures are implemented with line with the Government decision in a timely way. As well as dealing with matters requiring consultation and decisions, the two parties will also share information on all matters pertinent to the implementation of the new structures.

6. Modus Operandi & Resourcing of the IG

The IG will meet regularly – weekly for the near future – to scope out all the main issues to be followed-up. It was agreed that the appropriate resourcing of the IG will be facilitated. Specific issues for future discussion included (i) Structuring consultation with key stakeholders, and (ii) an assessment of the organisation's skills needs and gaps).

7. Update on filling of High-level Positions

The Central Bank gave an update on progress in the filling of top-level positions in the organisation. It was highlighted that an early decision on the composition of the new Board ("Commission") is essential, to (i) enable candidates for the top positions to be interviewed by a panel which comprises members of the new Commission, and to ratify the appointments, (iii) enable decisions on strategic scope and direction for the new organisation to be undertaken, on the basis of discussions involving the new members.

Next IG Meeting : Friday 3 July 2009 at 8.30 am.

Central Bank & Financial Services Authority of Ireland

Annual Report

Report of the Central Bank and Financial Services Authority of Ireland
for the year ended 31 December 2003

The Board of Directors and Management of the Central Bank and Financial Services Authority of Ireland

John Hurley, *Governor*

Liam Barron	David Begg	Tom Considine
Gerard Danaher	Friedhelm Danz	Roy Donovan
John Dunne	Martin O'Donoghue	Liam O'Reilly
Brian Patterson	Deirdre Purcell	

	Function	Head of Function
Director General Liam Barron	– *European Monetary Affairs and International Relations*	– John O'Leary
Deputy Director General and Secretary Brian Halpin	– *Financial Control*	– *Pat Treanor*
	– *Financial Markets*	– *Tony Grimes*
	– *Payments and Securities Settlements*	– *Dermot Maher*
Assistant Director General Louis O'Byrne	– *Currency Issue*	– Brian Murphy
	– *Currency Production*	– Daragh Cronin
	– *Engineering*	– Declan O'Brien
Assistant Director General Michael Casey	– *Economic Analysis, Research and Publications*	– Tom O'Connell
	– *Monetary Policy and Financial Stability*	– Frank Browne
	– *Statistics*	– Peter Charleton
Chief Executive Liam O'Reilly	– *Regulatory Enforcement and Development*	– Martin Moloney
	– *Registrar of Credit Unions*	– Brendan Logue
Prudential Director Pat Neary	– *Banking Supervision*	– Con Horan
	– *IFSC & Funds Supervision*	– Michael Deasy
	– *Insurance Supervision*	– Anne Troy
	– *Securities & Exchange Supervision*	– Mary Burke
Consumer Director Mary O'Dea	– *Consumer Information*	– Bernard Sheridan
	– *Consumer Protection Codes*	– George Treacy
Assistant Director General Gerry McGrath	– *Corporate Services*	– Hugh O'Donnell
	– *Human Resources and Planning*	– Jim Cummins
	– *Information Systems*	– Pádraig Ó Conaill
	Internal Audit	– Mary Sheehy
	Change Unit	

Donal Cahalane is currently on secondment to the World Bank as Advisor.

Foreword

Against the background of a generally improving international economy, Irish economic growth picked up through 2003. The increase in Gross National Product (GNP) was 3.3 per cent. A particularly favourable element was the performance of the labour market with unemployment remaining below 5 per cent. This generally positive picture is continuing into the first part of 2004.

While inflation has been relatively high for a number of years and still averaged 4 per cent in 2003, there has been a sharp improvement in the early part of 2004. The main factors behind this have been the appreciation in the exchange rate and weaker domestic demand. Inflation in 2004 is now forecast to be about 2¼ per cent. The deterioration in competitiveness in the recent past had been masked by the depreciation of the euro. However, the strengthening of the euro since mid-2002 has crystallised the adverse effect on competitiveness of a fairly prolonged period of relatively high inflation here.

House prices continue to increase at a rapid pace — 14 per cent for new houses nationally in 2003 — notwithstanding strong supply increases. This has been accompanied by extremely vigourous increases in residential mortgage credit — some 24 per cent on average in 2003. It is clear that these rates of increase must be reduced soon to a more sustainable pace.

Last year was a truly historic one for the organisation. The former Central Bank was fundamentally restructured, creating two separate entities that are linked by the sharing of services in relation to the supervisory function. The Financial Services Regulator is responsible for prudential supervision including consumer protection, and the Central Bank is responsible for overall financial stability. The two sides of the organisation cooperate and work closely together in the discharge of the latter function.

The creation of the new organisation was a major challenge for all concerned, and it represented change on an unprecedented scale. I am most impressed with the great progress that has been made in the short period of a little over a year. It is a great tribute to all staff and management. The good experience of the first year enables us to face the future confident that we can sustain and build on what we have already achieved.

One of the main organisational achievements of the past year has been the development of a three-year Strategic Plan. It represents the road map for the Central Bank and Financial Services Authority of Ireland over the next three years. This strategy is being published in conjunction with this Annual Report.

The launch of the Whitaker lecture series in honour of the former Governor of the Bank, Dr. T. K. Whitaker, on 31 May 2004 gave me particular pleasure. The lecture series, which is intended to be a biennial contribution by the Bank to economic debate in Ireland, is a fitting honour to a man who is recognised as having made an outstanding contribution to the development of modern Ireland in the twentieth century. I was very pleased that M. Jean-Claude Trichet, the President of the European Central Bank, was able to accept my invitation to deliver the inaugural lecture which is reproduced in this Report.

In conclusion, I would like to thank the members of the CBFSAI Board of Directors for all their work, leadership and assistance throughout the year. I would also like to express my sincere gratitude and thanks to the Chairman and Board of the Financial Services Regulator, with whom we have worked to ensure a smooth transition to the new organisation. Finally, I would like to commend all the staff of the CBFSAI, both in the Central Bank and in the Financial Services Regulator, for their work and commitment in what has been both a momentous and historic year.

Don chéad uair, tá leagan gaeilge den Tuarascáil Bhliantúil á fhoilsiú i mbliana. Fáiltím ó chroí le hAcht na dTeangacha Oifigiúla 2003. Cinnteoimid go gcuirfear seirbhísí d'ard chaighdeán ar fáil don phobal de réir chuspóirí agus dhualgaisí an Achta.

John Hurley,
Governor

Economic Overview

The recovery in the international economy finally began to pick up momentum over the course of 2003. After experiencing below-potential growth for a number of years, the major regional economies, with the exception of the euro area, began to see a notable upturn in growth, particularly in the second half of the year. Providing a platform for a pick-up in world activity more generally, the US economy experienced strong growth in the third and fourth quarters of 2003 and this has continued into the first quarter of 2004.

The Japanese economy experienced a resurgence in 2003 from the stagnation of previous years, registering growth of 3.6 per cent in the final quarter of 2003. Of significant importance to Japan and the world economy more generally has been the emergence of strongly growing East Asian countries, in particular China and India. Indeed, in 2003 East Asia became the euro area's largest export market.

In the euro area, the pace and nature of the recovery has been relatively disappointing, with GDP growth of just 0.9 per cent and 0.4 per cent in 2002 and 2003, respectively. The persistent weakness of private consumption can only partly be explained by sluggish growth in disposable income and lagged adverse wealth effects associated with the downward adjustment in equity markets. Other factors such as confidence effects related to the volatile geo-political situation, uncertainty about labour market prospects, the increasing awareness of the challenges posed by an ageing population and uncertainty generated by the relatively slow progress in structural reform are also contributing to the continued weakness in consumer spending.

During 2003 the euro exchange rate against the US dollar recovered strongly and was, on average, almost 20 per cent higher than in 2002. This seemed to reflect persistent concerns regarding the financing of the large US external current account, combined with the growing fiscal deficit and weaker than expected economic growth. In the early part of 2004, these exchange rate developments were partly reversed, although considerable volatility and uncertainty remain. The appreciation of the euro relative to sterling was more subdued, with the euro appreciating by about 10 per cent, on average, in 2003 over 2002, again with some turnaround evident into 2004.

The Irish economy has weathered the global slowdown and a number of earlier adverse shocks (particularly in the Information and Communications Technology (ICT) sector) reasonably well. Economic growth declined sharply from the unsustainable near double-digit rate over the 1995 to 2000 period. However, there were signs of a pick-up in the latter half of the year in line with the global recovery, and GNP growth reached 3.3 per cent in 2003. There was continued employment growth, at 1.8 per cent, and unemployment stabilised at a relatively favourable rate of 4.7 per cent of the labour force over the course of the year.

A significant factor in this better economic picture has been some pick-up in foreign direct investment (FDI) activity here. This had been relatively weak for some time against the background of a sluggish international economy and the substantial negative shock to the ICT sector. The outlook for FDI inflows looks quite positive in the light of the strong recovery in the US economy, from where most such flows come, and the relatively favourable business climate that continues to exist here. (This Report contains a paper on FDI.)

Another positive development in 2003 was the fall in inflation. Inflation, as measured by the HICP index, declined from 4.9 per cent in the first quarter of the year to 3.2 per cent in the final quarter. This easing was to be expected in the light of weaker demand growth, an easing of labour market pressures and an appreciating euro. By the early part of 2004, Ireland's inflation rate had come more into line with that of the euro area, and had declined further to 1.7 per cent by April 2004. However, this welcome development was preceded by a prolonged period of positive and persistent inflation differentials vis-à-vis the euro area. As a consequence, price levels in Ireland are now significantly above the euro-area average, and those of the US and the UK.

The strengthening of the euro during 2003 followed a period where the effect on competitiveness of cumulative unfavourable price and wage developments compared to elsewhere had been masked by exchange rate weakness. However, during 2003 the appreciation of the euro served to remove the latter effect. The Bank's real effective exchange rate index, which incorporates the effect of both price and nominal exchange rate changes on a trade weighted basis, appreciated by just over 10 per cent on average in 2003. This sharp movement has, undoubtedly, created a much more difficult competitive environment for many Irish businesses. As far as pay developments are concerned, average non-agricultural earnings rose by an estimated 5 per cent in 2003. This followed a large increase of 9.1 per cent in 2001 and about 5.2 per cent in 2002. These increases occurred against a background of increases of 2 to 3 per cent in euro-area countries.

In the area of fiscal policy, the state of the public finances is robust and compares favourably with most other euro-area member states. There was a General Government surplus of 0.2 per cent of GDP in 2003, which represents a significant improvement relative to the 2003 Budget target of a deficit of 0.7 per cent and is well within the limits set out in the *Stability and Growth Pact*. The policy stance was broadly neutral, with automatic stabilisers counteracting some of the fall-off in economic growth. The rate of increase in public spending was halved to 7 per cent in 2003, a rate more in line with the trend increase in revenue.

A continuing source of concern to the Bank is the protracted and continued rise in the price of housing, with new house prices nationally increasing by about 14 per cent in 2003. House price levels here are now amongst the highest in Europe, with new and second-hand house prices averaging €224,567 and €264,898, respectively, in 2003. Housing demand remains high, with cyclically low interest rates and reasonably positive developments in incomes and employment contributing to this. The supply response has been substantial, and housing output increased to about 69,000 units in 2003. This suggests that the market may be approaching equilibrium. The buy-to-rent sector of the market remains vulnerable, as rents have been falling throughout the year, reflecting significantly increased supply. Residential mortgage credit continued to increase strongly — by 24 per cent on average in 2003. Indeed, aggregate private sector credit increased strongly last year — the increase on average being almost 16 per cent — and the rate of increase has accelerated into 2004. There is clearly a limit to the extent that borrowers can sustain rates of credit growth that are substantially above nominal income increases. The debt to income ratios of Irish households, after being significantly less than those obtaining elsewhere for many years, are now on a par with other high-income countries. In the light of this, the Irish Financial Services Regulatory Authority will continue to liaise closely with the banking sector to ensure that adequate account is taken of lending risks and to urge consumers to be as fully informed as possible of the implications of assuming further borrowing.

Overall, the Irish economy performed relatively well in 2003 in the context of a generally weak international economic environment. Growth prospects for the international economy are improving this year. However, developments in oil prices, imbalances in the US and the geo-political situation pose potential risks.

The reduction in inflation in Ireland to the level of the euro area generally is welcome, but it was very necessary. Irish price levels are about 12 per cent higher than in the euro area as a consequence of substantially higher inflation here over a prolonged period. Although this has adversely affected competitiveness, the general business climate remains favourable to investment and job creation. If this is supported by a continuing strong focus on the containment of domestically generated inflationary pressures, the prospects for growth are good, provided that the global recovery proves to be sustainable.

Governance and Organisation

New Legislation

Under the *Central Bank and Financial Services Authority of Ireland Act, 2003*, the Central Bank of Ireland – which was established by the *Central Bank Act, 1942* and regulated under that and subsequent Acts passed in 1961, 1964, 1971, 1989, 1997 and 1998 – became the Central Bank and Financial Services Authority of Ireland (the Bank). This organisation has two component entities,

- the Central Bank, which is responsible for the activities originally carried out by the Central Bank of Ireland, with the exception of certain regulatory responsibilities which have transferred to
- the Irish Financial Services Regulatory Authority (Financial Services Regulator), an autonomous component with its own Executive Board and Members of the Authority, which has responsibility for financial sector regulation and consumer protection.

The new institutional arrangements entailed significant structural change of a corporate governance nature for the organization. The Board of Directors of the Bank is chaired by the Governor and comprises twelve directors, of whom six are also members of the Authority (see *Board Structure* below). The Central Bank has its own Management Board, which is chaired by the Director General of the Bank. The Financial Services Regulator has its own Executive Board, which is chaired by the Chief Executive Officer. The Central Bank is responsible for the provision of shared services to both the Financial Services Regulator and to its own departments.

In order to facilitate decisions on matters of common interest to both the Central Bank and Financial Services Regulator, a Joint Management Board, jointly chaired by the Director General of the Bank and Chief Executive Officer of the Financial Services Regulator, has been established. A number of other committees which have cross-organisational representation have also been established to ensure cohesion and efficiency between the functions of both entities.

The activities of the Financial Services Regulator for the period 1 January 2003 to 30 April 2003 are included in this Report, while their activities from 1 May 2003 to 30 April 2004 was published recently (**www.ifsra.ie/publications**).

Objectives

There are two dimensions to the objectives of the Bank and these are not necessarily mutually exclusive. As a national central bank member of the European System of Central Banks (ESCB), the

Bank participates in the formulation and implementation of monetary policy with the object of meeting the price stability mandate for the euro area. The legislation stipulates that the primary objective of the Bank is to maintain price stability. Various other objectives flow from this basic remit. On the domestic front, there are various other objectives to be met. The statutory objectives of the Bank, as laid out in Section 6 of the *Central Bank and Financial Services Authority of Ireland Act, 2003*, are as follows:

Objectives

"6–(1) The Bank shall perform all functions imposed, and exercise all powers conferred, on the Bank by or under the Rome Treaty or the ESCB Statute.

(2) The Bank also has the following objectives:

(a) contributing to the stability of the financial system;

(b) promoting the efficient and effective operation of payment and settlement systems; and

(c) discharging such other functions, duties and powers as are conferred or imposed on it by the Rome Treaty, the ESCB Statute or any enactment"

The legislation empowers the Minister to request the Governor, the Board or the Regulatory Authority to consult with him, in relation to their respective functions, and also to request the Governor to inform the Minister with respect to the price stability objective. The Governor and the Board are required to comply with this, in so far as the request is consistent with the Rome Treaty, the ESCB Statute or any law of the State.

Board Structure

Composition of Board

Responsibility for the management of the Bank is vested in the Board which comprises the Governor, the Director General of the Bank, the Secretary General of the Department of Finance, the Chairperson of the Financial Services Regulator, the Chief Executive of the Financial Services Regulator and seven other non-executive Directors appointed by the Minister for Finance. Of the latter, four are members of the Authority of the Financial Services Regulator. The sole shareholder of the Bank is the Minister for Finance.

Governor

Governor

The Governor is appointed by the President, on the advice of the Government, for a term of seven years. The current Governor, Mr. John Hurley, was appointed with effect from 11 March 2002. The Governor as an ex-officio member of the Governing Council of the European Central Bank(ECB) has sole authority and responsibility for the performance by the Bank of its ESCB functions and duties. All other functions, duties and powers of the Bank are vested in the Board. Total remuneration payable to the Governor for service during 2003 was €290,869. Superannuation benefits attaching to the Governor's salary are in accordance with the terms of the Civil Service Superannuation Scheme. The Governor was also provided with the use of a car.

Directors

Directors are appointed by the Minister for Finance for renewable fixed terms of five years except in the case of service Director(s) who may be removed by the Minister at any time. Two of the Directors may be service Directors (i.e. in the permanent service of the State) but the practice of successive Ministers for Finance has been to appoint one. The Governor and Board have no role in the nomination or appointment of Directors. Total fees due to Directors in 2003 in respect of membership of CBFSAI amounted to €92,038.

Members of the Board, as at 31 December 2003, were:

Name	**Occupation**	**Date first Appointed**
John Hurley (Chairman)	Governor	11.03.02
Liam Barron	Director General, CBFSAI	01.05.03
David Begg	General Secretary, Irish Congress of Trade Unions	12.05.95
Tom Considine	Secretary General, Department of Finance	11.03.02
Gerard Danaher	Senior Counsel	15.10.98
Friedhelm Danz	Company Chairman	01.02.96
Roy Donovan	Former Member of the Economic & Social Comm. of the EU	01.12.89
John Dunne	Chairman, IDA	01.05.03
Martin O'Donoghue	Former University Professor	01.07.98
Liam O'Reilly	Chief Executive Officer, Financial Services Regulator	01.05.03
Brian Patterson	Chairman, Financial Services Regulator	01.05.03
Deirdre Purcell	Author	01.05.03

Board Procedures

Chairman

The Governor is Chairman of the Board which meets on a monthly basis with the exception of August. By law, a quorum is seven and the Governor may exercise a casting vote.

Agendas

Agendas and Board papers are approved by the Governor for circulation to the Directors one week in advance of meetings. Additional Board meetings may be called by the Governor at short notice either on his own initiative or at the request of any two Directors. Minutes of all Board meetings are kept by the Secretary of the Bank.

The agenda for meetings typically includes:

i. reports on monetary and financial developments;

ii. reports on various issues relating to the Irish economy, the European economy and the international economy;

iii. regulatory issues requiring decision by the Board or for the purpose of keeping the Board fully informed of developments at a general policy level or relating to specific institutions;

iv. management of the official external reserves;

v. substantial financial contracts to be placed by the Bank with suppliers;

vi. general management, planning and budgetary issues;

vii. quarterly and annual financial statements and results.

Powers Delegated to Governor

The Governor, the Director General of the Central Bank and the Chief Executive of the Financial Services Regulator are executive members of the Board. As provided for in the *Central Bank Act, 1942*, it is the Board's practice to generally delegate powers to the Governor for the exercise and performance of all functions, powers and duties of the Bank with the exception of those powers which it would either not be possible or appropriate to delegate. These include provisions relating to the Governor's position or which are specified to be Board responsibilities or which require the forming of an opinion by the Bank.

The Board established three sub-committees on 30 June 1994 as follows:

- the Audit Committee
- the Remuneration and Budget Committee
- the Investments Committee

Terms of Reference

Board regulations detail the terms of reference of each sub-committee and membership in each case comprises three Directors — of whom one is appointed as Chairman — and an observer who is also a member of the Authority of the Financial Services Regulator. The Secretary of the Bank, or a nominee, minutes all meetings of the sub-committees and, when approved, these minutes are circulated to the full Board.

The composition of the Board's sub-committees, as at 31 December 2003, was as follows:

Audit Committee	David Begg (Chair), Martin O'Donoghue, Deirdre Purcell, Alan Ashe*
Remuneration & Budget Committee	Roy Donovan (Chair), John Dunne, Martin O'Donoghue, Dermot Quigley,* Liam Barron (Director General), Liam O'Reilly (CEO, Financial Services Regulator)
	(Mr. Barron and Dr. O'Reilly attend as members when the Committee is considering budgetary issues)
Investments Committee	Friedhelm Danz (Chair), Liam Barron, Gerard Danaher, Jim Farrell*

*Mr. Ashe, Mr. Quigley and Mr. Farrell are members of the Financial Services Regulator and they participate at meetings of the above CBFSAI Board committees with observer status.

Codes of Practice for Directors and Staff

The Governor is prohibited by law from holding shares in, or being a Director of, any bank or other credit institution, financial institution or insurance undertaking.

Disclosure of Interest

A Code of Practice for disclosure of interest by members of the Board has been in operation since 23 April 1992. This Code was updated during 2002, in accordance with the Government's 2001 Code of Practice for the Governance of State Bodies, and was adopted by the Board on 19 September 2002. The Code contains a wide range of requirements with which Directors are obliged to comply.

Ethics in Public Office Act, 1995 and Standards in Public Office Act, 2001

Members of the Board also submit annual statements of interests to the Public Offices Commission and to the Secretary of the Bank under the *Ethics in Public Office Act, 1995* and the *Standards in Public Office Act, 2001*. The statements are requested by the Commission for completion in January, in respect of the preceding year.

Code of Conduct

On 28 November 2002, the Board of Directors adopted a Code of Conduct for Board Members to record the standards of conduct and integrity expected of each member in the performance of his or her functions as a member of the Board of the Bank. The Code of Conduct consists of the following requirements:

Finance Dublin Conference

6 April 2005

The Future of Financial Regulation: Principles or Rules

Issues for the Irish Financial Services Sector

Address by Liam O'Reilly

Chief Executive, Financial Regulator

Introduction

Ladies and Gentlemen, distinguished guests. It gives me great pleasure to address again the Finance Dublin Conference. This conference, which is now in its 6th year, presents a wonderful and, indeed, rare opportunity for all the financial sectors; banking, funds, insurance and treasury, to assemble to listen and contribute to the manifold issues facing the financial services industry from a range of different perspectives.

For my part, today, I would like to address a number of challenges that both industry and the Financial Regulator are facing. Before doing that, however, I want to refer to issues that have arisen recently and that relate to the reinsurance sector.

The recent revelations are a matter of deep concern to the Irish Financial Regulator. Transactions having the effect of deliberately obscuring the transfer of risk are unacceptable. There is no tolerance in this jurisdiction for such activity.

Ethical behaviour, including transparency in business dealings, are key values expected of boards and senior management of all financial entities operating in Ireland. They must in turn instil these values throughout their organisations. The watchwords must be reputation; integrity; transparency.

We pride ourselves in matching best international practice in all aspects of financial regulation. All regulated entities whether engaged in international activities or domestic activities are required to comply with best international practice.

We are working closely with our international regulatory colleagues and are actively engaged with the firm concerned using our existing powers so that all necessary corrective actions are taken.

Europe is progressing a new comprehensive regulatory regime for reinsurance and the Irish Financial Regulator has been actively involved in the design and development of this regime. A mainstay of this regime is full transparency of all reinsurance transactions. This framework avoids some of the shortcomings associated with the alleged finite reinsurance transactions which were carried out in the past.

I will now return to the main issues that I want to talk to you about today.

First, I would like to cover recent and current EU legislative developments; I will briefly cover the wider international context in which we all operate. I will go on to address the challenges that these developments pose for the Irish regulatory model. I would also like to say a few words about the bedding-down process within the Irish regulatory structure.

Recent EU Developments

You will all be well aware of the European Financial Services Action Plan and I don't intend today to go into any detail on the various proposals contained in it. Suffice to say however, that although this ambitious plan in terms of setting the EU legislative process is drawing to a close we, as regulators and financial services providers, are now facing into a period of intensive adoption and implementation. I would not be exaggerating when I say that we will all be faced with a significantly increased regulatory burden over the coming years.

I was heartened when I read the various reports of the expert groups that assessed the success of the FSAP, particularly in relation to their calls for a regulatory pause. Equally, I was happy to hear the new Commissioner for the Internal Market state that there would be no “son of FSAP”. However, we are still faced with agreeing implementing measures in a wide range of areas. We are also still negotiating the Capital Requirements Directive and the Reinsurance Directive. Both of these will come into effect around the same time and they pose a significant challenge for us. Notwithstanding the Commissioner’s promise of no “son of FSAP” I understand that the Commission is bringing forward their review of the Financial Groups or Conglomerates Directive even though it only came into effect in January of this year.

At the same time, work is underway in relation to the Solvency II project for insurance companies and proposals for an insurance guarantee scheme are at an early stage. So, although the talking may be near an end actions are now required. It is vital, for the sake of the reputation of the Irish financial sector, that we are not found wanting in this regard. Let me assure you that, in the local implementation and administrative arrangements we are determined to ensure that, while standards are maintained, we will be business oriented and flexible in our approach in order to minimise unnecessary regulatory burden.

Wider International Context

Ireland is a significant player in the international financial services arena. There has often been debate about whether we are closer to Boston or Berlin. For me, we should look to both. Financial services are neither European nor American, they are global. Our reputation as a location of choice for major global players can only be sustained if our financial institutions continue to apply the highest standards of governance and compliance......and we, the Financial Regulator maintain the highest standards of supervision and a principles based approach.

Few laws are now solely European. Increasingly, our legislation derives from agreements arrived at by the major international organisations be it the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors or IOSCO.

On the accounting front, the decision by the European Union to adopt International Financial Reporting Standards as the accounting standard for all listed companies was, in my view, a significant step on the road to having a single global accounting standard. As I just said, it is not about being American or European, it is about being global. If we can agree global standards - industry, investors and regulators alike will reap the rewards.

Global standards, however, as well as bringing benefits also pose challenges, not least for me as Regulator.

Challenges for the Irish Regulatory Model

Whether in Ireland or elsewhere, regulation is necessary to instil confidence in the sector and to ensure a safe and fair market for participants and their customers. There are two broad ways in which such regulation can be carried out. The first, and my preferred approach, is principles-based. The second, which is the US and, increasingly, continental European model is rules based.

The present Irish principles-based system mandates the broad regulatory framework within which we expect institutions to be in compliance. It sets out basic principles in relation to, for example, solvency, governance, consumer protection and disclosure. It is relatively flexible. It is more easily and more quickly changed. It is also, I would suggest, easier and cheaper to comply with. It is a model that has worked well in the Irish context.

An alternative approach is a rules-based system. Here detailed rules across the whole range of regulatory powers are set out. The rules set out clearly what must be done and, importantly, what will happen in the event that something is not done. This method implies a very legalistic approach. It suggests doing things right rather than doing the right thing. It allows no scope for interpretation. It is slow to react to change. It punishes the compliant equally with the non-compliant. It suggests a system that is more costly to comply with because of detailed reporting requirements. Is it better?

The best example of highlighting the differences between the two systems that I have come across is from a paper prepared by Herbert Grubel, Professor of Economics (Emeritus), Simon Fraser University in Vancouver. In his paper he cites the difference in approaches to capital gains tax between Canada and Hong Kong. He tells us that the Canadian tax code is very long and detailed, yet human ingenuity continuously finds new ways of shifting highly taxed income into lower taxed capital gains. As a result, new rules are continuously added to the code. By contrast, Hong Kong has no capital gains taxation but prevents very effectively income shifting through the use of principle-based regulation, which quite simply states that current income and profits must not be converted deliberately into capital gains in order to avoid the payment of taxes. A government agency watches tax returns for violations, makes its rulings and defends them before an appeal board, which nearly always sides with the tax agency. The agency ends up having to make only very few rulings since business fully understands the principles and knows it does not pay to violate them. As against an ethical, principles based approach, Enron is another example where fastidious rule bending led to a coach and four being driven through a rules-based system

I find that, more and more, the approach being put forward in Europe favours the rules-based system, as in the US. The Lamfalussy process was laudably designed, in the first instance for the securities sector, to improve the quality of new legislation, promote consistent interpretation, and encourage convergence in supervisory practices and, importantly, called for greater enforcement by the European Commission. Although the process has had an encouraging start there is, however, increasing concern at the level of detail being set out either at level 1 or in level 2 implementing measures. The process is still at an early stage but we should be cautious in relation to its potential outcome.

In the securities sector alone over a 12-month period Directives were agreed on the Prospectus to be published when securities are offered to the public or admitted to trading, on Market Abuse, on Markets in Financial Instruments and, finally, on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market. Such is the level of additional work required on implementing measures in these areas that the implementation date for the MiFiD has been postponed by 12 months.

Further developments in the areas of the Capital Requirements Directive for banks and investment firms and potential changes in the Insurance Sector under Solvency II all point to an ever increasing body of rules to be applied by both financial services providers and regulators alike. However, even were we to move to a full rules-based system of supervision we could not examine every single transaction; every single contract. Any regulatory system relies, to a greater or lesser extent, on the reputation and integrity of the financial service providers governed by it.

I said earlier that we must recognise the global nature of financial services. We should continually assess and reassess our regulatory model to ensure, on the one hand, that it fits with European and international best practice and, on the other, that it continues to foster a sound, prudent and competitive international financial services sector in Ireland. However, we cannot do this alone. Regulators must work closely together.

Commissioner McCreevy in a speech in Frankfurt last December referred to the challenge of enhancing global co-operation. By this he emphasised that he was not so much talking about global cooperation and integration in the markets, which has been taking place at considerable speed for quite some time but cooperation between legislators and supervisors who urgently need to catch up with the markets in the way they work together worldwide. He made the point that, because markets are growing together, regulation increasingly spills over into other jurisdictions – across the Atlantic as well as the Pacific Ocean.

His message was that by building a closer working relationship and an atmosphere of trust, we are able to detect and solve problems upstream, before regulation starts. His motto was "ex-ante regulatory dialogue, to avoid downstream regulatory repair". I share his vision. Regulatory impact analysis at an early stage of designing legislation, that is, at EU level, has been absent in the past but is a must to avoid unnecessary burdens which, instead of enhancing the position, creates confusion, incurring costs which could lead indirectly to less choice and value for the consumers of financial services.

Where is the Financial Regulator

Before I finish I would like to say a few words about where we are as a Financial Regulator in terms of our legislative and operational programme. Earlier this year, speaking at the 3rd Annual European Financial Services Conference in Brussels, Martin Power, Commissioner McCreevy's Chef de cabinet, assured financial service market players that the Commission's emphasis for the next years will be on "consolidation, completion and implementation" rather than further regulation. I can say the same for the Financial Regulator.

We have now in place two significant pieces of legislation; the Central Bank and Financial Services Authority of Ireland Acts, 2003 and 2004. The organisation is now in a "settling in" phase. Not only have the regulatory structures been established but more recently the Industry and Consumer Panels as well as the Credit Union Advisory Panel were formed. And, only yesterday, Joseph Meade was appointed Financial Services Ombudsman. We look forward to working closely with him and his office to ensure consumers can access the new complaints resolution scheme.

We are now nearing completion of the first phase of our programme. We are consulting on Consumer Protection Codes, Fitness and Probity, and Administrative Sanctions. We will bring forward final proposals in these areas and then we will be in the implementation phase. We understand that these proposals are coming at a time when there are significant other issues that concern industry, many of which I have referred to earlier. They are not being brought forward for the sake of regulation but rather to ensure harmonisation in approaches across sectors and equality in the way they are implemented. They also have a principles based approach behind them.

On the Consumer side we have been very active in terms of providing information and advice and raising consumer awareness not only of their rights but the availability of competitive choices. We will continue to expand the range of information and services that we provide in this area.

For those of you who operate in the international financial arena and are located in multiple jurisdictions I want to assure you that we will continue to apply the regulatory model appropriate to the nature and scale of your business. We will not introduce additional regulatory burdens to those already applied to your operations in other jurisdictions. Nevertheless, if we are to have “reputation” – we must have regulation. Insofar as is practicable we will continue to rely on those regulatory structures applied elsewhere. We are actively working, specifically for the moment in the banking sector, with other supervisors to try to agree on a single reporting framework. If successful, this model may be applied throughout the financial services arena.

In conclusion

Let me finish by saying that, I know that the financial services sector is faced with a wide range of legislative and non-legislative proposals across the entire spectrum of financial services provision. I know that these proposals are costly to implement. I know they pose challenges, particularly from a competitive perspective. I know that challenges are arising from less well-regulated jurisdictions. But let me assure you that we in the Financial Regulator understand the challenges you face. Let me assure you that at European and international level we are active in arguing the case for the Irish financial services sector. Let me assure you that we will continue to ensure that practices and policies adopted reflect the unique nature of the Irish financial services sector. Finally, let me assure you that we, as Regulator, will not introduce or impose unnecessary regulatory burdens that will effect the continued competitiveness of our financial industry and will minimise the impact of such burdens coming from Europe.

CENTRAL BANK OF IRELAND

Annual Report

Report of the Central Bank of Ireland
for the year ended 31 December 2002

Restructuring of the Bank

Restructuring

Under the *Central Bank and Financial Services Authority of Ireland Act, 2003*, the Bank has become the Central Bank and Financial Services Authority of Ireland (CBFSAI), and the Irish Financial Services Regulatory Authority (IFSRA) has been formally established as an autonomous Authority within the CBFSAI. IFSRA is now the single Regulatory Authority for the Financial Services Industry in Ireland including credit institutions, the securities industry and insurance. It covers both prudential regulation and consumer interests. A second Bill, dealing with various specific provisions such as the establishment of a Financial Services Ombudsman and the setting up of consumer and industry consultative panels, is expected to be published by summer 2003.

Interim Board

An Interim IFSRA Board under the chairmanship of Mr. Brian Patterson was established on 16 April 2002. Those appointed to the Interim Board by the Minister for Finance were:

Name	**Occupation**
Brian Patterson	Chairman
Liam O'Reilly	Chief Executive
Mary O'Dea	Consumer Director
Alan Ashe	Company Director
Friedhelm Danz	Company Chairman
Gerard Danaher	Senior Counsel
John Dunne	Chairman IDA Ireland
Jim Farrell	CEO National Development Finance Agency
Deirdre Purcell	Author
Dermot Quigley	Former Chairman Revenue Commissioners

Interim Board Appointments

Following open competition, and with the approval of the Minister for Finance, the Interim Board appointed Dr. Liam O'Reilly as its Chief Executive Officer designate on 18 November 2002, and Ms. Mary O'Dea as Consumer Director designate on 28 January 2003. On their appointment they became members of the Interim Board. The statutory posts of Registrar of Credit Unions and Secretary will be filled on a similar basis. Total fees paid to members of the Interim Board in 2002 amounted to €112,592.

Composition of Board

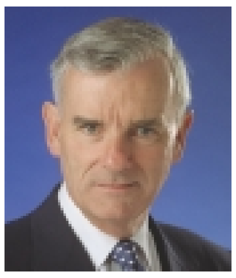
Under the new legislation, the Board of the Bank (which currently comprises the Governor and nine non-executive Directors) will comprise the Governor, the Director General of the Bank, the Secretary General of the Department of Finance, the Chairperson of the Regulatory Authority, the Chief Executive of that Authority and seven other Directors appointed by the Minister, of whom four are to be members of the Regulatory Authority.

Members of Interim IFSRA Board


Brian Patterson
Chairman

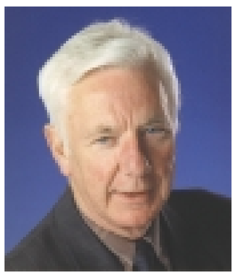

Liam O'Reilly


Mary O'Dea

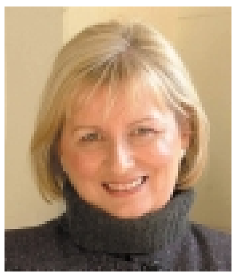

Alan Ashe


Friedhelm Danz


Gerard Danaher


John Dunne


Jim Farrell


Deirdre Purcell


Dermot Quigley

Central Bank &
Financial Services
Authority of Ireland

Central Bank Three Year Strategic Plan

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SECTION 1: INTRODUCTION

The **Central Bank and Financial Services Authority of Ireland (CBFSAI)** was established on 1 May 2003. This body carries out all of the activities formerly carried out by the Central Bank of Ireland and additional regulatory and consumer protection functions for the financial services sector. The CBFSAI has two component entities:

- the **Central Bank,** which has responsibility for monetary policy functions, financial stability, economic analysis, currency and payment systems, investment of foreign and domestic assets and the provision of central services;
- the **Irish Financial Services Regulatory Authority (Financial Services Regulator),** which is an autonomous entity within the CBFSAI and has responsibility for financial sector regulation and consumer protection.

This document sets out the three-year rolling strategic plan for the Central Bank. Our responsibilities extend to both European and domestic roles, and our legal mandate mainly derives from EU law and the CBFSAI Act, 2003.

Ireland became part of the Economic and Monetary Union (EMU) in Europe in 1999 along with ten (now eleven) other countries. The national central banks of these countries together with the European Central Bank (ECB) form the **Eurosystem**. The primary objective of the Eurosystem is to maintain price stability in the euro area. This is the most effective means by which Eurosystem monetary policy can support economic growth in the national economies of the Member States.

As a member of the Eurosystem, the Central Bank's main responsibilities include:

- **Contributing to the maintenance of price stability (low inflation) and a stable financial system.**

We achieve this through our work with the ECB and other national central banks in formulating monetary policy, implementing monetary policy and exchange rate policy decisions efficiently, and ensuring that financial stability is maintained in the euro area.

- **Ensuring safe and reliable payment and settlement systems, to enable firms and individuals to make payments to each other.**

Euro area monetary policy operations are implemented through the inter-central-bank system known as TARGET. It includes the national real-time gross settlement systems of the EU countries and the ECB. Nearly every EU credit institution is linked to TARGET and, although the system was primarily developed to meet the needs of the single monetary policy, it can also be used for transmitting both interbank and customer payments.

- **Producing and distributing euro banknotes and coins and ensuring the security and integrity of the euro currency.**

The ECB has the sole right to issue euro banknotes and approves the volume of euro coins to be issued in euro area countries. With the approval of the Eurosystem, the Central Bank issues euro banknotes and coins in Ireland and is responsible for ensuring the quality and authenticity of euro banknotes.

- **Managing foreign exchange assets, on behalf of the European Central Bank.**

At the start of EMU, the euro area national central banks transferred a part of their foreign reserves to the ECB. In the case of Ireland this amounted to €451 million. These reserves continue to be managed by us on behalf of the ECB, in accordance with the investment policy of the ECB.

Our **domestic** responsibilities also include:

- **Contributing to the maintenance of a stable financial system in Ireland, in co-operation with the Financial Services Regulator;**
- **Overseeing the domestic payment and settlement systems;**
- **Ensuring the provision and integrity of banknotes and coins; and**
- **Managing investments assets on behalf of the State.**

Furthermore we are responsible for:

- **Providing advice and guidance on Irish economic policies.**

  We are responsible for the provision of economic analysis to our stakeholders and to our domestic policy-makers with a view to promoting policies that are consistent with price stability and long-term growth in Ireland.

- **Serving the public interest.**

  We are accountable to the public through having transparent and active systems of public accountability and external reporting. We also assist the Government in the drafting of relevant legislation both domestically and at EU level.

The background and environment in which we work is set out in more detail in Section 2. To develop our strategic plan, the management and staff of the Central Bank carried out a comprehensive analysis of our business priorities and organisational capability. We also agreed our new Mission, Values and Vision, (Section 3), which were developed in close co-operation with the Financial Services Regulator, and which are consistent with our responsibilities.

The four principal objectives which underpin our work and the strategies we will adopt are detailed in Section 4, while Section 5 highlights some specific actions which we will take to implement our Strategic Plan. The plan will be subject to ongoing review which will allow us to revisit our priorities and responsibilities as needed, and ensure consistency with the strategy of the Eurosystem, which is currently being reviewed.

The key to implementing the strategy will be the continued commitment and efforts of our staff, who have made significant contributions in successfully facing the many challenges to the organisation over recent years.

John Hurley,
Governor

Liam Barron,
Director General

SECTION 2: BACKGROUND AND ENVIRONMENT

2.1 Background

The Central Bank of Ireland was founded in 1943 as Ireland's independent central bank. Its primary objective was to safeguard the value of the currency, i.e. ensure low inflation. This was brought about through an exchange rate link (firstly with sterling, and later with other European currencies) and by influencing the level of interest rates and the amount of money in circulation. The Central Bank was also charged with maintaining financial stability, promoting secure and efficient payments systems and currency supply operations.

Major changes in the economic and financial environment, along with changes to our organisation structure following the establishment of the CBFSAI in May 2003, have substantially expanded our core responsibilities. The most significant difference is that, since the introduction of the euro in 1999, the Central Bank does not carry out its functions on a purely national basis, but does so as part of the Eurosystem. We also have a greater responsibility to influence domestic economic policy, now that monetary and exchange rate policies are not available solely for Irish purposes.

2.2 Environment

This section describes the environment in which the Central Bank operates and some of the more significant issues facing it.

The Eurosystem and the single monetary policy

Structure

Ireland became part of the euro area on 1 January 1999. The euro area comprises the twelve countries which operate:

- a common currency, the euro;
- a single monetary policy, i.e. setting common interest rates, and
- a single exchange rate policy for the euro.

Policy

The primary objective of the Eurosystem is to maintain price stability (i.e. low inflation) in the euro area, as low inflation facilitates economic growth and stability. The Eurosystem uses monetary policy to achieve this objective. This means setting interest rates at levels which are consistent with inflation in the euro area - below but close to 2% over the medium term. The decision-making body for setting interest rates is the Governing Council of the ECB, whose members are the Governors of each of the twelve member national central banks and the six members of the ECB's Executive Board. For example, if inflation seemed likely to increase and remain above 2% over the medium term, the Governing Council would increase interest rates. Euro area decisions on monetary policy are all based on inflation conditions for the euro area; other policies need to be used to control domestic costs.

Implementation

All national central banks engage in research and analysis for Governing Council discussions, and the decisions are then implemented on a decentralised basis. This involves each national central bank providing funds to financial institutions in its own domestic market at the rate set by the Governing Council. The rate charged by the ECB influences the interest rates paid by and charged to customers of commercial banks. This implementation role involves the Central Bank providing liquidity to Irish financial institutions, in return for certain types of collateral and at an agreed rate, and monitoring the operation of reserve requirements by Irish banks.

2.2.1 Expanding Responsibilities and Challenges in the Eurosystem

To successfully run the 12-country euro area and implement monetary policy on a common basis, the Central Bank and the other national central banks have to co-ordinate their positions in a diverse range of areas.

The **policies and practices** which we are required to develop, implement and manage include:

- The framework for implementing monetary policy;
- Forecasting methodologies for the economic outlook;
- Statistical requirements and credit and money supply developments;
- Currency production and security;
- Efficiency and reliability of payment and settlement systems; and
- Methods of mitigating risk and planning for crisis events.

Over the past five years, the size and breadth of our Eurosystem responsibilities have expanded significantly, leading to a shift of emphasis and resources within the Central Bank towards our Eurosystem roles.

Our Eurosystem **obligations** will increase in the coming years with the anticipated expansion of the system to include:

- Broader financial stability responsibilities;
- Increased exchange rate monitoring;
- Wider scope to our economic and financial analysis and research; and
- Providing more assistance and advice to prospective members.

In line with the emerging trend among national central banks to develop specialisations, we also face a challenge to develop our unique competencies, to be in a position to be of most benefit to the Eurosystem and also to the domestic economy, while still continuing to meet all of our other responsibilities.

In our Eurosystem work, we need to balance the requirements of the 'subsidiarity principle' (which commits EU members to carry out as many of their functions as possible at national level) with the need to be as efficient as possible. In developing the policies and systems for the conduct of euro area monetary policy, our challenge is to be as cost effective as possible while respecting the subsidiarity principle.


Photograph reproduced with permission from the ECB

European Central Bank, Frankfurt.

2.2.2 Challenges in the Domestic Economy

Economic Policy role

Domestic economic policymaking and the role of the Central Bank has changed substantially since joining the Eurosystem. Monetary and exchange rate policy are no longer set on the basis of economic conditions in Ireland alone. This means that other national policies – fiscal, structural, wages and labour – have a greater role to play in supporting low inflation and long term growth. Our challenge is to:

- Use our economic, financial and monetary expertise, and our institutional independence, to influence other domestic policymakers; and
- Ensure that other policymakers have the information and tools available, to take decisions on policies that support low inflation, growth and financial stability.

Currency role

As the body responsible for issuing euro currency in Ireland, our challenge is to:

- Meet demands for banknotes and coins in Ireland efficiently;
- Produce our share of the euro area's banknotes and coins; and
- Safeguard the integrity and security of the euro banknotes and coins.

As there is considerable competition in the euro area for currency production contracts, our challenge is to remain cost effective while continuing to achieve a very high standard.

Payment and Settlement role

Payment and settlement systems are a critical part of the financial system. Fast and reliable payment flows between banks, businesses and consumers are essential to ensure that all of these parties can transact their business smoothly. The Central Bank oversees these systems in Ireland, to ensure that they:

- Operate efficiently, effectively and fairly;
- Support financial stability, by being safe and reliable; and
- Promote electronic payment capability.

Some of these systems are "real-time" systems, i.e. payments are made electronically, almost instantaneously and are irrevocable, which helps to reduce risks.

The national real-time payment systems of each EU country and that of the ECB are interlinked into a system called TARGET. This was developed to transmit payments associated with monetary policy in the euro area, but is also used for other high-value or very urgent payments. The current TARGET system will be replaced by an EU-wide single common platform system in 2007 and our challenge is to contribute actively to its successful development and implementation.

Financial Stability and Risk Management role

The financial system has evolved as a more global, integrated and complex system. This has led to greater financial stability and risk management challenges for the Central Bank, including

- Managing and aiming to reduce economic, financial and operational risks;
- Balancing the financial risks we are willing to bear on our investment assets, against the rate of return we are aiming for;
- Developing crisis management procedures and business continuity arrangements, to be in a position to deal with major disruptions to financial activity or to the financial system.

2.2.3 Our Stakeholders

We must take account of the needs of our stakeholders in how we fulfil our Eurosystem and domestic roles. Our primary stakeholders are:

The Public

The public's concerns include ensuring convenient access to cash and certainty that cash held is authentic. Also, in making important financial decisions, the public require information and independent analysis on the economic and financial outlook, and confidence in the security of their savings and investments. We must be responsive to the public's needs when we carry out our roles in

- Protecting the value of their savings through maintaining low inflation;
- Safeguarding their ability to carry out financial transactions through ensuring financial stability;
- Providing independent economic and financial information and advice;
- Ensuring euro banknotes and coins are available in appropriate denominations, and
- Exchanging outstanding Irish currency into euro.

The Eurosystem and other International Organisations

As well as closely co-operating with other national central banks and the ECB, we are also involved in international institutions such as the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD). In all our dealings with these stakeholders, we aim to provide efficient and high quality services and develop and maintain close working relationships with them.

The Financial and Business Community

The financial industry plays a major role in making monetary policy work, providing currency to the public and providing finance to the business community. Both the financial and business communities play an important role in contributing to economic activity, both directly and indirectly. In formulating our view on central banking matters, we must be responsive to the challenges facing these communities, through, for example;

- Ensuring there is sufficient (but not excessive) liquidity in the financial system to facilitate economic activity;
- Providing a supportive environment for conducting business and attracting investment; and
- Promoting Ireland's reputation as a location for high quality financial services.

The Government

We must take account of the economic and financial environment facing the Government in carrying out our responsibilities. These issues include:

- Greater pressure on Government policies to be in a position to support growth and low inflation, now that monetary and exchange rate policy can no longer be used for Irish purposes;
- Pressures on the public finances, given Ireland's need for infrastructure development; and
- Balancing Ireland's growing responsibilities in the international community with the need to ensure the domestic economy is safeguarded.

2.2.4 Internal Organisation

The establishment of the Financial Services Regulator, as an autonomous entity within the reorganised CBFSAI, involves developing our new institutional structure. Our challenge is to ensure that the two parts work together to create a strong, cohesive organisation.

As one of the smallest NCBs in the Eurosystem, the diverse range and expected expansion of our responsibilities pose important challenges. These include:

- Continuing to meet all of our responsibilities within a small and efficient organisation, which cannot avail of the economies of scale available to larger central banks;
- Deciding which areas to focus our energies on for maximum effect and developing special relationships with other NCBs on areas of common importance; and
- Developing new indicators of performance, to ensure that we are achieving the levels of effectiveness to which we aspire.

As an organisation working in the public interest, our challenge is to demonstrate as fully as possible how we fulfil our domestic and European roles and to provide value for money.

SECTION 3: ORGANISATIONAL MISSION, VALUES AND VISION

3.1 Our Organisation

The Central Bank and Financial Services Authority of Ireland Act, 2003, which came into force on 1 May 2003, restructured and renamed the Central Bank of Ireland as the Central Bank and Financial Services Authority of Ireland (CBFSAI) and established within that framework the new Financial Services Regulator. The previous regulatory functions of the Central Bank and certain regulatory functions carried out by the Department of Enterprise Trade and Employment were transferred to the Financial Services Regulator along with a significantly increased role in relation to consumer protection.

The CBFSAI, therefore, incorporates the functions of a Central Bank and a Financial Services Regulator, each with specific responsibilities. In order to address these responsibilities in a coherent manner, we have agreed our respective missions and a common set of values. This allows us both to share a mutually co-operative sense of identity and purpose.

The Board of the CBFSAI is chaired by the Governor and includes the Director General of the Central Bank, the Chief Executive and the Chairman of the Financial Services Regulator, the Secretary General of the Department of Finance and seven other non-executive directors. Four of the non-executive members of the CBFSAI Board are also members of the Irish Financial Services Regulatory Authority.

The Director General of the Central Bank and the Chief Executive of the Financial Services Regulator jointly chair a non-statutory Joint Management Board which co-ordinates work and communications on central services and other issues of common concern.

3.2 Our Mission

Our mission is based on the fact that as a member of the Eurosystem and as an Irish public body we are required to:

- Contribute to the operation of the Eurosystem in an effective manner and thereby maintain price stability in the euro area;
- Contribute to financial stability in Ireland in collaboration with the Financial Services Regulator;
- Ensure safe and efficient payments and currency systems; and
- Manage our investment assets to achieve maximum return for the Exchequer.

The **mission** of the **Central Bank** is to maintain price stability, contribute to financial stability and efficient and effective payments and currency systems, manage our investment assets, and so contribute to long run sustainable economic development.

The **mission** of the **Financial Services Regulator** is to help consumers make informed financial decisions in a safe and fair market and to foster sound dynamic financial institutions in Ireland, thereby contributing to financial stability.

3.3 Joint Values

The joint values of the Central Bank and the Financial Services Regulator reflect six core commitments. These values, which are elaborated on in Appendix 3, have been developed by the Boards of the Central Bank and of the Financial Services Regulator and have evolved from engagement with staff.

They are:

- We attach primacy to the public interest.
- We act in the best interests of consumers of financial services.
- We foster an internationally competitive and successful financial services industry.
- We work with integrity and transparency.
- We operate efficiently and effectively.
- We respect and value each other as colleagues.

In implementing our strategy, these values will guide the way we:

- Carry out our work;
- Make decisions;
- Relate to others – internally and externally;
- Design our structures and procedures; and
- Set our priorities.

3.4 Our Vision

By 2007, the Central Bank is committed to achieving a level of performance which will be recognised

- in our **Eurosystem** work, as

- Making a distinctive, valuable contribution to price and financial stability, to the efficiency of Eurosystem operations and to the management of any crises, through consistently achieving top quality performance against Eurosystem benchmarks;
- Being a source of innovative contributions to Eurosystem strategic thinking and change management and, in particular, contributing to the integration of new EU members.

- within **Ireland**, as

- Excelling in our core functions of contributing to financial stability, conducting monetary policy operations, ensuring efficient payment and settlement systems, and managing the country's investment assets;
- Being highly influential in our economic analysis and commentary;
- Being exemplary in our currency production and distribution work.

- in our vital relationships with the **Financial Services Regulator**, as

- Having excellent working arrangements, fostered in a spirit of cooperation;
- Being the service "provider of choice" by all business units.

To achieve these levels of performance, we will have efficient structures and processes, aimed at providing clear direction and accountability and attracting talented people across our range of business activities. We will also ensure that our expressed core values are reflected in our work and our behaviour.

SECTION 4: OUR PRINCIPAL OBJECTIVES AND STRATEGIES

The development of the Central Bank's Strategic Plan has given us the opportunity to reassess our role following five years membership of EMU. Over this time there has been a significant shift in emphasis from our responsibilities in the domestic economy to our role in the Eurosystem and this is reflected in most of our activities.

Four principal objectives

We have identified **four principal objectives** which evolve from our mission and vision and reflect our business responsibilities in the Eurosystem and domestic economy. Underlying each of these objectives are a number of strategies which are elaborated on in this Chapter.

These principal objectives are to:

1. Participate fully in Eurosystem policy-making and implementation, for price and financial stability;
2. Contribute to national economic policy-making ;
3. Provide and promote effective payment systems and currency services; and
4. Optimise the returns on the investment assets of the CBFSAI and the ECB reserves

4.1 Participate fully in Eurosystem policy-making and implementation, for price and financial stability

The primary goal of the Eurosystem is to maintain the inflation rate below but close to 2% in the euro area over the medium term. This is achieved by designing a monetary policy strategy which signals early risks to inflation and by implementing monetary policy decisions on a common decentralised basis in each of the twelve euro area countries.

The Central Bank is also charged with contributing to financial stability in both Ireland and the euro area. This role is carried out in co-operation with the Financial Services Regulator.

We aim to achieve our goal by:

Monetary policy

- **Enhancing our input into monetary policy setting;**
- **Specialising in economic niches;**
- **Developing strategic relationships.**

Operations

- **Contributing to the further development of the Eurosystem operational framework;**
- **Implementing monetary policy decisions efficiently and effectively;**

Financial stability

- **Continuing to identify and monitor risks to the stability of the financial system;**
- **Enhancing our crisis management procedures.**

How does monetary policy lead to price stability?

The Eurosystem aims to maintain the inflation rate below but close to 2% in the euro area over the medium term by:

- Developing the best monetary policy strategy to deliver low inflation in the euro area; and
- Setting interest rates to achieve this strategy.

These are both decided on by the Governing Council. The strategy is reviewed every year while interest rates are reviewed every month.

The assessment of the outlook for price stability is based on an analysis of:

- Economic, financial and exchange rate developments; and
- Money and credit data..

If, for example, these sets of economic indicators signal unacceptable risks of inflation over the medium term, the Governing Council increases interest rates.

Enhancing our input into monetary policy setting

The regular reviews of the monetary policy strategy ensure that it remains effective in maintaining price stability. This involves:

- Assessing how effective the existing strategy is in influencing inflation expectations; and
- Assessing alternative strategies and designing new strategies as appropriate.

We intend to extend our research and analysis in this area to be in a position to influence the Eurosystem's decisions on how the strategy should evolve. We have identified a number of areas for additional research. These include aggregate demand and its components, price and cost indicators and market conditions. We are also changing some of our existing processes to make our policy role more efficient.

Specialising in economic niches

We intend to specialise in economic areas where we already have distinctive expertise in the Eurosystem and where we can exploit synergies with our domestic role. We have identified productivity growth and its impact on inflation, and foreign direct investment and its long run impact on the economy, as areas for development of specific competencies.

Developing strategic relationships

One of the ways we will seek to increase our influence within the Eurosystem is through the development of strategic relationships with other national central banks and the ECB. Our participation in a significant number of Eurosystem committees and other structures will assist us in developing these alliances and in identifying issues where we already have particular expertise.

The international role of the Central Bank

The Central Bank participates in a large number of European and international bodies, which enables us to both promote economic and financial co-operation, and to benefit from a global network of data, research and expertise. We will continue to use this expertise to assist new Member States progress towards European integration.

In Europe, this co-operation is carried out mainly through the EU and the Eurosystem. Internationally, co-ordination of economic, financial and developmental issues is carried out by a range of institutions, including the IMF, World Bank and the BIS. We actively participate in all these international bodies.

How is monetary policy implemented?

All monetary policy and exchange rate decisions taken by the Eurosystem are implemented on a common, decentralised, basis by the twelve national central banks.

The methods which central banks use to implement monetary policy include:

- Supplying funds to commercial banks, at the agreed interest rate; and
- Taking funds on deposit from commercial banks, at an agreed interest rate.

In the euro area, commercial banks have an ongoing requirement for funds, to meet their needs for lending and borrowing operations. The national central banks supply funds to commercial banks through weekly repurchase transactions. Commercial banks submit tenders to borrow a particular sum, at an agreed rate, in return for acceptable collateral.

The ECB decides the amount of funds the Eurosystem will lend through these operations and the interest rate to be charged. If the bids received exceed the amount the Eurosystem is willing to lend, the bids are met on a pro-rata basis.

The annual value of monetary policy transactions carried out by the Central Bank exceeds €150 billion. This accounts for a greater proportion of total Eurosystem operations than our size within the euro area, mainly due to the size of the IFSC. We also manage foreign assets on behalf of the ECB, worth €450 million. The purpose of these assets is to have funds available to support the euro, if necessary.

Implementing monetary policy decisions efficiently and effectively

The Eurosystem conducts monetary policy operations primarily to influence conditions in the money and credt markets. We aim to reduce the risks involved in carrying out these operations which arise through provision and settlement of funds and acceptance and valuation of collateral.

We also oversee minimum reserve requirements. This is the obligation for commercial banks to hold funds on deposit at the Central Bank, which are used to help steer euro area money market rates. We aim to ensure that all these operations match best practice in terms of efficiency. We intend to conduct a comprehensive assessment of the systems and structures we use for these operations, and upgrade our existing risk assessment processes.

Contributing to the further development of the Eurosystem operational framework

The Eurosystem operational framework includes the payment, settlement, collateral management and legal requirements for carrying out monetary and exchange rate policy. The framework is under ongoing review to ensure it remains as effective as possible.

Since the start of EMU, the Central Bank has successfully influenced changes in the framework (e.g. types of collateral used) to meet our needs in this area. We aim to ensure that the structures and practices of the framework continue to evolve as efficiently as possible. Some of the initiatives we have identified include influencing new collateral arrangements, identifying the concerns of domestic stakeholders and ensuring that these are dealt with as far as possible.

What is financial stability?

The Central Bank is charged with contributing to financial stability both in Ireland and in the euro area.
A stable financial system is necessary for:

- Economic growth, as so much activity relies on funds and services provided by the financial system; and
- Monetary policy, which works by banks passing changes in Eurosystem interest rates onto their customers.

If banks run into difficulties and cannot make new loans, or are unable to repay their own borrowings, then other banks, business and consumers are negatively affected. Examples of financial crisis in the international economy show that, when this happens, it can be very costly in terms of lost growth, economic disruption and business failure.

Continuing to identify and monitor risks to the stability of the financial system

We know from research and experience that many crises have their roots in the way in which the economy evolves. Problems in individual institutions can spread quickly to the whole financial system and failures in payment and settlement systems are another source of risk because if they malfunction they cause cash flow problems.

To enable us to take preventative action where necessary, we need to have reliable early indicators of any deterioration in the financial system. We intend to:

- Conduct more local and global research into episodes of financial sector problems and use the results to refine our leading indicators of economic, financial, prudential and settlement risks to the system;
- Develop our understanding of how developments in some areas spill over onto others and threaten the whole system. We will use this analysis to identify what new actions need to be taken;
- Broaden the use and publication of our analysis, to encourage more prudent behaviour by financial system participants; and
- Further develop our dialogue with the financial sector to identify where potential risks may be concentrated and what corrective steps may be needed.

Enhancing our crisis management procedures

Despite international best efforts to forecast and try to mitigate financial risks, crises can still occur. On those rare occasions, it is essential to deal with the damage caused as quickly as possible. We have developed a domestic crisis management framework and are also involved in developing the framework for the EU. We will continue to review and test these procedures, to ensure that they are well geared for dealing with any such events.

The Central Bank's financial stability function is interlinked with the Financial Services Regulator's prudential function. We intend to further develop our combined arrangements for stress testing, dialogue with financial institutions, authorisations of financial institutions, free exchange of information and relevant data, and conducting EU and Eurosystem business.

Financial Regulator
Rialtóir Airgeadais

Protecting Consumers Through Effective Regulation

Annual Report of the Financial Regulator 2005

Chairman's Statement

Brian Patterson
Chairman

The responsibilities and duties of the Financial Regulator continue to widen. Our mandate now covers 9,638 financial service providers and collective investment schemes, across virtually the whole financial services industry. Since our last report we have taken on additional responsibilities arising from the implementation of a number of European Directives: Prospectus, Market Abuse, Insurance Mediation, Distance Marketing of Consumer Financial Services and Financial Conglomerates, with the Reinsurance Directive due to be implemented in 2006. We are also working hard preparing for the implementation of the Capital Requirements, Markets in Financial Instruments and Transparency Directives which will come into operation in early 2007.

At the same time, our duty as a single regulator implies the need for a consistent approach across all sectors of the financial services industry - something which until now has often been missing. The development and implementation of the Consumer Protection Code will go a long way to bringing this about.

This inevitably gives rise to a lot of change. As we go about introducing these changes, we put a lot of effort into consultation so that, to the greatest possible extent, we can be flexible and there will, at least, be no surprises. This consultation takes a number of forms:

- We now have the formally established Consumer and Industry Consultative Panels, whose role is set out in the 2004 Act. We welcome the setting up of these Consultative Panels and are always open to their views and constructive criticism.
- We also consult directly with the various representative bodies who speak for consumers and the different sectors of the financial services industry.
- We consult with the legislators both here in Ireland and in Brussels and are also represented on a wide number of international committees whose job it is to work out the detail of implementation.
- Finally we consult directly with financial institutions, accepting that this necessarily has to be limited because of the numbers involved.

The structure under which we operate is somewhat unique in international terms:

- It has brought together under one single regulator virtually all parts of the wide-reaching financial services industry. This recognises the complexity of financial services products, and the need for a consistent and 'joined-up' approach to regulation.
- It has put the consumer at the heart of regulation, through a stronger and focused consumer agenda and the continuation of professional safety and solvency regulation - which is itself a basic consumer protection.
- It has included regulation of the credit unions in a way which recognises its volunteer and community-based ethos.
- Our independent Authority serves as a public interest board, to guide our management team and mediate all of the conflicting interests which inevitably arise in carrying out our mandate.
- Through the over-arching structure of the Central Bank and Financial Services Authority of Ireland, solvency regulation by the Financial Regulator is linked to the wider need for systemic stability which is the function of the Central Bank and the European Central Bank.

Ireland needs an efficient and competitive financial services industry - because it oils the wheels of the whole economy and is the repository of the country's savings. The industry needs to be competitive and profitable in order to underpin its stability - something we can easily take for granted.

The financial services industry also competes internationally and is subject to all the rigours of fast-paced global competition. The international funds industry is now a major employer and contributor to the Exchequer. While not directly impacting consumers, it is nevertheless of vital importance. Ireland's reputation as a country with a regulator that is professional and independent, but also open and friendly, is an important aspect of that industry's competitiveness.

Thanks are due to all those who work tirelessly to support our mandate:

- Ministers and civil servants, particularly in the Department of Finance.
- Members of the Authority who give of themselves tirelessly and often beyond the call of duty.
- Our management team under our newly appointed Chief Executive, Patrick Neary. A special word of thanks to our Chief Executive, Liam O'Reilly, who retired earlier this year and to whom we owe much.
- Our dedicated and professional staff.
- The Governor and staff of our sister organisation, the Central Bank - without whose support our task would be considerably more difficult.

Our role is to serve the public interest. It is that principle which guides all of our work and which motivates all of our people.

Brian Patterson

Brian Patterson
Chairman

Financial Stability Report
2005

Contents

The current conjuncture is one of ample liquidity in international financial markets and buoyant asset markets. In the past, this combination has often led to the build-up of vulnerabilities in financial systems and been followed by episodes of financial stress. In this environment, this conceptual article looks at the general role of liquidity in financial stability. Concepts of liquidity are presented, before exploring the nature of the relationship between liquidity and asset prices. The ways in which liquidity can both contribute to and undermine financial stability are set out, and highlight how, when a shock hits the economy or financial system, the behaviour of liquidity has the potential to exacerbate its effects. Given the number of shocks which hit the world economy in the past decade, the evolution of liquidity more recently is presented. Finally, some of the implications of these issues for Ireland are briefly explored.

The prices of virtually all asset classes have seen substantial gains over the last two to three years, following on from the more mixed performances that occurred after the rapid succession of shocks in the early years of this decade. At the same time, liquidity conditions over this entire period can be broadly characterised as exceptionally easy. This was reflected in strong money growth and low short-term interest rates. This article examines the relationship between these liquidity conditions and asset price developments. Our graphical and highly tentative results indicate considerable monetary laxity as proxied by both excess money growth and the gap between the short-run real interest rate and its estimated equilibrium value (i.e., the natural rate of interest). The graphical evidence suggests that this lax liquidity situation began to impact positively on asset prices around the end of 2002 and the beginning of 2003. What is especially noteworthy is the escalation of prices across all asset classes since then. This suggests, subject to more rigorous econometric testing, that abundant liquidity has imparted significant momentum to asset prices across the board. This description seems to be broadly correct for the three economic regions examined, the US, the euro area and the UK.

Over the last four decades or more, the volatility of output growth in six of the G-7 industrialised economies has fallen significantly. In this article, we illustrate the decline in output growth volatility, review the factors identified in the literature as being behind this fall, and examine the implications for financial stability. We conclude that a broad confluence of structural, financial and policy factors likely explain this fall-off in volatility and can be expected to continue to have an ameliorating effect in calming the economy in the face of shocks. Fluctuations in economic activity have long been recognised as a source of financial instability and so the macroeconomic phenomenon of declining output growth volatility is likely to be, in its own right, of considerable benefit from this perspective.

Any increase in interest rates will have implications for the Irish economy, and more specifically for the stability and soundness of the Irish financial system. The overall impact of an interest-rate rise will depend on the factors behind the increase. This paper examines some of the likely causes and consequences of an interest-rate hike. In order to understand how the nominal interest rate might evolve over the short and medium term, we decompose the nominal interest rate into its constituent components, the most important of these being the equilibrium real rate of interest. Analysis of various models of the equilibrium real rate of interest for the euro area shows that in the short-run, there does not appear to be a likelihood of a substantial increase in the nominal interest rate stemming from a significant shift in the underlying equilibrium real rate of interest, or from the other components of the nominal interest rate. Over the medium-term horizon (chronologically approximately three to seven years), however it is likely that the euro area economy will revive and will see a much higher equilibrium real rate of interest. A steady state growth rate of 3 per cent, combined with an inflation rate of about 2 per cent (consistent with the ECB's inflation objective) and a risk premium of 1 per cent would add up to an equilibrium mortgage rate of approximately 6 per cent. With the typical variable mortgage rate of interest being around 3 per cent now (October 2005), an increase in interest rates to this putative equilibrium level would double the repayments burden. For highly indebted borrowers, this would be an intolerable burden and would almost certainly mean a sharp increase in the ratio of non-performing loans.

The ability of the financial system to withstand adverse shocks is a key concern for those charged with responsibility for financial stability. The banking system, which is at the centre of the financial system, has a number of buffers in place to absorb unexpected losses, one of which is capital. To strengthen the stability of the international banking system, the Basel Committee on Banking Supervision proposed a framework, the Basel Accord, introduced in 1988, designed to set capital adequacy rules for banks and thereby strengthen the stability of the international financial system. This formula was largely successful but developments in the market accentuated certain limitations in the Accord, creating the necessity for revisions. Basel II, which comes into effect in 2007, has been developed to address these weaknesses. This paper discusses these developments in the regulation of banks' capital and considers some implications of the developments for financial stability.

The aim of this paper is to examine the effects of a 'correction' in the residential construction sector, whereby the current high level of house building reverts back towards a more 'normal' rate of building. The paper looks at the extent to which the housing sector has grown in Ireland and its contribution to overall growth in the economy as well as comparing it with European countries. From this it is quite evident that current rates of house building in Ireland are excessive and will need to fall back towards rates more in line with the underlying or medium-term demand for housing.

Through using the Bank's econometric models, the consequences of quite a rapid fall in housing output, toward medium-term levels, is examined over a four-year and two-year horizon. This is modelled as an exogenous shock to housing investment. Overall, the effects of a correction are found to be significant but could probably be accommodated reasonably well by the economy if other sectors continued to grow and the international environment remained favourable. The likelihood of such a sharp fall against an otherwise favourable background is also assessed and considered to be limited. The inflated size of the construction sector could, however, be a source of additional vulnerability, if the economy were hit by other adverse shocks, such as a large loss of competitiveness or a sharp fall-off in foreign direct investment (FDI).

Large-value payment systems play a pivotal role in modern economies. They facilitate the ultimate settlement of obligations arising from transactions in both the real and the financial economy. The volumes and values of such transactions require robust and efficient mechanisms. Central banks oversee and, in many cases, operate such large-value payment systems, which operate on the basis of real-time gross settlement (RTGS). Such systems are designed to minimise risk in the financial infrastructure. They also facilitate the implementation of monetary policy by central banks.

Foreword

I am pleased to present to you our second stand-alone Financial Stability Report. The central aim of the report is to analyse and assess the systemic health of the financial system in Ireland and to point to areas where risks and vulnerabilities may be present or may arise.

The report is essentially divided into three complementary sections: the main commentary, which provides an analysis of domestic and international economic and financial developments and highlights potential areas of concern relevant to the Irish financial system; a special thematic piece on the growth in mortgage indebtedness; and a number of research articles which provide more in-depth analysis. The purpose of these articles is to support the conclusions reached in the main commentary, and to add to knowledge among our stakeholders about financial stability issues. The diversity of topics addressed in the research articles highlights the wide-ranging scope of our financial stability mandate.

The publication of this report derives from the Central Bank's mandates under both domestic and European law. The Central Bank & Financial Services Authority of Ireland Act, 2003, requires the Central Bank to contribute to the overall stability of the Irish financial system, while the mandate of the European System of Central Banks requires the European Central Bank and national central banks to contribute to financial stability in the euro area. While the Central Bank has overall responsibility for financial stability, the Financial Regulator is responsible for overseeing the prudential health of individual financial institutions. The Central Bank and Financial Regulator co-operate fully on matters relating to financial stability. A joint committee, the Financial Stability Committee (FSC), chaired by the Director General of the Central Bank and with senior representatives from the Financial Regulator, oversees financial stability matters. The Financial Stability Report reflects the extensive input of the FSC.

The overall conclusion of the report is that the Irish banking system continues to be in a good state of health. Our central expectation, based on our assessment of the risks facing both the household and non-financial corporate sectors, as well as the current shock-absorption capacity of the banking system, is that this current state of health will not be compromised over the short- to medium-term horizon. There are, as always, risks to the outlook which could cause the outturn to be somewhat different to this central expectation.

Where last year's report focused on the risks arising from strong house price growth and the possibility of a sudden and unanticipated fall in the level of house prices accompanied by an increase in the default rate among borrowers as the key risk facing the banking sector, this year's report highlights the risks posed by the growth in indebtedness in Ireland in some detail. This includes an exploration of the factors that may explain the sustained growth in levels of mortgage indebtedness, which has been the main factor behind the rise in our private-sector debt to GDP ratio to one of the highest ratios in the EU.

As well as the analysis of domestic and international financial developments, other financial stability issues examined in this report include the operation of the payments and settlements system, the role of liquidity generally and, specifically, its links with asset markets, the falling volatility of output growth, and the move to the new Basel II framework.

I hope that this comprehensive analysis, which is part of a regular series, conveys to lenders and borrowers the importance of a stable financial system and that its key messages may serve as an essential input into decision-making by all financial market participants and the wider public.

John Hurley

John Hurley,
Governor

Summary

Overall Assessment

The Bank's 2004 Financial Stability Report identified the risk of an unanticipated and sudden fall in residential property prices, combined with an increase in the default rate among mortgage holders, as the risk that posed the greatest threat to the health of the banking system. A moderation in house price growth in the meantime suggests that, while the risk identified in last year's report of a sudden fall in prices cannot be dismissed, this risk may have receded somewhat. However, tentative evidence suggests that this moderation may not have persisted. If house price growth were to reaccelerate, this would increase the risk of a sharp correction in house prices in the future.

At present, the primary risk is considered to be credit growth and indebtedness levels. Last year's report singled out the speed with which private-sector debt was accumulating as an especially worrying development. Since then, the rate of debt accumulation has accelerated, with virtually all categories of bank debt increasing at rapid rates. As a result, Ireland's debt-to-income ratios are now close to the top of the European league.

The stability and health of the Irish banking system appears generally sound, according to the standard indicators of financial health such as asset quality, profitability, solvency, liquidity and credit ratings. The central expectation, based on an assessment of the risks facing both the household and corporate sectors, as well as the current shock absorption capacity of the banking system, is that the current health of the banking system leaves it reasonably well placed to withstand pressures from potential adverse developments in the short to medium term. However, there are a number of vulnerabilities, in the medium term, particularly from the very high rate of credit growth.

This report is an important tool in creating awareness among all participants in the financial system of the potential impact of their behaviour on the health of the system. The Bank continues to monitor and analyse financial stability issues on an on-going basis. A key feature of this analysis has been the development of indicators to aid early identification of emerging stress in the financial system. The assessment presented in this report reflects analysis of these indicators, as well as a general review of economic and financial pressures. Stress-testing exercises are also conducted periodically with domestic credit institutions to inform the risk assessment.

The Bank engages in on-going dialogue on financial stability issues with domestic credit institutions in order to exchange views on the risks to the financial system and on the strength of the banking system to withstand these risks. The Bank also continues to develop procedures to deal with a potential crisis and to facilitate an orderly resolution, should the stability of the financial system be threatened.

Economic and Sectoral Summary

Domestic Macroeconomic Outlook

National Accounts data show that the volume of GDP increased by 4.5 per cent last year, with a corresponding increase in GNP of 4 per cent. Some deceleration was observed during the first half of 2005, however, with preliminary growth rates in GNP and GDP of 3.4 per cent and 3.1 per cent, respectively. Output growth this year is being driven to a significant extent by a pick-up in some components of domestic demand, including consumer spending and business equipment investment. By contrast, the external performance of the economy was very muted during the first half of 2005. This reflected developments in both merchandise and services exports, although the weakness in the latter largely reflected apparently one-off developments in insurance related transactions. Construction activity is expected to remain at a high level over the next two years. However, a much lower contribution to growth is expected to come from the housing construction sector, which was a key driver of growth in 2003 and 2004.

GNP growth is currently projected to average around $4\frac{1}{2}$ per cent this year with a broadly similar outturn expected for 2006. GDP growth is projected to average around $4\frac{1}{4}$ per cent this year, rising to around $4\frac{3}{4}$ per cent next year. There are, however, some significant downside risks to these projections arising from both the external and domestic environment.

Other broad indicators of economic activity remain generally favourable. The labour market continues to perform well with particularly strong employment growth in construction and some parts of the private services sector. The unemployment rate is projected to remain close to 4¼ per cent in both 2005 and 2006. Despite continued strong employment growth and the modest tightening of labour market conditions, inflationary pressures remain relatively subdued. The headline HICP figure is expected to average 2¼ per cent this year with a modest pick-up to around 2½ per cent in 2006.

Following a rapid expansion between mid-2003 and mid-2004 (when world growth expanded at its fastest pace for over three decades), global economic growth lost some of its momentum in the second half of last year and in the first six months of 2005. The reduction partly reflects an inevitable move to a more sustainable — but still robust — level of activity, following the exceptional pace of growth in the preceding year. Looking ahead, global activity is expected to continue to moderate in the second half of the year. Risks to this outlook are generally perceived to be on the downside, and are related to concerns over oil price movements, global imbalances and financial market developments. Furthermore, while the central projection is for continued robust activity in the remainder of the year, it has become increasingly apparent that concerns over these risks — none of which are new — are growing, increasing the probability of a less favourable outturn.

The Bank's central forecast for the economy is for overall economic growth to remain broadly stable over the next two years (for instance, GNP growth is currently projected to average around 4½ per cent this year with a broadly similar outturn expected for 2006). Moreover, this forecast is accompanied by noteworthy domestic and international risks to the outlook. These risks are set out here to increase awareness among financial system participants and the wider public of where risks could affect financial stability. It should be stressed that, in alluding to these risks, the Bank is not predicting that they will materialise.

At this conjuncture, the risks to the economy are predominantly from the international environment. The three most important international risks are considered to be the prospects for continuing high and volatile oil prices, large and growing global imbalances and the associated risk of a sharp movement in exchange rates, and possible mispricing in international bond and some other asset markets. A sustained high level of oil prices could impact negatively on both global and domestic economic growth and inflation. In addition, Ireland is exposed to fluctuations in the health of the US economy and, in particular, the value of the euro against the dollar. The possibility of adverse developments in the US economy leading to a rapidly appreciating euro is a significant risk to Irish growth and employment prospects. Finally, there is a risk of a correction in international bond and some other asset markets, where possible overpricing and narrowing of spreads reflect an ongoing search for yield leading to a possible understatement of overall risks. Any sharp correction would have implications for global growth, resulting, *inter alia*, in an increase in the cost of borrowing for Irish households and corporates and thus impinge on growth and employment.

Apart from these significant international risks, a number of vulnerabilities exist on the domestic front. The first is the possibility of a correction in the domestic construction sector, which is currently producing housing units apparently well in excess of medium-term requirements. A lower contribution to economic growth and employment is expected to come from a gradual slowdown in the housing construction sector in the next few years. However, a sharp fall in construction output cannot be entirely ruled out and, given the size of the sector in the economy, such an event could have significant adverse effects on employment and growth. A second domestic risk, in the medium term, is for further deterioration in Ireland's competitiveness, following four years of decline already. This would leave the economy at a significant disadvantage relative to our main trading partners, especially if the deterioration were to continue alongside a sharply appreciating euro. The result would be painful adjustment costs through lower future output and employment.

The threat to financial stability in Ireland comes from the possible realisation of the above risks, especially if there were a simultaneous realisation of more than one of them. Their impact would be felt on unemployment and growth, with negative effects on the banking sector. Any significant increase in unemployment, given the rise in household indebtedness, would strain high-debt households' repayment capacity, especially if interest rates had moved into a tightening cycle. Alongside this increase in household indebtedness has been rapid credit growth to the corporate sector, especially for property-related lending, leading to increased vulnerability of the banking sector to growth and employment risks.

Private-Sector Credit and Indebtedness

Private-sector indebtedness, measured as the value of private-sector credit to the value of GDP or GNP, is growing at historically high rates. The Irish private debt-to-income (GDP) ratio has grown from 115 per cent in 2003 to 134 per cent by end-2004 and could, if recent trends persist, be as high as 160 per cent by end-2005. There is no longer any doubt that the private sector is highly indebted by international standards and that the level of indebtedness will soon match the levels recorded in Europe's most indebted economies.

The most worrying aspect of private-sector indebtedness patterns is the accelerating speed at which debt is increasing in the context of an already high level of indebtedness. The rate of increase in the indebtedness ratio rose by over 16 per cent in 2004 and could increase by 19 per cent in 2005. This accelerating growth in the debt ratio is significantly above the record rates last seen in the late-1990s but at that time economic growth and interest-rate trends were much more favourable. This persistent trend upwards in debt ratios raises concern because the increased level of private-sector indebtedness is a domestic vulnerability, which in the event of a domestic or external negative shock to the Irish economy, could have serious consequences for borrowers and lenders and the wider economy. Moreover, if credit growth does not slow significantly over the next few years, Ireland's level of indebtedness will become even more significant and possibly an outlier among international comparators.

Private-sector indebtedness continues to increase, and at an accelerating rate, from already relatively high levels by international standards. As mentioned previously, this acceleration is above record levels last seen in the late-1990s, but at that time economic growth was significantly higher and interest rates were still trending downwards. The acceleration in household debt accumulation largely reflects residential mortgage growth, which represents around four-fifths of personal lending. The rate of growth in mortgages remains at elevated levels. The combination of slowing house price growth along with expected lower new house construction levels, expected in the next number of years, might normally be expected to contribute to a slowdown in mortgage credit growth, albeit with a lag. Concerns will remain until evidence of this emerges. The other major element of household credit — personal credit for non-housing purposes — is also growing very quickly. This poses risks for financial stability in the medium term.

As well as very high rates of residential mortgage lending growth, commercial property lending has also grown significantly. Up to half of the banking system's aggregate loan book is now in the broadly-defined property category. Credit booms in many countries have passed without causing significant difficulties for their banking systems but international experience suggests that persistently high rates of credit growth, mostly driving property booms, have been important, if not decisive, factors leading to fragility in the banking system.

From a system-wide perspective, the investment of a significant share of the banking system's assets in this one, albeit broadly defined, asset class raises some concerns. The broad nature of property-related lending provides diversification benefits since all sectors of the property market may not be closely correlated. The concern, however, is that the various segments that may not be correlated in normal times, could, in a serious and widespread downturn, become correlated. An adverse shock originating from, or impacting on, the property market would affect all domestic credit institutions simultaneously. This increases financial instability risks.

The rapid accumulation of private-sector debt poses potential financial stability concerns in the medium term. These concerns are shared by the IMF. The experience is that persistently high rates of credit growth have been an important leading indicator of future fragility in banking systems. In particular, increasing indebtedness incurred for asset purchase, possibly reflecting excessive exuberance by leveraged borrowers, carries inherent dangers. The more indebted is the private sector, the more susceptible it is to risk of default if any shocks hit the economy which impact negatively on employment and/or incomes. In mitigation of this, it should be noted that, in the international context, many credit booms have faded without posing significant difficulties for the banking system or the wider economy.

Household Sector

The household sector is becoming increasingly indebted, with the ratio of personal-sector credit to disposable income estimated to increase to 133 per cent in 2005. As with private-sector credit growth, a worrying aspect is the speed at which this indebtedness is increasing: the estimate of almost 19 per cent in 2005 is a continuation of a similar record rate of growth in 2004. The largest component of personal-sector credit is residential mortgage credit (80 per cent share of total) continues to grow at an exceptional rate (25.7 per cent in the twelve months to August 2005) and will remain a matter of concern until some evidence of a slowdown materialises.

The other major element of household credit — credit for non-housing purposes — has also experienced considerable growth in recent quarters, reaching 30 per cent at the end of 2004 before slowing in the second quarter of 2005 to 24.9 per cent. Bank lending to the corporate (non-financial) sector is also growing at a fast pace, especially to the construction and real estate sectors (over 40 per cent growth in 2004 and approximately 45 per cent in recent quarters).

A further concern is that, while average indebtedness does not appear to be excessive, this disguises the fact that a proportion of households and individuals are quite significantly indebted relative to their incomes. In particular, some recent newly mortgaged households are more heavily exposed to the potential for lower income growth, poorer employment prospects and rising interest rates. Because of the weight of mortgages in overall private-sector credit growth and its recent rapid rate of growth, the Bank has paid particular attention to this area in this report.

The Growth of Mortgage Indebtedness in Ireland

It is important to identify whether exceptionally fast mortgage credit growth and increasing mortgage indebtedness in Ireland can, to some extent, be accounted for by changes in fundamental factors. These factors include income and employment growth, falling interest rates and demographics. The issue is whether mortgage credit growth and mortgage indebtedness have become significantly misaligned from underlying factors and could therefore be more susceptible to one or more shocks to the economy or financial system.

The Bank's analysis[1] examines a number of macroeconomic influences — coming from both the demand and supply sides of the loan market — and assessing if these exogenous influences can largely "explain" the pattern of mortgage credit growth and the associated increase in household indebtedness. The results are tentative and subject to a number of caveats. However, they provide some tentative evidence that the way in which mortgage indebtedness has evolved over the past couple of decades can, to a significant extent, be accounted for by demand and supply-side factors which are both macroeconomic and structural.

On the demand side, these factors include the exceptional growth in the economy, particularly in the last decade; the accompanying pickup in employment creation to its strong current level; demographic trends, particularly the increase in the household-formation cohort of the population and significant net inward migration; demand for higher loan-to-value ratios, reflecting the release of earlier pent-up mortgage loan demand from an era of formal and indicative guidelines on sectoral credit allocation to the now higher financing-capacity of households and firms in the low interest-rate environment; lower public-sector indebtedness, which facilitated easier fiscal conditions and therefore higher private debt repayments, and the decline in average inflation over the period, which eased the front loading of real mortgage repayments and increased entry into the mortgage market by customers who previously would have been unable to meet the initial repayment burden.

On the supply-side of the mortgage loan market, important explanatory factors include financial liberalisation, the removal of regulations and controls in credit markets and the reduction in liquidity ratios; the full integration of the money market in the euro area as a result of monetary union in 1999, and the entry of foreign banks. All of these factors contributed to a greater availability of loan funding, and a reduction in the cost of funding for banks, which has in turn facilitated their ability to extend more credit to the private sector. A further contributing factor is the trend fall in the volatility of output growth over the business cycle, both in Ireland and internationally, which could be seen as contributing to a lower risk of default by borrowers, insofar as output volatility is a contributor to default risk.[2] Lower default risk, in turn, makes it feasible for banks to undertake further lending. Additional support to lending growth from the supply side comes from the effect of product innovation, such as interest-only mortgages, equity withdrawal products, and longer maturity mortgages, which have been able to meet the diverging needs of customers in the loan markets.

The modelling exercise identifies a number of fundamental factors that have been important in explaining the growth in mortgage credit over the last twenty years. These factors are fundamental in the sense of not being subject to any imbalances or misalignments, which allows the inference that the indebtedness that has accumulated to date can be justified, and deemed not to be excessive. This suggests that mortgage market

[1] This analysis is presented in the article "The Growth in Mortgage Indebtedness in Ireland", in Part II of this report.

[2] The financial stability aspects of falling output growth volatility are explored in more detail in the article "The Decline in the Volatility of Output Growth — Its Causes and Its Consequences for Financial Stability", in Part III of this report.

developments to date are not a source of systemic fragility. The modelling of the above factors helps to explain a significant portion of the change in households' mortgage indebtedness levels until fairly recently, but does not imply that there is little cause for concern for financial stability.

In this regard, there are a number of concerns. Although developments in these same fundamental factors can account for the rapid growth in mortgage credit to date, it appears unlikely that these factors can continue to improve significantly in the future. For example, it is unlikely that interest rates, inflation and unemployment can fall much lower. Furthermore, it appears likely that incomes will not grow for a prolonged period at similarly high rates to those experienced over the past decade. Therefore, mortgage credit trends should reflect the fact that underlying fundamentals cannot continue to support the kind of growth rates experienced in recent years and consequently one would expect the rate of growth of mortgage credit to be relatively lower in the medium term. In the short-term, however, it is expected that mortgage credit will continue to grow strongly despite the slowdown in the rate of house price growth as the volume of house completions and purchases is expected to remain high. It would be of concern if the high rate of growth were nevertheless to continue in the medium term because this would signal a departure from that justified by fundamental factors.

Another concern is that, even if rapid credit growth could be accounted for in terms of supposed fundamentals, there is scope for any of these fundamental determinants of loan growth to deteriorate significantly in a short space of time causing problems for over-indebted households in servicing their debts. This could arise as a result of factors originating in either the domestic or international economies. These include, for example, a fall in incomes or a rise in unemployment, which would negatively impact on debt affordability, or a change in net inward migration trends (also likely to reflect a shock to economic activity) which would reduce demand for residential property and lead to lower returns on investment in such property for many borrowers and possibly lead to higher defaults. There is also a risk arising from the fact that the mortgage interest rate is currently at the bottom of the interest-rate cycle and only about half of its estimated long-run equilibrium level.

A further concern relates to the fact that the model captures an element of house price speculation. This would seem to suggest that households, in particular, who are keen to borrow on the strength of their existing asset base and who have a favourable repayment capacity, are borrowing increasingly to fund further property investment. These activities could drive house prices too high, with the result that they may get out of line with fundamentals. Mortgage borrowing for purposes other than the purchase of housing in Ireland (e.g., the purchase of foreign property or general household consumption) may introduce new risks and make financial stability assessment more difficult.

The confluence of an unusual number of demand and supply influences helps significantly in explaining the evolution of mortgage indebtedness patterns over two decades. However, concerns remain from a financial stability point of view. The primary concern is the risk that the level of mortgage indebtedness in the economy could continue to rise significantly and to go beyond that largely explained by changes in fundamental and structural factors. Should a decoupling occur between accelerating mortgage indebtedness and underlying fundamentals the result could be a build up of greater vulnerabilities in the financial system. These vulnerabilities, if realised in the context of a threat to borrowers' ability to repay, coming from either higher unemployment or much higher interest rates, could have important spillover effects not just on the private sector but also on the banking sector. In addition, given the extent to which domestic indebtedness relates to domestic property, that market would also be affected. This concern is exacerbated by the extent to which the domestic economy generally has become reliant on the performance of the construction sector and, in particular, residential and commercial property construction.[3]

House Prices

There are clear signs that overall house prices are slowing, although there are differences in the performance of different market sectors. Second-hand house price growth showed a steady decline since mid-2003, as the annual rate declined from 11.5 per cent in August 2004 to 6.1 per cent in August 2005 while new house price growth also declined but remained somewhat higher at 7.0 per cent in the twelve months to August 2005. Annualised rates of growth, based on figures for the first eight months of 2005, suggest

[3] This issue is explored in more detail in the article "The Implications of a Construction Sector Correction" in Part III of this report.

national average house price growth of 6 to 7 per cent in 2005. The continued increases in housing supply may in part explain the gradual easing of house price growth; record housing output was experienced in 2004 for the tenth successive year, with an estimated 77,000 house completions.

Residential property investors remain an important segment of the market, accounting for 21.1 per cent of purchases in 2004. Despite this large market share, research suggests that there was a net reduction in the number of transactions involving investors in the market during 2004, which reversed a two-year trend of the share of investors purchasing properties outweighing the share selling. The net reduction in investor numbers in 2004 may, in part, reflect the decline in rental income experienced over the last number of years.

Rents have tended to stabilise recently. The annual decline of 5 per cent in the second quarter of 2004 recovered somewhat to an annual growth of 2 per cent in August 2005. Despite the recent pick-up in rental values, the divergent trends for house prices and rental values evident in recent years has continued for most of 2005 and, as a consequence, rental yields have continued to fall and remain low by historical standards. As highlighted in last year's Financial Stability Report, the current trend in rents could leave recent investors in the housing market facing a shortfall in terms of their ability to cover mortgage repayments with rental income; the shortfall between rents and mortgage repayments is more pronounced for recent investors in second-hand property. Despite this shortfall, it appears unlikely that existing investors will exit the market, given the current environment of positive growth in capital values and, for those in the market for some time, their relatively lower mortgage repayments compared to more recent investors.

The current slowdown in Irish house prices mirrors the trend seen internationally. In the UK, for example, house price growth declined significantly over the course of the last year. While it is too early to say what effect the slowdown in house price growth will have on these economies, previous international evidence suggests that a stabilisation in house prices need not impact negatively on the health of the economy.

Non-Financial Corporate Sector

The rate of increase in lending by resident credit institutions to non-financial corporates continued to pick-up in the first half of 2005 further intensifying the rebound in credit growth evident since 2002. This pick-up is evident across most sectors. Credit growth to construction and real estate continues apace at just over 45 per cent, slightly above its 2004 level. Commercial property-related lending is the largest component of outstanding loans to the non-financial corporate sector in 2005. However, realised credit risks remain at low levels. For example, the rate of potentially insolvent liquidations remains significantly below its long run average.

There appears to be no substantial short- to medium-term risks to financial stability arising from the corporate sector. However, the skewed distribution of debt, with a disproportionately small number of firms holding the majority of debt, suggests that this overall assessment for the corporate sector is dependent on the continuing health of this small group of large firms. However, the debt of these companies is likely to have been sourced from outside the Irish financial system thereby reducing the financial stability implications for the Irish banking system somewhat.

Banking Sector

Growth of the domestic banking sector remains high with no obvious signs that it may slow down in the near future. The current annual nominal growth rate of Irish banks' assets is 24.6 per cent, which is approximately double the growth rate of the euro area banking system (11.6 per cent). The health of the banking system remains generally solid, when measured by asset quality, profitability, solvency, liquidity and credit ratings of the Irish banks. Earnings growth has been strong and capital ratios are generally well in excess of minimum requirements; total own funds as a percentage of risk weighted assets average 10.5 per cent, approximately, compared to a regulatory minimum of 8 per cent.

There are, however, five main concerns with respect to the outlook for the health of the banking system over the medium term. First, the rate of credit growth and indebtedness is exacerbating the vulnerabilities of the system to a variety of potential shocks, both domestic and external. Second, the share of the loan book in property-related sectors continues to increase very rapidly and now constitutes the greater part of the outstanding loan book. This suggests a significant and possibly excessive concentration of the loan book in property, albeit broadly defined. While the increase in property-related lending implies a higher fraction of the loan book is secured by tangible collateral and may, therefore, be somewhat less risky than the unsecured loans for which property lending is substituting, the concentration of risks in one, albeit broad, sector is a concern. Third, net interest margins are declining. While banks are cushioned somewhat from these declining margins by the current strong rate of lending growth, this has been at the expense of a possible over-concentration in property-related lending. In the face of declining margins, banks may be tempted to seek alternative and possibly riskier sources of higher-yielding interest and non-interest sources of income. Fourth, banks are having to source increasing amounts of funding from non-retail sources, including international sources. There is a risk that a country-specific shock to the Irish economy would constrain the supply and/or raise the price of this funding sharply. Finally, banks' provisioning levels are already low by historical comparison and the adoption of International Financial Reporting Standards will see these provisioning levels fall further.

Insurance Sector

The rapid growth of the banking sector over the period 1998 to 2004 (averaging 22.4 per cent per annum) has been almost matched by that of the insurance sector (averaging 18.7 per cent per annum). The latest data suggest that the domestic insurance sector may now be about one third the size of the group of mortgage-lending domestic banks. Insurance companies can affect financial stability mainly through

1. bancassurance groups, where banks own life insurance companies or vice versa, and
2. the provision of insurance products which are crucial to the real economy.

The structure of the industry in Ireland suggests that financial stability risks arising from the insurance sector are currently very low.

Payments System

The payment and settlement systems in Ireland continue to operate satisfactorily, suggesting that risks to financial stability through these systems are very limited. The overall availability of the TARGET system in 2004 was 99.8 per cent. Availability of the IRIS component of TARGET was 99.6 per cent in 2004 — which exceeds ECB requirements — and, in nine months in 2004, was 100 per cent. An elaboration on the financial stability implications of developments in payments systems is set out in a separate article (''Large-Value Payment Systems: An Introduction to Operation, Design and Risk Mitigation'') later in this report.

Conclusions

The Bank's 2004 Financial Stability Report identified the risk of an unanticipated and sudden fall in residential property prices, combined with an increase in the default rate among mortgage holders, as the risk that posed the greatest threat to the health of the banking system. A moderation in house price growth in the meantime suggests that, while the risk identified in last year's report of a sudden fall in prices cannot be dismissed, this risk may have receded somewhat. However, tentative evidence suggests that this moderation may not have persisted. If house price growth were to reaccelerate, this would increase the risk of a sharp correction in house prices in the future.

The Bank's central forecast for the economy is for overall economic growth to remain stable for the next two years but this is accompanied by external and domestic downside risks. The main external risks to the outlook are uncertain prospects for oil prices, large global imbalances (and the associated risk of a sharp movement in exchange rates), as well as possible mispricing in international bond and some other asset markets. Some growing domestic vulnerabilities relate to the construction sector and competitiveness. At present, the risks to the economy are predominantly from the international environment. The possibility exists that the realisation of these international risks could trigger the domestic risks and lead to a greater cumulative impact on economic growth.

The central expectation, based on an assessment of the risks facing both the household and corporate sectors, as well as the current shock absorption capacity of the banking system, is that the current health of the banking system leaves it reasonably well placed to withstand pressures from potential adverse developments in the short to medium term. However, there are a number of vulnerabilities, in the medium term, particularly that ensuing from the very high rate of credit growth. The Bank's concern in this respect relates to the rapid rate of accumulation of private-sector indebtedness. In particular, increasing indebtedness incurred for asset purchase, possibly reflecting excessive exuberance about prospective returns by leveraged borrowers, contain inherent dangers for creating fragility in the banking system. There are many elements of the very benign economic environment, which has persisted over the last decade or so and which were important in driving rapid rates of mortgage growth (such as falling inflation, interest rates and unemployment, as well as rapidly rising disposable incomes). These favourable elements almost certainly cannot be repeated over the coming years. This, along with the predictable pattern of amortisation of outstanding mortgage debt, would point to a medium-term slowdown in mortgage debt growth. A failure of mortgage growth to slow in line with these developments would be a worrying indicator for financial stability. It should also be borne in mind that the ability of fundamental factors to account for the rapid pace of mortgage growth to date does not completely allay financial stability concerns since these fundamental factors themselves can be vulnerable to shocks which could leave many borrowers facing default.

FINANCIAL REGULATOR
Rialtóir Airgeadais

Summary of the Annual Report of the Financial Regulator 2006

Consumer Protection with Innovation, Competitiveness and Competition

Introduction

This Annual Report outlines how the Irish Financial Services Regulatory Authority (Financial Regulator) performed its functions and exercised its powers during 2006. It incorporates the Consumer Director's and Registrar of Credit Unions' Annual Reports to the Authority. It also incorporates the Annual Reports required under the Unit Trust Act 1990, Consumer Credit Act 1995, Prospectus Regulations 2005 and Market Abuse Regulations 2005.

The Chairman's statements relating to corporate governance and our system of internal financial controls, which are required in order to comply with the various legislative codes and regulations, are contained in Chapter 7 - Corporate Governance.

Members of the Authority and Senior Executives

Martin Moloney (Secretary) Deirdre Purcell Alan Gray John Dunne Con Horan (Prudential Director) Jim Farrell Gerard Danaher

Brendan Logue (Registrar of Credit Unions) Dermot Quigley Brian Patterson (Chairman) Mary O'Dea (Consumer Director) Patrick Neary (Chief Executive) Alan Ashe

Chairman's Statement

Brian Patterson
Chairman

Our purpose is to help consumers make informed financial decisions in a safe and fair market; and to foster sound, dynamic financial institutions in Ireland.

So, what does this mean in practice?

- Consumers need to know that the institution which holds their savings or their life policies, insures their house or their car, is likely to be solvent and sound. This is the most basic protection for consumers. It is the focus of our prudential supervision.
- Consumers need to know that there are basic, enforceable standards for transacting business, which require transparency, ensure suitability and prohibit mis-selling. Our Consumer Code and our Minimum Competency Requirements for sales staff, ensure that this is the case.
- Consumers make their choices based on impartial, clear information. Our surveys and publications provide this.
- When consumers exercise choice, this fosters competition - which in turn increases value to the consumer. So we foster competition between the providers of financial services. We work constructively with them on competitiveness and innovation.

So, we have placed the consumer at the heart of financial regulation. And in so doing, we respect the right and ability of consumers to make their own informed choices and decisions, in a market which is safe and fair.

Ireland also has an important and growing international financial services industry. Here we also work to foster competitiveness and innovation, recognising that they are central to the industry's ability to compete in global markets.

We recently published our Strategic Plan for 2007 - 2009. It sets out in clear terms our purpose, values and goals and explains our regulatory approach. In particular, our principles-led approach to regulation aims to strike the right balance between under and over regulation - and to encourage competitiveness and innovation. We place the responsibility clearly with the Boards and managements of financial institutions to manage their businesses in a responsible and prudent manner. We insist on their fitness and probity to fulfil that responsibility. In so doing, we avoid the excesses of rules-based regulation, which can fail to see the wood for the trees and can suffocate innovation.

Our Authority is a public interest board. Its members give selflessly of their time, experience and wisdom, often well beyond the call of duty. We are fortunate to have such a great team, and I thank them for their commitment.

I also want to thank our Chief Executive, his management team and all our staff for their dedication and achievements. Our culture reflects their strong ethos of public service.

Thanks are also due to the Governor and staff of the Central Bank for their continued support.

I want to thank too the Minister for Finance, his officials and the various Government Departments and State Agencies who have worked with us throughout the year.

Our Consultative Consumer and Industry Panels play an important role in our accountability framework. Both Panels have made constructive suggestions to us during the year, many of which have been readily adopted or built into our planning. We value their commitment and expertise and we thank the members of both panels for their continuing input. We also thank all the representative bodies with whom we engage as we go about our work.

Finally I want to thank the consumers of financial services who place their trust in us to look after their interests. It is a trust we intend not to betray.

Our guiding light is the public interest. It is the value we strive to live.

Brian Patterson
Chairman

Strategic Plan 2007-2009

Our Purpose

is to help consumers make informed financial decisions in a safe and fair market and to foster sound dynamic financial institutions in Ireland.

Our Vision

to be a top tier financial regulator for consumer protection and prudential supervision.

Our Values

- We attach primacy to the public interest.
- We act in the best interests of consumers of financial services.
- We foster an internationally competitive and successful financial services industry.
- We operate with integrity and transparency.
- We work efficiently and effectively.
- We respect and value each other as colleagues.

Our High Level Goals

1. We will set and monitor standards for financial service providers in dealing with their customers.
2. We will set and monitor standards for the running of sound financial service providers and fair markets.
3. We will provide relevant information to consumers.
4. Our regulatory approach will facilitate innovation and competitiveness.
5. We will maximise our operational efficiency and cost effectiveness.

FINANCIAL REGULATOR
Rialtóir Airgeadais

Financial Regulator - 2006 at a glance

Financial Regulator 2006 at a glance

Sector	Advising on EU Directives and Irish legislation
Consumer Protection	Publication of Consumer Protection Code Publication of Minimum Competency Requirements Renewal of Non-Life Insurance Regulations Review of money lending industry
Consumer Information	New advertising awareness campaign - 'on the bus' developed and launched 11 Cost Surveys published - Personal, Student and Business Current accounts, Home Insurance, Motor Insurance, Life Insurance, Personal loans, Credit cards, Car finance and Stockbrokers fees and charges Publications on SSIAs, Mortgages, Savings and Investments, Pensions, Your options at retirement, Getting financial advice and Managing your money published. Consumer information campaigns: Debt Management, mortgages, SSIAs, pensions, using your credit card abroad, fraud, motor pack, savings and investments, 28 regional visits nationwide, Private Motor Insurance Statistics 2003 and 2004, Research on Financial Access published, National Steering group for Financial Education established, Recommendations of Competition Authority Banking and Insurance reports progressed
Authorisation and Funds	Common Fitness and Probity test introduced New authorisation regime for qualifying investor funds and mortgage intermediaries Marketing of Non-UCITS to Netherlands agreed
Banking	Notice on the Implementation of the Capital Requirements Directive for banks Requirements for management of liquidity risk Additional capital required for high loan-to-value mortgages
Insurance	Full solvency regime for reinsurance companies introduced Revised supervisory regime for captive insurers Insurance Statistical Review 2005 Private Motor Insurance Statistics 2003 and 2004
Investment Services	Notice on the Implementation of the Capital Requirements Directive for Investment Firms Revised prudential handbooks for Investment & Stockbroking firms and Authorised Advisors and Restricted Intermediaries
Markets	Prospectus Rules and Market Abuse Rules
Credit Unions	Rollout of web-based Prudential Return completed Guidance Note on Investments by Credit Unions issued Credit Union Newsletter (RCU News) published Longer term lending limits reviewed Approval for provision of mortgage services by credit unions streamlined
Corporate	Annual Report 2005 and Strategic Plan 2007-2009 Industry Funding Regulations and Guide to Funding Levy 2006 Regulatory Connection - 4 issues Settlement of Administrative Sanctions cases

Advising on EU and Irish Legislation	Activities / Key Statistics
Draft Directives for Consumer Credit and Markets in Financial Instruments	97 on-site consumer focused inspections Themed inspections on SSIA maturity process Payment Protection Insurance and Foreign Exchange 84 advertising issues investigated
	330,000 publications requested 325,000 online users visited www.itsyourmoney.ie 110,000 cost surveys downloaded 29,200 callers used our consumer helpline 6,500 visits to Information Centre
Draft Directive for Eligible assets.	2,205 financial service providers and 738 Collective Investment Schemes authorised 6,290 financial service providers and 4,090 Collective Investment Schemes under supervision 4 warning notices issued regarding unlicensed providers of financial products UCITS III Management companies converted
Capital Requirements Regulations Asset Covered Societies Act 2007 Building Societies Act 2006	1,589 returns analysed 60 inspections and review meetings
Reinsurance Regulations Draft Directive for Solvency II	510 (Life and Non-Life) returns analysed 199 inspections and review meetings
Draft Directive for Markets in Financial Instruments	2,679 returns analysed 55,676 funds returns analysed 167 inspections and review meetings
Draft Directives for Markets in Financial Instruments and Transparency. CESR Report on CESR Members' Powers under the Market Abuse Directive and its Implementing Measures. CESR Report on CESR Members' Powers under the Prospectus Directive and its Implementing Measures.	16 market abuse enquiries initiated 2,687 prospectuses approved
Amendments to Credit Union legislation.	289 inspections/visits undertaken Over 1,500 returns analysed
Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing	96% funding levy collected by end December Recommendations of Competition Authority Banking and Insurance reports progressed

Values of the Central Bank and Financial Services Authority of Ireland

In fulfilling our purpose, we make six core commitments, that:

1. We attach primacy to the public interest.
2. We act in the best interests of consumers of financial services.
3. We foster an internationally competitive and successful financial services industry.
4. We work with integrity and transparency.
5. We operate efficiently and effectively.
6. We respect and value each other as colleagues.

WE ATTACH PRIMACY TO THE PUBLIC INTEREST

We work to provide a stable, attractive, fair business environment by making sound, prudent decisions in the public interest.
We promote a sound economic and financial environment, directing our work towards achieving price stability.
We manage the official external reserves to the country's best advantage.
We view all matters in our domain as linked and interdependent.
We are good 'corporate citizens'.

WE ACT IN THE BEST INTERESTS OF CONSUMERS OF FINANCIAL SERVICES

Our decisions are made in the best interests of consumers.
We are accessible and have clear & open channels of communications.
We facilitate consumers in getting redress on financial matters.
Our policies, systems and behaviour are consumer-friendly.
We take the initiative in informing and educating all relevant parties, and we are responsive to them.
We promote transparency in the provision of financial services.

WE FOSTER AN INTERNATIONALLY COMPETITIVE AND SUCCESSFUL FINANCIAL SERVICES INDUSTRY

We design and operate a regulatory regime conducive to an internationally competitive financial services industry and one that is profitable and growing in both the domestic sector and the international sector based in Ireland.
We seek to be well informed about the needs and concerns of financial institutions through regular consultation and research.
We provide world-class service to financial institutions in all our dealings with them.
We work to ensure a safe and reliable payments system including production, circulation and use of high quality banknotes and coins.
We strive to fulfil our statutory roles thoroughly and at the minimum necessary cost.

WE WORK WITH INTEGRITY AND TRANSPARENCY

Integrity, impartiality and thorough professionalism characterise everything we do and say.
We have transparent, comprehensive, and proactive systems of accountability and external reporting.
We meet all requests for information within the constraints of the law.

WE OPERATE EFFICIENTLY AND EFFECTIVELY

We are responsive and dynamic in our approach to our constantly changing environment and strive for continuous improvement.
We seek to develop and execute our strategies successfully.
We review performance regularly and learn from experience, measuring ourselves against best international standards.
We embrace a performance culture and recognise achievement.
We make efficient use of resources and provide value for money.
Co-operation and teamwork is the norm across the organisation.

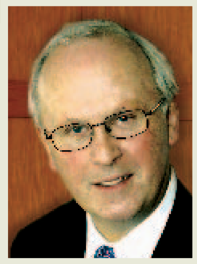
WE RESPECT AND VALUE EACH OTHER AS COLLEAGUES

Our human resource policies and practices are fair and transparent.
We have effective systems of communications and consultation.
Training and development opportunities are available to all.
We trust each other to act responsibly and with commitment.
Our reward and recognition systems are fair and competitive.
We recognise the need to maintain a reasonable balance between work demands and family life.
We maintain a safe and healthy work environment.

Financial Regulator
Rialtóir Airgeadais

Consumer Protection with Innovation, Competitiveness and Competition

Annual Report of the Financial Regulator 2006



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Chairman

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Thanks are also due to the Governor and staff of the Central Bank for their continued support.

Effective Regulation, Fostering Innovation, Competitiveness and Competition in the Financial Services Industry

Mitigating Risk through Compliance

A principles-led approach to regulation is the right model for Ireland. It means that the responsibility for the proper management and control of a financial service provider, and the integrity of its systems, rests with its board of directors and its senior management. This approach focuses on outcomes, is robust and internationally credible. It both allows and requires financial service providers to manage themselves. This vital work is overseen by the Prudential Director. Financial service providers must have systems and policies in place to mitigate risk and monitor compliance with their internal policies. Our role involves oversight of the quality of the institution's corporate governance, including risk management and internal control systems.

We fully expect boards and senior management of all financial service providers operating in Ireland to adopt ethical behaviour and transparency in business dealings as key values. We do not examine each transaction or contract entered into by institutions to test compliance. Neither do we seek to interfere with the design of financial products. We expect all financial service providers, whether engaged in international or domestic activities, to comply with best practice. Where a financial service provider does not fulfil these reasonable expectations we have a number of enforcement measures available to us, culminating in administrative sanctions. I am satisfied that the majority of financial service providers operate to a high standard. This is borne out by the very small number of cases that required such actions in 2006.

Better Regulation

We strive for a regulatory system that is robust, is internationally credible and that allows financial service providers the freedom to run their businesses properly. We want to implement European regulation in a manner consistent with this approach. However, in keeping with this form of implementation, we must be able to depend on industry to honour the obligations and commitment that this model of supervision demands. We are committed to ensuring that our regulatory requirements do not become a barrier to competitiveness and innovation. We apply the Government's 'Better Regulation' principles and are active members of the Taoiseach's Better Regulation Group.

In accordance with the 'Better Regulation' principle of transparency, we consult publicly before introducing a new regulation. The Consultative Consumer and Industry Panels provide an important mechanism for ensuring that the consultation process with stakeholders is effective and efficient. Both Panels were invited to make a number of valuable submissions to us on a range of regulatory proposals, including our Strategic Plan for 2007-2009 and provided us with comments on our draft statement of income and expenditure. 2006 has been a year of further development in our constructive relationships with the two Consultative Panels.

Pictured at the Insurance Institute Industry Leaders Conference with the Chief Executive Patrick Neary who spoke at the event are (l–r) Michael Brennan, President, The Insurance Institute of Ireland; Mary Fulton, Partner, Deloitte; and Cormac McCarthy, Group Chief Executive Officer, Ulster Bank Group.

Table 1.7 - Principles we expect financial service providers to abide by
We expect financial service providers to: 1. Conduct their functions in a transparent and accountable manner; 2. Act with prudence and integrity and in the best interests of their customers at all times; 3. Maintain at all times sufficient financial resources to meet all their commitments; 4. Have in place sound corporate governance procedures; 5. Have oversight and reporting systems that allow the board and management to monitor and control all operations; 6. Have in place internal controls that are adequate for the nature, scale and complexity of their operations; 7. Have risk management policies and risk control systems appropriate to the nature, scale and complexity of their operations; 8. Comply with any regulatory rules set down by the Financial Regulator in relation to, for example, solvency and capital adequacy, liquidity, segregation of client funds, consumer protection codes; and 9. Produce accurate, complete and timely information, when required.

In order to assist financial service providers to become aware of their legal obligations and to clarify what we mean by 'principles led' we issued a number of regulatory rules and guidance notes during 2006. The Consumer Protection Code and the Minimum Competency Requirements were published in July 2006. In addition, rules relevant to banks, investment firms and collective investment schemes were issued. A full list of regulatory rules and notices issued is provided in Appendix 2. Appendix 3 provides a list of guidance notes issued.

Administrative Sanctions

Our 'principles led' approach to regulation also means that it is a matter for each financial service provider to determine for itself how best to abide by regulatory requirements. Proactive compliance with legislation, codes and supervisory requirements is our preferred approach. Where issues arise our goal is to resolve them to the benefit of consumers speedily and efficiently. In setting out our philosophy on the use of administrative sanctions, we have stated that major factors which we will consider before we decide to pursue a sanctions case are:

- The nature and seriousness of the contravention;
- The conduct of the financial service provider after it came to light;
- The previous compliance record of the financial service provider; and
- The availability of other appropriate regulatory actions.

Where the need arises, however, we will not hesitate to use all the sanctioning powers available to us.

Our Administrative Sanctions Procedure permits a settlement agreement to be reached between a financial service provider or individual and us. Where we have reasonable grounds to suspect that a financial service provider has committed a breach or an individual has participated in such a breach, the agreement must be in writing and is binding on us and on the parties involved.

FINANCIAL REGULATOR
Rialtóir Airgeadais

Annual Report of the Financial Regulator 2007

Five Year Anniversary

Chairman's Statement

Brian Patterson
Chairman

On the establishment of the Financial Regulator on 1 May 2003, we were set with a dual challenge:

- To help consumers make informed and responsible decisions on their financial affairs in a safe and fair market, and
- To foster sound and solvent financial institutions which gives depositors and other consumers of financial products confidence that their deposits and investments are safe.

I believe that, since our establishment, we have managed to meet both of these challenges while still maintaining high prudential standards. Five years on, we have, and continue to, put consumers of financial services at the heart of what we do through direct consumer protection initiatives, providing accessible information for consumers and promoting a safe and sound financial system. In all our work to date, we have shown that this can be done in a cohesive and complementary manner. The recent market turbulence and its impact on a number of notable international entities already illustrates how prudential supervision and consumer protection are inextricably linked. Where we have had to make hard decisions, they are always made in the public interest.

There have been many successes during the last five years, which are outlined throughout this report. It has been a great privilege for me to be involved in creating and embedding the new institutional arrangements for financial regulation in Ireland, not just at the initial stages but also with the many additional functions given to us since our establishment. In this demanding but exciting experience, it has been a particular privilege to enjoy the wisdom and support of the Governor of the Central Bank and Financial Services Authority of Ireland, John Hurley. We value our links with the Central Bank - through the cohesive structure of the Central Bank and Financial Services Authority of Ireland - and this relationship is especially important for ongoing vigilance on financial stability.

We have managed all aspects of our work through the development of a strategic planning approach - an approach which I strongly affirm. In each of the years since our establishment, we have published a Strategic Plan, grounded in our six core values to serve the public interest. The Strategic Plan clearly sets out where we intend to focus our efforts in an open, transparent and measurable way but is flexible enough to take account of any surprise or unexpected events. All our stakeholders are consulted during the planning process.

None of the achievements of the Financial Regulator over the last five years could have been possible without the commitment and support of all those who have supported our mandate:

- The Minister for Finance, his officials and the various Government Departments and State Agencies;
- Fellow members of the Authority who have contributed so much in terms of time, effort and experience;
- The Chief Executive, his management team and all staff of the Financial Regulator for their continued dedication, support and professionalism toward the achievement of our mandate;
- The Governor, Director General, management and staff of the Central Bank, and
- The Chairmen and members of both the Consultative Consumer and Industry Panels as well as the executives of all representative bodies with whom we engage.

Finally, I wish my successor every success as the organisation moves on from its establishment phase. The new Chair will take on this role with the assurance of strong, ethical and professional support from management and staff dedicated to the public interest and confident of the support of everyone working in financial services in this country.

Brian Patterson
Chairman

Chief Executive's Report

Patrick Neary
Chief Executive

We were established as a single regulator for all financial services in Ireland to put consumer interests at the heart of financial regulation. It is with great satisfaction that I can report that, five years on, we have made significant strides in delivering on our mandate both to protect consumers by helping them to make informed financial decisions in a safe and fair market and also to foster sound and dynamic financial institutions.

So, how successful have we been in delivering on these objectives since our establishment? I believe that we now have a first-class regulatory system that provides an integrated and consistent approach to consumer protection and prudential supervision across all sectors of the financial services industry.

- We have built today's regulator from the expertise developed over many years in the Central Bank, the Department of Enterprise Trade and Employment, the Office of the Director of Consumer Affairs and the Registrar of Friendly Societies in the areas of prudential supervision and consumer protection and have successfully brought together and enhanced these regulatory systems;

- We have articulated and embedded our principles-led and risk-based approach to regulation, in line with the Government's Better Regulation principles. With this approach, responsibility for the proper management and control of a financial service provider and the integrity of its systems now rests squarely with its board of directors and senior management. Ethical behaviour in all business dealings is a feature we expect to see in all financial service providers under our regulation. Our prudential activities underpin this approach;

- The new Consumer Division was established with two particular aims. First, to provide impartial user-friendly information on financial products, which helps consumers make informed choices in terms of the products they choose, the amount of risk they take on and the cost of financial products. Second, to ensure that the market for financial products is safe and fair. This has resulted in the development and implementation of the Consumer Protection Code which provides for a level playing field for almost all financial service providers in how they deal with their customers;

- We are one of a small number of regulators internationally who commit to developing our mandates in a strategic, business like way. We now publish a three-year rolling plan, which clearly sets out our strategies and actions in a transparent and measurable way. Our latest Strategic Plan covers the period 2008 - 2010;

- Over the past five years, we have taken on significant additional regulatory responsibilities, in particular those arising from new EU directives in the markets, capital requirements, reinsurance, funds and investment management areas;

- We have tailored our regulatory approach to accommodate the special character of the credit union sector, recognising its volunteer and community-based dimension;

- We have developed an administrative sanctions process, under the powers given to us in the Central Bank and Financial Services Authority of Ireland Act 2004;

- Throughout this time, we have invested heavily on building relationships, at home and abroad, working with our key stakeholders for our mutual outcomes, including the Consultative Consumer and Industry Panels and relevant Government Departments, and

- Over the period, we have operated with maximum transparency through the publication of our annual reports and our rolling strategic plans, our attendance at Dáil committees, the introduction of our Stakeholder Protocol and through our websites.

2007 - The Year in Review

As we look back on 2007, the year could be seen as something of a watershed in our short history being marked by a number of significant regulatory developments including the full implementation of the Consumer Protection Code, the implementation of the Markets in Financial Instruments Directive (MiFID) and the other markets directives, the application of the Capital Requirements Directive to credit institutions, continued work to prepare for the Solvency II Directive for insurance companies, the process for the regulation of reinsurance business and new initiatives relating to the lending policies of credit unions. These and our many other achievements are expanded on in the following chapters of this report. Of particular interest will be the various regulatory actions taken across the organisation during the year, which can be summarised in the table below. Many of these will be expanded on throughout the report.

FINANCIAL REGULATOR
Rialtóir Airgeadais

Annual Report of the Financial Regulator 2008

- There were significant tax incentives for property investment. These included mortgage interest tax relief and a large number of property-based tax incentive schemes. Relatively low personal tax rates (at 20 and 41 percent) also encouraged property acquisition; and
- The ready availability of credit, facilitated by a range of financial liberalisation measures during the 1980s and 1990s, encouraged borrowing. Product innovation also contributed through interest only mortgages, 100 percent mortgages, equity withdrawal, re-mortgaging and mortgages with longer terms (up to 35 years in some cases).

It should be noted that prior to the second phase of the financial crisis occurring in September 2008, most economic commentators were forecasting that economic growth would continue, albeit at a more moderate level. For example:

- In early 2007, the EU[10] stated that the Irish economy was expected to continue growing at a high rate of around 5 percent in 2007 and to decelerate to 4 percent in 2008. While the report suggested that robust growth would continue over the short-term, it stated that risks to this outlook persisted. In particular, the high reliance on recent output and employment growth in the construction sector, coupled with the significant increases in household indebtedness, were noteworthy risks over the medium-term; and
- In the summer of 2007, the ESRI[11] stated that it was becoming clear that 2006 would represent a peak in terms of the recent experience of economic growth. They forecast that the slowdown would be moderate, with GNP growing by 4.8 percent in 2007 and 3.7 percent in 2008.

Actions Taken by Financial Regulator to Address Emerging Risks

We were acutely aware of the increasing risks facing the financial sector. This was specifically recognised in our 2006 Strategic Plan[12] where we highlighted the growth in credit and the increased level of indebtedness in a low interest rate environment as the major domestic risk factors. The global imbalances, the uncertain outlook for world economic activity, the evolution of oil prices and the dollar were also identified as the major international risks. In light of these concerns, we took a number of strategic actions aimed at maintaining the soundness and safety of credit institutions against the background of growing exposure to funding in the wholesale markets and strong increases in lending for property, even though some commentators, as stated above, were still predicting continued economic growth. These actions included:

Prudential Actions

- New requirements for credit loss provisioning, including requirements for credit risk management were introduced in October 2005. The purpose of these requirements was to ensure that credit institutions managed their credit risk appropriately and that appropriate levels of provisions were made for impairments and uncollectable amounts written off. The rules included not only qualitative requirements on credit risk management and impairment provisioning, but also quantitative criteria and reporting guidelines for impairment provisioning.

10 EU (2007) Economic Forecast, Spring, page 59.

11 ESRI (2007) Quarterly Economic Commentary. w ww.esri.ie/news_events/press_releases_archive/2007.

12 Financial Regulator (2005) Strategic Plan 2006, page 5.

- With the increasing prevalence of high Loan to Value (LTV) mortgages, including 100 percent mortgages which were first launched in Ireland in 2005, we introduced more onerous capital requirements in advance of the Capital Requirements Directive coming into effect. From 1 May 2006, the risk weighting of Irish residential mortgages was amended. Mortgages with an LTV ratio in excess of 80 percent now required a 100 percent risk weighting for the portion of the loan that exceeded the 80 percent threshold. Before this development a 50 percent risk weight applied. This resulted in credit institutions having to set aside additional capital in respect of these loans.

- New liquidity requirements were introduced in June 2006 (becoming effective July 2007, before the start of the international crisis) based on a maturity mismatch approach. This resulted in credit institutions being required to analyse their cash flows under various headings and to allocate them into pre-determined time bands depending when cash was due to be paid in or out.

- The EU Capital Requirements Directive, which was implemented on 1 January 2007 and became fully effective on 1 January 2008, introduced a new capital adequacy regime for banks. The Directive gives supervisors some flexibility through national discretions to tailor the capital requirements to reflect their national circumstances. We used these discretions to introduce a more stringent capital regime than the Directive, aimed at supporting the measures already introduced here in respect of property transactions. This was designed to counter the growing exposure of Irish banks to that sector, as follows[13]:

  - Where a credit institution had retail owner occupied residential exposures with an LTV ratio of greater than 75 percent it was required to apply a risk weight of 75 per cent to the part of the exposure exceeding the 75 per cent LTV ratio. The Directive provides for a possible 35 per cent risk weight;

  - The risk weighting imposed by us for exposures to properties that are not occupied by borrowers ranges from 75 per cent, for retail exposures, to 100 per cent for non-retail exposures. The Directive provides for a possible 35 per cent risk weight. The Directive also provided discretion to allow a 50 percent risk weighting to exposures secured on commercial real estate. We did not take up this discretion and a full weighting of 100 percent applies. Table 1 sets out these changes in requirement and compares our implementation with that mandated in the Directive; and

Table 1 – Restrictions of Residential Loan/Value Ratios

	2006	2007 and 2008
1. Minimum Risk Weighting of residential mortgages in EU directives	50%	35%
2. Risk Weighting of residential mortgages imposed on Financial Institutions in Ireland	Residential mortgages that exceed 80 percent LTV attracted risk weighs of 100% for portion of mortgage in excess of 80% at inception of loan	35%-100%[14]

13 With effect from January 2008 we introduced Interim Capital Requirements, linked to the Basel 1 framework, in order to restrict any possible capital releases pending completion of the CRD ('Basel 2') Supervisory Review and Evaluation Process. In the case of banks which use the CRD Internal Ratings Based Approach and for which we are the consolidated supervisor, we have introduced capital floors super-equivalent to the CRD.

14 We decided not to avail of an option under the CRD to risk weight all residential mortgages at 35%. Under our implementation of the CRD, loans with a LTV not higher than 75% attract a 35% risk weight. The amount of a loan above 75% LTV attract a risk weight of 75% if the exposure is classified a retail exposure under the CRD or a 100% risk weight if not. Residential mortgages on properties that are not owner-occupied (e.g. residential investment properties) attract a risk weight of 75% if exposure is classified as retail under the CRD or 100% risk weight if not.

- The Directive allowed us to decide that exposures, associated with particularly high risks such as investments in venture capital firms and private equity investments, be assigned a risk weight of 150 percent. We applied this discretion to speculative commercial real estate, as we determined it to be a high-risk category. We were the only regulator in the EU to use this provision in relation to commercial real estate. Table 2 below sets the changes in requirements, together with our implementation and that of other EU regulators.

Table 2 – Capital Requirement Level Required on Speculative Commercial Real Estate

	2006	2007 and 2008
1. Minimum capital requirements as specified in EU directives	100%	50%-100%[15]
2. Minimum capital requirements imposed on credit institutions in Ireland	100%	100%
3. Discretion to apply increased capital requirements	100%	150%[16]
4. Capital Requirements imposed by Ireland	100%	150%
5. Application of above requirements in other EU Member States	100%	50%-100 %
		In relation to the use of 150% risk weight, while other member states may have availed of this discretion for other types of exposure we are not aware that any did so in respect of speculative real estate.

Consumer Actions

- The Consumer Protection Code introduced by the Financial Regulator became effective in July 2007. One of the key objectives of the code is to address aggressive lending by financial institutions in the face of increasing levels of personal debt being taken on. The Code is designed, not only to protect consumers, but also to clearly set out the standards we expect financial institutions to meet when dealing with consumers. The measures included:
  - Institutions must act fairly and in the best interests of their customer;
  - The obligation to obtain sufficient information about the applicant to be in a position to provide the most suitable product;
  - The obligation on a mortgage provider to have sight of an original valuation before the drawdown of funds;
  - The prohibition on offers of pre-approved credit facilities;
  - In relation to lending, the Code requires that an institution must ensure that, at the time a loan is approved, the borrower is in a position to make the required repayments;

15 Under the Standardised Approach of the CRD exposures fully secured by commercial real estate carry a risk weight of 100 percent with a national discretion available to apply a lower risk weight if certain criteria are met.

16 The CRD provided an option to risk weight certain high-risk exposures at 150% and the Financial Regulator applied this to speculative commercial real estate.

- All loans offered to customers must be suitable for the individual customer – this would include an assessment of affordability. Furthermore, the institution must be able to demonstrate after the event that the loan it offered was, in fact, suitable at that time on the basis of the borrower's circumstances;
- Offers to consolidate several loans into one must contain information on the extra cost involved;
- Offering pre-approved unsolicited credit is banned; and
- Unsolicited increases in credit card limits are also banned.

- Since the Financial Regulator was established in 2003, debt has been, and continues to be, the focus of many of our consumer campaigns. Consumers have been advised to examine if they can afford to borrow, to make sure that they consider all options, to assess the overall cost of debt and take measures to reduce debt. In 2006 we intensified this campaign by:
  - Publishing a new guide to Mortgages (February 2006);
  - Warning of the risks and the cost of re-mortgaging (March 2006);
  - Warnings on the risks of equity release; and
  - Urging consumers to pay off the debts with their matured Special Saving Incentive Accounts (May 2006).

International Commentary

The actions described above were commended by the OECD[17] as recently as April 2008, where it stated that we "had clearly identified strong credit growth and rising indebtedness as major systemic vulnerabilities." The OECD referred, in particular, to the implementation of a new Consumer Protection Code, which limits the scope for predatory lending practices, and the introduction of a forward-looking liquidity regime just before the international financial market turmoil struck. The regulatory action to reduce risks by increasing the risk-weighting for high loan-to-value mortgages for owner-occupiers and speculative commercial real estate lending was also praised.

Actions Taken by Government to Restore Financial Stability in Ireland

The actions referred to above and taken on both the Prudential and Consumer fronts were framed against the background of international and domestic economic forecasts which grossly underestimated the scale and rapidity of the downturn in the international and domestic economic environment. Therefore the actions taken were not sufficient to head off the domestic financial crisis that arose. While more robust actions might have mitigated the impact of the crisis in Ireland it is unlikely that any action, however severe, taken by the Financial Regulator in isolation would have substantially reduced the scale of the problems.

Few, if any, foresaw the immense scale of the financial crisis that was precipitated by the failure/serious difficulties of US financial institutions: Bear Stearns (March 2008), Freddie Mac, Fannie Mae and Lehman Brothers (September 2008). These resulted in the collapse of bond and loan markets and the cost of unsecured 'overnight interbank borrowing' dramatically increased.[18] Even though we had implemented

17 OECD (2008) OECD Economic Surveys, Ireland, April, page 13.

18 Furceri, D. and Mourougane, A, (2009), "Financial Crises: Past lessons and Policy Implications", OECD Economics Department Working Paper number 668, page 7.

measures to modernise liquidity risk management, banks found it increasingly difficult to source funding. In order to bring stability to the financial system, the Government has taken four major initiatives to address the impact that the international financial crisis has had in Ireland:

- In September 2008, the deposits of the seven major banks were guaranteed, including covered bonds, senior debt, and dated subordinated debt;
- In January 2009, Anglo Irish Bank was taken into public ownership;
- In February 2009, the Government agreed to inject Core Tier 1 capital into Allied Irish Bank and Bank of Ireland. In May 2009 it also agreed to inject capital into Anglo Irish Bank; and
- In April 2009, it was announced that a National Asset Management Agency (NAMA) is to be established to address the issue of asset quality in the banking system.

The Government has also announced that the role of the Central Bank of Ireland will be reformed to place it at the centre of financial supervision and financial stability oversight. This will result in the full integration of the prudential supervision of individual financial institutions with that of the financial system as a whole.

Regulatory Reform

Since the onset of the crisis in 2007, the international financial community has been developing proposals to improve the regulatory system. In this regard, developments at EU level are the most appropriate to Ireland. The initial response by the EU to the adverse credit development in late 2007 focused on how transparency in the market, risk management by firms and prudential rules could be improved. In this regard, a number of refinements have been proposed by the European Commission to the Capital Requirements Directive (CRD). These include changes in respect of large exposures, cross border supervision, crisis management arrangements, hybrid capital and risk management for securitised products. However, the principal response to the financial crisis was published earlier this year and is currently under consideration at EU level. The de Larosière report[19] recommends:

- Better identification of systemic risks across the system;
- Closer supervision on an EU-wide basis;
- Stronger capital requirements;
- Supervision of credit rating agencies;
- Amendment of accounting rules;
- Clear rules and enforcement powers;
- Better compensation mechanisms; and
- Better crisis resolution mechanisms.

The recommendations were endorsed by the EU Commission in its communication to the Spring European Council (Heads of State) of March 2009. Discussions in the EU Council (Heads of State), Ecofin (Economic and Finance Ministers) and the European Parliament, as well as a public consultation, have demonstrated a broad consensus about the need for reform and the objectives to be achieved in line with the de Larosière Group's recommendations and the EU Commission's proposals for its follow up. More details on the recommendations of de Larosière Group are included in Table 3.

19 De Larosière and others (2009) "EU High Level Group on Financial Supervision in the EU", pages 13-37.

Table 3 – Principal recommendations of the de Larosière report on Financial Supervision

- A fundamental review of the Basel II rules, with a view to gradually increasing minimum capital requirements, encouraging capital buffers and tightening liquidity management.
- A common definition of regulatory capital should be adopted.
- Credit Rating Agencies should be supervised and the use of ratings in financial regulations should be significantly reduced over time.
- Accounting rules (such as the mark-to-market principle) need to be examined so that they do not promote pro-cyclical behaviour or discourage long-term investment.
- The Solvency II Directive should be adopted for insurance undertakings.
- Supervisors in all Member States must have sufficient powers, including sanctions, to ensure the compliance of financial institutions with the applicable rules.
- It is necessary to extend regulation to all firms or entities (such as hedge funds) conducting financial activities of a potentially systemic nature, even if they have no direct dealings with the public at large.
- Over-the-counter derivatives should be simplified and standardised. At least one well-capitalised central clearing house for credit default swaps is needed in the EU.
- Common rules for investment funds in the EU need to be developed.
- In order to tackle the current absence of a truly harmonised set of core rules in the EU, inconsistent transposition and application of legislation should be avoided.
- Compensation incentives in financial institutions must be better aligned with shareholder interests and long-term firm-wide profitability.
- The risk management function within financial institutions must be made independent and responsible for effective, independent stress testing.
- There is a need for a coherent and workable regulatory framework for crisis management in the EU.
- Deposit Guarantee Schemes in the EU should be harmonised and preferably be pre-funded by the private sector.
- In view of the absence of EU-level mechanisms for financing cross-border crisis resolution efforts, Member States should agree on more detailed criteria for burden sharing.
- Strengthen EU regulatory structures, by creating (1) European Systemic Risk Board to decide on macro prudential policy and provide early risk warning to EU supervisors, and (2) European System of Financial Supervision, composed of EU wide banking, insurance and securities authorities, who would:
  - Co-ordinate the work of national supervisors;
  - Arbitrate between national supervisors in supervisory colleges in cases of disagreement on supervisory issues regarding cross border financial institutions;
  - Take steps to harmonise national regulatory rules and move towards a common European rulebook; and
  - Directly supervise certain pan-European institutions which are regulated at EU level, such as Credit Rating agencies.

A number of matters regarding strengthening EU financial supervision have since been addressed at Ecofin. It is anticipated that the European Commission will develop legislative proposals by early autumn 2009 with the new EU institutions expected to be fully in place during the course of 2010.

It is also recognised that the regulatory approach that had been adopted in Ireland needs to be enhanced. Following the Government decision to guarantee the deposits of seven credit institutions (covered institutions), we adopted a more intensive system of supervision. This more intensive approach to the prudential supervision of covered institutions places an increased focus on business models, strategies and risks. It includes a comparative analysis of firm performance. We now seek more detailed information on key risks facing covered institutions and meet the Chief Executives regularly to discuss the risks. For covered institutions we have supervisory staff located on site. Our staff attend, on a sample basis credit, treasury, audit, board and other meetings to assess the strength of corporate governance of the institutions. We have also tightened reporting of governance issues through regular meetings with the heads of risk at the credit institutions and more timely submission of information on issues raised by internal and external audit. We are also proposing to introduce rules that require banks and building societies to disclose in their audited annual financial statements details of loans made to directors or connected persons. In line with the de Larosière recommendations we are also using our enforcement powers to achieve encourage overall compliance and to act as a deterrent to poor controls and risk management.

To enable us to undertake this more intense form of supervision, not only are we recruiting additional staff but we also are securing the services of staff with specialist prudential skills, particularly those with more highly specialised market expertise.

Conclusion

The current turmoil in the international financial markets is unique in that a series of crises occurred over a two year period, namely the freezing of credit and liquidity, bank failures and the bursting of property bubbles, not only here but also in other countries. International co-operation and co-ordination is now high on the world agenda and actions are being taken in a number of countries to restore stability to financial markets. In the EU, financial supervision is being strengthened along the lines recommended by de Larosière Group, while in Ireland, the Government is also taking steps to restore stability to the financial system and improve the regulatory structure.

In retrospect, it is clear that the actions we took were insufficient and were not taken early enough. We took what we considered to be proportionate actions to mitigate the risks in the system. Clearly this was not enough as the scale and rapidity of the crisis (which was exacerbated by events such as the Lehman's collapse) greatly exceeded forecasts. A more intensive form of regulation is now required and is already in place in the covered institutions. We are also working with the Government and EU with regard to their plans for further improvements to regulation in the future.

Key Actions in 2008

While dealing with the impact of the crisis has been our top priority throughout 2008, we undertook a number of other initiatives and activities, the principal ones of which are outlined below, to discharge our statutory functions.

Prudential Supervision Actions

- Continued close co-operation with the Central Bank, Department of Finance and international authorities in the face of the worsening international financial crisis;
- The establishment of a new supervisory unit to monitor intensively compliance with the objectives of the Government Guarantee Scheme;
- Active participation in discussions on need to recapitalise the banks;
- Active participation in discussions on significant amendments to the Capital Requirements Directive (CRD) and other measures necessitated in EU and internationally arising from the financial crisis;
- Launch of major investigations of directors' loans in Anglo Irish Bank and of Financial Regulator's handling of matter;
- New regulatory regime for reinsurance companies in place;
- Survey of insurance companies conducted to assess solvency and asset composition in light of international financial market turmoil;
- Establishment of a dedicated Anti-Money Laundering Unit;
- Draft Guidance Note for Credit Unions on Matters relating to Accounting for Investments and Distribution Policy;
- Significant preparatory work completed for a new EU wide regulatory regime for insurance companies;
- Implementation of the governance and control requirements of the MiFID;
- Introduction of ban on short selling in Irish financial shares;
- Inspection conducted of the operations of the Irish Stock Exchange under the market abuse, prospectus and transparency delegation agreements;

Consumer Protection Actions

- Introduction of regulatory regime for retail credit and home reversion firms and a consumer protection code for clients of moneylenders;
- Introduction of a voluntary consumer protection code for credit union members;
- Actions taken, including administrative sanctions, against financial service providers who did not comply with regulatory requirements;
- Helped over 43,000 consumers who contacted us with personal finance queries;
- Enhancement of *www.itsyourmoney.ie*, with number of visitors increasing by 54% on 2007; and
- Completion of 8 consumer focused themed inspections.

BANKING SUPERVISION

Significant Events

- Introduction of the Government Guarantee Scheme.
- Establishment of a new supervisory unit to monitor compliance with the objectives of the Scheme and application of existing regulatory requirements to credit institutions covered by the Scheme.
- Significant amendments to the Capital Requirements Directive (CRD) proposed, including review of hybrid capital adjustments, large exposures and liquidity requirements.
- Introduction of a new supervisory electronic reporting framework as part of the implementation of the CRD.
- Additional reporting requirements introduced in respect of non-performing assets.

Market Turmoil and Liquidity Crisis

The turmoil in global financial markets can be traced back to early 2007, originating in the US sub-prime market.

Market uncertainty deepened further in mid-September 2008 with the collapse of Lehman Brothers. The markets, which had already been working at a fraction of their capacity, froze. This severely curtailed inter-bank and international wholesale term funding in the banking sector.

On 30 September, the Minister for Finance announced that the Government had decided to put in place, with immediate effect, a guarantee arrangement to safeguard all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II), with the following banks: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society, the Educational Building Society and Postbank Ireland. The Government's objective in taking this decisive action was to maintain financial stability for the benefit of depositors and businesses in the best interests of the Irish economy.

This announcement was made following advice from the Governor of the Central Bank and the Financial Regulator on the impact of the international market turmoil on the Irish banking system. The guarantee is being provided at a charge to the institutions concerned and is subject to specific terms and conditions so that the taxpayers' interest can be protected. The guarantee covers all existing aforementioned facilities with these institutions and any similar facilities issued from midnight on 29 September 2008, and will expire not later than midnight on 28 September 2010. The government proposes a new guarantee scheme to replace the existing scheme which will be called a guarantee of certain eligible instruments scheme ('EIG'). The scheme will last at least 5 years from when the legislation is passed. In contrast to the existing scheme, it allows for issuance of unguaranteed debt and the taking of un-guaranteed deposits and therefore will not provide a blanket coverage for all debt securities.

The Government announced in the April 2009 supplementary budget that it intends to put a State guarantee in place for the future issuance of debt securities with a maturity of up to five years.

In September 2008, the Government also announced an increase to the maximum amount covered under the Deposit Protection Scheme to €100,000. This action was taken to further reassure depositors and prevent outflows of funds from Irish credit institutions, including credit unions. We are assisting with the development of legislation to give effect to the details of the Government announcement and the new EU Deposit Guarantee Directive, which was transposed into law at end-June 2009.

Government Guarantee Scheme

Under the legislation introducing the Government Guarantee Scheme, we have a number of specific new responsibilities, which must be carried out in consultation with the Minister for Finance. These are to impose conditions regulating the commercial conduct of a covered institution's business, having regard to capital ratios, market share and balance sheet growth, in order to minimise any potential competitive distortion that may otherwise arise and to avoid any abuse of the guarantee.

As part of our remit we:

- Require Compliance Certificates provided by a covered institution to be audited by an independent auditor;
- Require specific reports, to monitor compliance with the terms and conditions of the scheme;
- Submit reports as necessary to the Minister for Finance on the compliance by covered institutions with the terms and conditions of the scheme; and
- Monitor the operation of the scheme and report regularly to the Minister for Finance.

To meet these responsibilities, we have set up a new supervisory department whose role is to monitor compliance by the credit institutions with the objectives of the scheme and to continue to apply all existing regulatory requirements for credit institutions covered by the Guarantee. We recruited senior supervisory staff with banking experience and have placed some of them on-site in the covered institutions to monitor their activities.

In early December 2008, business plans were submitted to us by the covered institutions to demonstrate how they plan to operate in a manner consistent with the terms and conditions of the scheme. We met with the senior executives of each institution to discuss these plans and challenged assumptions made where we considered plans to be unrealistic or overly aggressive.

We have now intensified our supervision of the covered institutions which are under far more scrutiny than ever before. We have an ongoing on-site presence and monitor the internal operations by attending a selection of internal committee meetings (including Audit, Credit and Risk). We have also increased the reporting obligations on the institutions both in terms of frequency and the amount of information that is provided. Our focus is on the key risks and challenges facing the institutions, particularly, how effective their corporate governance structures are and how they are managing their funding positions and their loan books. We have also engaged more intensively with the boards and senior management of each of the institutions. Arising from this process the business plans were updated reflecting our engagement and changing economic circumstances.

Reporting

The Financial Regulator reports to the Minister on all the aspects provided for in the Credit Institutions (Financial Support) Scheme 2008. The reporting requirements include:

- End monthly reports (with effect from September 2008) on the level of covered liabilities of each covered institution (weekly liquidity reports for each covered institution);
- Confirmation that each covered institution continues to meet minimum regulatory solvency standards on a material basis; and
- Confirmation that aggregate growth of balance sheet volume complies with the requirements of the Scheme and that the provisions on dated subordinated debt are being complied with.

Box 1.1 – Prudential actions taken by the Financial Regulator to address the financial crisis

In response to accelerating credit growth, we had taken steps in the period 2004 to 2007 to slow bank lending. Our steps included the following:

- In October 2005, new requirements for credit loss provisioning, including requirements for credit risk management, were introduced;
- In May 2006, we increased capital requirements on high loan-to-value mortgages;
- In June 2006, we introduced new liquidity requirements that came into effect in mid-2007; and
- In January 2007, a stringent approach to property-related requirements under the Capital Requirements Directive was introduced, with 150% risk weighting from the previous 100% weighting on exposures to speculative real estate and high capital requirements on residential investment properties.

These measures recognised concerns that were being expressed, at that time, about problems that could emerge in the property market and which, in the event, were accentuated by the unexpected speed and severity of the international crisis.

Box 1.2 – Special investigations being undertaken by the Financial Regulator

A number of issues have arisen in financial institutions which resulted in formal investigations:

1. Anglo Irish Bank and Irish Life & Permanent: Circular transactions.
2. Unwinding of Contracts for Difference position in Anglo Irish Bank shares and comparison of information gathered in this investigation with information previously provided to us.

   We have brought matters arising from both these investigations to the attention of the appropriate authorities including the Gardaí, the Office of the Director of Corporate Enforcement and the Irish Auditing and Accounting Supervisory Authority. We continue to cooperate with these bodies in relation to their enquiries.

   Other potential regulatory breaches are being investigated by the Financial Regulator.
3. Anglo Irish Bank – The objective of our investigation is:
   - To ascertain details of all loans provided by Anglo to current and former directors and connected parties;
   - To consider if individuals within the bank were key to the provision and management of the directors and related party loans; and
   - To identify potential breaches of our requirements, other regulations and Anglo Irish Bank's own internal governance and policies.
4. A report into our investigation into Directors loans in six of the covered credit institutions for the period December 2005 to December 2008 was published in March 2009. Its main findings were:
   - No evidence was found in the six covered institutions of the removal or reduction of loans at the year-end to avoid disclosure in the financial statements;
   - None of their directors' loans were impaired, in arrears or otherwise non-performing for the period 31 December 2005 to 31 December 2008;
   - All of the directors' loans reviewed were in compliance with the limit of 2% of own funds; and
   - There were some inaccuracies in disclosures in financial statements in most of the institutions examined, because of weaknesses in the procedures and controls for the preparation of the disclosures of directors' loans.

   This information has been brought to the attention of the ODCE.

Box 1.3 – Review of director's loans at Anglo Irish Bank and our regulatory response

On 20 December 2008 the Authority established a committee of members to undertake an urgent review of directors' loans at Anglo Irish Bank and the regulatory response. The report was delivered to the Authority on 9 January 2009. The committee was asked to look at two issues within the organisation: (1) when the information about these loans was obtained by the organisation, and (2) how the information was communicated and followed up by way of response. It did not include an examination of any other issues relating to Anglo Irish Bank, which are the subject of a separate and ongoing investigation. Box 1.2 refers.

The Authority is subject to strict obligations of confidentiality under legislation and has been legally advised that it may not publish the committee's report. In the interests of transparency and the public interest the essence of the report was published, and is available on our website *www.financialregulator.ie*.

On the issue of directors' loans in Anglo Irish Bank, the committee concluded that there was a breakdown in terms of internal communications and process and in the regulatory follow-up and response of the organisation. This resulted in a failure to take appropriate and timely actions in relation to what was a serious matter and to escalate the matter to the Authority.

The committee noted:

- That it had been greatly impressed by the quality, dedication, commitment and strong work ethic as well as the integrity of the officials with whom they engaged;
- The pressures that the staff had faced since the onset of the crisis in the global financial system in August 2007;
- Issues with staffing requirements; and
- That the adequacy of existing resources would need to be kept under review particularly where modification of the approach to regulation and more intensive supervision would require more staff.

The committee recommended that:

- The review of our strategic regulatory approach in the light of developments in 2007 and 2008 should be advanced as quickly as possible;
- The staffing requirements for the organisation should be reviewed on the basis of both the strategy review and also of the outcome of the work being undertaken by external consultants for the Authority;
- Internal communication and escalation procedures and procedural manuals should be reviewed taking account of the lessons to be learned from this report;
- Filing and document management and tracking arrangements should be improved;
- The review instigated by the Authority to determine the treatment of directors' loans in all institutions covered by the Government Guarantee Scheme should be completed at an early date (published on 3 March 2009 – Box 1.2 refers);
- Loans to directors should be examined in greater detail; and
- Arrangements should be made to ensure more effective monitoring of the more important prudential returns, including those for loans to directors, with on-line submission and built-in data validation and checking processes.

We have already commenced implementing these recommendations.

Capital Requirements

Revised Capital Regime

The Capital Requirements Directive (CRD) was implemented on 1 January 2007 and became fully effective on 1 January 2008.

The CRD implemented the Basel II[20] framework which sought to create an international standard with respect to risk and capital management requirements. This involved a very significant shift in the regulatory approach to risk and capital requirements. The new framework introduced a revised regulatory capital calculation regime and new requirements with regard to internal governance arrangements and risk management systems and controls. It applies to all credit institutions and investment firms within the EU.

The revised capital adequacy framework is based upon three pillars. Pillar 1 (minimum regulatory capital) updates the framework of minimum capital requirements. Pillar 2 (supervisory review) requires institutions to assess their own capital needs and to consider the adequacy of their internal governance and risk management arrangements. This is then subject to supervisory review and evaluation. Pillar 3 (market discipline) requires institutions to disclose to the market certain qualitative and quantitative information about Pillars 1 and 2.

However, primarily as a result of the market turbulence, the EU proposed significant amendments to the CRD in October 2008:

- Elements of the CRD that recognised further work would be required at the time of its adoption. Specifically, these relate to the proposed amendments on hybrids (capital instruments which have both debt and equity characteristics) and large exposures (the regulatory regime which tries to limit a bank's exposure to any one client or group of connected clients); and
- Amendments that have been prompted as a direct result of the current financial turmoil. These amendments relate to: (1) The treatment of hybrid capital instruments and large exposures in light of market developments, (2) waivers for co-operative bank networks, (3) supervisory arrangements, (4) securitisation, (5) liquidity and (6) technical amendments. The revisions were agreed on 6 May 2009, to be adopted by 31 October 2009, for implementation by 31 December 2010.

Electronic Reporting

As part of our implementation of CRD, we introduced a new supervisory reporting framework with submissions via a web-based electronic reporting platform. The new reporting framework (COREP and FINREP), which follows guidelines on an EU-wide CRD common reporting framework developed by the Committee of European Banking Supervisors (CEBS), replaces the Prudential Return. The COREP return deals with the capital solvency ratio of the institution. The FINREP return collects relevant financial data including balance sheet and income statement data. These returns are important supervisory tools for us in our off-site supervision and monitoring of credit institutions.

20 Basel II sets out recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision.

All credit institutions were required to report using the on-line system and COREP and FINREP framework from March 2008 and all credit institutions have complied with this requirement since then.

CRD Supervisory Review and Evaluation Process

We carried out extensive work during the year in relation to the Internal Capital Adequacy Assessment Process (ICAAP) for credit institutions and the Supervisory Review Evaluation Process (SREP). SREP assesses the risk profile of an institution using a variety of sources (including statistical desk-based analysis, on-site visits and routine dialogue with the institutions as part of prudential supervision). These provide the foundation for the evaluation of the institution's entire risk profile (i.e. not just market and credit risk) to enable us to apply prudential measures over a period of time.

Additional Reporting on Non-Performing Assets

In addition to the regular quarterly reporting on large exposures and in order to facilitate a broader assessment of the quality of credit exposures, supplemental information on non-performing assets was requested from credit institutions from September 2008 onwards. These additional reporting requirements include analyses of loan accounts in arrears (60 days and 90 days past due) according to category; quarterly movements in loan account arrears; geographical breakdowns and information relating to property related arrears.

Box 1.4 – Review of risk management and internal controls following Société Générale

Following the events in Société Générale, which resulted in significant trading losses as a result of the actions of a trader, in April 2008 we required all credit institutions to provide (i) confirmation that they had conducted a review of the adequacy of their operational risk framework having due consideration to the control issues identified by us, and (ii) an outline of the institution's plan for any remedial measures should the review identify any control issues or areas that needed strengthening.

While no significant control weaknesses were identified, improvement in certain internal controls was warranted and this was followed-up bilaterally with the institutions in question.

General Information Relating to Credit Institutions

There were 25 on-site inspections and 88 formal review meetings with authorised credit institutions in 2008. The number of inspections conducted was 25 per cent more than scheduled reflecting the increased difficulties in the Irish banking sector during 2008. In addition, authorised officers are on-site to monitor the internal operations by attending internal committee meetings (including Audit, Credit and Risk) in the Guaranteed Credit Institutions. Regular collection and analysis of financial information also assists in the monitoring of the key areas of liquidity and capital adequacy including weekly liquidity reports from credit institutions, monthly summary prudential ratios on solvency, liquidity and own-funds from credit institutions, quarterly large exposures returns and monthly mortgage statistical data from the main mortgage lenders. From October 2008, daily liquidity reports were received from the Guaranteed Credit Institutions.

Address to the Chairpersons' Forum Institute of Public Administration by Matthew Elderfield, Head of Financial Regulation, Central Bank of Ireland

08 November 2010

View speech in PDF format.

Good afternoon ladies and gentlemen. Thank you for inviting me here this afternoon. I am very pleased to be given the opportunity to launch our new Corporate Governance Code at this distinguished gathering. As chairpersons of semi-State bodies, your commitment to promoting good governance is well reflected in the important guidance materials you have developed for your members. Your manual "A Chairpersons Guide to Good Governance" is an impressive document and your more recent work setting out criteria for the composition of State boards is very timely.

It is probably regarded as somewhat of a cliché at this stage to talk about the importance of Corporate Governance within the corporate sector generally and more significantly, from my point of view, the financial services sector. But important it is. One has only to look at corporate failures in all sectors of industry in recent times to gauge the significance of sound Corporate Governance or, more to the point, the significance of the absence of sound Corporate Governance.

How to define Corporate Governance? There are many definitions – at its simplest it is the system by which companies are directed and controlled at the highest level of the organisation. Good Corporate Governance highlights the importance of the role played by the Chairman and by non-executive directors as well as having sound and effective audit and risk committees. This is particularly the case in the financial services sector.

The importance of good Corporate Governance is best highlighted by the calamities that have happened when it was not present within organisations. We have seen that in companies like Enron and Worldcom, but probably where it has most manifested itself – with catastrophic effect – was in the financial services sector and particularly banking. The financial crisis and the resulting turmoil in that sector brought about, in part, by woefully inadequate Corporate Governance triggered the provision of unprecedented government support to banks and other financial institutions. Nowhere is this more evident than here in Ireland.

Several reasons have been given for the failure in Corporate Governance. The then existing principles, while well meaning, were too general in nature and encouraged box ticking as a means of compliance. There was no statutory obligation on enterprises to comply with the recommendations which were generally issued by international organisations unable to enforce them. Boards were unwilling or unable to curtail excessive risk taking. And the same boards were unwilling or unable to exercise sufficient control over senior management.

I should also say that supervisory authorities failed in this area. They, or should I say, we, clearly didn't press hard enough for good Corporate Governance in the institutions we regulated. This, coupled with the absence of effective sanctions or, where they existed, perhaps an unwillingness to enforce them, significantly contributed to the problem. The blame cannot of course be principally attributed to imprecise rules and weakness on the part of regulators – failures at board and senior management level were the significant factors in bringing about the near collapse of the financial system.

Situations which now, with the benefit of hindsight, seem totally unacceptable, were in some instances the order of the day – for example, the presence of CEO's with unfettered powers who carried out their roles with clearly insufficient challenge. Apart from that it is clear, again with the benefit of hindsight, that many boards became too complacent, perhaps because in times of plenty no great effort was required. Whatever the reason, many members of boards, and I have in mind particularly non-executive directors, failed on many fronts. They failed to comprehend the risks associated with the business and the potential for disaster in not knowing or confronting these risks. In particular, it is now evident that many non-executive directors, and indeed possibly executive directors, did not understand the complex and technical nature of the businesses over which they had charge. Most disturbingly, all the evidence points to some boards that were seriously out of touch with what was happening on the ground in their organisations.

These unfortunate developments have prompted many international organisations and national regulators to put in place or revisit their Corporate Governance standards and requirements. They were very much encouraged to do so by the G-20 in its recent pronouncements on the need to strengthen Corporate Governance. In consequence, bodies such as the OECD, the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors, have all recently taken initiatives in the area. In June of this year, the European Commission issued a green paper on Corporate Governance in financial institutions and remuneration policies for comment by 1 September. In the Green Paper, the Commission notes the unique position of the financial services sector where corporate governance requirements should take into account the interests of all stakeholders including depositors, savers and policy holders, as well as the stability of the financial system. Apart from the requirements that will eventually emerge from the Green Paper, many recently adopted directives and some currently under discussion will seek to specifically strengthen Corporate Governance in their respective areas, for example, the Capital Requirements Directive for banks and investment companies, the Solvency II Directive for insurance companies and UCITS and the Alternative Investment Funds Managers Directives for collective investment schemes.

In the UK, Sir David Walker completed a Treasury commissioned review of Corporate Governance in banks and other financial services entities. Also in the UK, in June 2010, the Financial Reporting Council, the body responsible for promoting high quality Corporate Governance and reporting in the UK, reviewed its existing Code and replaced it with a new one: the UK Corporate Governance Code. It is interesting to note that the two principal conclusions drawn by the Financial Reporting Council in its review were (i) that much more attention needed to be paid to following the spirit of the Code as well as its letter and (ii) that the impact of shareholders in monitoring the Code could and should be enhanced by better interaction between the boards of listed companies and their shareholders.

And where does all this leave Ireland and more specifically the Central Bank? We have taken a number of initiatives in this area, principally the issue of a new Corporate Governance Code for credit institutions and insurance undertakings, more of which shortly. The Code is part of a wider strategy to update the domestic regulatory framework. We also plan to develop Corporate Governance frameworks for other sectors of the financial services industry which we regulate. We have asked the funds industry to devise an appropriate code for its sector. We will also be devising a code for investment firms. The question of the appropriate governance framework for credit unions will be considered in the context of the forthcoming Strategic Review of the Credit Union Sector. We will carve out captive insurers from our proposals and develop bespoke standards with the assistance of the industry. Last month we issued our Code of Practice for Lending to Related Parties. We will also issue requirements on other related matters such as remuneration policies within the financial services sector and a revised fitness and probity framework. We will also develop requirements in respect of internal governance and risk management next year informed by international initiatives in these areas.

Here today I would like to talk in more detail about our Corporate Governance Code for credit institutions and insurance undertakings. As you are no doubt aware, this was the subject of a well publicised consultation process over the summer. The consultation paper was issued with a view to addressing the lack of a statutory Corporate Governance regime for both banks and insurers. The need to reform Corporate Governance within the local financial sector was highlighted in the findings of the two reports commissioned to understand the sources of Ireland's banking crisis. These reports, by Klaus Regling and Max Watson on the one hand, and also by the Governor of the Central Bank, were published in June of this year. They both emphasised the need to reform Corporate Governance. Regling and Watson commented that "... Ireland was one of those cases where there were at least some instances of extremely serious breaches of corporate governance, going well beyond poor risk assessment, and eventually having a systemic impact".

We received an unprecedented volume of responses to the consultation paper compared to any other consultation - over 130. We received responses from many sources including banks, insurance and reinsurance undertakings, the funds industry, stockbrokers, industry and trade associations, academics, consumer protection sources, state/semi-state bodies, the accountancy and legal professions, management consultants and individuals.

Almost invariably, all respondents welcomed the proposals in broad terms - some, however, felt that they were too draconian, others felt that we did not go far enough - I will let you decide yourself who thought that we were too harsh and who thought that we were too lax! We welcome all the responses – the topic clearly seized the imagination of many interested parties. A great deal of time and effort was put into the responses and many of the suggestions were very useful. We gave considerable thought to them all and took on board quite a number in drafting the final version of the Code. As you can imagine, this proved to be a mammoth task but I believe that the Code, in its final form, combines the best of what was contained in the consultation paper and the responses to the consultation. I know that it will not please everyone - as with the consultation paper some will think that it goes too far, others that it does not go far enough. I believe that it represents a balanced and proportionate strengthening of the Corporate Governance regime for banks and insurance companies in Ireland.

We know that the new Corporate Governance standards we are publishing in final form today are, in fact, more demanding than those in place in other jurisdictions. For example, our standards are on a statutory basis – rather than a "comply or explain" Code – and we have included restrictions on the number of Board directorships in financial institutions, an issue I will return to later. The decision to impose more demanding standards is a conscious one. We have acknowledged some of the concerns regarding the international competitive impact of our earlier proposals by adjusting the standards we are setting out for IFSC companies, or more specifically for Irish subsidiaries of companies regulated in other jurisdictions. However, in the area of corporate governance we have decided we do not want to simply match best practice internationally but wish to set a higher standard. Ireland has suffered more than most countries in the financial crisis and needs to get to grips with the home grown elements of that crisis. Poor governance has been exacerbated by the concentrated nature of corporate life in Ireland, with challenge and awkwardness in the Board room blunted by the social constraints of working and living in a small business community in a small country. Stronger remedies are needed here to shake up prevailing corporate governance practices by injecting some fresh blood and setting more exacting standards. This will improve the reputation of Ireland as an international financial centre by knocking on the head concerns about too cosy corporate governance practices.

One major theme that emerged from the responses to the consultation process was the request for clarity on the basis upon which we would adopt a proportionate approach towards imposing the proposed requirements on different types of entities. As a result, we altered the proposed requirements so as to adopt a dual approach, imposing minimum core requirements on all institutions covered by the Code and also imposing additional requirements upon those institutions which we deem to be major institutions.

In the latter respect, we have set out in our Code very high level criteria and we will make our own judgements with regard to what constitutes a major institution. We are doing it this way very deliberately because we consider black line definitions to be too inflexible for this important area. We will operate this Code in line with our risk based system of regulation and our one size does not fit all approach. We are likely to align major institution status with the structure of our risk model to cover higher impact firms. Some large IFSC firms could therefore be designated major institutions. But we will give firms an opportunity to make representations to us as to whether they are major or not – we are open to dialogue.

We will in the coming months be advising these institutions of their "major institution" status. Clearly, all banks with a significant retail presence in Ireland should fall within this category. I would of course add that there is no bar on non-major institutions deciding to implement the additional requirements should they wish to do so and indeed I would encourage other firms to consider doing just that.

Another area of concern was that relating to the proposal that each board should have a majority of independent non-executive directors. We will still retain this requirement for domestic major institutions. But for banks and insurers that are subsidiaries, we will now require that they have a significant presence of INEDs on their boards rather than a majority. For example, three independent non-executive directors out of a typical seven member board for major institutions and two directors out of a typical five member board for non-major institutions. This is a recognition of the need of the parent company to be able to direct and control its Irish subsidiary - the presence of the independent non-executive directors is to provide an independent voice that will challenge and question both the parent and the group executives within that subsidiary.

On the question of numbers of directorships, this was one of the most contentious areas of the Code and an area which resulted in us receiving hugely diverging views. Originally we proposed that directors of all credit institutions and insurance companies should be limited in the number of directorships which they could hold to 3 directorships in a bank or insurer and no more than 5 directorships in companies outside of those financial institutions. We received 99 submissions in total in relation to both of these proposals. While many agreed with our proposals, a very small number thought we should restrict the limits further to just one directorship. The majority, however, were concerned that our approach was too restrictive, that it would put stress on the limited pool of talent and overall quality of directors in companies. They favoured the abolition of any set limits preferring instead that we should adopt a case by case approach.

We disagree with these concerns. While we have given some leeway to non major institutions, by increasing the limits to 5 financial directorships and 8 non financial directorships, we have retained the limits proposed in relation to directors of major institutions. This is in recognition of the significance of these institutions and the importance of these directors. These requirements will help to ensure that independent non-executive directors devote sufficient time to their oversight responsibilities (and are in fact broadly consistent with the Walker Report recommendations on the time to be devoted to board work). We think this will allow more focus and attention on the board role and crucially, improve challenge in the board room.

Frankly, we also hope that this change will improve challenge in financial board rooms by broadening the gene pool in Irish corporate life. The TASC Report - "Mapping the Golden Circle" - published in May, set out very clearly the current limited breadth of board membership at the heart of corporate Ireland. Many submissions said that a limit on board directorships should be dropped because there were not enough existing directors to go around with our proposed limit. We believe that it is possible to bring more directors into the financial services sector in Ireland by looking beyond the existing pool of directors.

We need to bring more outsiders into the board room. We share the globally accepted view that more diversity, for example of national and international background and of gender, will help to avoid the pitfall of "groupthink" which contributed to the crisis. This is not to be ungenerous to my adopted country or to doubt the ability of Irish men and women. However Ireland is a small country and it would be healthier to bring some fresh voices and perspectives into the boardroom both from outside Ireland and from new people within Ireland who do not have the close social ties that could be blunting challenge. These will bring a different perspective and understanding of standards and practices elsewhere.

The EU Internal Market Commissioner Michel Barnier put it succinctly when he said recently "I also think more effort needs to be made for a more diverse boardroom. It is always difficult to take good decisions. But debate and different views help us to get there. And diversity in all forms creates the right conditions for a real exchange of views."

We are mindful of the concern that limiting directorships could have a detrimental effect on the ability of directors to contribute to charitable and social development. We have therefore also excluded from these calculations directorships held in the public interest on a voluntary and pro bono basis provided always that they also do not interfere with a director's ability to properly fulfil his or her role and functions as a director of a financial institution.

In addition to ensuring that the best directors are appointed, we believe that there should be a bigger investment in training, both in general board skills and in technical risk skills. I call on the Institute of Directors and insurance and banking institutes to rise to that challenge.

We plan to host a roundtable with the Institute of Directors (IOD), the institutes and corporate governance experts and other stakeholders, chaired by our new Commission Board member Blanaid Clarke, to see what action they can take to improve corporate governance standards, prepare more people to be more challenging in the board room and assist the industry to implement our new standards.

I recognise that our changes raise questions about remuneration. An independent non executive director (INED) role should be more demanding and take more time. So they should be paid accordingly.

In recognition of the importance we attach to the position of Chairman and CEO we are maintaining our proposed restrictions and requirements on them, in particular;

- The prohibition upon either holding such a position for more than one institution at any one time;
- The absolute requirement for the chairman to lead the board, encourage critical discussions and challenge mindsets;
- The absolute requirement for both the Chairman and the CEO to have the necessary personal qualities, professionalism and integrity to carry out his or her obligations;
- The prohibition on an individual who has been CEO, executive director or member of senior management of an institution during the previous 5 years progressing to Chairman of that institution.

These all serve to underpin the general requirement that no one individual may have unfettered powers of decision. The terrible damage done by over-dominant CEOs or directors is all too evident in some of our leading banks and insurance companies.

We have to learn the lessons of this experience and put better controls in place. Colourful and dynamic entrepreneurs are a welcome source of innovation and economic success, but when depositor and policyholder money is at risk, it is essential that strong corporate governance checks and balances exist to ensure that a dominant personality doesn't ride roughshod over the board in pursuit of unacceptable risk-taking.

Let me pause to take a moment to reflect in particular on the IFSC firms' concerns with aspects of CP41 regarding the impact of the ability of a parent to exert control over a subsidiary.

We believe it is important that IFSC firms too have high standards of corporate governance – both IFSC banks and insurance companies have had their problems in the not too distant past.

We are aware that Irish subsidiaries of overseas companies can be subject to their parents seeking them to take on too much risk and they need to be willing to push back. Or sometimes subsidiaries can become too remote and drift into weak practices due to a lack of local scrutiny.

However, we accept the strength of the concerns expressed. The key is to strike a balance here. We note in particular the concern over the chairman of the subsidiary having to be an INED, as a group executive often is appointed to this role, and over the number of INEDs – so we have amended these proposals to allow the chairman of a subsidiary to be a group director and have modified the standard which industry felt required a 50 – 50 balance between INEDs and other board members.

We feel this is a reasonable adjustment to our proposals to take account of the reasonable concerns of IFSC firms on these points.

Notwithstanding some concern expressed by respondents on the requirement to submit compliance statements in respect of adherence to the Code, we are persisting with this requirement. We will, however, issue relevant guidelines specifying what will be needed, which will allow industry input on this issue and we will seek to develop a balanced approach. This opens up another issue – the possible role for external auditors in providing some form of assurance in respect of compliance statements prepared by institutions. We are not looking for any such assurances in the Code but we have initiated discussions with the auditing profession on the matter. While we recognise the difficulties for auditors in providing any such assurances, it is a topic to which we intend to return, possibly in the context of discussions at EU level and in other fora on the role of external auditors, particularly in the financial services sector.

As I have explained, these new standards apply to all credit institutions and insurance companies (other than captives). However, I am often asked whether more needs to be done regarding the Boards of the domestic Irish banks, given the significant losses that have been imposed on taxpayers by these institutions. In fact major changes have already taken place in the composition of the boards of some of the covered institutions including the appointment of public interest directors. More changes are underway with the imminent government majority ownership in AIB. The new standards announced today should act as a catalyst for further changes in board composition at the banks. We will also use our new fitness and probity standards to set a higher bar for incoming directors for the banks. In addition, we have commissioned reviews of governance and risk management standards at the two largest banks and will use the results of these to consider what further changes are required in board structure and composition. I think it would be unfair to say that all board members at all the covered banks in the pre-crisis period should depart the scene, as there are no doubt different stories about what happened in the board rooms of different institutions. And even if we wanted to make such a generalisation, we clearly wouldn't have the powers to act on it. But I think it is right that where it has yet to happen there is an orderly process of freshening up the boards at the banks and this is something we will be pursuing on a firm by firm basis.

I have set out the main changes which we would propose to make in our Corporate Governance Code. I hope you will agree when you have had time to digest the new package that it represents a reasonable and balanced initiative to foster best Corporate Governance practices in the banking and insurance sectors in Ireland. The Code will be published on our website today. It becomes effective on 1 January and institutions will be given until 30 June next to introduce the necessary changes. Where changes to board membership are necessary this period will be extended to 31 December 2011 in order to allow institutions to identify and assess candidates prior to making appointments.

We all know that rules alone are not sufficient to ensure an effective Corporate Governance Code. While it may be easy in one sense to observe quantitative requirements and to monitor adherence to them, it is much more difficult to monitor qualitative requirements. By that I mean such things as the quality and calibre of directors' involvement and contributions. In this respect I was very taken by one of the findings of the UK Financial Reporting Council in its review to which I have already referred, namely that much more attention needs to be paid to following the spirit of the Code as well as its letter. The report noted that to follow the spirit of the Code to good effect, the board must think deeply, thoughtfully and on a continuous basis, about their overall tasks and the implications of these for the roles of their individual members. Absolutely key in this endeavour is the freshness and openness of mind with which issues are discussed and tackled by all directors. I fully endorse these sentiments and I am hopeful that they will be fully taken on board by all to whom our Code is addressed. And I can assure this audience that a key part of our supervisory process will involve making judgements about how well this is happening in practice and taking appropriate steps where we believe it is inadequate.

My basic message today is that the buck stops with the Board of Directors. We need to learn the lessons of the financial crisis by improving corporate governance practices in the financial services sector in Ireland. These new rules from the Central Bank deliver stronger standards for banks and insurance companies operating in Ireland. It's time to bring fresh blood into the board room, which brings more challenge, asks more awkward questions and devotes more time to assessing risk. Depositors, policyholders and, indeed, Irish taxpayers have the right to expect no less from the guardians of their money.

Thank you for your attention.

Central Bank & Financial Services Authority of Ireland

Eurosystem

Banking supervision: our new approach

21 June 2010

INTRODUCTION

In the last decade, Irish banks borrowed imprudently and lent recklessly. The consequence is a prolonged period of financial instability, which is in the process of being resolved by decisive, but costly, government intervention.

The banking crisis, both international and domestic, combined with the construction sector contraction and competitiveness losses in Ireland, has had a severe impact on the economy and public finances. Unemployment is at 13.7%. Economic output has fallen by 12.5%.

As the banking crisis subsides, a moderate recovery in the real economy is likely to emerge. Maintenance of long term economic growth will depend on a sound banking system. Funds from savers will need to be matched with borrowers and banks remain the main mechanism for doing so. Banks may not be popular, but they remain essential to the functioning of the economy.

The Central Bank, working with the Government, National Treasury Management Agency ("NTMA") and National Asset Management Agency ("NAMA"), has already taken decisive action to place the nation's banks on a sound and stable footing. Building on this work, the longer term challenge is to make sure that the banks remain a source of strength, rather than a threat, to the economy. Although that task principally falls to the banks themselves, they will do so under a Central Bank regime of attentive, assertive supervision.

This paper describes how the Central Bank intends to deliver that regime. We have adopted a challenging, and where necessary, intrusive stance; but we will not operate a 'one size fits all' approach. The banking system contains a diverse range of domestic and international institutions, and we will reflect those differences in the actions we take.

This paper also identifies possible future areas of work and consultations. We welcome views on these issues.

Responses to this paper may be sent to bankingpaper@centralbank.ie

Contents

Summary of actions

Actions taken	Status	Date
Restructured organisation to deliver more intrusive and challenging supervision	To be completed	September 2010
Recruit additional staff	In progress	Ongoing
Establish Risk Experts Panel	In progress	Ongoing
Reform internal committee structure for financial regulation	Implemented	May 2010
Complete Prudential Capital Adequacy Review ("PCAR")	Done for BOI, AIB and EBS Recapitalisation Being progressed for other banks	March 2010 December 2010 Ongoing
Strengthen Supervisory Review and Evaluation Process (SREP)	In progress	Ongoing
New corporate governance requirements for banks and insurers	Consult Implement	April 2010 October 2010
Interview and assessment process: ▪ Senior appointments in major banks ▪ Extend process to other institutions	 Implemented To commence	 Q1 2010 June 2010
Related party lending requirements	Consult Implement	May 2010 October 2010
Revised approach to handling overcharging issues	Implemented	May 2010

Actions we will take	Status	Date
Implement risk assessment model	Consult Implement	Q4 2010 Q2 2011
Supervision themes for 2010: ▪ New mortgage credit standards ▪ Remuneration ▪ Risk management and governance ▪ Bank strategies	 Report publically Report publically Report publically Report publically	 July 2010 November 2010 January 2011 January 2011
Revised fitness and probity framework: ▪ Prescribe Controlled Functions ▪ Fitness and Probity Standards	 Consult Implement Consult Implement	 December 2010 Q2 2011 December 2010 Q2 2011
Internal governance requirements ▪ Including requirements for audit, risk, credit functions.	 Consult Implement	 Q1 2011 Q3 2011
Remuneration standards	Consult Implement	September 2010 Q1 2011
New rules on large exposures: ▪ Capital Requirements Directive (CRD) revisions ▪ Updated reporting format	 To commence To commence	 December 2010 December 2010
New standards on credit risk management and valuation	Consult Implement	Q1 2011 Q2 2011

Actions we will take	Status	Date
New standards on liquidity: ▪ Banks projections to take account of CRD changes ▪ Reporting Net Stable Funding Requirement (NSFR) and Coverage Ratio ▪ Reporting of CRD Monitoring Tools Revise Liquidity Requirements	 Submit to Central Bank To commence To commence Consult	 Q1 2011 June 2011 June 2011 Mid 2011
Revised minimum competency requirements	Consult Implement	June 2010 March 2011
Review of process and methodology for assessing consumer charges	To commence	September 2010
Revised Consumer Protection Code	Consult Implement	September 2010 June 2011
Revised Code of Conduct on Mortgage Arrears	*Dependent on recommendations of Mortgage Arrears and Personal Debt Advisory Group*	
Statutory Switching Code	Consult Implement	September 2010 June 2011
Implement Comptroller and Auditor General's recommendation on auditor attestation regarding the functioning of the internal corporate governance regime in institutions.	Consult Implement	July 2010 onwards Q1 2011
Assessment of data needs for financial stability assessments.	Publish for comments	October 2010
Development of a financial stability systemic risk assessment framework.	In progress	Ongoing
Conduct in-depth comparative analysis of the performance of the Irish banking sector to inform discussions on the future structure of banking in Ireland	Complete	Q4 2010
Further development of bank specific quantitative risk assessment models	Implement	Q4 2010

Actions we will take	Status	Date
Detailed micro level analysis of important counterparts of the financial sector: non-financial corporations and households	In progress	Ongoing
New format Financial Stability Report	Publish	Q4 2010

Issues requiring further research	Status
Review structure of domestic savings industry	Working collaboratively with other relevant agencies
Central credit register	Discussion Paper in Q2 2011
Special resolution regime	Proposals being developed in conjunction with the Department of Finance
New sectoral concentration limits Research to be conducted on feasibility and desirability of imposing predetermined standard limits on systemically important credit institutions	Paper to be published in Q1 2011

Chapter 1 – Background

1.1 Learning the lessons of the crisis

In response to requests from the Minister for Finance, two reports have now been prepared into the Irish banking crisis – "A Preliminary Report on the Sources of Ireland's Banking Crisis" by Klaus Regling and Max Watson and "The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008" by Patrick Honohan, Governor of the Central Bank (hereafter referred to as the Honohan report). While this paper draws on both reports, it largely focuses on addressing issues raised by the latter. Governor Honohan summarised his conclusions on the root causes of the systemic failures as follows:

"Apart from the role of the CBFSAI, banking practice and Government policy both clearly played a central role in contributing to the crisis:

i) there is prima facie evidence of a comprehensive failure of bank management and direction to maintain safe and sound banking practices, instead incurring huge external liabilities in order to support a credit fuelled property market and construction frenzy; and

ii) macro economic and budgetary policies contributed significantly to the economic overheating, relying to a clearly unsustainable extent on the construction sector and other transient sources for Government revenue (and encouraging the property boom via various incentives geared at the construction sector). This helped create a climate of public opinion which was led to believe that the party could last forever. A less accommodating and procyclical policy would have greatly reduced the need for preventive action from the CBFSAI.

As regards the CBFSAI, the root causes appear to have been threefold:

i) a regulatory approach which was and was perceived to be excessively deferential and accommodating; insufficiently challenging and not persistent enough. This meant not moving decisively and effectively enough against banks with governance issues. It also meant that corrective regulatory intervention for the system as a whole was delayed and timid. This was in an environment which placed undue emphasis on fears of upsetting the competitive position of domestic banks and on encouraging the Irish financial services industry even at the expense of prudential considerations.

ii) an under-resourced approach to bank supervision that, by relying on good governance and risk-management procedures, neglected quantitative assessment and the need to ensure sufficient capital to absorb the growing property-related risks.

iii) an unwillingness by the CBFSAI to take on board sufficiently the real risk of a looming problem and act with sufficient decision and force to head it off in time. "Rocking the boat" and swimming against the tide of public opinion would have required a particularly strong sense of the independent role of a central bank in being prepared to "spoil the party" and withstand possible strong adverse public reaction.

There are undoubtedly many other factors which may have militated against the effectiveness of the CBFSAI during this period. These include: aspects relating to the quantity and skill mix of the staffing of the bank regulation function; an unduly hierarchical CBFSAI culture discouraging challenge; management process problems; difficulties, relating to the rather unwieldy organisational structure, in ensuring coordination between economist and regulator sides of the house; and weaknesses in preparing for a crisis. These factors may have contributed to the crisis but were not fundamental. Nor was the failure of Lehman Brothers decisive".

1.2 Addressing these challenges

We are reshaping our approach to banking supervision to institutionalise these lessons.

In broad terms, our work can be categorised in four ways:

- Changes to supervisory structures;
- Changes to supervisory culture and approach;
- Changes to the regime within which we supervise; and
- A greater focus on international supervisory cooperation.

This paper describes work the Central Bank has already done to reform banking supervision. It sets out work underway and identifies actual and possible future changes. Most of this work falls to the Central Bank. Some of it will require additional legislation or the involvement of other agencies and Government.

1.3 The challenge for banking supervision in Ireland

Repositioning the Irish banking sector to contribute to economic recovery is a task which will demand new efforts by a wide range of stakeholders. The decline in output and employment has been severe. The transfer of liabilities from the private to the public sector is adding to the already high level of borrowing necessitated by the decline in tax revenue and increased pressures on some components of public expenditure. Yet, as has been recognised in the international financial press "[Ireland] has a credible recovery plan and has bounced back before"[i]. "Meanwhile, both the OECD and the EU's statistics agency predict that Irish growth – still seen slightly down for this year – will pick up to 3% in 2011, well above their average forecasts for the overall euro zone. What a difference credibility makes."[ii]

This growth will occur in an economy highly open to global trade and international capital flows.[iii] This economic model is the product of reforms made over a number of decades, the cornerstone of which is Ireland's membership of the European Union. This has delivered very significant economic benefits.[iv] But it also exposes Ireland to the full force of global macroeconomic conditions - indeed its success is predicated on doing so. It further means that the Government's ability to intervene to ameliorate those conditions is also lower than in less liberalised, less open economies. In particular, membership of the eurozone, where monetary policy and exchange rate developments reflect average conditions in the euro area, reduces the range of policy tools available and places greater weight on those that remain in the hands of domestic policy makers.

A striking lesson of the global banking crisis is the danger of allowing unregulated banks free rein in the modern financially globalised economy.[v] Banking supervision can help counter this risk. However, it will only be truly effective if it is part of a wider institutional and policy framework that is able to lean against risks when it is most difficult to do so.

1.4 Banking as a social contract

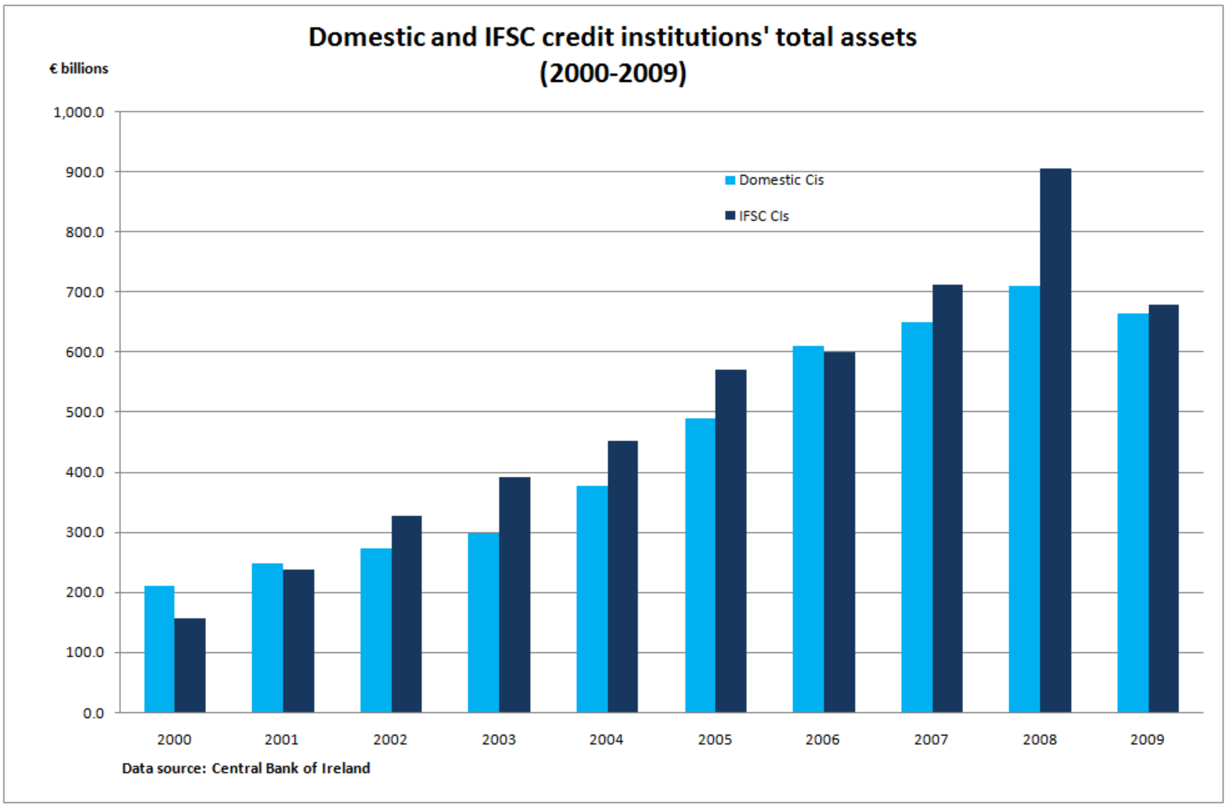
Banks are inherently risk entities, as they profit from maturity transformation by turning liquid savings into illiquid loans. Maturity transformation, in a fractional reserve banking system, relies on confidence because borrowing short to lend long is risky. There has to be confidence that loans will be repaid and that funds will be available to savers should they require them at short notice. If confidence dissipates, depositors and shareholders suffer losses; the flow of credit is disrupted; the payments system may be disrupted and the economy can contract.

It is not always recognised that, "almost everywhere in the past century, banking has not been a right but a privilege, regulated by the State – and for good reason[vi]." It is now being recognised again that there is a need to redraw the implicit three part social contract around banking in which "in exchange for being allowed to profit from taking risks inherent in providing liquidity, or monetary and credit services, to the economy, banks have been subject to prudential regulation; given access to liquidity insurance at the central bank; and required to finance industry-wide insurance schemes to protect depositors." [vii]

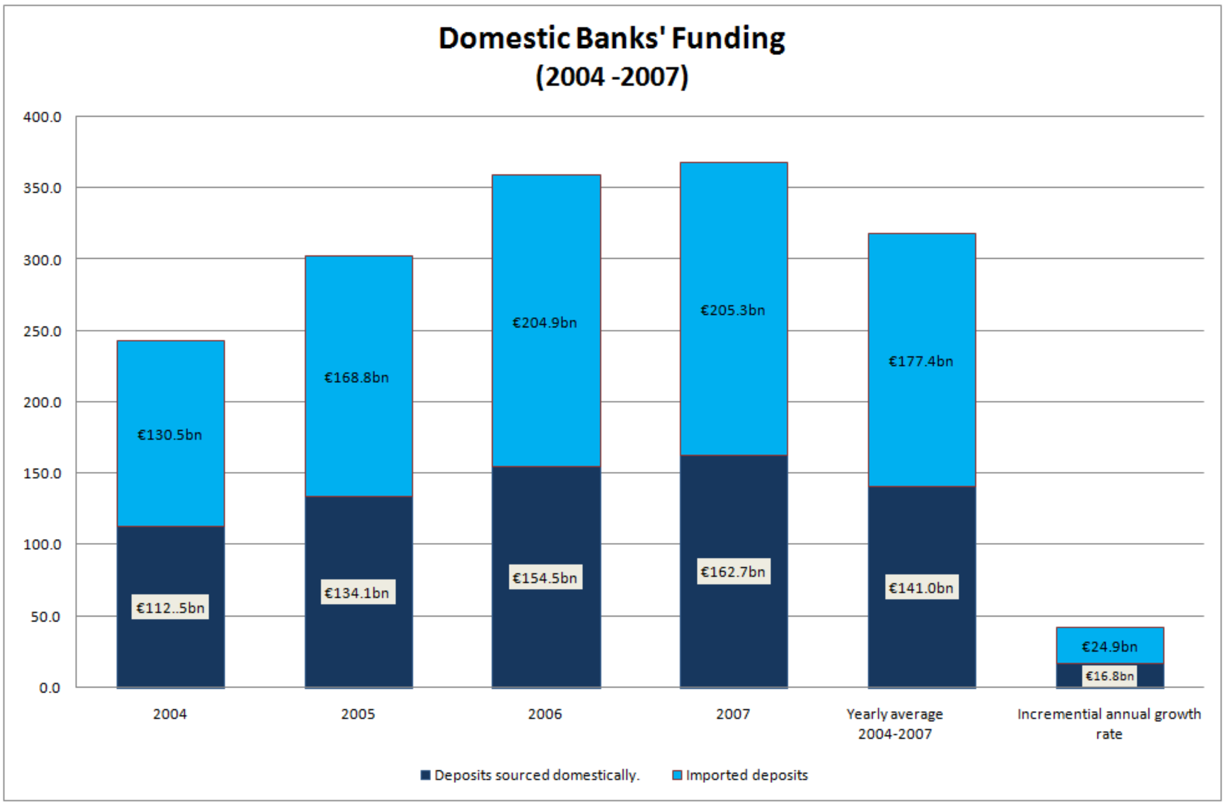
In pre-crisis Ireland, banks extended their maturity transformation activities and some came to rely heavily on short-term, wholesale market funding. Eventually confidence evaporated, leaving banks unable to access not only short term, liquid funds, but funds at any maturity for many Irish banks. It has fallen to the Central Bank and other public authorities to implement reforms to restore trust and confidence in the banking system.

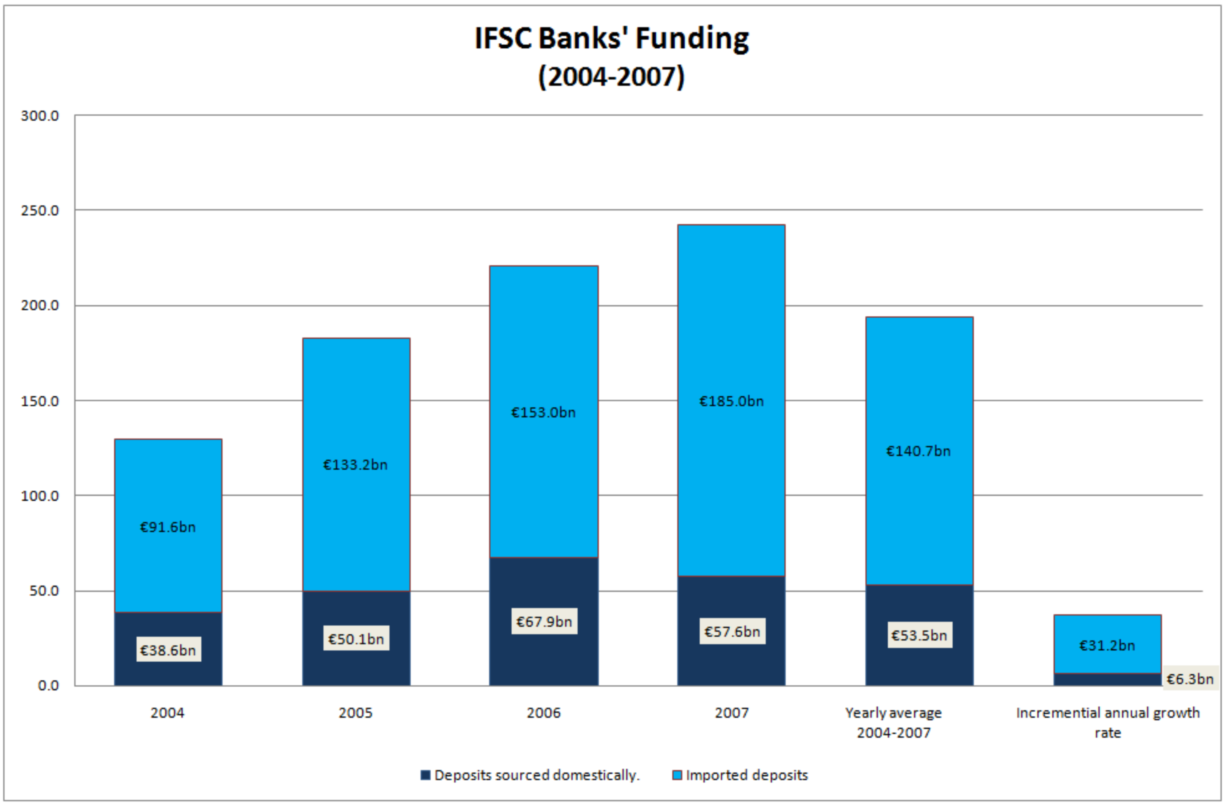
1.5 Structure of the Irish banking system

The Irish banking system comprises a small number of banks focussed on the small domestic market and a significantly larger number of the banks selling or trading into a range of international markets. This split is further reflected in the differing business models of the two sets of banks. The first group concentrating on the largely SME and retail domestic sector; and the second on a range of business lines from proprietary trading to banking services for the funds industry and specialist lending. We examine these two sectors in more detail below. It is important to note that the assets of the international banking sector in Ireland are generally greater than those of the domestic banking sector.



Another fundamental difference between the sectors is that the international sector by design is typically funded by way of wholesale market funding, whereas the domestic sector was traditionally funded by retail deposits. This difference meant that domestic banks in the past were relatively insulated from the vagaries of international markets, but this has changed over time with an increasing proportion of domestic banks' funding coming from wholesale markets.





Intrinsically, the domestic savings pool on which the banks can draw for stable deposit funds is limited by the size of the Irish economy. As they expanded their lending for construction and property both at home and abroad, the domestic banks needed to source external funds to meet the demand for credit in the economy. Although the range of funding sources that the domestic banks were tapping was considered to represent a diversification of funding, the new sources were inherently more volatile and it eventually exposed the domestic banks to the swings in sentiment in international markets.

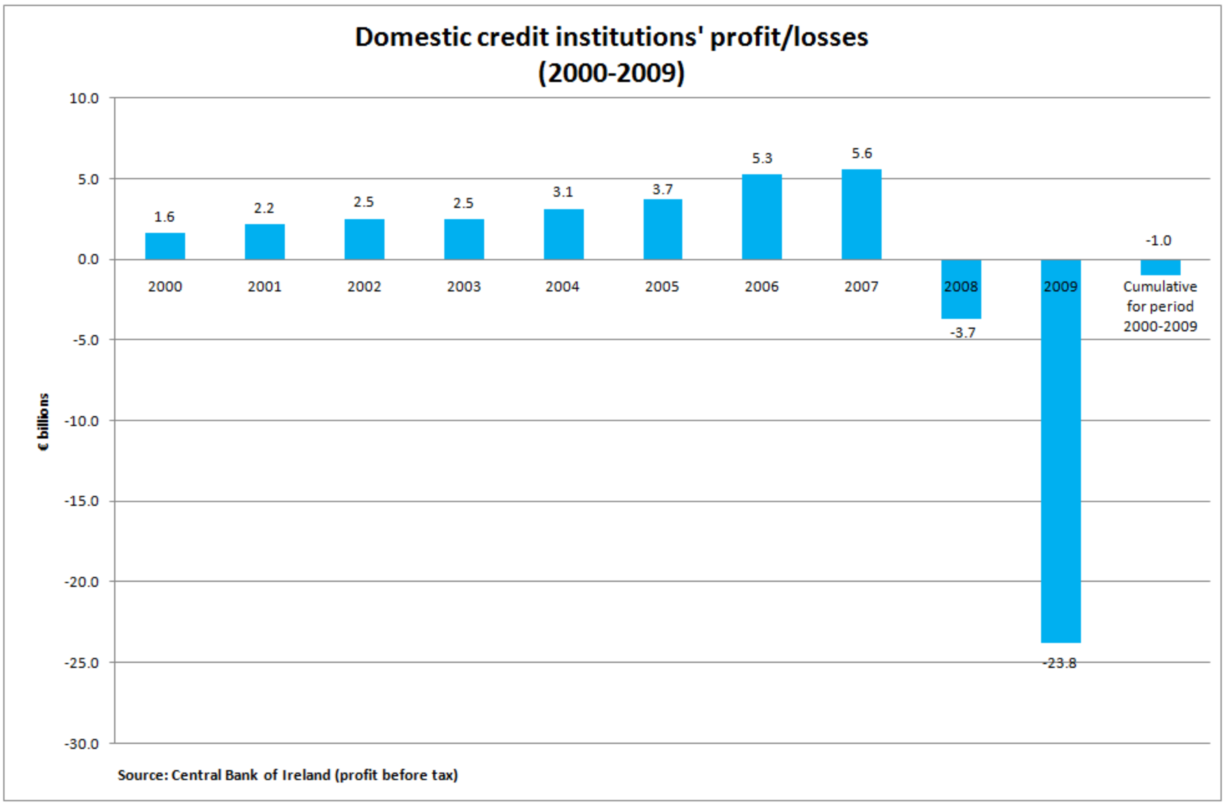
1.6 The domestic banking sector

This sector comprises ten banks[viii], six of which are controlled in Ireland, with the remaining four being subsidiaries of foreign banks.

Market composition

The Irish domestic banking market is essentially a commercial banking market (loans and advances represent c72% of total assets and deposits represent c43% of total liabilities[ix]), with a significant focus on retail and business lending. Commercial banking in Ireland is also focused on property related lending, namely to the construction and property development sectors.

The focus on property related lending has resulted in a dramatic erosion of the profitability of the domestic banks over the last few years. This has manifested itself in terms of sharp falls in profits and net interest margin, significantly increased bad loan charges and sharp falls in return on equity.



In order to satisfy their shareholders, these banks will be pressed to find new revenue streams and to develop new business lines. Given the previous over reliance on property, this implies a shift in their business plans so that they can do this in a profitable and controlled manner. In doing so they will be changing the way in which they are contributing to the future development of the Irish economy. Commercial lending, especially in relation to new businesses, requires a specific skill base and a very disciplined approach to lending. These skills will have to be renewed in the Irish banking sector.

Supervisory theme for 2010: governance and risk management at the major retail banks

Our intrusive model of supervision means that we have regular, detailed contact with banks. This includes attendance at board meetings and key risk management committees.

To supplement this work, during the second half of 2010 we will commission in-depth reviews of governance and risk management arrangements at the major retail banks. These reviews will inform the results of the Supervisory Review and Evaluation Process ("SREP").

The in-depth reviews will be completed by independent third parties and will cover, inter alia:

- The skills and experience of bank board members;
- The effectiveness of non-executive directors;
- The skills, experience and independence of staff in risk management positions;
- The effectiveness of risk management arrangements;
- The adequacy of measures banks have taken to address weaknesses in practices and processes exposed during the crisis;
- Whether banks have taken sufficient measures to address deficiencies in attitudes amongst staff at all levels towards risk management as well as compliance with internal policies and regulatory requirements.

We will publish the headline findings of these reviews in January 2011.

Market structure

The domestic banking sector is highly concentrated: there are few banks, and two have significant market share between them. The Herfindahl-Hirschman Index of Total Assets for the domestically active banking sector shows a value of 0.177[x], indicating a relatively concentrated market.

But this market is also highly contestable. Because of EU membership, the domestic banking sector is open to low cost entry into the Irish market by foreign banks. These banks can enter the Irish market at very little cost on a branch or provision of cross-border services basis that is made all the more easy by electronic and internet technology. Halifax Bank of Scotland, Northern Rock and the Nationwide Building Society demonstrated in the past that market entry is a real phenomenon.[xi]

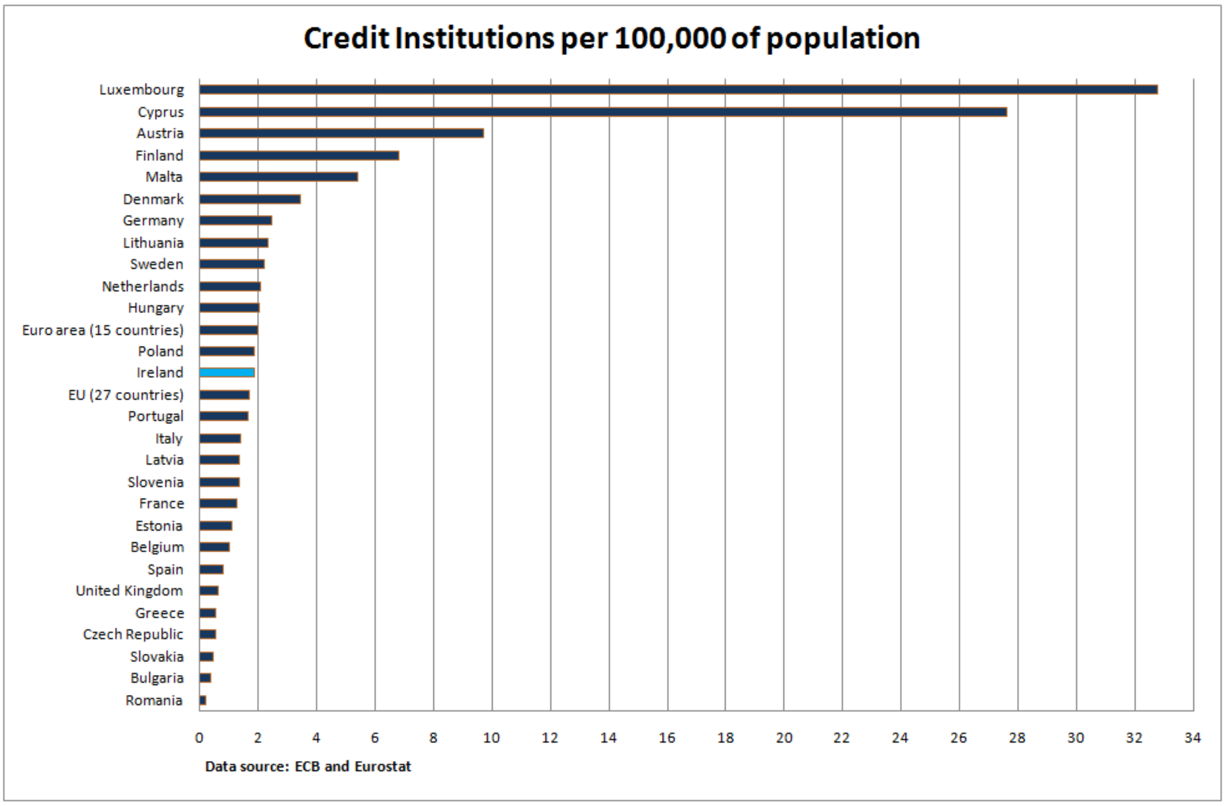
The role of competition in the genesis of the crisis is instructive as we re-design our supervisory regime.

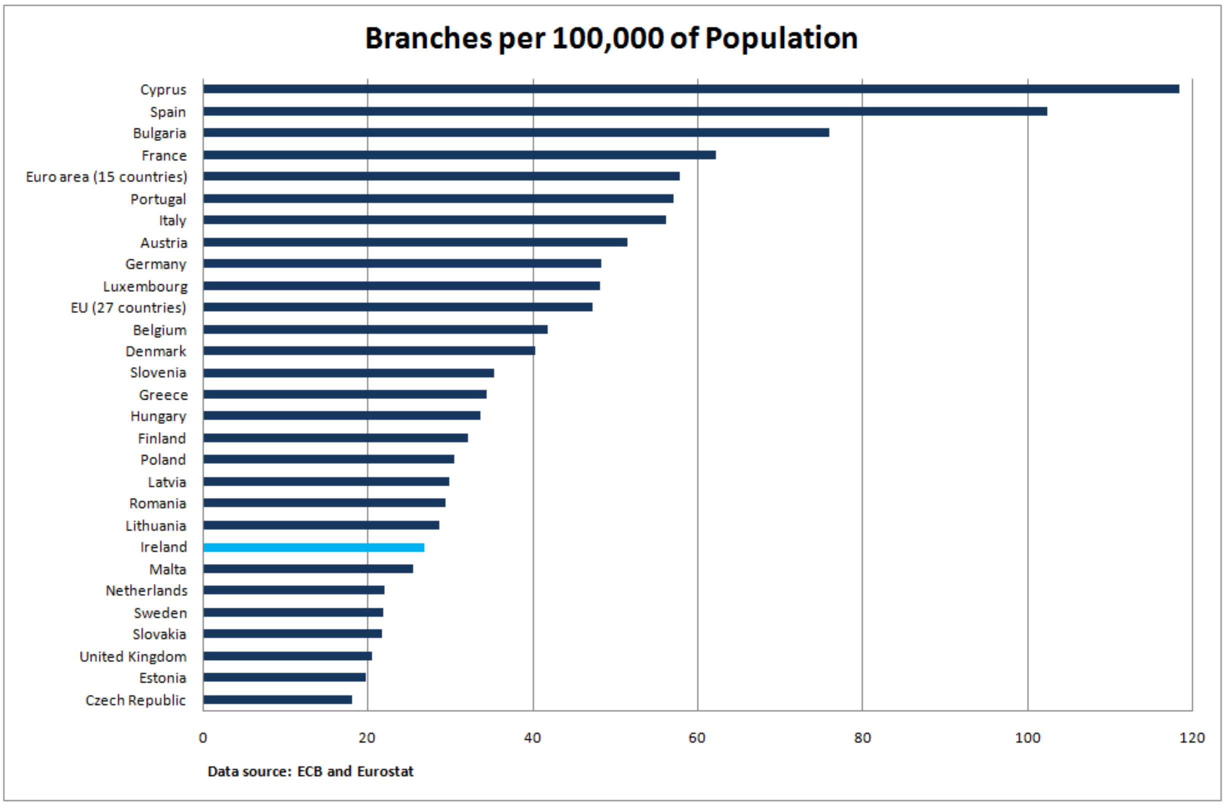
In terms of commercial property lending, domestic banks became increasingly focussed on the value of collateral in their commercial property lending decisions. This displaced a more disciplined approach based on cash-flow analysis and led to an undermining of credit quality. Moreover, as the commercial property market started to surge, banks that had previously not participated in this market started to develop commercial property lending businesses. As some of these banks entered close to its peak, they suffered significant losses in the subsequent downturn.

There is evidence that the domestic banking sector has been competitive to the point that banks actually competed on non-price terms to maintain or grow market share. This was done to the detriment of their underlying risk profiles and ultimately led to significant losses.

Although the final outline of the post-crisis Irish banking system is unclear, its structure will shape how its participants behave. We will engage with individual banks to understand their emerging risk profile. If necessary, we will also recommend wider reforms of the banking system in order to ensure that its make-up does not incline its participants towards excessive risk-taking.

Data suggests that Ireland is not particularly overbanked by reference to EU standards, neither could it be said to be over branched.





Source: European Central Bank: EU Banking Structures, October 2008

1.7 The international banking sector

The international banking sector in Ireland comprises 32 institutions, with a combined balance sheet of €679bn at end 2009. They are focused on foreign markets and are typically engaged in business with other financial institutions.

These banks fall into a number of diverse categories and business lines:

- Providers of banking, custodian, trustee and other services to the funds and investment industry, either within own group or outside;
- Investment banking for single parent company or group;
- Euro funding operations for associated group or bank, either through market access or ECB borrowing; and
- Niche areas of international lending.

The range of banks is marked: some banks have few employees and a single office in Dublin, while others represent very large head office operations with many employees and multiple branch or subsidiary operations.

From a financial stability perspective, the behaviour and health of the domestic banking sector is our primary concern. Although the direct links appear limited, this does not mean that international banks are not important from a financial stability perspective, as there would be significant reputational risk for Ireland as a financial centre in the event of an adverse shock to one or more of these institutions. In addition, these banks may be important counterparties for domestic banks' in certain markets and domestic banks can hold securities issued by international banks.

However, these banks' direct involvement in the domestic financial system is limited. These institutions hold relatively small shares of deposits placed by Irish households and businesses (7% at end 2009) and they provide a relatively small share of the total credit outstanding to these same customers (5% at end- 2009).

Cross-border supervision

The presence of subsidiaries of foreign financial institutions in Ireland that sell into foreign markets generates challenges in relation to their supervision.

The Central Bank is responsible for the compliance of the Irish subsidiary with EU and domestic prudential requirements. It is reliant on the consolidating supervisor for the group, of which that subsidiary is a part, for information on the state of the parent/related entities, supplementary supervision of the related entities and co-ordination of supervision across the various operations.

Although the EU's Post-BCCI Directive provided a framework for supervision in such situations, there is an asymmetry of information across the various supervisory authorities involved. This could lead to important risks and scope for contagion not being identified and a failure in one entity being transmitted to a related entity in another jurisdiction. This creates potential for direct contagion risk and for reputational risk for Ireland as a financial centre. The problems faced by Hypo Group and its Dublin based subsidiary, DEPFA Bank, in 2008 provide a striking example of this problem.

This asymmetry extends to the management and operation of large cross-border operations where the parent of a subsidiary located in Ireland may be at a disadvantage in terms of information relative to the management of the Irish operations. This challenge is compounded, where the Irish subsidiary has subsidiaries or significant branch operations in other jurisdictions. This generates a significant challenge in terms of co-ordinated supervision and ensuring that banks are capturing and managing all their risks.

Finally, the crisis has demonstrated that the interests of the home country of the parent entity and the home country of the subsidiary entity can diverge. In a crisis situation, banking groups with operations in Ireland may seek to protect the interests of the parent entity to the detriment of the subsidiary. This could take the form of a cash sweep or failure to provide liquidity. It could also include the location of 'problematic' assets or business practices outside the home jurisdiction.

Balancing these risks

Plainly, the international banking sector provides a significant contribution to national output, exports, employment and tax revenue. This, however, must be set against the risks that arise from the presence of these banks in Ireland. Internationally, there is support for closer, more co-ordinated supervision of cross-border banks. Ireland, given its small size and the significance of these banks in economic terms, must weigh up its interests. The challenge in the future will be to effectively supervise these institutions, while at the same time preserving Ireland's attractiveness as a financial centre and protecting the broader economic interests of the State.

1.8 International Responses to the Crisis

The recent crisis has resulted in international efforts to (i) strengthen the regulatory system, (ii) improve co-ordination among supervisors and other national authorities and (iii) develop improved resolution and compensation systems. The G20, the Financial Stability Board, the Basel Committee on Banking Supervision, the European Commission and the Committee of European Banking Supervisors have all been active in this area.

The Basel Committee on Banking Supervisions recommendations have included[xii]:

- Procyclicality of regulatory solvency measures and provisioning;
- Limits on bank leverage;

- Quality of bank capital;
- Liquidity risk management; and
- Remuneration structures within financial institutions.

There have also been proposals to improve supervisory co-ordination across borders and to increase the intensity and risk sensitivity of prudential supervision across the board.

Individual national supervisors have launched initiatives to review and strengthen their supervisory approaches. In framing our recommendations we have taken account of these international initiatives.

Chapter 2 - A new structure for banking supervision

2.1 Objectives

The newly constituted Central Bank will be a unitary organisation with responsibility for, inter alia, regulation and oversight of banking in Ireland, both at an individual institution level ("micro-prudential) and at a system-wide financial stability level ("macro-prudential").

Our objectives, as set out in the Central Bank Reform Bill 2010, include:

- Stability of the financial system; and
- Proper and effective regulation of financial institutions and markets, while ensuring that the best interests of consumers of financial services are protected.

To deliver on these objectives the Central Bank needs to change its approach to regulation and supervision of both individual credit institutions and the banking system. The organisation is being restructured and resourced to:

- Deliver a more assertive, risk based and challenging approach to banking supervision;
- Ensure a greater focus on macro-prudential analysis to identify the risks and stresses for business models, sectors of the economy and the financial system;
- Translate the macro-prudential analysis and micro-prudential oversight into agreement on, and imposition of, supervisory actions necessary to address identified risks;
- Better influence and implement the regulatory legislation and requirements emanating from the EU;
- Reinforce the domestic regulatory framework where necessary; and
- Enforce standards, rules and requirements delivering a credible threat of enforcement to underpin the new approach to banking supervision.

2.2 Structure

The 2010 Bill provides for a single unitary Board – the Central Bank Commission – to manage and control the affairs and activities of the Bank. The Commission's primary functions will be to ensure that the central banking and financial regulation functions of the organisation are integrated and co-ordinated and that the powers and functions conferred on the Central Bank are properly exercised and discharged.

While a strong legislative base provides a cornerstone for building a strong independent body, the manner in which the organisation is structured, managed and staffed is key to delivering on our responsibilities. The appointment of senior executives with responsibility for Financial Institutions, Risk and Policy, Enforcement, Markets and Consumer Protection will strengthen our executive management and enable us to restructure the directorates and departments which are most directly involved in banking supervision. This in turn allows us to overhaul the system of banking supervision taking account of the lessons learned from the financial crisis, both domestic and international, and to keep pace with international best practice.

Key changes in structure which most directly impact on banking supervision:

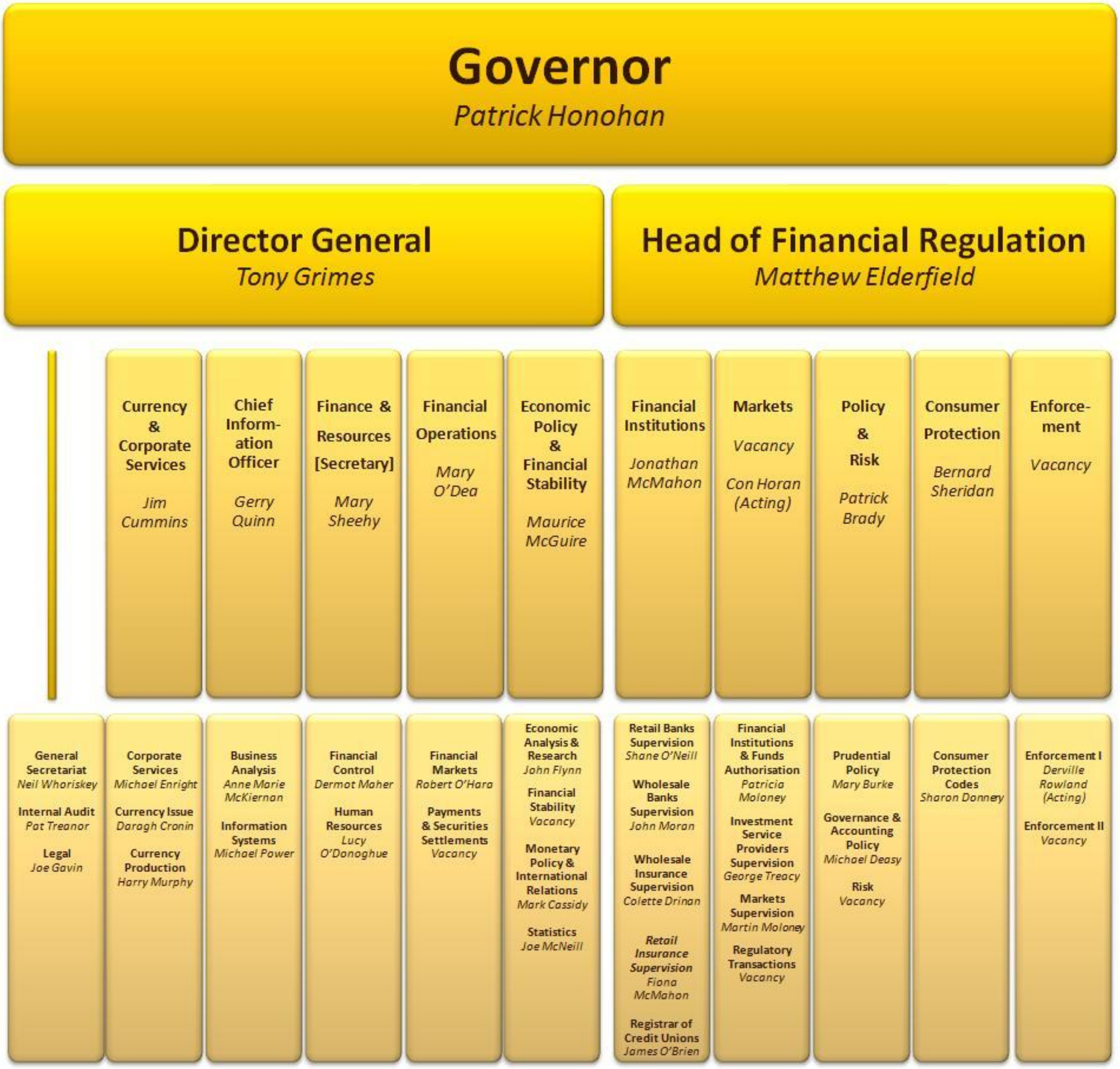
- The two frontline banking supervision departments will be restructured as Retail Banking and Wholesale Banking in a move away from a division purely based on “covered institutions” (i.e. those covered by the Credit Institutions (Financial Support Scheme) 2008) and other banks. This creates a new business as usual structure, grouping banks with similar models and associated risks within the respective departments.

- A new team, Prudential Analytics, containing quantitative specialists, financial analysts and business model analysts will support supervisors. This new team, together with the ongoing recruitment of specialist staff for banking supervision departments and the establishment of a Risk Experts Panel (see 2.4 below) will address the lack “of some of the specialised expertise needed” as noted in the Honohan report.

- A dedicated Enforcement Directorate will have investigative expertise and deliver a credible threat of enforcement action. The need for credible enforcement and the consequential benefits were outlined in the Honohan report: “When a new agency is created it is important that it quickly establishes its credibility and reputation as an enforcer. This creates expectations as to how the rules, codes, regulations and principles will be enforced which will, in turn, influence behaviour. If the regulated firm anticipates prompt regulatory action if it infringes a principle, code, rule or regulation and also that the action will increase in severity if it is repeated, the regulated firms will strive to minimise such infractions”.

- The Policy and Risk Directorate addresses the need to overhaul the domestic framework for regulation in line with international recommendations and best practice, better monitor and influence EU and international policy proposals and implement EU legislative changes into our system of supervision. Responsibility for the development and maintenance of the organisation-wide Risk Assessment Model will be centralised in a Risk Department. The establishment of dedicated policy departments also recognises the impact on frontline supervision when resources are diverted to policy and other support functions. The Honohan report noted that in banking supervision “management resources were regularly diverted from day-to-day supervisory tasks to deal with policy development work and work related to the Committee of European Banking Supervisors (CEBS)” and that “key staff were diverted into activities such as the implementation in Ireland of the many new and technically demanding international requirements introduced over the period and participation in various EU and ECB groups".

- Later this year, following preparatory work on our information systems, we will establish a Regulatory Transactions Department where all processing of regulatory returns and routine regulatory transactions will be centralised with common risk-based processes and, over time, a common work flow IT platform.



2.3 Resources and skills

The IMF in its May 2010 paper "The Making of Good Supervision: Learning to Say No"[xiii] identifies, inter alia, that having adequate resources is a fundamental requirement for good supervision:

"Supervision is resource intensive. Offsite reporting and surveillance requires access to technology and data sources. Onsite inspection requires significant human capital. Together they require constant skill development to keep pace with market developments. The follow-through on issues can be particularly resource intensive, which is why this often is observed as a problem for supervisory agencies"

Governor Honohan in his report stated that "The financial crisis has made it clear, though, both in Ireland and elsewhere, that effective bank supervision simply cannot be performed with the thin staffing that was applied to frontline operations of the FR". He also concluded that:

- "Broadening the scope and intensifying supervision, especially its quantitative aspects, which could have addressed the above problems, would have required considerable additional staff resources and training to help offset the asymmetry in skills vis-a-vis the regulated institutions";
- "There were difficulties recruiting and retaining persons with the required expertise, mainly reflecting salary competition in the market and the constraints on what the FR could offer in terms of salary"; and
- "Only a small number of persons was allocated to supervise leading credit institutions. Given the considerable asymmetry in expertise and seniority between the staff of the FR and the regulated institutions, this is likely to have hampered effective supervision".

The size of the banking sector in Ireland illustrates the scale of the challenge for this new team. In addition to the 7 "covered credit institutions" and their Irish licensed banking subsidiaries, there are another 36 banks licensed and regulated by the Bank. In total, these banks employ approximately 41,000 staff and manage assets in the region of €1.4 billion with operations in 19 countries. In addition to Irish licensed credit institutions 33 credit institutions operate in Ireland on a branch basis based on the right of establishment provisions of Articles 25 -27 of the Capital Requirements Directive (Directive 2006/48/EC).

In the past, resources for supervision were far below what was required. The number of supervisors is being increased. To deliver a more effective intrusive approach to supervision we plan to:

- Recruit 150 staff in 2010, bringing overall Central Bank staff numbers to 1,300;
- Increase regulatory staff numbers by perhaps a further 150-200 over the following 2 years;
- Have a minimum ratio of 10 supervisory staff per firm for major institutions;
- Improve specialist expertise by recruiting staff with direct business/banking experience – credit, liquidity, treasury, market and operation risk experts; and
- Establish a Risk Experts Panel.

Our new approach to supervision requires staff with appropriate technical and commercial skills that are able to effectively challenge and interrogate institutions. In order to recruit and retain staff with the required skills and expertise we need to ensure that remuneration arrangements and personnel policies are flexible and appropriate. Increased use of contract staff, secondees from professional firms and staff exchange with other international regulatory authorities are all options which we will use to build up resources and skills.

Ongoing training and professional development is fundamental to developing and maintaining high standards among our staff. We have introduced a compulsory training programme for all new and many existing staff. All staff joining the organisation must complete the introductory module within six months. Additional specialist training will be mandatory on an annual basis.

2.4 Risk Experts panel

We are establishing a panel of external risk advisors comprising experienced professionals who have a long and well established record of operating at a senior level in a financial services environment. These experts will be a resource available to both the organisation and to individual staff members who may require advice or a "sounding board" on policy proposals or issues arising with individual firms.

These experts will:

- Prepare periodic reports on key risks arising or evolving and make proposals as to how such risks may be mitigated;
- Provide advice on proposed rules/regulations;
- Advise on international developments with potential to impact on financial services in Ireland;
- Interview directors and executives seeking our approval under the fitness and probity regime;
- Act as designated decision makers in cases of enforcement action; and
- Contribute to reports on financial stability.

2.5 Revised committee structure

In parallel with the new approach to supervision, we will deliver enhanced assessment of, and reporting on, financial stability focusing on risks and vulnerabilities.

As part of these changes, the Central Bank's Financial Stability Committee has been restructured and meets more regularly. It is now chaired by the Governor and includes senior staff from across relevant central banking and regulatory departments. The role of the Financial Stability Committee includes monitoring and assessment of:

- Developments in economic and financial markets both domestically and internationally;
- Micro prudential and systemic risk indicators;
- Stress-testing methodologies and results of stress tests; and
- Strengths and vulnerabilities of the financial system.

A key focus will be to identify actions that can be taken to mitigate risks to financial stability. Where actions are required on our part, they will be taken. Where actions are required at government level, they will be so advised.

In addition, the expansion and restructuring of the organisation requires the implementation of clear channels and systems for (i) escalation of regulatory issues and agreeing regulatory action and (ii) development and implementation of policy initiatives and strategic commitments. We have established clear management structures and reporting lines. However, given the scale and complexity of our responsibilities, we believe that formal specialist committees, chaired at a senior level, will ensure that:

- Significant issues are appropriately escalated and actioned;
- Policy is developed with the benefit of specialist expertise and frontline supervisory input while taking on board cross-sectoral interdependencies and approaches;
- Implementation of commitments to rebuild and reform the domestic regulatory framework are tracked and implemented on schedule; and
- We are in a better position to influence EU policy developments and identify implementation issues at an early stage.

Three financial regulation committees chaired by Matthew Elderfield, Head of Financial Regulation have been established:

<u>**Supervisory Risk Committee**</u>	<u>**Policy Committee**</u>	<u>**Risk Assessment Programme Board**</u>
Frequency: Weekly	Frequency: Monthly	Frequency: Monthly
Escalation of supervisory cases and discussion of supervisory risks	Prudential banking, prudential insurance, funds, credit unions, markets, consumer policy issues and international policy co-ordination	Development of risk model including impact framework, probability scoring, on-site process, IT requirements, management information, project management and implementation

Chapter 3 – Supervisory approach

3.1 Introduction

With these new structures in place we also need to reform our approach to supervision. This work is well underway. However, the expectations of banking supervision are now so very different from the past that change will inevitably take time.

The need for change is clear.

In the period preceding the crisis, supervisory culture internationally, with some notable exceptions, tended to be too deferential towards free market ideas, and too responsive to critics of regulation and regulators. It is also clear that numerical estimations of risk came to beguile financial institutions and regulators alike – for example, the outputs of VAR models or Basel II capital calculations. Although this reflected the increased complexity of financial markets, the consequence was to erode confidence in basic prudential checks as well as broader judgements on the merits of rapid growth in the financial system.

Similar issues were also a feature of the Irish banking crisis. Governor Honohan in his report concluded, with respect to the CBFSAI, that "While consistent with the espoused regulatory philosophy, the reluctance to take decisive action can also be characterised as displaying both deference and diffidence to the regulated entities. These characteristics are brought out clearly also when it comes to looking at the way in which individual institutions were dealt with...".

Our task is to foster a supervisory culture where we take judgements on banks' own judgements, and are then prepared to be tenacious, but not pig-headed, in defence of the public interest objectives Government has given us.

Supervisory theme for 2010: Mortgage credit standards and funding risks

In May 2010 we commenced a review of new mortgage lending to establish the soundness of credit risk practices and the adequacy of the management of associated funding risks.

The initial focus of that work has been the market for first time buyers as this represents a significant portion of new lending. We have asked banks to provide us with the following:

- Data on new mortgages and sales targets for the coming period;
- Pricing and estimated profitability of this lending;
- Their current risk appetite for lending to this sector, and confirmation of when the bank's board last reviewed the issue;
- Their policies defining risk appetite, including Net Disposal Income, DSR, Loan to Value, Term, Room Rentals and stress testing of repayment;

- Levels of exceptions to policy in the 6 months to 31 May 2010;
- Arrears levels for the past year;
- Drawdowns for the past year; and
- Summary of key risks identified to future lending and how they have mitigated those risks.

Where we have identified risks, we have already intervened to ensure that banks manage them appropriately.

We will publish our findings from this review in July 2010.

3.2 Supervisory approach

Supervisory culture

Delivering a more assertive, risk based and challenging approach to banking supervision requires not only resources and skills but a will, both at an individual and institutional level, to question, intervene and act. This culture will apply not only in our supervision of individual institutions but also in the context of macro-prudential or financial stability oversight.

Question

It is clear that Irish banks will emerge from the crisis with different business models. The stability of the banking system will depend on the soundness and profitability of these business models. One of the weaknesses of regulation has been, as noted in the Honohan report, that "it relied on the deferential view that, as long as there was a good governance structure, decisions of the people actually running the banks could normally be trusted to keep the banks safe and sound, and their decisions did not need to be second-guessed". The Governor was also clear that "even if armed with the necessary information to be effective there would have had to be a greater degree of intrusiveness and assertiveness on the part of regulators in challenging the banks".

We will examine very carefully banks' commercial direction. Where the stakes are sufficiently high we will 'second guess' commercial decisions as it is clear that poorly thought through business choices can later morph into prudential problems. For example, we will challenge banks on the availability of the requisite skills, the depth of research into new markets, their product design and development, the contingency planning for unforeseen developments, and their appetite for risk. We will also press the banks on how they will take account of funding pressures in their financial forecasts. However, expectations of the regulatory regime need to be realistic – even with increased resources we cannot assess every decision of institutions or have knowledge of everything they do.

The recruitment of specialists with industry experience will ensure that our frontline supervisory staff have access to the requisite expertise and support to deliver this challenge.

Intervene

A key focus of supervision has been, and continues to be, assessing governance, systems, controls and compliance with rules and requirements. This has tended to focus on the current regime or look back to assess evidence of compliance. This needs to be done. However, we will also be more forward looking in assessing their business models and strategies to form our own judgement on the associated risks so that we can intervene early. This approach is designed to address the concern expressed in the Honohan report that "overall supervision was focused on procedural aspects of how the bankers did their job, and did not seek to second-guess the business models of the banks, by, for example, requesting additional provisioning or capital buffers against increasingly risky loans".

Act

We are determined to avoid falling again into "a pattern of inconclusive engagement with regulated entities on prudential matters, and lack of decisive follow-through"[xiv].

Where we identify risks in a credit institution we will insist on action to mitigate that risk. Whether we require immediate action or a clear plan and timeframe to address the matter will depend on the nature, scale and potential impact of the risk or shortcomings. Having identified actions required it is critical that these are all followed up to ensure that undertakings and commitments are delivered on and the issue is fully resolved. Where institutions cannot, or do not, take appropriate actions, the Central Bank will use its supervisory powers to force a resolution. These powers are wide ranging (e.g. requiring specific action by the firm, requiring independent third party review and recommendations, capital add-ons, directions to cease certain business).

A similar will to act will form part of our macro-prudential oversight. Where we believe that action on our part would mitigate or help to mitigate emerging risks to financial stability we will take the necessary action. However, it must be acknowledged that, in the absence of domestic monetary policy or interest rate tools, such actions largely relate to interventions via banking or financial services supervision. Such actions will only be effective if they complement rather than run counter to Government economic or fiscal policy. Where the Central Bank believes that changes are required in Government policy we will be clear in our advice to Government and our public commentary.

Risk Model

A key component of our risk based approach is the development of a more systematic risk framework or model. This will be used to enhance and develop our engagement levels with all regulated entities, which will drive our resource requirements, and facilitate the allocation of supervisory resources towards entities on the basis of impact and risk. Fundamental to development of the risk framework is the categorisation of all regulated entities based on inherent impact and/or risk.

Entities will be categorised initially on an impact basis from low to high impact, with those entities of systemic importance ranked as highest. The G20 criteria for systemic importance of financial institutions, namely size, substitutability and interconnectedness, will influence categorisation. Engagement levels will be established at base levels for each impact category and sub-category that will by necessity differentiate between entity type and industry. Entities judged riskier by supervisors will be subject to closer, more assertive, supervisory engagement. In this way, appropriate regulatory stances can be defined on the basis of impact and risk.

The risk model will reflect quantitative and qualitative data available to the Central Bank that will facilitate in-depth financial analysis, peer group analysis, performance tracking, and the development of early-warning triggers. For the largest, high impact firms, we will have a much more intensive level of supervisory engagement, including regular, comprehensive risk-assessments, a regular on-site presence, scheduled meetings with business management and control functions, and frequent ad-hoc contact. But it needs to be recognised that it is not possible to perform regular on-site assessments for the approximately 15,000 financial services firms we supervise, hence the establishment of base engagement levels by category of regulated entity. Low impact or low risk entities can expect a less intensive regime which is expected to derive primarily from early warning triggers or system-generated "r*ed flags"* identifying significantly different risk characteristics between individual entities' situations and those of their peers, their past performance, or projected future performance based on actual or stress scenarios.

Our concept envisages a risk assessment model which separately rates key individual risks (e.g. credit, market, liquidity, operation, business, legal, strategic) and mitigants (e.g. controls, organisation, management, ownership structure, access to capital) to generate an institution-specific aggregate score. The risk assessments required as part of the Supervisory Review and Evaluation Process under Pillar II of the Capital Requirements Directive, which are described in more detail below, will form an important contribution to both institution-specific aggregate scores and planned levels of, and approaches to, supervisory engagement.

The Central Bank will inform institutions of their scores and key risks (or areas) identified and will require risk mitigation plans to be produced by institutions to address risks identified during the assessment process. Monitoring the implementation of risk mitigation plans by required deadlines will be a key part of planned supervisory engagements. As we will use this model to inform our allocation of resources and supervisory engagement with individual institutions, these institutions need to be clear on what their score is, why and, where necessary, what they need to do to change it.

The risk model will impact significantly on the operations and staff of the Central Bank in its supervision of regulated entities. A project of this size and complexity will require time and resources to develop, roll out and bed down. We will consult on the impact framework and the metrics used to decide on categories in Quarter 4 2010. We will implement the model in Quarter 2 2011.

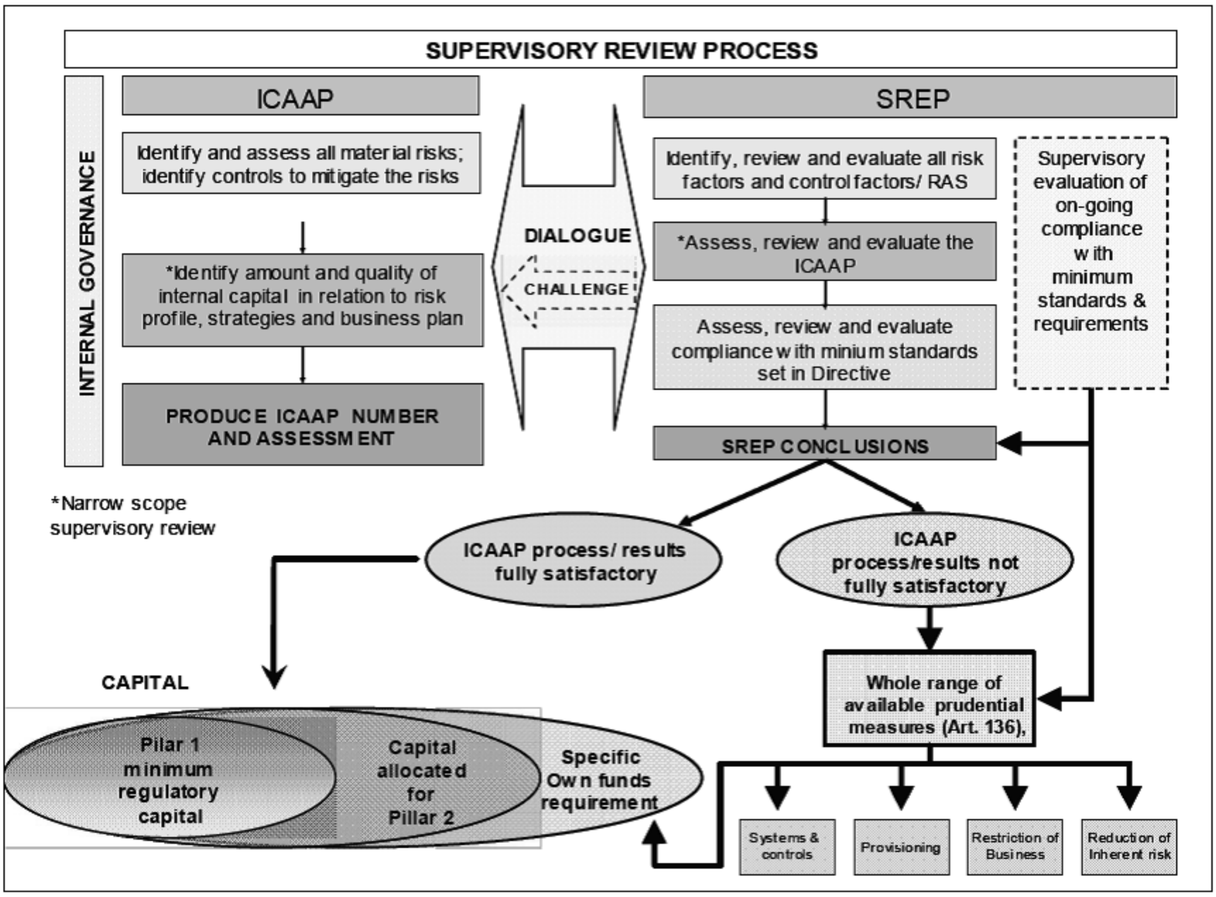
Supervisory Review and Evaluation Process (SREP)

Comprehensive risk assessments will be conducted as part the Supervisory Review and Evaluation Process (SREP) for each credit institution. The SREP, a component part of the Capital Requirements Directive[xv] (CRD), requires that supervisors assess the overall prudential risks of a credit institution/group covering inherent business risk, control factors and oversight/internal governance.

The CRD prescribes the minimum capital requirements in respect of credit, market and operational risk (Pillar 1 risks), which are calculated on either a standardised or Internal Ratings Based Approach

("IRBA") (bespoke internal models) basis. It also requires that credit institutions assess the additional risks they are exposed to and determine the capital that they must hold against these risks. The Internal Capital Adequacy Assessment Programme ("ICAAP") must then be subject to assessment by supervisory authorities as part of the SREP. A formal annual SREP will be conducted for each institution including qualitative and quantitative assessment.

The Committee of European Banking Supervisors representation of the SREP gives an overview of the process.



We are strengthening our SREP process:

- The depth and intensity of the SREP will vary depending on our risk rating of the institution with systemically important or high risk/high impact firms being subject to a comprehensive annual review.

- The qualitative elements of the SREP include assessment of strategy, governance, management, culture, policies, controls, compliance and internal audit.

- There is an increased focus on business models/strategies and stress testing. The viability and sustainability of business plans or models on a standalone basis, or in the context of a wider group, will be subject to supervisory challenge by specialist teams.

- Rigorous stress testing, incorporating scenarios analysis, stress testing and reverse stress testing should be part of an institution's decision making, capital planning and risk management processes. All material risks should be stressed on a regular basis. The Governor in the Honohan report questioned whether the scenarios used in past stress tests had represented a sufficient "turning up of the switches" and concluded that "it is clear that the shocks involved, while thought to be "extreme" at the time, did not in fact capture the scale of what could and did happen". Institutions will be required to carry out robust stress tests at different level (e.g. product, business unit or division) as well as institution wide stress or scenario testing and factor in possible contagion effects. The assumptions, hypothesis, methodologies, granularity and results of stress tests and evidence of their practical application in decision making and risk management will be challenged by specialists. Where we believe that the stresses or scenarios are not severe enough parameters will be prescribed. The Prudential Capital Assessment Review ("PCAR") (see Section 5.4) has, and will, inform our SREP for relevant institutions.

- Specialist credit risk analyst resources have been, and are being, recruited to ensure greater analysis (including industry benchmarking) and challenge on credit risk, credit risk management policies, credit procedures, large exposures, credit grading, impairments and provisioning as part of the supervisory review. This increased analysis and challenge is designed to ensure that institutions adopt more appropriate and prudent approaches to credit, risk, grading, impairments, provisions and write-offs.

In the Honohan report analysis of micro-prudential supervision, the Governor asserts that "quantitative analysis needs to be at the heart of off-site supervision of financial firms". The quantitative assessment and challenge will be driven by a combination of data and analysis. Institution-specific data is sourced from a mixture of publically available information (financial statements), standard regulatory returns (COREP, FINREP, liquidity report, large exposure report and ICAAP portal) and detailed supplementary information received from the institutions via electronic data template submission. Data received from each institution are input into a series of proprietary risk quantification tools developed by the Central Bank, which are known collectively as the "Pillar II capital toolbox". This toolbox produces an independent estimate of the capital needed to absorb potential losses across a number of risk types for a given portfolio and frequency of occurrence. This suite includes credit portfolio analysis tools to facilitate better understanding of the risks from the perspectives of concentration, borrower linkages and sensitivity of estimates to the inputs/assumptions used.

The Central Bank has recently enhanced its supervisory review process by introducing the concept of a "Risk Dashboard" for each licensed credit institution. This approach goes some way towards addressing the concern identified in the Honohan report that "although inspectors did identify many of the key governance and procedural weaknesses in a qualitative way, the process-based regulatory model they were adhering to was not designed to provide a quantitative or graduated indication of the magnitude of the risks to solvency and the likelihood that they would materialise". The risk dashboard provides a concise portrayal of the institution's risk profile and business model and how they have evolved through time. It describes the level of exposure the institution has to a wide spectrum of risk types including credit default, credit grade migration, market, operational, business/strategic, interest rate risk in the banking book, pension, liquidity, residual, securitisation, insurance underwriting, equity holdings and property holdings. The dashboard facilitates analysis and consistent and focused challenge of the institution's own estimates of risk exposure as part of the annual SREP. This process helps ensure that institutions' capital is representative of the risks in their portfolio and that risk mitigation and capital plans can be implemented effectively.

Cross-organisational panels, drawing on supervision, banking, risk analytics and financial stability expertise, (i) review and agree the proposed focus, plan and methodology for each institution's SREP in advance of the formal SREP commencing and (ii) assess the SREP report, challenge examiners on their findings and agree any supervisory actions.

Where we assess the quality of an institution's ICAAP, controls, oversight, management and governance as being high we may make allowance for this in deciding on an institution's capital requirement.

The Central Bank expects that any shortfalls identified during the supervisory review will be addressed through each institution's Pillar II development plan. This plan provides details of scheduled improvements to internal risk and capital management tools and processes. When credit institutions fall short of what is required or expected of them, the Central Bank will be clear on what we view as the shortcomings and appropriate remedial actions. Capital is not always the only, or indeed, the appropriate response to risks or deficiencies identified by a supervisory regime. In some cases controls or limits may serve to eliminate or mitigate risks. Supervisory measures can include, but are not limited to, requiring credit institutions to hold additional capital, improve policies, processes, systems and controls, revise its business strategy, apply a specific provisioning policy, restrict or limit the business, operations or branch/subsidiary network of the credit institution or reduce the risk inherent in its activities and/or products.

The formal annual SREP is supported by ongoing supervisory engagement and processes, both on-site and desk-based, which include:

- Analysis of financial data including audited accounts and regulatory returns (e.g. profit & loss, balance sheet, liquidity report, large exposures report);
- Inspections, either on a themed industry-wide basis or focused on particular issues with individual credit institutions;
- Challenge meetings with directors, management and control functions;
- Review of board and sub-committee minutes and attendance, as an observer, at selected board and committee meetings;
- Expert reports commissioned where fundamental weaknesses identified in systems of oversight and controls; and

- Review of auditor's management letter and follow-up on delivery of recommendations.

The SREP is not a one-off annual exercise. It is informed by our ongoing engagement and supervision of each institution and use of the formal SREP process does not prevent us from taking supervisory actions at any time should the need arise.

Supervisory theme for 2010: bank strategies

We will use the Supervisory Review process to evaluate the quality of bank strategies.

It is clear that the environment for banks will be challenging. We expect bank boards to have thought through, and then described in credible detail, what these challenges will mean for their business models.

A key area of focus for the Central Bank will be the steps banks are taking to broaden their lending capabilities. There is now an economic imperative to lend to growth businesses and sectors. There is also a prudential imperative that banks will require diversity in their earnings to attract lower capital charges and higher credit ratings.

We will intervene if we observe a poorly conceived strategy. We will also intervene if we see a lack of progress in implementing a well-conceived strategy.

We will report publicly our findings in January 2011.

Supervisory colleges

Co-operation among regulatory authorities has always been central to banking supervision, both in terms of bi-lateral engagement and membership of groups such as the Committee of European Banking Supervisors ('CEBS'). Formal structures - "colleges of supervisors" - evolved from the legal arrangements for decision making in the CRD (e.g. joint decisions on IRBA model approval). These colleges are permanent structures for co-operation and co-ordination among authorities responsible for, and involved in, the supervision of different parts of cross-border banking groups.

The financial crisis emphasised the need for such international co-operation and amendments to the CRD, to take effect from end 2010, have provided a legal basis for the establishment of supervisory colleges and provide for the participation of 3rd country (non EU) regulatory authorities. CEBS now establishes targets, monitors and reports to the membership on the establishment and functioning of colleges.

Given the presence of many international institutions in the IFSC and the increased focus on the need for an international co-ordinated approach to supervising groups we expect that colleges will play a greater role in setting the supervisory priorities and approach to the supervision of individual institutions licensed by the Bank. More regular college meetings, joint work programmes and joint inspections are a feature of the longer established colleges and we will be supporting further moves in that direction. Clearly, increased participation in colleges and collaborative work with other regulatory authorities places increased demand on staff resources and is factored into our recruitment plans.

3.3 Not a 'one-size fits all' approach

All banks can expect a more intrusive and challenging approach to banking supervision.

However, this does not mean a one-size fits all approach. It would be impractical, not to say illogical, for the Central Bank to apply the same level of resources and approach to supervising domestic commercial banks, for which we are the consolidated supervisor , and to supervising " a niche bank" operating in the IFSC as a subsidiary of a global financial services group. Clearly these characterisations are at extreme ends of the spectrum and many banks operating in Ireland will fall within a middle ground.

Systemically important financial institutions, which will include the domestic commercial banks and a small number of international banks can expect a detailed analysis and challenge of their systems, controls, policies, business model, plans, financials, returns and audit reports together with a regular on-site presence and attendance at certain board and committee meetings.

In the case of international banks, we recognise that they are part of a wider financial services group and that our engagement with them should reflect that. We will be placing increased emphasis on engagement at Group level and with the consolidating supervisor, both via Colleges of Supervisors and on a bi-lateral basis. Where institutions rely on group policies and systems local boards and management need to understand them and be satisfied as to their appropriateness for the Irish business. Business models need to be sustainable and while we recognise that this may be in the context of a wider group strategy, rather than purely locally, all group regulators need to understand this and be satisfied that this is the case. Banks can expect an increased level of engagement, particularly in the short to medium term – meetings, queries and data requests – as we seek to ensure that we have the necessary knowledge and understanding of institutions' strengths and weaknesses to feed into our risk model and inform our approach to supervision of individual entities.

We will also seek to apply a proportionate approach to the development of rules and regulations, providing where appropriate flexibility for international banks in recognition of the overall regulation of the Group and the application of comparable regulation at a consolidated level.

Chapter 4 – Financial stability and its contribution to banking supervision

4.1 Introduction

The Central Bank's overall responsibility for financial stability draws on the expertise and knowledge base of supervisors at the individual bank level as well as being based on analysis at the aggregate level. Thus financial stability analysis involves examining the stability of the overall financial system, its component parts, and the relationships between the financial system and the real economy. This short chapter of the paper is organised in two parts. The first broadly describes the role of the Financial Stability department in the organisation and the second part outlines a roadmap for work within the economics and supervisory areas on financial stability and banking sector issues designed, inter alia, to address issues highlighted in the Honohan report.

4.2 Financial stability within the broader organisation

The work of the Financial Stability department is informed and enhanced by a high level of regular interaction with Financial Institutions Supervision, addressing a concern raised in the Honohan report that closer interaction between the staff involved in these respective areas is required. Staff from the Financial Stability department are part of the Supervisory Review and Evaluation Process (SREP), regular supervisory challenge meetings, and prudential analytics work. While these meetings serve to provide crucial first-hand information of developments within the financial system, they also afford the Financial Stability department the opportunity to provide its bigger picture risk assessment perspective.

The department is a key user of supervisory and externally provided official sector data such as residential property price indices. The department will strengthen its advocacy role as a user of micro and macro-prudential data that is the lifeblood of financial system surveillance and research. To this end, the department will produce an assessment of the data needs for financial stability assessment and publish it by October 2010 for comments by academics and reporting agents in industry. Furthermore, the department plans to expand the data sources at its disposal by utilising private sector data sources in common with best practice in major central banks and international organisations.

Much of the empirical assessment conducted by the Financial Stability department will underpin the conjunctural assessments which are prepared as a core output of the financial stability review process and which have formed the core of past Financial Stability Reports released by the Central Bank. These reviews are an integral aspect of the macro-prudential policy of the Central Bank forming the basis for mitigating actions to be undertaken by the Bank. As such, the Financial Stability department provides as rigorous and independent a risk assessment as possible.

As part of its risk assessment process, Financial Stability has already started to develop bi-lateral contacts with other major central banks and the wider academic community. In terms of the overall work streams identified, increased contact with these relevant peer groups through publication of work, attendance at conferences and organisation of workshops will be a key priority in benchmarking the quality of the work conducted by the Financial Stability department.

4.3 Financial Stability work stream: a roadmap

The work of the Financial Stability department involves day-to-day monitoring of sectoral developments, briefing, crisis management coordination activities, input into the authorisation process and the provision of the secretariat and inputs to the Bank's Financial Stability Committee. The department also has significant commitments in relation to the various international committees and task forces on which it participates, particularly those of the ESCB.

In preparing our "roadmap" we have taken account of issues raised in the Honohan report including that:

".... FSRs did not end up conveying an appropriately forceful message that could have served as a springboard for strong remedial action.";

"..... a rather defensive approach was adopted to external critics or contrarians."; and

"Regulator-maintained data on individual financial entities continued to be accessible to Central Bank staff; however the relatively "raw" nature of these data as well as the constrained availability of FR staff to assist in their interpretation, appear to have inhibited the extensive usage of the data in report preparation".

Both the domestic aspects of the crisis and developments at the EU level have meant that the economics division has had to reassess the weight applied to various issues in terms of what and how work is carried out within the business area. One of the conclusions of this reassessment is that the conjunctural financial stability assessment will be strengthened by a commitment to analysis underpinned by advanced empirical research. This involves rigorous statistical analysis across the main areas of responsibility for the department: systemic risk assessment, comparative analysis of the Irish banking sector, and both macro and micro level examination of the interaction between the financial system and the real economy.

The need for development of a systemic risk assessment capability is given considerable impetus by the establishment of the European Systemic Risk Board (ESRB). Within the Central Bank, Financial Stability department will be taking a lead role in the work of Central Bank relating to the ESRB. In practical terms, the Central Bank will be in a position to understand, examine and at times critique this type of assessment conducted by the ESRB. Finally, significant influence on the analysis conducted by the economics division within the Central Bank will be participation on the new Macroprudential Research (MaRs) network of the Eurosystem. This research network will contribute to the ESRB by providing policy directed research. It consists of three workstreams (i) financial stability and the general economy, (ii) early warning and systemic risk indicators and (iii) contagion.

Therefore, both domestic and EU influences will shape work on financial stability within the Central Bank over the coming years. In the near term, this will lead to the following work:

- Development of a systemic risk assessment framework. This will include the estimation and update of balance sheet and market-based indicators for financial institutions, and sovereigns. Related to this ongoing work is a potential work stream on contagion and network analysis of Irish banks. This may involve use of either or both large interbank exposure data and Target 2 payments data and would help to provide a greater understanding of the interdependencies of the Irish banking system.

- The Central Bank will also conduct an in-depth comparative analysis of the performance of the Irish banking sector that will feed into the discussions on the future structure of banking in Ireland. This work will be undertaken through an in-depth analysis of the private sector databases that contain annual financial data for banking institutions. Cross-sectional and panel examination of this data will be very important in conditioning discussions about the future nature of banking in this country and in the EU.

- In addition to crisis management work at a domestic level on Deposit Guarantee Schemes, restructuring of the domestic financial sectors, and other crisis related issues, this will also involve participation in the significant issues relating to enhancing the framework for cross-border (financial) crisis management at the EU level.

- In terms of the further development of bank specific risk assessment, joint work is planned for the latter part of 2010 between the Financial Stability staff and the Prudential Analytics team within Financial Institutions Supervision. Broadly speaking this work will be based on extending the quantitative risk assessment models that are currently in use thereby contributing to the Pillar 2 infrastructure development already underway in Financial Institutions Supervision.

- Parallel to this work, detailed micro level analysis will examine the important counterparts of the financial sector: non-financial corporations (NFCs) and households. This work will examine issues such as the implications for non financial corporation's of changes in financing conditions, the availability of credit for small and medium sized enterprises (SMEs) and the nature of distress in the Irish mortgage market.

- Findings and assessments arising out of all of these strands will form the basis for public communication in the Financial Stability Report cycle which will be resumed later in 2010 in a new format.

Chapter 5 – Regulatory framework

5.1 Introduction

The national and international regulatory framework is being rebuilt to address the lessons of the financial crisis. The fundamental framework for banking supervision in Ireland is governed by rules and structures laid down in EU law, primarily the Capital Requirements Directive. It is likely that the establishment of the European Banking Authority, and associated moves towards a "single rulebook", will leave national regulators with less discretion to introduce their own requirements. The EU Commission is amending the CRD on a phased basis over the next 3 years mirroring expected changes to the Basel II framework. These will address the quality and quantum of regulatory capital, liquidity requirements, counter-cyclical measures and improved supervisory co-operation. Our regulatory framework needs to adapt to, and plan for, these changes.

However, while international factors contributed to the Irish banking crisis, many contributory factors were "home-made". Both the Honohan report and the report by Messrs Regling and Watson support this view. "Home-made" elements included fiscal policy, weak bank governance and risk management, the response of supervisors to the build-up of risks and the absence of forceful warnings on financial stability risks. Aside from changes to the regulatory framework driven by the EU, the domestic regulatory framework needs to be reviewed. Where national discretions exist or particular issues need to be put on a statutory and enforceable basis we plan to introduce specific national requirements. This Chapter deals with a number of the key initiatives, in a banking supervision context, both at an Irish and EU level.

5.2 Governance

The board of directors, together with its senior management, is the first line of defence in ensuring that a bank is well managed, with systems and controls, appropriate to the nature, scale, complexity and risk of its operations. This is recognised by Governor Honohan in his report:

"In an important sense, the major responsibility lies with the directors and senior management of the banks that got into trouble. They are the first line of defence to protect those who have entrusted them with their funds".

Strengthening the corporate governance framework for credit institutions is a priority given that both domestically and internationally corporate governance failings have been identified as one of the causes of the financial crisis. In an Irish context key elements of improved governance in banking will be the introduction of codes on both corporate and internal governance together with a statutory basis for fitness and probity reviews. The absence of these elements was criticised in the Honohan report.

Improved governance, more demanding regulatory requirements and intrusive supervision will contribute to improving the resilience of the banking industry to future stresses. Boards and senior management of credit institutions will be required to understand, and clearly demonstrate that they understand the strategy of the institution, its risk appetite and associated mitigants.

Corporate governance will be assessed as part of our ongoing supervisory engagement and as part of the SREP. This will include an assessment of the structures and policies together with their practical application and outputs.

Corporate governance requirements

The Central Bank is introducing, under its statutory powers, corporate governance standards designed to strengthen the domestic regulatory regime. In April 2010 the Central Bank has been involved in a public consultation process on Requirements for Corporate Governance of Banks and Insurance Companies. The Requirements propose mandatory minimum standards as to how banks and insurance companies should organise the governance of their institutions including:

- Imposing a minimum number of directors;
- Limiting the number of directorships that directors may hold to ensure that they can comply with the demands of Board membership of credit institutions;
- Requiring that Board membership is reviewed at a minimum every 3 years;
- Having clear separation of the role of Chairman and CEO;
- Prohibiting individuals who were executives of the institution during the previous 5 years moving into the Chairmanship of that institution;
- Clarifying the role of independent non-executive directors and the criteria for director independence;
- Setting out requirements for Board committees; and
- Requiring annual confirmation of compliance to the Central Bank.

Conscious of the need for proportionality and that a somewhat differentiated approach may be appropriate for institutions that are part of an international financial services group, the consultation paper provides for certain exemptions and flexibility depending on the ownership structure and the nature, scale and complexity of the business model. Applying such a proportionate approach recognises that the regime applied to a specialist wholesale bank operating in the IFSC may, for example, differ from that applied to retail “high street” banks.

The Requirements will be finalised and issued in October 2010, following consideration of submissions to the consultation. Breaches of these requirements will be liable to administrative sanction by the Central Bank under its Administrative Sanctions Regime as set out in Part IIIC of the Central Bank Act 1942.

Comptroller and Auditor General recommendation

The C&AG Special Report No 72 "The Financial Regulator: responding to the Financial Market Crisis December 2009" recommended that:

"At the level of financial institutions, while recognising that it would have some cost implications, an annual positive assurance by their auditors in regard to the functioning of the internal corporate governance regime in each institution including the risk management function could strengthen public assurance".

We will commence consultations with the auditing profession and the Irish Auditing and Accounting Standards Authority (IAASA) in July 2010 with a view to implementing a framework for regulatory assurance by the institutions' auditors to the Central Bank.

Fitness and probity

Improving corporate governance is not just a question of introducing new codes and regulatory requirements. It is also driven by the integrity, professionalism, skills and experience of directors and senior managers.

The Central Bank Reform Bill 2010 provides for a statutory Fitness and Probity Regime for directors and senior management of financial institutions, including credit institutions. In summary, Part 3 of the Bill provides that the Central Bank:

- May issue standards of fitness and probity with which firms must comply regarding officers and employees performing controlled functions;
- Would prescribe controlled functions as well as specifying which functions require pre-appointment approval by the Central Bank;
- May suspend a person from a controlled function pending investigation of their fitness and probity. Such a suspension runs for an initial period of 10 days and can then be confirmed by the Central Bank for a further period of 3 months (during which time the Central Bank may apply to Court for a further extension of up to 3 months);
- Will have specific powers to demand documents and sworn testimony for the purposes of investigating a person's fitness and probity, including the power to apply to Court for an order requiring compliance; and

- May, where it forms the opinion that a person is not fit and proper, issue and publish a 'prohibition notice' forbidding that person to carry out a controlled function in a single firm or as a general industry-wide prohibition.

The Central Bank will issue a consultation paper setting out its proposals on prescribed controlled functions and revised fitness and probity standards in December 2010.

Interview and assessment process

We have already commenced an interview process as part of our "fitness and probity" assessment for those being appointed at senior levels within the domestic banks and plan to roll this out in a targeted and risk-based manner consistent with resources. Interviews focus on, but are not limited to, the individual's role and responsibilities, expertise, experience and qualification, knowledge of the regulatory regime and understanding of the institution, its business strategy, key risks and risk mitigation.

We are also introducing periodic interviews with directors of significant institutions to assess their understanding of key risks. Combined with attendance at selected board and other key committee meetings these interviews will assist us in assessing the performance of individual directors. However, we will not solely focus on individuals. We will be reviewing the overall quality of boards, including balance and skill sets, management oversight and adherence to the requirements proposed for corporate governance.

Internal governance

Credit institutions are required[xvi] to have robust and comprehensive governance arrangements, proportionate to the nature, scale and complexity of their business, including:

- A clear organisational structure with well defined, transparent and consistent lines of responsibility;
- Effective processes to identify, manage, monitor and report the risks to which it is exposed;
- Adequate internal control mechanisms; and
- Sound administrative and accounting procedures.

The Central Bank's Notice on Implementation of the CRD instructs credit institutions that their operations should be consistent with Guidelines issued by the CEBS. These include CEBS Principles for Internal Governance[xvii] and High Level Principles for Risk Management[xviii]. The CEBS work programme for 2010 includes further work on risk management and internal governance in Quarters 3 and 4 2010. The Central Bank will issue a consultation paper on Internal Governance Requirements in 2011 following CEBS review of its policy. As part of this consultation, we will consider the merits of Directors' Compliance Statements.

5.3 Remuneration standards

Excessive risk taking by credit institutions and other financial services firms has contributed to the financial crisis. A factor in this was a failure to appropriately link remuneration and reward to the long-term sustainability and performance of institutions. Rewarding directors, management and staff for short term profitability gave incentives to pursue riskier activities which provided higher short-term income and profit. In Ireland this was characterised by focusing on balance sheet growth rather than the stability of the business or funding model.

In their report Messrs Regling and Watson noted: "A third issue concerns remuneration and incentives. In many popular accounts of the global financial crisis (and Ireland is no exception), this topic conjures up images of top management bonuses, or the practice of awarding stock options on a large scale. A fair degree of consensus has emerged internationally about the need for improvements concerning such practices. However, in Ireland, at least one should not neglect incentives set for middle-level management and indeed loan officers."

We will issue a consultation paper on Remuneration Requirements for the Financial Services Industry in September 2010 with a view to finalising and imposing requirements in Quarter 1 2011. The Requirements will be based on international best practice including, the EU Commission Recommendations on Remuneration Policies in the Financial Services Sector[xix], CEBS High Level Principles for Remuneration Policies[xx] and the Financial Stability Board Standards as endorsed by the G20[xxi]. They will include:

- Linking remuneration policies and procedures to business strategy, risk tolerance and the long-term interest of the institution;
- Board approval and review of the policy and oversight of its application;
- Ensuring that control functions are specifically addressed;
- An appropriate balance between fixed and variable remuneration elements;
- Performance related pay policies including a fully flexible bonus policy, use of a multi-year framework, deferral of some bonus payments and measurement of performance based on longer term performance, individual and collective performance and capturing non-financial criteria; and
- Internal and external transparency of remuneration policy.

Supervisory theme for 2010: remuneration practices

As part of our SREP visits to the domestic banks in 2010, we will take a close look at the governance and oversight of remuneration practices at banks.

It is clear that the structure and quantum of compensation has been a major factor in the financial crisis globally. Within Ireland, it would appear that remuneration arrangements over-emphasised asset acquisition and under-emphasised the effective stewardship of funding needs. The consequences of this skewed approach are clear today.

To this end, we are going to drill-down into two areas: the arrangements at board-level for setting and scrutinising remuneration priorities, and the nature, substance and frequency of board-level debate about remuneration practices; and how banks, through their remuneration policies and practices, balance rewards and incentives between asset acquisition and funding risk management.

At present, we have seen some evidence that some banks are still failing to match the maturity of assets and liabilities in a way that would create a stable long-term balance sheet structure and sustainable future profits.

We will report publicly our findings in November 2010.

5.4 Capital

Introduction

It is estimated that €841 billion[xxii] could be lost in write downs by Eurozone and UK banks as a result of the financial crisis. Given the scale of the potential losses and the resultant need for Government interventions, it is widely recognised that the quality of regulatory capital must be improved and the quantity increased. The Basel Committee and the EU Commission have moved to introduce wide ranging changes to the capital framework.

Prudential Capital Assessment Review [PCAR]

The Central Bank has conducted a Prudential Capital Assessment Review ("PCAR") for Allied Irish Banks plc ("AIB"), The Governor & Company of the Bank of Ireland ("BOI") and EBS Building Society ("EBS") to determine forward-looking prudential capital requirements; the results of which were announced on 30 March 2010. In addition, an update on the status of Irish Life & Permanent plc ("ILP"), Anglo Irish Bank Corporation Limited ("Anglo") and Irish Nationwide Building Society ("INBS") was provided as part of the PCAR announcement.

The PCAR assessed the capital requirements arising for expected base and potential stressed loan losses, and other financial developments, over a three year (2010-2012) time horizon. In setting a target level of 8% Core Tier 1, with 7% Equity Core Tier 1, under the base approach and 4% Core Tier 1 under the stress approach the Central Bank has recognised current requirements, market expectations, the direction of proposed changes to the capital regime and the need for increased loss absorption capability. Details of the PCAR methodology, stress tests and results are set out in Annex 2.

As a result of the PCAR; AIB, BOI and EBS were required to prepare and submit recapitalisation plans within 30 days of the announcement outlining their approach to raising the additional capital required by the end of 2010. It is intended that a PCAR will be completed for ILP in the coming months as the institutions' restructuring plan is developed. It is also intended that the PCAR methodology will be applied to Anglo and INBS following completion of their restructuring plans.

As part of the SREP engagement we are conducting prescribed PCAR-like stress tests on a number of international banking subsidiaries operating in Ireland with business models similar to the domestic "covered institutions". The aim of the prescribed stress tests is to assist in determining the level of projected loan losses in these institutions and the potential capital deficits arising in each institution. The analysis will also identify possible events or cyclical changes in market conditions that could adversely impact the institution's earnings, liquidity and asset values. More tailored stress testing will be conducted for other international banks given the range of different business models and markets in which they operate. Where our analysis indicates a possible capital shortfall, credit institutions will be required to prepare a capital plan to comply with any additional capital requirement specified. As with the PCAR, these prescribed stress tests will inform the SREP and will ensure that the risks which have resulted in additional capital requirements will be appropriately recognised and managed in the ICAAP.

Capital Requirements Directive [CRD]

The Capital Requirements Directive ("CRD") provides the framework for banking supervision and capital requirements across the EU. There are two components to the calculation of capital under the CRD:

- Pillar 1 provides a comprehensive set of rules to determine minimum capital requirements for credit, market and operational risk.
- Pillar 2 ("supervisory review") requires that, notwithstanding the Pillar 1 minimum, institutions make their own assessment of the adequacy of capital in the context of their risk profile, risk management and internal governance arrangements. This is then subject to supervisory review and evaluation. Pillar 2 aims to ensure that an institution's capital level is sufficient to cover its overall risk. Regulatory authorities can direct credit institutions to hold additional regulatory capital where they believe institutions are not in compliance with the requirements of the CRD.

Currently the CRD requires that institutions must hold minimum capital equal to 8% of risk-weighted assets. Institutions are allowed to use different levels or tiers of capital to meet this requirement, subject to limits. The highest form of capital is Tier 1, which typically consists of equity capital and hybrids. Tier 2 capital, primarily consists of preference shares and subordinated debt. Tier 3 capital, the lowest form of capital comprises subordinated debt of at least 2 years maturity and net trading book profits. (Tier 3 is only allowed to cover market risk.)

The onset of the international financial crisis in August 2007 has triggered a fundamental review of the CRD with CRD II amendments agreed. It is due to be implemented in Member States by October 2010 and effective 31 December 2010. In relation to regulatory capital, these include:

- Providing clear EU wide criteria, on permanence, loss absorption and flexibility of payments, to determine whether hybrid capital is eligible to be counted as part of Tier 1 capital;
- Establishing harmonised limits, ranging from 15% to 50% depending on the quality of the instrument and on the extent to which hybrid capital constitutes Tier 1 capital; and
- Allowing a grandfathering clause to avoid disruption in financial markets related to instruments already issued and providing for an adequate transitional period for both institutions and regulatory authorities.

CRD IV also proposes further amendments to regulatory capital, introducing revisions to all levels or tiers of capital. Key proposals include:

- Improving the quality of capital by defining criteria for core and non-core Tier 1 and 2 capital;
- Reinforcing the need to have common equity, i.e. Core Tier 1 as the 'predominant' component of Tier 1;
- Simplifying the Tier 2 capital structure and eliminating Tier 3 capital;
- Applying prudential filters and adjustments to Core Tier 1. This includes deduction of minority interest, deficits in defined benefit pension schemes and deferred tax assets from core Tier 1; and
- Enhancing disclosure requirements of capital instruments.

In addition to these proposals, the Commission is examining the application of two countercyclical[xxiii] measures to the current framework. These are a <u>through-the-cycle provisioning</u> for expected credit losses and a <u>capital buffer</u> to include both a conservation buffer and a countercyclical buffer. The conservation buffer would be fixed above the regulatory minimum capital requirement and would be built-up in 'good times' to be used in the 'bad times.' Institutions operating below the fixed target in 'good times' would be constrained from distributing capital. The counter-cyclical buffer would operate by extending the capital conservation buffer depending on the level of a macro variable. The chosen macro variable would be an indicator of excessive level of credit growth. During periods of excessive lending the conservation buffer would increase. The purpose of this macro prudential measure would be to prevent excessive lending during boom periods and encourage bank lending during economic downturns.

As an indicator of excessive credit or balance sheet growth, it is proposed to introduce a non-risk based <u>leverage ratio.</u> This will supplement the risk-based capital requirements of the CRD. Proposals are centred on a leverage ratio, which would take the form of a traditional capital versus assets measure – the numerator and denominator respectively. The numerator would be based on very high quality capital and the denominator would comprise of both on and off balance sheet assets.

The Central Bank is generally supportive of the direction of reforms outlined above and has contributed to the consultation process as a member of CEBS.

We believe that appropriate timing/phasing of the introduction of these amendments to take account of the prevailing economic environment is critical. A Quantitative Impact Study (QIS) is currently being conducted by a sample of banks and investment firms across Europe. The purpose of the QIS is to assess the impact of the proposed changes and calibrate the new capital requirements. The results and analysis of the QIS will be key in setting the future regulatory landscape.

While the calibration of quantitative measures being proposed remains to be finalised, initial analysis by international brokers indicates that the impact will be manageable for most banks across Europe on the new core/equity/common Tier 1 capital calculations (although the outcome with the leverage ratio varies to a larger extent). Until the new rules have been formalised and their potential impact becomes more apparent, the market is likely to focus on its capital target expectations under the current capital framework. However, as we move through 2011 we could see it begin to distinguish between the capitalisation of banks under the revised rules.

As the detail of the proposed amendments to the CRD are agreed, institutions will be required to develop capital plans to ensure compliance with these higher standards. The PCAR targets set by the Central Bank were designed so that credit institutions would be well on the way to meeting the new CRD standards when they are implemented.

5.5 Credit

Overview

Credit risk makes up a significant proportion of the risk portfolio of the majority of Irish credit institutions. Experience globally, and particularly domestically, has highlighted the need to overhaul the regulation of credit risk across a number of headings. The most obvious issue in an Irish context, highlighted by both reports into the Irish banking crisis, is concentration risk (i.e. exposure to one sector or a number of sectors with a common predominant risk factor). We also believe a case exists for considering narrower single-obligor limits for systemically important institutions.

Lending by commercial banks needs to return to sound fundamentals and lending standards – what might be regarded as a traditional form of banking - with a focus on ability to repay and cashflow and conservative valuation of security. The Central Bank also needs to ensure that it has the capacity to analyse and challenge banks on credit policies, exposures and provisions supported by input from our economic departments on sectoral and wider economic risks driven by both national and international factors.

Concentration risk

Concentration risk is a Pillar 2 risk under the CRD which falls to be assessed as part of an institution's SREP. Concentration risk, which is generally seen as related to credit risk can also arise in the context of other risks (e.g. market risk). It arises from exposures to counterparties or groups of counterparties which have a common underlying risk factor (e.g. economic sector, geographical location, currency, linked credit risk mitigation measures).

In the case of lending by commercial banks, diversification (e.g. geographic spread, different business sectors, property type, rental income flow) and other arguments (e.g. securitisation) previously put forward as mitigants all need to be revisited and challenged by regulatory authorities. Banks need to have effective policies, systems and controls to identify measure and control their credit risk concentrations. As a banking regulator, the Central Bank needs to have the data, including appropriate economic analysis on correlations between countries and business sectors to establish the existence and extent of common risk factors, to challenge banks' assessment of concentration risk and assess the value of any potential mitigants.

Concentration risk which will be a key component of an institution's SREP is assessed using a number of stress testing techniques (e.g. stressed market conditions, economic downturns and funding stresses). Those institutions with more concentrated risks will be required to hold more capital. However, depending on the scale of the risk and the systemic importance of the institution, capital may not be the only supervisory measure we take. We will direct banks to reduce their exposures or alter their business strategies, including ceasing to lend to particular sectors, if we deem it appropriate.

Internationally, regulation of concentration risk is generally done on a case by case basis. In the case of systemically important credit institutions we plan to examine the possibility of imposing limits on sectoral exposure across the industry. We believe that the experience of the current crisis combined with the benefit of transparency, both in terms of banking supervision and wider economic policy, warrants its examination. Our Financial Stability department will research the merits of such a proposal – specifically, what sectoral classification would be appropriate, how granular it should be, which sectors should be linked, what diversification benefits should be recognised and how any hard limit might be measured. We set out in Chapter 6 a number of the issues surrounding sector specific limits.

Single obligor risk

Significant exposures to a single borrower or group of connected borrowers are restricted by the CRD Large Exposures Rules. As a result of the global financial crisis and the failure by industry and regulators to recognise underlying economic interconnectedness, amendments have been agreed to the CRD Large Exposure[xxiv] rules which are due to come into effect at end December 2010. The revisions to the large exposures regime seek to ensure the effectiveness of the regime and harmonisation across Europe by:

- Including certain exposures that were previously outside the regime (e.g. interbank exposures);

- Requiring entities to look through exposures that have underlying assets to ensure that all exposures are correctly identified;

- Providing additional guidance in relation to connected clients, exposures to schemes with underlying assets and reporting;

- Significantly reducing the national discretions; and

- Standardising definitions, reporting dates and reporting formats.

Subject to certain exemptions and conditions, the CRD rules continue to limit a credit institution's exposure to a client or group of connected clients[xxv] to 25% of the institution's Own Funds. Critical to the effectiveness of this limit is the manner in which clients are "connected". Given the difficulty, judgement and potential subjectivity in appropriately connecting clients, CEBS at the request of the EU Commission, developed detailed guidance on how to assess the concepts of control, economic interconnectedness and the treatment of exposures to underlying assets for large exposures purposes[xxvi]. Institutions will be required to comply with this guidance from end December 2010 to coincide with the related CRD amendments.

CEBS has also agreed detailed regulatory reporting requirements which will be mandatory across the EU from end December 2012. Irish credit institutions have been advised that the Central Bank plans to move to this reporting format early - with effect from end December 2010 – to facilitate better monitoring of the revised large exposures regime.

For the majority of credit institutions licensed by the Central Bank the 25% limit has proved adequate. Many of these banks are subsidiaries of large international groups and the exposure can be considered in the context of the financial strength of the group and the availability of group support in the event of difficulties. However, in the context of systemically important institutions we believe that a lower limit is appropriate given the potential impact on a credit institution should repayment difficulties arise for an exposure at that limit. The Central Bank will impose lower limits, where necessary, as a supervisory action following the SREP engagement. If we decide to adopt a standard lower limit for this sector of the industry we will consult with industry regarding a revised limit, the manner of its imposition and any transition arrangements should they be necessary.

Credit risk management, security and valuations

The Honohan report analysed, inter alia, the macroeconomic background to the banking crisis and specifically the role of banks. It notes, inter alia, that:

- "Overall, despite the traditional nature of lending during the period while prices rose, there was a distinct decline in loan appraisal quality for residential mortgages";
- "Lending to property developers also soared and much of it turned out to be unrecoverable thus proving to be a major weakness of the banks"; and

- "Complicated cross-collateralisation meant that banks were much more exposed then they seemed to have realised".

When granting credit an institution's main focus should be on repayment capacity. Security and collateral, while an essential component of prudent lending, should be viewed only a secondary source of repayment if the primary source, normal income or cash flow, proves inadequate. Insufficient analysis and assessment of credit applications and poor lending standards contributed to the global financial crisis - from sub-prime lending in the US to property related lending closer to home. As lending to property developers, and to a lesser extent private individuals and businesses, grew in Ireland credit institutions increasingly focused on collateral values, complex cross-collateralisation, profit sharing and personal guarantees to justify lending decisions.

Credit institutions must return to more prudent lending standards, in an economy that will not be driven by property. They must have credit policies, approved by their Boards, appropriate to their risk appetite.

In satisfying the requirement that credit institutions must have adequate internal controls, the CRD specifically requires in respect of credit risk that:

- Credit-granting shall be based on sound and well-defined criteria;
- The process of approving, amending, renewing and refinancing credits shall be clearly established;
- The ongoing administration and monitoring of their various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions, shall be operated through effective systems; and
- Diversification of credit portfolios shall be adequate given the credit institution's target markets and overall credit strategy.

Clearly loans need to be secured and collateral and, to some extent, guarantees are an essential part of banking. However, the quality of the security depends on valuation, ability to realise and the perfection of title.

Credit institutions must ensure that valuations are prudent, up-do-date and independent of the decision to grant credit.

In the case of significant loans, collateral should be reviewed on a regular basis and independently revalued as necessary.

Credit institutions must assess realisability and the resulting net proceeds. Complex arrangements for collateralisation, cross-collateralisation and profit sharing may require protracted legal action such that credit institutions cannot realise the security or overestimate its value, net of costs.

Credit institutions must ensure that the borrower has good title, there are no prior claims and all legal regulations (e.g. planning) have been complied with.

All legal documentation must be in order and completed as security has no value if it cannot be enforced.

Credit institutions' credit policies and procedures will be reviewed as part of our ongoing supervision. We will be undertaking quantitative testing of institutions' credit portfolios and assessing the quality and value of their security in order to inform our judgement of their credit policies, risk management policies and practices and the adequacy of their provisioning. This latter aspect was focused on in the Honohan report where the Governor noted that "provisions could be taken if there was any objective evidence of impairment" and that "regulators could have required more provisions to be taken, thereby inducing the bank to consolidate their capital, for example by limiting dividends, or by issuing new capital".

As part of our programme to overhaul the regulatory framework, the Central Bank will issue requirements on credit risk management including, valuation standards, in 2011.

Related party lending

Lending to related parties (i.e. directors, senior managers and persons connected to them), in particular where large sums are concerned, is a form of lending that has potential to give rise to conflicts of interest and abuse, bearing in mind the relationship between the borrower and the lender.

Specific cases of lending to directors and related parties have highlighted the need for detailed rules on limits, approval and monitoring of such lending. While this may not have been an industry wide issue, we believe that credibility of the regulatory regime and by association the reputation of the financial services industry will be enhanced by introducing rules under statutory and enforceable powers.

In May 2010 we issued a consultation paper on a Code on Related Party Lending which requires that such lending is on an arm's length basis, subject to appropriate and effective management oversight and limits and reported to the Central Bank on a regular basis.

We will finalise and impose the Code in October 2010.

5.6 Liquidity

Overview

Banks act to provide maturity transformation, holding assets (i.e. loans) with a longer term than liabilities (i.e. deposits and other sources of funding). This is a vital service to the wider economy, allowing businesses and households to hold longer term liabilities to finance asset purchases. This function can never be risk free. No regulatory regime can make it risk free nor can liquidity regulation provide liquidity - that is a function of markets or, in extremis, central banks as lender of last resort.

Liquidity regulation forces banks to plan for and manage liquidity separately, over the short, medium and long term based both on normal business trends and various stressed scenarios. Such regulation is designed to give them breathing space in the event of market disruption or a crisis.

Current requirements

The Bank's Requirements for the Management of Liquidity Risk were issued in June 2006 and updated in June 2009. In summary, the requirements are based on a maturity mis-match system which divides projected inflows and outflows into various time bands ranging from 0 – 8 days out to over 2 years. Ratios are prescribed in the first two time bands which cover the period out to 30 days such that cash inflows plus liquid assets must at least equal cash outflows in the period 0 – 8 days and be at least 90% of outflows in the period 8 – 30 days. We monitor ratios in subsequent periods to assist in liquidity planning and oversight. The Requirements also set out requirements in respect of stress testing, diversification of funding, management oversight, systems and controls, regulatory reporting and require the submission of an annual internal audit report on compliance with the Requirements.

Credit institutions are required to comply with CEBS Guidelines on Liquidity Buffers and Survival Periods[xxvii] on the maintenance of liquidity buffers. A liquidity buffer represents holdings of unencumbered assets by a bank that should be maintained for use in stressed conditions to ensure adequate funding even if exceptional liquidity outflows occur. These guidelines provide that credit institutions must stress test liquidity arrangements on the basis of (i) idiosyncratic risk, (ii) market risk, (iii) a combination of both, and that the buffer should be sufficient to give at least a one month survival period under the stress scenarios. Minimum stress scenarios include assuming no rollover of unsecured funding and some loss of retail deposits together with a decline in the liquidity value of some assets and deterioration in funding-market conditions.

We have to date not prescribed standard industry-wide liquidity stress tests. It is important not to over-simplifying the exercise and discourage banks from analysing where vulnerabilities may exist in their funding approach. Credit institutions are required to develop and set parameters for the buffer stress tests specific to their institution and its business model. The area of stress tests and their adequacy will be assessed as part of our ongoing supervisory engagement and the SREP. Prescription of minimum industry wide stress tests will be considered in the context of reviewing the Liquidity Requirements which we have scheduled for mid 2011.

Proposed changes to liquidity framework

The Central Bank's current Requirements for Liquidity Risk Management combined with the CEBS buffer are in keeping with the EU-wide qualitative requirements due to take effect at end December 2010.

CRD IV[xxviii] proposes quantitative harmonised EU-wide liquidity standards for credit institutions based on the Basel Committee proposals on liquidity which would become effective from January 2013.

These changes include the introduction of improved liquidity buffers, an increased emphasis on stable funding sources, standard monitoring tools and criteria for liquid assets. In summary:

- The Liquidity Coverage Ratio will require institutions to have sufficient high quality liquid assets to survive a severe stress scenario lasting one month.
- The European Banking Authority will be requested to develop technical standards specifying the criteria for liquid assets for the purposes of the Liquidity Coverage Ratio.
- The Net Stable Funding Requirement (NSFR) aims to ensure a sound funding structure over a one year horizon such that contractual obligations to fund have to be matched with sources of funding that can be considered stable over the same horizon. The initial proposals for the NSFR weight categories of funding available to credit institutions based on stability, with retail or SME deposits rating higher, for example, than wholesale funding.
- Standard liquidity monitoring metrics will be introduced to enhance monitoring and facilitate consistency. The monitoring will include contractual maturity mismatch, concentration of funding, available unencumbered assets and certain market based data.

The EU Commission is anxious to avoid a proliferation of national approaches to the technical requirements underpinning the CRD amendments and proposes that the new European Banking Authority should set out Technical Standards ensuring completeness and transparency of applicable rules at a European level.

Centralised liquidity management

The Bank's Liquidity Requirements, CEBS Guidelines and CRD IV proposals recognise that in the case of international banking groups, liquidity may be managed centrally and therefore consolidated regulation of liquidity risk may be useful. The Central Bank's view is that centralised liquidity management may be acceptable once it has been established that there are no impediments to the transfer of liquidity within the group and the relevant regulators are satisfied that the ability to move funds between entities would be resilient in a stress situation. It can only be considered on a bi-lateral case by case basis, following engagement with the consolidated regulator and taking into account, inter alia, whether a robust legally binding confirmation of liquidity support is forthcoming from the group, the business model, interconnectedness of the subsidiary with the group, the financial strength of the group and its systemic importance both in a Home State and local context.

Transition to the EU framework

In order to facilitate a smooth and timely transition to the EU liquidity standards we plan to:

- Advocate a transitional period that takes account of the quantitative and economic impact of the new requirement across EU and international markets;

- Require credit institutions to commence reporting, for monitoring and planning purposes, both the NSFR and Coverage Ratio from 1 June 2011;
- Introduce reporting of CRD standard liquidity monitoring tools from 1 June 2011;
- Require banks to provide us with funding projections from early 2011 taking into account (i) the CRD standards, (ii) market expectation of improved funding (iii) recapitalisation plans and (iv) possible deleveraging; and
- Comprehensively review our Requirements for the Management of Liquidity Risk in mid 2011 taking into account the EU liquidity framework which should by then be finalised with clear implementation timelines.

5.7 Conduct of Business

Introduction

The current framework for consumer protection for credit institutions consists of national legislation, codes of conduct and regulatory requirements introduced by the Financial Regulator. The main requirements are:

- Consumer Credit Act, 1995 (transposed the 1987 Consumer Credit Directive);
- Consumer Protection Code;
- Code of Conduct on Mortgage Arrears;
- Code of Conduct for Business Lending to SMEs;
- European Communities (Payment Services) Regulations 2009;
- European Communities (Markets in Financial Instruments) Regulations 2007; and
- Minimum Competency Requirements.

The Code came fully into effect in 2007 and is a set of General Principles backed up by more detailed rules in certain areas. The General Principles require firms to act in the best interest of the consumer and to act honestly, professionally and fairly. The Code also contains specific chapters on Banking Products and Services, Loans and Advertising. In keeping with the prudential regulation of lending, the Code introduced the concept of responsible lending. Three of the most significant measures that were included in the Code to embed responsible lending in the day-to-day activities of lenders are:

- The ban on the offering of unsolicited pre-approved credit facilities;
- The ban on increasing a consumer's credit card limit unless requested by the consumer; and

- The requirement to carry out the Know Your Customer and Suitability assessments before providing a consumer with a loan.

Compliance with all aspects of consumer protection is primarily undertaken through a themed inspection process. As with prudential regulation, the focus and depth of our consumer protection mandate will be re-evaluated and intensified.

Minimum competency requirements

The Minimum Competency Requirements were introduced in 2007 and established minimum standards across all financial services providers, with particular emphasis on areas dealing with retail consumers, including the provision of housing loans and consumer credit. They were introduced to ensure that consumers can expect a minimum acceptable level of competence from individuals acting for or on behalf of regulated firms. Individuals providing advice on or selling retail financial products, or undertaking certain specified activities, must have either a certain level of experience or hold a relevant recognised qualification. We have commenced a review of the Minimum Competency Requirements.

A consultation paper on our proposals in this area will be published in June 2010, with a view to the revised Requirements being published in March 2011. The main area where we are proposing changes is in relation to the CPD requirements. We are considering more detailed rules in this area, for example, specifying when a pro rata adjustment can be made and setting out the consequences of failure to comply with the CPD requirement. There are also proposals dealing with the requirement to make the Register of Accredited Individuals publicly available and the documentation to be provided to a "grandfathered" individual when moving from one firm to another.

Overcharging

Earlier this year we indicated that we would conduct a review of our approach to handling overcharging issues. While previously we have sought to ensure that overcharging errors are dealt with speedily, efficiently and fairly, our focus in dealing with charging issues is now moving to setting deadlines for communicating with customers and providing compensation, making it clear that enforcement action will follow if our timelines are not met. Enforcement action may also be taken where a firm fails to implement adequate systems and controls to ensure compliance with the Code.

Consumer Credit Act 1995

Section 149 of Consumer Credit Act, 1995, as amended, requires banks and building societies, to notify the Central Bank if they wish to:

- introduce any new customer charges (this may be as a result of producing a new financial product); or

- increase any existing customer charges.

The Central Bank reviews these notifications and either rejects the proposal, approves the proposal but at lower levels than requested by the firm or approves the charge in full. The Central Bank assesses each submission based on the following, as set down in legislation:

- the promotion of fair competition;
- the impact new charges or increases in existing charges will have on customers; and
- how the bank justifies its proposed new charges or increase in existing charges.

As credit institutions restructure and implement new business strategies with a greater focus on the domestic market we expect that we will see institutions reviewing their pricing model. In light of the changing market conditions we have decided to review how we process and assess submissions for approval of charges. This review, which will commence in September 2010, will consider whether we:

- Need to get more or different information on submissions;
- Should consult with consumer bodies/interests on proposed charge changes; and
- Should review proposed changes collectively for an institution rather than individual product applications.

We will engage with relevant stakeholders, including the Department of Finance, in relation to our proposals for amendments to the operation of this provision further to the completion of this review. If we believe legislative amendments are necessary proposals will be put to the Department of Finance.

Consumer Protection Code

We have already committed to review the Consumer Protection Code. Specific issues will be under consideration as part of this review, quite apart from reviewing the operation of the Code to date, including:

- Incorporating new provisions in relation to product development/design and risk, particularly in relation to the information to be provided to consumers;
- The incorporation of the voluntary Switching Codes into the Code; and
- The incorporation of the recommendations of the personal current account and credit card transparency projects into the Code.

We intend to publish a consultation paper setting out our proposals in September 2010 and aim to publish the revised Code in June 2011.

Code of Conduct on mortgage arrears

Due to the high level of mortgage arrears, we have decided to review the Code of Conduct on Mortgage Arrears ("CCMA"). We will reword the provisions for clarity where required. We are also considering including new provisions in the CCMA to assist customers who anticipate falling into mortgage arrears and to protect those in arrears from harassment by lenders. As part of the review, we will also consider any relevant recommendations which are produced by the Government's Mortgage Arrears and Personal Debt Advisory Group.

In order to increase the protections available to those in mortgage arrears, we may re-issue the CCMA in advance of the completion of the Code review. However this decision will be influenced by the recommendations of the Mortgage Arrears and Personal Debt Advisory Group, which are expected in the near future.

Switching Code

In light of the high number of bank branches closing and the withdrawal of a number of retail banks from the State, we intend to put the current voluntary Codes on switching current accounts – one for personal customers and one for SMEs – on a statutory footing. We plan to do this in advance of the completion of the Code review and to consult on any proposed changes to the Switching Codes as part of the public consultation on the revised Code.

Consumer Credit Directive

The new Consumer Credit Directive on credit agreements (referred to as the new CCD), which replaces the 1987 Directive, was transposed on 11 June 2010. It is intended to facilitate cross-border sourcing of credit and aims to open up the internal EU market through increased transparency for consumers. This maximum harmonisation Directive applies to credit intermediaries as well as credit institutions.

The Directive applies to credit amounts ranging from €200 up to €75,000 (both figures inclusive). Certain types of credit agreements are excluded from the scope of the Directive, including mortgage credit agreements, hiring and leasing agreements, overdraft agreements where the credit is to be repaid within one month, deferred payment agreements not attracting any interest, and pawn broking agreements.

In order to comply with the Directive, credit institutions will have to:

- Issue a standard Single European Consumer Credit Information (SECCI) form to allow consumers to compare the cost of credit;
- Assess the creditworthiness of the consumer;
- Inform the consumer if they have been rejected on the basis of a creditworthiness check; and

- Provide additional information to the consumer (both pre-contractual and within the credit agreement).

We will also have to cease application of certain provisions of the Code to ensure that there is no conflict with, or "gold plating" of, the requirements of the Directive.

The prudential and consumer protection frameworks work together to ensure that a holistic approach is taken to the regulation of credit institutions and other firms. This will also be reflected in our new risk-based regulatory model.

Chapter 6 – Domestic structural issues

6.1 Future structure of the domestic savings industry

This paper describes our future approach to banking supervision. It also sets out possible policy reforms. In presenting these changes, we have not assumed that the savings industry, of which the banks are the most important part, will retain its current structure or scale. The actions taken to help resolve the crisis are already leading to a smaller but more strongly capitalised banking system.

In fact, we expect the savings industry to look different, possibly markedly so, in the future. These changes will reflect the effects of the crisis, the need for banks to re-focus their lending from households to businesses, the likely impact of mergers between credit unions, and the impact of foreign competitors entering the Irish market.

During the past three years, the public authorities in Ireland have worked together to resolve the crisis in the banking system. We will continue to collaborate to resolve issues as they arise. Naturally, however, the focus of the public authorities will increasingly be on the future structure of the savings industry in Ireland, with the central question being how the borrowing and savings needs of households and businesses can best be met in the interests of the real economy.

We are already taking actions designed to deliver this objective. Our Prudential Capital Assessment Review ("PCAR") is leading to much higher levels of capital in the banking system. We are evaluating the capacity of banks to lend to businesses outside the property sector, and we will require changes where we observe deficiencies. In the credit union sector, while a differentiated approach is appropriate, we believe further strengthening of the prudential regime is necessary to ensure that individual credit unions hold adequate financial resources. Taken together, these measures create the foundations for a strong savings industry and, in turn, sustainable economic growth.

It is clear, though, that further reforms will be required, either in response to specific private sector proposals (for example, for mergers or acquisitions in the savings industry), or at our initiative.

To drive forward this initiative we are working collaboratively with other relevant agencies to review the future structure of the Irish savings industry and make recommendations for further reforms. This initiative is also addressing other matters, including:

- Proposals for consolidation, at all levels, within the Irish savings industry;
- Proposals to enhance competition;
- Proposals to reform the ownership structures of financial institutions within the savings industry;
- Proposals to reduce barriers to entry for non-Irish savings institutions; and

- Proposals to enhance the flow of credit to non-property sectors within the economy.

6.2 International Financial Services Sector

The global financial crisis has required a strengthening of our financial stability assessment for projects or proposals in the International Financial Services Sector (IFSS). We believe an approach based on four key pillars will be compatible with the continued growth and success of the financial services industry in Ireland while ensuring that the financial system is not exposed to systemic failure or the Exchequer to potential loss from failures of large international financial firms.

- Regulatory mitigants already exist and will be enhanced to minimise the risk of failure of a large or complex institutions (e.g. high regulatory capital, limits on the nature of the business and allocation of sufficient supervisory resources, development of an improved Risk Assessment Model).
- The Exchequer's exposure to the potential failure of a large institution could be minimised through the establishment of ex ante burden-sharing arrangements across Europe. While there is currently little appetite in several countries for such arrangements, we will continue to take advantage of opportunities to promote such burden-sharing. Absent burden-sharing, we need to make it clear to other regulatory authorities, and to the market in general, that there is no implicit State or Central Bank guarantee in the event of subsidiaries or branches of IFSS firms failing whether in Ireland or in other jurisdictions.
- We will review the existing deposit protection and insurance compensation funds to ensure that costs are borne fairly, that arrangements work well across borders and that the Exchequer is not exposed to extraordinary funding requirements. We will also support proposals at EU level to create EU-wide insurance compensation schemes.
- There may be some institutions in the world – though only a very small number - which, due to their scale, geographic coverage, type of business and opaque structures, the Central Bank would be unable to concede to business plans that would place Ireland as a responsible supervisor for a significant part of their businesses.

In developing supervisory responses to systemically important financial institutions, we will be guided by the outcome of the debate at international level (see Section 7.2).

6.3 Credit register

Credit information, relevant both for supervision and for improved credit appraisal by lenders, is a key resource for any banking system. Ireland has not followed the model of many continental European countries in operating a centralised Credit Register. The Central Bank nevertheless believes that the infrastructure for credit information could be improved, whether through establishing a Central Credit Register or by strengthening the legislative framework under which private registers may operate.

A well constructed Credit Register to which credit institutions are obliged to report has the potential to be an important tool for both regulatory authorities and the banking industry. In accordance with the CRD, credit institutions are required to report large exposures to the Central Bank. In addition, the Central Bank requires reporting of the top 30 exposures of each credit institution on a quarterly basis. As mentioned above, credit institutions are obliged to identify "connections" between different exposures and the report is based on these connected exposures. While this regulatory reporting provides significant information, there are a number of shortcomings:

- Credit institutions must themselves make the connections between exposures based on CEBS guidance.
- Where a borrower has exposures among various institutions, the level may be such that it falls below the reporting threshold. This means that the authorities do not necessarily have a complete picture of large exposures.
- Industry-wide information is not available to individual banks.

A Credit Register could be made responsible for making the "connections" which would act as a check on the credit institution's compliance with large exposures limits and reporting. In addition, if credit institutions were obliged to report all lending, or lending above a prescribed level to a Credit Register, a more complete picture would be available. Industry access to data would be essential if the benefits of a Credit Register are to be fully realised. The only Credit Register currently operating in Ireland is the Irish Credit Bureau ('ICB'). However, as the ICB focuses on retail and SME lending and data are provided on a voluntary basis, as currently structured it would fail to deliver as a Central Credit Register.

The maintenance of high quality, accessible and reliable credit history information also brings significant benefits for consumers. It allows for greater competition both from among existing lenders as well as new lenders by bringing transparency to the market. It helps to ensure that those consumers who have a positive credit history can benefit from having a good track record. It also assists lenders in ensuring that any lending is suitable and affordable including for those consumers who have had difficulty in the past with keeping up repayments.

Legislation may be required to provide a suitable framework and data protection issues would need to be fully addressed. While a Credit Register could be operated under the auspices of a public body, we do not see this as the only approach. One such option could be:

- Credit bureau/x licensed by the Bank;
- Mandatory reporting by all regulated lenders operating in the State;
- Credit bureau/x required to share information with the Bank; and
- Credit bureau/x to provide data to lenders on commercial terms.

We will explore the options further with interested parties during the remainder of 2010 and make recommendations in early 2011.

6.4 Special Resolution Regime

The global financial crisis has highlighted weaknesses not only in financial supervision and regulation but also revealed gaps generally in legislative regimes for dealing with distressed financial institutions. In Ireland, the winding-up or restructuring of a distressed credit institution, absent nationalisation, is dealt with under general company law through the appointment of either a liquidator or an examiner. Such 'normal' insolvency procedures are not well suited to ensuring the necessary continuity of banking and payment systems nor do they cater for the complexity and inter-connectedness of modern financial institutions. In the banking sphere where one of the essentials in working to deliver an orderly winding-up or restructuring is to avoid "a run on the bank", clarity and speed of delivery are vital. For depositors a mechanism for the resolution of commercial banks is essential. The IMF 2009 Article IV Consultation with Ireland noted that a "special resolution regime for financial institutions would facilitate a speedy and less disruptive resolution of distressed banks". The Minister for Finance has also commented on the need to have "a range of tools to protect deposit holders and ensure that we can deal effectively with problem institutions and at the same time maintain the confidence of the international markets".

The liquidation of any credit institution is a complicated and protracted process. Eligible depositors will be entitled to a timely compensation payment from the Deposit Guarantee Scheme. From 31 December 2010, payment must be made to eligible depositors within 20 working days of the entry of a credit institution into liquidation. Despite this, depositors may seek immediate access to their deposits. Equally, it is not realistic to expect that depositors or other sources of funding will remain with a bank on the appointment of an examiner while waiting a number of weeks for accountant's reports and viability assessments.

On foot of the Banking statement from the Minister for Finance on 30 March 2010, we are working closely with the Department of Finance to develop legislative options in the area of special resolution. While the priority is to provide the necessary tools to deal quickly and effectively with distressed deposit taking institutions, this could be developed over time to extend to other financial institutions.

In addition, the Deposit Guarantee Directive is currently under review by the European Commission and it is expected the Commission will publish proposals to revise the Directive in July 2010.

At EU level, the Commission has issued a Communication on an EU framework for cross-border crisis management in the banking sector to allow the relevant authorities to manage financial crisis events at cross-border banks. The Commission is expected to bring forward legislative proposals in Spring 2011. The Minister for Finance has announced that, as part of the reform package for financial regulation and longer term planning, he is examining options for the introduction of a legislative regime to deal in a systematic way with distressed financial institutions. The objectives of a Special Resolution Regime (SRR) are to safeguard against financial instability, protect depositors and minimise/eliminate the impact on public funds in the event of the failure, or likely failure, of a credit institution. Internationally, SRRs are seen as a mechanism to provide powers to the relevant authorities (e.g. Central Banks, Regulatory Authorities) in some or all of the following areas:

- The transfer of all or part of the business of a credit institution to a willing 3rd party (i.e. an existing licensed credit institution);
- The establishment of a "bridge bank" which would have to be authorised, capitalised, managed, operated and supervised as a licensed credit institution subject to relevant legislation;
- Temporary public ownership;
- A Special Administration Procedure whereby the Central Bank could appoint an administrator to take over the management of a credit institution with a view to either placing it on a sound financial footing or to achieving a better result for the credit institution's creditors than would be likely if the credit institution was immediately wound up;
- The splitting of a distressed bank into a "good bank" (a going concern) and a "bad bank" (a gone concern) including powers to move deposits to a good bank (either existing or newly established) such that depositors can access their funds; and
- A Special Insolvency Procedure whereby the Central Bank may apply to the Court for the appointment of a special liquidator to a credit institution. The Special Liquidator's primary objective would be to ensure payment of compensation is made as soon as reasonably practicable, or that depositor's accounts are transferred to another financial institution.

Work is currently underway with the Department of Finance to examine the scope of any regime and the powers that might be appropriate for inclusion in it. It is clear that significant legislative, policy and commercial issues will need to be carefully examined in the coming months in moving forward on the design of a possible SRR for Ireland.

6.5 Consumer credit limits

Consumer credit markets in Ireland are highly developed, and consumers' ability to access to credit largely unfettered. This allows households to borrow from a range of sources to meet consumption requirements.

The Consumer Credit Act 1995 provides a framework for the regulation of consumer credit including requirements on advertising, credit agreements and rights both during the period of the agreement and on termination of the agreement or default. The legislation is supplemented by the Central Bank's Consumer Protection Code which includes requirements on knowing the customer, the suitability of the product or loan for the handling of customer and complaints.

However, there is no direct regulation of credit limits, for example through restrictions on Loan-to-Value (LTV) ratios or the imposition of a maximum multiple of net disposable income. This has meant that Irish households have been able to accumulate liabilities more easily than consumers in countries where there is direct regulation of credit, for example in France or Germany. We must take account of the absence of such 'dampers' in our supervision of banks.

We anticipate that, as part of a series of legislative amendments following the restructuring of the Central Bank, we will be given broader regulatory powers which would include the ability to prescribe lending limits. We believe there is a case for further examination of whether liberalised consumer credit markets can work against financial stability across the economic cycle. Clearly the impact on consumers and the wider economy will also need to be factored in. This is a complex issue. We therefore propose only to bring forward recommendations following a process of research and consultation.

6.6 Sectoral concentration limits

As set out in Chapter 3, we plan to examine the possibility of imposing standard industry-wide limits on sectoral exposures for systemically important credit institutions. These could be absolute limits or limits which automatically trigger additional capital charges. While concentration risk can arise across a credit institution's business including market and operational risk, our primary focus for the purpose of this exercise will be on credit risk.

The Honohan report, in discussing the imposition of sectoral limits, noted that "Albeit old-fashioned, this kind of rule would, if enforced, have been quite effective in slowing the bubble." However, it goes on to acknowledge that "experience shows that quantitative credit limits can be circumvented fairly easily".

Given the steps taken to address the banking crisis, this may not be an immediate concern. However, as part of a supervisory framework designed to prevent similar issues arising in the future we believe it warrants examination. Predetermined limits would have the added benefit of transparency and clarity in terms of bank strategies and wider economic policy. Clearly such limits would not be our only tool in assessing concentration risk and the underlying exposures would need to be examined on a bank by bank basis. Issues to be addressed in developing a stable valid methodology for imposing predefined limits include:

Sectoral classification

A prerequisite for the introduction of standard sectoral limits is a suitable sectoral classification which recognises relevant risk factors such that exposures within different classifications are highly correlated. Where there are common risks between different classifications these also need to be recognised. While data on lending to different business sectors is collected for statistical purposes, these were not developed for risk measurement purposes and may not appropriately link sectors whose credit risk has a common predominant risk factor.

Regional exposures

Regional exposures or country risk, a component of concentration risk, recognises the potential risk related to the economic, political or social environment of the region or country. In this case the issue is deciding on the level of detailed breakdown of countries or regions and the interdependencies and possible contagion effects between individual countries.

Stability of Correlation Estimates

Predetermined limits must be set, or reset, at particular points in time. However, the interdependency or correlation between different sectors, regions or countries inevitably changes to some degree. The challenge is to establish correlation estimates which are stable and valid over a reasonable period.

Hedging mechanisms

Depending on the business model and the sophistication of their risk management techniques, credit institutions may seek to limit or hedge certain exposures (e.g. through the purchase of credit derivatives). The extent to which recognition might be given for such risk management needs to be considered. Failure to give any "benefit" for such risk management effectively penalises institutions with a strong proactive approach to risk management and acts as a disincentive to implement such a framework. However, recognising such mitigants in a formulaic industry-wide approach does not take account of the quality and effective matching of individual institutions risk mitigation techniques with their underlying risks.

Intra-Group Diversification

Consideration would also need to be given to the extent to which diversification benefits in a Group context should be recognised. Where the Central Bank is both the supervisor of an individual institution and the consolidated supervisor of the Group in question, a view of the Group's concentration risk could be taken and the option would be available to impose the limits at a consolidated level. However, if an institution, which is a subsidiary of an international group, is viewed as systemically important should standard limits be imposed at an institution level without considering the concentration risk profile of the wider group?

Specialist business models

Certain business models wil,l by their nature, be concentrated and depending on the measurement and/or method of enforcing sectoral concentration limits, such models could effectively be prohibited. For example, traditional building societies given their objectives have exposures concentrated in residential property with the additional complexity that these may be exposed to country or regional risk. Counterbalancing this is the fact that the exposure to the sector would generally be composed of multiple relatively small individual exposures. Other institutions with significant property exposures may have a different borrower profile. Capturing the specificities of different business models, the profile of its borrower base and the appropriate approach to capital can be examined on a case by case basis. An industry standard metric is more problematic.

This is a highly complex issue. We will only bring forward recommendations following a process of research and consultation. We aim to issue a consultation paper in Q1 2011.

6.7 Composition of boards of directors for systemic banks

We recently consulted on wide-ranging changes to our regulatory regime for board members and senior executives. We expect that, when finalised, our proposals will improve governance standards across the banking and insurance sectors.

As the banking system emerges from the crisis, it is clear that banks will re-structure their business models, leading them to engage in new areas of commercial activity. This will require banks to refresh their boards so that they include individuals with relevant skills, knowledge and experience. Some of these new members will be found in the domestic market. We consider, though, that a proportion will have to be found outside Ireland. We consider that a better balance between domestic and internationally qualified board members will be of benefit to banks, their customers and the system as a whole. There is some evidence from the crisis to support this proposition.[xxix]

We do not propose to introduce specific rules on these issues. We expect banks to address these matters themselves. We will, though, seek to address it through our supervisory process; and we will also consider these issues as we roll-out the new fitness and probity regime.

6.8 Licensing 3rd country (non-EEA) branches

The Central Bank Act, 1971 provides the power for the Central Bank to license credit institutions to operate in Ireland. Licences may be granted to the branch of a bank that is not licensed in another EU Member State, hereafter referred to as a 3rd country branch. Branches of EU incorporated banks are excluded from this provision because EU Directives provide a legal framework by which banks licensed by one EU Member State ("the Home State") may establish branches in other Member States ("the Host States") by a simple notification procedure. In the case of EU branches, prudential supervision remains primarily the responsibility of the regulatory authorities of the Home State.

Currently only one bank, which commenced operations in Ireland in the 1960s, is operating on a 3rd country branch basis. From an authorisation and supervision perspective the lack of an incorporated entity in Ireland presents difficulties in imposing standard regulatory requirements. For example, (i) regulatory capital requirements cannot be imposed on branches as they are imposed and assessed at the level of the incorporated entity (ii) the board of directors of a 3rd country branch is, by definition, located outside the jurisdiction and subject to corporate governance and remuneration requirements of another regulatory authority. This disconnect between our supervisory responsibilities and our powers limits our ability to impose and enforce the standard regulatory framework.

EU directives recognise the peculiarities associated with licensing on a 3rd country branch basis. While the directive provides that countries may facilitate licences on this basis it specifically prohibits their "passporting" into other Member States on the basis of such a licence. Our policy will remain that we are not favourably disposed to applications for bank licences on a 3rd country branch basis.

6.9 EU branches

EU banking directives, most recently the CRD, provide for the freedom to provide services and the right to establish branches on the basis of authorisation by a regulatory authority in any EU or EEA Member State, commonly referred to as "passporting". The establishment of bank branches in other Member States ("host countries") is a simply notification procedure and there is no formal mechanism for a Host Member State to refuse to accept such a notification.

The regulatory framework can be summarised as:

- Prudential regulation of branches remains primarily with the Home State;
- Host Member State authorities have responsibility for liquidity regulation, in co-operation with Home State authorities; and
- The deposit protection regime of the Home Member State applies to depositors in Host States except to the extent that the credit institution may have opted to "top-up" by joining the deposit protection scheme in a Host State where that gives a higher level of protection to local depositors.

The global financial crisis has brought into focus concerns regarding the EU branch model of banking on a cross-border basis. Where the Home State is unwilling or unable to resolve a crisis encompassing individual institutions with branches abroad or where its deposit protection scheme is insufficient to fund deposit insurance payments, the crisis becomes a local Host State crisis. There is broad agreement that the regulatory framework has to change but there are different stances on what that change should be – all responsibilities to move to the Home State authority or more powers devolved to the Host State regulatory. The EU has taken some measures to address these concerns including:

- Harmonised the deposit protection arrangements across Europe;
- Introduced a new regulatory structure based on the De Larosiere report including the establishment of a European Banking Authority and a European Systemic Risk Board under the auspices of the ECB;
- Reinforced the role of Colleges of Supervisors by putting them on a legal footing and putting greater emphasis on supervisory co-operation;
- Requiring greater information sharing particularly with Host regulatory authorities for significant branches; and
- Provided, through the CRD, that Host State authorities can take unilateral action against branches in emergencies.

An approach of forcing banks to establish on a subsidiary only basis is being pursued in some quarters – "subsidiarisation" – followed by the imposition of capital and liquidity add-ons and in some cases restrictions on these subsidiaries upstreaming capital or liquidity. The EU Commission maintains that limiting the choice of institutions, either directly or via incentives to adopt a particular business model, would constitute a breach of the EU Treaty.

It can be argued that the establishment of a subsidiary, rather than a branch, does not of itself protect against failure and any associated depositor exposure. A subsidiary is not necessarily easier to isolate or disentangle from the wider group structure - it may be dependent on the Group for liquidity, support services (e.g. IT) and/or business. For subsidiarisation to deliver the benefits, espoused by its proponents, the subsidiaries need to be "standalone subsidiaries" with strict controls on intra-group business, no group outsourcing of support functions and no reliance on the group for funding. However, even this will not insulate a subsidiary from the reputational impact of issues at Group or parent level.

Subsidiarisation may facilitate easier restructuring in the event of a crisis and may impose greater discipline and accountability on management and controls at the subsidiary level. However, in the extreme there is a higher moral hazard that a parent bank may find it easier to walk-away from a subsidiary increasing the risk of failure and a call on the local deposit guarantee scheme. In addition, groups may become very cautious about entering new markets, particularly smaller countries, that risks a move away from EU economic integration.

Further discussion on subsidiarisation will continue for some time within the EU and the various financial services committees with a view to agreeing a framework for crisis management. On balance the benefits to the Irish economy from operating within the established EU framework for financial services, including the presence of EU branches, supports a policy of continuing to facilitate the freedom of establishment, pending any changes in EU legislation.

Chapter 7 - EU and international initiatives

7.1 Introduction

Ambitious work programmes have been developed by the EU and the Basle Committee on Banking Supervision to meet the G20 commitments. The EU's roadmap includes:

Transparency

AIFM Directive (hedge funds and private equity)
Initiative on derivatives and initiative on short-selling
Revision of the Markets in Financial Instruments Directive

Responsibility

Framework for remunerations (CRD III)
Revision of the Deposit Guarantee Scheme Directive
Revision of the Market Abuse Directive
Strengthening capital requirements for banks (CRD IV)

Supervision

Creation of a European Framework for Supervision
Credit Rating Agencies

Crisis Prevention and Management

Reforming corporate governance
Creation of a crisis management framework
Making accounting standards less pro-cyclical

A number of these issues are beyond the scope of this paper while others have been covered in earlier chapters. In this chapter we focus on two issues which will directly impact on how we supervise credit institutions – Systemically Important Financial Institutions and the establishment of the European Banking Authority and the European Systemic Risk Board.

7.2 Too Big to Fail

The scale of the financial crisis and the need for government interventions has focused attention on crisis management arrangements, particularly the difficulties associated with the collapse of Systemically Important Financial Institutions ('SIFI'). The fallout of the failure of Lehman Brothers is a clear demonstration of "too big to fail/too big to rescue".

The financial crisis led governments to take exceptional measures to protect banking systems. However, such interventions cannot continue in perpetuity. As economic and financial market conditions stabilise, we will need to structure policy towards the financial sector so that financial institutions can, in controlled circumstances, be allowed to fail.

Given the interconnectedness of banking and global markets the issue clearly needs to be considered in an international context. The Financial Stability Board (FSB) in response to a G20 request has developed "Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Infrastructure: Initial Considerations" to provide a framework for identifying SIFIs. While it may assist judgements which need to be made in a crisis, it is primarily intended to assist in "assessing systemic importance in normal times for the purpose of mitigating the exposure of the system to the risk of failure of systemic components and enhancing the financial system's resilience to shocks". The FSB identifies three criteria to measure the scale of the potential impact of the failure of an institution, or group of institutions, on the financial system and real economy:

- Size. The importance of a single component for the working of the financial system generally increases with the amount of financial services that the component provides.

- Lack of substitutability. The systemic importance of a single component increases in cases where it is difficult for other components of the system to provide the same or similar services in the event of a failure.

- Interconnectedness. Systemic risk can arise through direct and indirect linkages between the components of the financial system so that individual failure or malfunction has repercussions around the financial system, leading to a reduction in the aggregate amount of services.

These criteria have garnered broad international acceptance among regulators and other authorities. Clearly, assessments of systemic importance will change over time. Institutions which may be considered systemically important in the throes of a global financial crisis may not be considered systemically important during more normal market conditions. The criteria and the analysis/metrics underpinning them will be factored into our Risk Assessment Model (see Chapter 3) which will in turn drive our approach to the supervision of individual institutions. Agreeing how to identify SIFIs and accepting that national regulatory authorities and colleges of supervisors need to review, and in most cases, change the approach to their ongoing supervision is the relatively straightforward part of the process. Agreement among policymakers on the wider issue of "too big to fail" and crisis management is divided. Views range from those who believe that large complex groups are unavoidable and are more focused on agreeing a mechanism for orderly wind down and burden sharing to others who focus on policies aimed at reducing the risk of failure.

There is broad acceptance of the desirability of requiring institutions to prepare 'living wills'. Living wills require financial services groups or institutions to prepare plans for their own orderly wind down in the event of a financial crisis. While regulators are requiring institutions to develop living wills this is not a straightforward process and, taken to its ultimate conclusion, would require the break-up or fundamental restructuring of many international groups. While they go some way towards a better framework for cross-border bank resolution, other approaches are also being considered. The US "Volcker Rule", which would prohibit proprietary trading at deposit taking commercial banks, does not have universal support. The UK authorities support for capital surcharges for SIFIs would appear not to have the full support of other EU members who argue that there are benefits in having large diversified universal banks.

The Basle Committee Report and Recommendations of the Cross Border Bank Resolution Group builds on some of these ideas recommending national resolution frameworks/powers, better coordination and crisis planning among relevant regulators, simplifying group structure where necessary and preplanning exit strategies in the event of State support.

Ultimately this will require international consensus on the solution or range of solutions.

From an Irish perspective, after recapitalisation and any restructuring by the main domestic banks, we will be requiring these groups to develop living wills. As the regulator of international banking subsidiaries in the IFSC, we will pursue the issue of living wills in co-operation with other regulators either bi-laterally or via colleges of supervisors. On the wider issues we will continue to engage in the debate in EU and international fora.

7.3 EU regulatory architecture

On 23 September 2009, the Commission published 5 legislative proposals, based on the De Laroisere[xxx] proposals, aimed at reforming the supervision of financial services in the EU by establishing a European Systemic Risk Board (ESRB) and a network of European System of Financial Supervisors (ESFS) consisting of:

- Three new European Supervisory Authorities (ESAs) - the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) to replace the three existing committees (CEBS, CESR and CEIOPS);

- The national supervisory authorities (responsible for day-to-day supervision of banking, securities, insurance and pensions in member states); and

- A Joint Committee of ESAs to cover cross-sectoral issues and reach common positions.

The principal tasks of the ESRB will be:

- To identify and assess risks to systemic stability in the EU's financial system;

- To issue risk warnings where systemic risks are deemed to be significant; and

- If necessary, to recommend specific remedial actions to address identified risks including, where appropriate, legislative initiatives.

If systemic risks are identified the General Board, the main decision-making body of the ESRB, can issue warnings or recommendations to the Community as a whole, to a group of Member States, to an individual Member State, to one or more of the ESAs, to one or more national supervisory authorities or to the Commission on EU legislation. While recommendations will not be legally binding, addressees are expected to act on them unless inaction can be adequately justified ("act or explain").

The Governor and Mr Matthew Elderfield, Head of Financial Regulation will represent Ireland in the General Board as a national central bank and as a competent national supervisory authority.

The new ESAs will take over all the functions of the CEBS (including the issuance of non-binding guidelines and the ability to give advice on certain issues), in addition they will also be:

- Developing proposals for binding technical standards which, once they are confirmed by the Commission, will apply directly across the EU;
- Resolving cases of disagreement between competent authorities in cross-border situations where legislation requires them to co-operate or agree;
- Contributing to ensuring consistent application of EU rules;
- Adopting individual decisions addressed to a financial market participant requiring action to comply with EU legal obligations where there is a breach of EU law; and
- Providing co-ordination between national competent supervisory authorities in Emergency Situations.

On 10-11 December 2009, the European Council welcomed Ecofin (Finance Ministers of the EU Member States) agreement on the complete package for a new EU supervisory framework. The framework is scheduled to be up and running at the start of 2011.

The European Parliament is currently considering the detailed draft regulations establishing the European Supervisory Authorities and the ESRB. CEBS is progressing structural, procedural and staff changes to aid a smooth transition to the EBA. Jonathan McMahon, Assistant Director General, Financial Institutions is the Central Bank's CEBS member and will be our representative on the EBA.

We have strongly supported the proposals to establish the ESRB as an important step at European level to mitigate macro-prudential risks arising in the future. The new supervisory authorities will mark a significant change in the structure of regulation in Europe. The scope for variation in regulatory approach will narrow progressively and there will be a clear obligation to conform to practices and procedures adopted or recommended by the particular Authority. We are committed to playing an active and influential part in the future of European financial services supervision.

Annexes

Annex 1 – responding to "The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008" report

Summary of micro-prudential and financial stability related issues raised in the Honohan report	Response
Micro-prudential policy	
Relying excessively on a regulatory philosophy emphasising process over outcomes, supervisory practice focused on verification of governance and risk management models within the institutions rather than attempting independent risk assessments.	▪ Risk based, more asserting and challenging approach to supervision. ▪ Introduction of a Risk Model. ▪ Enhanced Supervisory Review and Evaluation Process incorporating quantitative and qualitative analysis, rigorous stress testing and increased focus on business models/strategies. ▪ Establishment of a Prudential Analytics Unit to support supervisors. ▪ Establishment of a Regulatory Transactions Department where all processing of regulatory returns and routine regulatory transactions will be centralised with common risk-based processes. *(See Section 2.2 and 3.2 for further details)*
Shortcomings in governance and risk management structures within credit institutions which allowed a **much greater accumulation of risk than the bankers had envisaged or indeed that they seemed to recognise**.	▪ Introduction of Corporate Governance Requirements. ▪ Statutory Fitness and Probity Regime. ▪ Interview process for proposed appointees to senior positions. ▪ Introduction of Remuneration Requirements for the Financial Services Industry. ▪ Introduction of Internal Governance Requirements. ▪ Introduction of credit risk management and valuation standards. ▪ Auditor regulatory assurance on internal governance including risk management. *(See Section 5.2 and 5.5 for further details)*
Reliance on assessment of systems, structures and models, **downplayed quantification of risks.**	▪ Implementation of a risk model reflecting quantitative and qualitative data to facilitate in-depth financial analysis, peer group analysis, performance tracking and the development of early-warning indicators. ▪ Enhanced Supervisory Review and Evaluation Process underpinned by quantitative assessment and challenge and rigorous stress testing. ▪ Introduction of a "Risk Dashboard" for each institution to provide a concise portrayal of the risk profile, business model and how they have evolved over time. *(See Section 3.2 for further details)*

Summary of micro-prudential and financial stability related issues raised in the Honohan report	Response
Broadening the scope and intensifying supervision, especially its quantitative aspects, would have required considerable **additional staff resources and training to help offset the asymmetry in skills vis-a-vis the regulated institutions.** It was already difficult to staff-up to intended levels given the high salaries and plentiful job opportunities available at the time in the private financial sector. Only a small number of staff within the FR were directly involved in the prudential supervision of credit institutions – no more than two per major firms.	▪ Increase staffing to approximately 1,500 by 2012. ▪ Recruit specialist expertise with direct business/banking experience. ▪ Minimum ratio of 10 supervisory staff to major institutions. ▪ Flexible personnel policies including contract appointments and secondments. ▪ Compulsory training programme. ▪ Establish Risk Panel *(See Section 2.3 for further details)*
Even if armed with the necessary information, to be effective there would have had to be a **greater degree of intrusiveness and assertiveness** on the part of regulators in challenging the banks.	▪ A more assertive, risk based and challenging approach. ▪ Strengthened Supervisory Review and Evaluation Process. *(See Section 3.2 for further details)*
There was **a pattern of inconclusive engagement** on the part of supervisors with regulated entities and lack of decisive follow-through.	▪ Clear channels and systems for escalation of regulatory issues and agreeing regulatory action. ▪ Supervisory culture with a will to question, intervene and act. ▪ Insistence on action to mitigate risk – immediate or with a clear plan and timelines. *(See Section 2.6 and 3.2 for further details)*
The appetite for legal challenge was limited which meant that in practice entities were given the benefit of the doubt.	Establishment of a dedicated Enforcement Directorate with investigative expertise and ability to deliver a credible threat of enforcement action. *(See Section 2.2 for further details)*
Overall financial stability policy	
Although the FSRs included significant analytical material analysing the **underpinnings of the property boom**, the relatively sanguine conclusions tended to be reached on a selective reading of the evidence. More generally, a rather defensive approach was adopted to external critics of constraints.	▪ Benchmarking the quality of work will be a key priority. ▪ As part of risk assessment process Financial Stability Department is developing bi-lateral contacts with other major central banks and the academic community. *(See Section 4.3 for further details)*

Summary of micro-prudential and financial stability related issues raised in the Honohan report	Response
Such quantification of risks as was attempted was carried out in the context of the stress test exercises reported annually in the FSRs. Although many caveats were noted, **too much confidence was placed in the reliability of the tests** which were overseen by desk-based analysts without sufficient engagement by hands-on regulators.	▪ Rigorous stress testing part of Supervisory Review and Evaluation Process. Assumptions, hypothesis, methodologies, granularity and results challenged by specialists. ▪ Development of a systemic risk assessment framework. ▪ Comparative analysis of the performance of the Irish banking sector. ▪ Enhancing banks specific risk assessment. *(See Section 3.2 and 4.3 for further details)*
A **closer interaction between the staff involved in financial stability and regulatory staff** could have had the effect of alerting both sides to the limitations of the stress test methodology and reduced the sense of complacency.	▪ Cross organisational panels, including both supervisory and financial stability staff to review and agree the Supervisory Review and Evaluation Process, challenge examiners on findings and agree supervisory actions. ▪ Financial stability staff participate in regular challenge meetings and prudential analytics work. ▪ Restructured Financial Stability Committee now chaired by Governor. *(See Section 2.5, 3.2 and 4.1 for further details)*
More generally, it may be that **the institutional separation of the Regulator from the rest of the organisation** contributed to an insufficient appreciation of the micro-macro interlinkages involved in financial stability analysis.	▪ Central Bank Reform Bill 2010 provides for a unitary structure. *(See Section 2.1 and 2.1 for further details)*

Annex 2 – PCAR Statement

Prudential Capital Assessment Review

The Central Bank and Financial Regulator has carried out an exercise to determine the forward-looking prudential capital requirements of certain of the Irish credit institutions covered by the government guarantee. The Prudential Capital Assessment Review (PCAR) process for Allied Irish Bank, Bank of Ireland and EBS has been concluded and the results are set out below, together with the status of Anglo Irish Bank, Irish Nationwide Building Society and Irish Life and Permanent.

The Prudential Capital Assessment Review (PCAR) assesses the capital requirements arising for expected base and potential stressed loan losses, and other financial developments, over a 3 year (2010-2012) time horizon. It involves the Central Bank and Financial Regulator making an assessment of the recapitalization requirements of the credit institutions in order to satisfy both a base case and stressed target capital requirement.

The PCAR has been undertaken to determine the recapitalisation requirements of the credit institutions with reference to both:

- A target level of 8% core tier 1 capital should be attained after taking account of the realisation of future expected losses and other financial developments under a base case scenario. This test is designed to ensure the credit institutions are capitalised to a level which reflects prudential requirements and current market expectations, after taking account of forecast loan losses through to 2012. As a further prudent requirement, the capital used to meet the base case target must be principally in the form of equity, the highest quality form of capital, with 7% equity as the target level. In calculating the requirements, individually specified amounts have been added to the institutions' estimates of expected losses to take account of the uncertainty of loss forecasts for particular portfolios.

- A target level of 4% core tier 1 capital that should be maintained to meet a stress scenario or a portfolio level sensitivity analysis. This capital test, which is similar to that employed by US and UK supervisory authorities, is designed to ensure the credit institutions have a sufficient capital buffer to withstand losses under an adverse scenario significantly worse than currently anticipated.

The Financial Regulator has required the credit institutions that have completed the exercise to prepare recapitalisation plans to comply with the additional capital specified by the PCAR. The level of additional capital required for each institution under the PCAR analysis is set out below. This amount of capital set by the PCAR process must be in place by the end of 2010.

Recapitalisation to the target requirements specified in the PCAR will provide market participants with the confidence that the institutions have a strong capital base after realising forecasted expected losses and that a prudent capital buffer is in place to withstand additional losses in adverse stress conditions.

PCAR Methodology

The PCAR has involved the Central Bank and Financial Regulator making an assessment of the recapitalisation requirements of the credit institutions involved in the exercise in order to satisfy both a base case and stressed target capital requirement.

A team of prudential supervisors, credit specialists and treasury specialists in the Financial Regulator, supported by Central Bank economists and financial stability specialists, conducted the PCAR by:

- Assessing the provisioning estimates of each credit institution, their Basel capital model outputs, expected loss forecasts, funding costs and projected operating income;
- Reviewing independent third party estimates of provisions and expected losses conducted on specific credit institutions' portfolios;
- Reviewing likely and stressed scenario loan loss projections for portfolio categories by credit rating agencies and other sources including regulatory agencies;
- Reviewing the outcome of modelled base and stress macro-economic scenarios that we specified and mandated the credit institutions to calculate;
- Using information received from NAMA in respect of the first tranche of "haircuts" as the basis for estimating the NAMA loan losses[1];
- Applying prudent buffers to estimates of expected loan losses;
- Applying prudent adjustments to base case and stress scenario funding costs and treasury asset losses;
- Applying knowledge of the quality of loan portfolios gained through our more intensive supervisory interaction with the banks, including observation of Credit Committee deliberations; and
- Benchmarking our analysis to the approaches taken by other leading international financial supervisors.

The PCAR methodology assessed the capital requirements arising for expected base and potential stressed losses, and other financial developments, over a 3 year (2010-2012) time horizon.

The PCAR required the assessment to take account of changes to EU prudential banking capital requirements that have been formally adopted, even if they have yet to be implemented. This does not include the "Basel II plus" changes that are still at consultation stage, although the potential changes were noted as part of our overall assessment of target capital levels.

[1] Credit institutions may apply to the Financial Regulator by 30 June 2010 for a downwards revision to their capital requirements, if the haircuts on subsequent tranches are materially lower than the first tranche or the quantum of loans to be transferred is lower.

Stress Test

In this test the capital requirement of 4% core tier 1 capital is designed to ensure that banks will be adequately capitalised even after experiencing a hypothetical adverse macroeconomic scenario or unexpected severe losses on particular loan portfolios. This capital level is equivalent to that established by the UK Financial Services Authority[2] and similar to that established by the US Federal Reserve, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency[3].

The stress test requirement is based on a severe scenario of hypothetical adverse macroeconomic conditions and therefore involves an element of judgment. The stress test inputs **do not represent a forecast** of likely economic developments by the Central Bank and Financial Regulator, instead they are much more adverse than what is considered likely.

The Central Bank and Financial Regulator required firms to stress test their portfolios to the higher of:

- The firms estimated loan losses in a stress scenario based on a delayed macroeconomic recovery scenario prescribed by the Central Bank and Financial regulator[4] ;and

- Application of severe sensitivity shocks to the loan book at a portfolio specific level. This included loan loss rates of 5% for mortgages in Ireland and non-NAMA developments property loan losses of 60% in Ireland and 35% in the UK. We emphasise that these are not forecast or expected loss levels, and are disclosed to show the extent of the stress that has been applied in the test. These loss rates are not based on any macroeconomic scenario and therefore should not be interpreted in that manner.

It is the losses established under the portfolio level sensitivity approach that have provided the binding stress case capital requirements, rather than the macroeconomic scenario.

The use of stress testing to benchmark prudential capital requirements will become a part of the regulatory framework operated by the Central Bank and Financial Regulator.

Recapitalisation Plans

The Financial Regulator has required the credit institutions to prepare recapitalisation plans in light of the PCAR results. The credit institutions are required to set out their plans to ensure that capital is in place by the end of 2010 to a level calculated by reference to the base capital target, after taking account of projected expected losses, including bank-specific and other adjustments. We will permit credit institutions to take account of projected asset disposals, based on valuations confirmed by independent third parties, where these are well progressed at year end.

The credit institutions are also required to set out their plans to ensure that capital is in place by the end of 2010 to a level calculated with reference to the stress capital target, taking account of stressed

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[2] FSA Statement on its use of stress tests, 28 May 2009

[3] Joint Statement by US Authorities on the Treasury Capital Assistance Program and Supervisory Capital Assessment Program, 6 May 2009. The Committee of European Banking Supervisors has also conducted bank stress testing exercises but has not set a common buffer stress capital requirement, leaving this to national discretion. The result of the adverse scenario was that on aggregate Tier 1 would remain above 8% and no single bank would fall below 6% Tier 1.

[4] As the starting point for determining the stress capital requirement, the banks were provided with a specified macroeconomic scenario based on a hypothetical delayed economic recovery, involving negligible GDP growth in 2011 and 2012, persistent unemployment increasing to 14.7% in 2012, a further cumulative house price decline of 24.8% in the years 2010-2012 beyond the 31.5% decline reported and other parameters. The severity of the stress test takes account of the circumstances of the Irish economy and its position in the economic cycle.

losses and other adjustments. We are currently assessing various approaches to meeting the stress capital target and in principle we will permit credit institutions to take account of contingent capital facilities which trigger at a level of 5% core tier 1.

PCAR Results by Bank

The capital requirements resulting from the PCAR exercise are:

Allied Irish Banks plc ("AIB"):
(1) An additional €7.396 bn of equity capital to meet the base case target of 7% equity, before taking account of projected asset disposals; and
(2) €4.865 bn of Core Tier 1 capital, less any equity generated under paragraph 1 excluding conversion of preference shares held by the Government, to meet the base case target of 8% Core Tier 1. This additional Core Tier 1 capital will also satisfy AIB's stress case target of 4% Core Tier 1.

The Governor & Company of the Bank of Ireland ("BOI"):
(1) An additional €2.66bn of equity capital to meet the base case target of 7% equity; and
(2) In meeting this requirement provided at least €0.25 bn of new Core Tier 1 is raised, then Bank of Ireland also meets (a) the base case target of 8% Core Tier 1, and, (b) the stress target of 4% Core Tier 1.

EBS Building Society ("EBS"):
(1) An additional €875m of Core Tier 1 capital to meet the base case target of 8% Core Tier 1,; and
(2) Contingent capital of €120m of Core Tier 1 capital to meet the stress case target of 4% Core Tier.

Other Institutions for which the PCAR has not been completed:

Anglo Irish Bank Limited ("Anglo"):
The PCAR for Anglo has not yet been undertaken because discussions on its restructuring plan between the bank, Government and the European Commission are still at a formative stage. If the bank's preferred option – which is to carve out a much smaller but viable going concern banking entity with the remainder becoming an asset management entity – is approved by the European Commission, the PCAR will be applied to the balance sheet of the new banking entity.

As an interim measure, Anglo Irish Bank will require an additional €8.3 billion of capital to meet current minimum capital requirements, pending conclusion of the restructuring discussions and the application of the PCAR.

Irish Nationwide Building Society ("INBS"):
The Financial Regulator has estimated the capital shortfall to meet current minimum capital requirements for INBS at €2.6 billion. In line with all credit institutions, INBS must comply with this minimum regulatory capital requirement on an ongoing basis.

Irish Life & Permanent plc ("ILP"):
ILP was not included in the first wave of PCAR as it has not received a government capital injection and is not taking part in NAMA.

The PCAR process for ILP will be completed over the coming months as the institution's restructuring plan is developed.

The PCAR Map

Base Capital Calculation

Start with Current Capital of bank and forecast Operating Results

Deduct impairments on NAMA loans

Deduct impairments on non -NAMA loans until 2012

Make Adjustments on bank specific basis:

Add/Deduct: changes to NAMA volumes and % haircut

Deduct: regulatory adjustment for loan loss uncertainty

Deduct: adjustment for funding cost risk

Deduct: Other amendments to forecast operating results

Amend: Risk Weighted Assets to reflect impact of impairment and other changes

Determine Capital Shortfall for base case ratios based on adjustments

Add: Capital injection by 31 December 2010

Result: Target Base Capital of 8% Core Tier 1 of which 7%

The PCAR Map

Stress Capital Calculation

Start with Current Capital of bank and forecast Operating Results
Deduct impairments on NAMA loans

Deduct impairments on non NAMA loans until 2012

Make Adjustments on bank specific basis:

Deduct: changes to NAMA volumes and % haircut

Deduct: hypothetical stress losses through to 2012 derived from the higher of:

(a) the prescribed macroeconomic scenario

(b) the prescribed portfolio level sensitivity loss rates

Deduct: regulatory adjustment for funding cost risk under stress scenario

Deduct: Other amendments to forecast operating results *(same as base)*

Add: capital injection by 31 December 2010-03-25 or Contingent Capital Facility

Amend: Risk Weighted Assets to reflect impact of impairment and other changes

Determine Capital Shortfall for base case ratios based on adjustments

Add: Capital injection by 31 December 2010

Result: Target Stress Capital of 4% Core Tier 1

END NOTES:

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i Lex, Financial Times, 28 April, 2010.

ii "The Irish Example/Dublin is showing other indebted governments how to cut spending" Wall Street Journal, 1 June 2010.

iii The Economic and Social Research Institute provides a pithy, precise description of the development of the Irish economy at http://www.esri.ie/irish_economy/

iv When it joined the EEC in 1973, Ireland had an average income per head of 62% of the EU average. Living standards have since outpaced the EU average in terms of GDP per capita standards. By 1995 GDP per capita in Ireland stood at 88% of the EU-15 average, peaking at 133% of the average in 2007. EU membership has served to increase Ireland's attractiveness as a significant location for inward FDI. The EU has provided Ireland with improved trade opportunities, providing a source of market access for the trade of Irish products and offering a pool of labour supply, delivering a consequent expansion in employment opportunities. Further gains are associated with relatively stable inflation and the steady interest rate expectations which have ensued. In addition, membership of the EU has led to the breakup of former national monopolies and enhanced competition.

v Reinhart and Rogoff have written about the incidences of banking crisis following periods of liberalisation. *This time is different*, 2009, pp. 155-157.

vi Caprio and Honohan, Finance for Growth, 2001.

vii Paul Tucker, Deputy Governor of the Bank of England described the contract in a speech to the British Bankers Association on 30 June 2009.

viii Analysis is based on Irish licensed credit institutions.

ix Source: Central Bank – 'Domestically Active Banks' aggregate financial reports, 31 March 2010

x Source: Central Bank – Herfindahl-Hirchmann Index of 'Domestically Active' banking sector's total assets 31 March 2010.

xi In a recent speech, Lord Turner observed that even had Ireland sought to impose controls on the amount of lending its domestic banks were doing in the 2000s, such a measure would probably have been ineffective given the economy's openness to foreign entrants. This is one of the issues we will consider in our upcoming paper on banking supervision. Adair Turner, What do banks do, what should they do and what public policies are needed to ensure best results for the real economy? CASS Business School, 17 March 2010.

xii "Strengthening the Resilience of the Banking Sector", Consultative Paper, Basel Committee on Banking Supervision, 2009

xiii IMF Staff Position Note (May 18 2010) "The Making of Good Supervision: Learning to Say No", Jose Viñals and Jonathan Fiechter

xv The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008. Patrick Honohan. Issued 31 May 2010

xv Directive 2006/48/EC of the European Parliament and the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)

xvi Article 22 of Directive 2006/48/EC of the European Parliament and the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)

[xvii] Part of CEBS Guidelines on Application of the Supervisory Review Process under Pillar 2. Issued 25 January 2006.

[xviii] CEBS High Level Principles for Risk Management. Issued 16 February 2010.

[xix] Commission of the European Communities, Commission Recommendation on remuneration policies in the financial services sector. Issued 30 April 2009.

[xx] CEBS High Level Principles for Remuneration Policies. Issued 20 April 2009.

[xxi] FSB Principles for Sound Compensation Practices, Implementation Standards. Issued 25 September 2009.

[xxii] IMF Global Financial Stability Report, April 2010

[xxiii] The capital adequacy rules, outlined in the CRD, require that banks charge off bad loans and hold more capital when the riskiness of their assets (loans and securities) increases and vice versa. As bank assets, loans in particular, typically become more risky during economic downturns (as the borrowers' net worth and collateral values decline), required capital will increase. Since it may be expensive for banks to raise additional equity they may decide to cut back on lending. By contrast, as capital requirements become more relaxed during economic upturns banks may dispose of some of their excess capital by extending their lending to a larger extent than on average over this business cycle. Thus capital requirements may potentially enhance pro-cyclicality.

[xxiv] Directive 2009/111/EC of the European Parliament and the council of 16 September 2009 amending Directives 2006/48/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management.

[xxv] A group of connected clients means:

- Two or more natural or legal persons, who, unless it is shown otherwise constitute a single risk because one of them, directly or indirectly, has control over the other or others; or
- Two or more natural or legal persons between whom there is no relationship of control as set out in point (a) but who are to be regarding as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties.

[xxvi] CEBS Guidelines on the Implementation of the Revised Large Exposures Regime. Issued 11 December 2009

[xxvii] CEBS Guidelines on Liquidity Buffers and Survival Periods. Issued 9 December 2009.

[xxviii] Commission Services Staff Working Document – Possible Further Changes to the Capital Requirements Directive. Issued for consultation until 16 May 2010.

[xxix] "Mapping the Golden Circle". Paula Clancy, Nat O'Connor and Kevin Dillon, TASC. May 2010

[xxx] The financial crisis highlighted serious deficiencies in the assessment of systemic risk in the existing European framework of financial regulation and supervision. In October 2008, in order to address these deficiencies, the European Commission established a High Level Group on Financial Supervision, chaired by Jacques de Larosière, to review financial supervision in the EU. In February 2009, the Group recommended the establishment of an enhanced European financial supervisory framework, with two new supervisory pillars to deal with (i) system-wide, or macro-prudential issues and (ii) supervisory, or micro-prudential issues.

Number 12 *of* 2003

CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND ACT 2003

ARRANGEMENT OF SECTIONS

PART 1

Preliminary

PART 2

Amendment of Central Bank Act 1942

being produced in any form capable of being reproduced visually or aurally;

'the regulations' means regulations made by the Minister under section 61A and in force under this Act;

'Regulatory Authority' means the Irish Financial Services Regulatory Authority established by section 33B;

'Rome Treaty' means the Treaty establishing the European Community done at Rome on 25 March 1957, as amended by the Treaty on European Union done at Maastricht on 7 February 1992.

(2) In this Act—

(*a*) a reference to an enactment is, unless the context otherwise requires, a reference to that enactment as amended or extended by or under any subsequent enactment (including this Act), and

(*b*) a reference to a section is a reference to a section of this Act unless it is indicated that a reference to some other enactment is intended, and

(*c*) a reference to a subsection, paragraph or subparagraph is a reference to the subsection, paragraph or subparagraph of the provision in which the reference occurs, unless it is indicated that reference to some other provision is intended.

(3) A function or responsibility imposed, or a power conferred, on a person by a provision of this Act is not to be taken to be limited merely by implication from another provision, whether of this or any other Act, that imposes a function or responsibility, or confers a power, on that person.''.

Substitution of section 5 of the Principal Act.

4.—The Principal Act is amended by substituting the following section for section 5:

''Constitution, functions and powers of the Bank

Constitution of Bank.

5.—(1) The body corporate formerly called 'Banc Ceannais na hÉireann' in Irish and the 'Central Bank of Ireland' in English is continued, but with the corporate name of 'Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann' in Irish and the

'Central Bank and Financial Services Authority of Ireland' in English.

(2) The Bank—

(*a*) has perpetual succession, and

(*b*) may take legal proceedings and be proceeded against in its corporate name.

(3) The Bank is required to have a seal. The seal is to be judicially noticed.

(4) Except as expressly provided by this Act, the affairs and activities of the Bank are to be managed and controlled by the Board of Directors of the Bank.''.

Substitution of section 5A of the Principal Act.

5.—The Principal Act is amended by substituting the following sections for section 5A (as inserted by section 4 of the Central Bank Act 1998):

''General functions and powers of the Bank.

5A.—(1) The Bank has the following functions:

(*a*) to carry out the efficient and effective co-ordination of—

(i) the activities of the constituent parts of the Bank, and

(ii) activities undertaken by any of those parts with persons who provide services to, or receive services from, the Bank, and

(iii) the exchange of information among those parts and between any of those parts and any of those persons;

(*b*) to promote the development within the State of the financial services industry (but in such a way as not to affect the objective of the Bank in contributing to the stability of the State's financial system);

(*c*) where appropriate, to represent and co-ordinate the representation of the Bank on international financial bodies and at international meetings relating to financial or economic matters;

(*d*) to establish and maintain, either directly or indirectly, contact with the monetary authorities established in other countries and in territories;

(*e*) whenever it thinks fit, to provide to governments of, and financial institutions and other bodies established in, other countries and in territories advice or other assistance on matters within its expertise and, when appropriate, to co-ordinate application of the resources of its constituent parts for that purpose;

(*f*) to provide banking services to its constituent parts;

(*g*) to provide for the collection and study of data that deal with monetary and credit problems and to publish information about that data;

(*h*) to provide advice and assistance to the Central Statistics Office about the collection, compilation, analysis and interpretation of statistics relating to the balance of payments, national accounts and other financial statistics and, where appropriate, to collect data for that purpose;

(*i*) to perform such other functions as are imposed on it by or under this and any other Act or law.

(2) The Bank has power to do whatever is necessary for or in connection with, or reasonably incidental to, the performance of its functions.

(3) In particular, the powers of the Bank include powers of a kind that, in accordance with normal banking practice, may be exercised by a bank.

(4) The Bank is required to perform its functions and exercise its powers in a manner consistent with the Rome Treaty and the ESCB Statute.

(5) The Bank can perform its functions and exercise its powers both within the State and elsewhere.

Specific powers of the Bank.

5B.—Without limiting section 5A, the powers of the Bank include power to do all or any of the following:

(*a*) subject to paragraph (*b*), acquire, hold, dispose of or otherwise deal in all kinds of property (including real property, securities, coins, gold or silver bullion and other precious metals, and any kinds of currency or currency units); Pt.2 S.5

(*b*) acquire, hold or dispose of shares in a bank or other institution formed wholly or mainly by banks that are the principal currency authority in their respective countries, but only with the approval of the Minister;

(*c*) enter into, carry out, assign or accept the assignment of, vary or rescind, any contract, agreement or other obligation;

(*d*) provide loans and other kinds of financial accommodation to credit institutions and other persons on the security of such assets and on such terms and conditions as the Board considers appropriate;

(*e*) give guarantees and make payments under them;

(*f*) receive funds on deposit;

(*g*) open accounts in other countries or act as agent, depository, or correspondent of any credit institution carrying on business in or outside the State;

(*h*) re-discount exchequer notes or bills, local authority bills, bills of exchange and promissory notes on such terms and conditions as the Board considers appropriate;

(*i*) keep registers of securities generally;

(*j*) operate or participate in a depository of securities or other instruments;

(*k*) keep the accounts for the clearing and settlement of securities or payment instruments;

(*l*) become a member of, or a party to, the establishment or operation of one or more payment systems;

(*m*) operate or participate in a system that provides a settlement service for transactions in securities or other instruments for its members;

(*n*) enter into agreements with depositories of securities or of other instruments, and carry out transactions under the terms of those agreements so far as necessary for the settlement of transactions between members of those depositories and the members of any depository operated by the Bank;

(*o*) transfer assets, income or liabilities to the European Central Bank where required under the ESCB Statute.''.

Substitution of section 6 of the Principal Act.

6.—The Principal Act is amended by substituting the following section for section 6 (as substituted by section 5 of the Central Bank Act 1998):

``Bank to perform functions of European System of Central Banks.

6.—(1) The Bank shall perform all functions imposed, and exercise all powers conferred, on the Bank by or under the Rome Treaty or the ESCB Statute.

(2) This section is subject to section 19A.

(3) Section 9 of the Ministers and Secretaries Act 1924 does not apply to the Bank.''.

Insertion into the Principal Act of new sections 6A to 6K.

7.—The Principal Act is amended by inserting the following sections after section 6 (as substituted by *section 6*):

``Objectives of Bank in discharging ESCB functions, etc.

6A.—(1) In discharging its functions and exercising its powers as part of the European System of Central Banks, the primary objective of the Bank is to maintain price stability.

(2) The Bank also has the following objectives:

(*a*) contributing to the stability of the financial system;

(*b*) promoting the efficient and effective operation of payment and settlement systems; and

(*c*) discharging such other functions and powers as are conferred or imposed on it by the Rome Treaty, the ESCB Statute or any enactment.

(3) The Minister may, from time to time, request the Governor, the Board or the Regulatory Authority to consult with the Minister, in relation to their respective functions, as regards the performance by the Bank of any function of the Bank (other than

one imposed on it by the Rome Treaty or the ESCB Statute).

(4) The Minister may, from time to time, request the Governor to inform the Minister with respect to the pursuit of the primary objective of the Bank.

(5) The Governor, or the Board, shall comply with a request made to the Governor or the Board under this section in so far as the request is consistent with the Rome Treaty, the ESCB Statute or any law of the State.

(6) Without prejudice to the objective of maintaining price stability, the Bank is required to support the general economic policies of the European Union with a view to contributing to the achievement of the objectives of that Union as laid down in Article 2 of the Rome Treaty.

Offices of the Bank.

6B.—Where the Board considers—

(*a*) that it is necessary for the purpose of the due performance by the Bank of its functions, the Board may build, purchase, lease or otherwise acquire, establish, equip and maintain offices and other premises of the Bank in such places, whether in the State or elsewhere, or

(*b*) that it is no longer necessary for that purpose, sell or let any such premises.

Power of the Bank to establish divisions, etc. within the Bank.

6C.—(1) The Bank may, from time to time, establish divisions, branches or offices as part of the Bank's structure.

(2) The Board is responsible for administering the staff of the Bank and its constituent parts and for administering the provision of accommodation and office and other equipment with a view to enabling the Bank and its constituent parts to perform and exercise their respective functions and powers.

Staff of Bank.

6D.—(1) Subject to this section, the Board shall appoint a Secretary to the Bank and such other employees of the Bank as it considers necessary for the effective performance and exercise of the functions and powers of the Bank and each of its constituent parts.

(2) The Regulatory Authority shall appoint a Secretary to that Authority.

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(3) Except as regards the appointment of a Secretary to the Bank and the Secretary to the Regulatory Authority—

(*a*) the Governor has the same power to appoint employees of the Bank as the Board has under subsection (1), but that power is only exercisable in respect of responsibilities specified in section 19A(1)(*a*) and (*b*) and (2),

(*b*) the Chief Executive has the same power to appoint employees of the Bank as the Board has under subsection (1), but that power is only exercisable with the agreement of the Regulatory Authority.

(4) The Secretary to the Regulatory Authority and employees appointed under subsection (3) are taken, for the purposes of this Act, to have been appointed under subsection (1).

(5) The employees of the Bank are to be employed on such conditions (including conditions as to remuneration and allowances) as the Board fixes from time to time. However, in fixing the conditions of employment of the Secretary to the Regulatory Authority and employees appointed by the Chief Executive under subsection (3), the Board shall obtain the concurrence of the Regulatory Authority or Chief Executive (as the case requires) with respect to those conditions of employment.

(6) Subject to subsection (8), an appointment under this section is to be made by competition to be conducted in accordance with rules made by the Board.

(7) The Board may, in relation to a particular competition, impose conditions of entry, limitations and safeguards. If the competition relates to an appointment to be made under subsection (2) or (3), the Board may impose such conditions only with the concurrence of the Regulatory Authority or the Chief Executive, as the case requires.

(8) Subsection (6) does not apply to an appointment to a position if the Board, or, in relation to appointments under subsection (2) or (3), if the Regulatory Authority or Chief Executive (as the case requires), decides that appointment to the position by competition would be inappropriate.

(9) The Board shall establish and operate a policy under which provision is made for

employees of the Bank to be given opportunities for training and experience in various activities, and in different constituent parts, of the Bank.

Assignment of employees of Bank.

6E.—The Board shall arrange for employees of the Bank to be assigned to the Regulatory Authority and to any divisions, branches or offices established under section 6C. However, any assignment of an employee to or from the Regulatory Authority shall take place only with the agreement of the Chief Executive.

Bank may engage agents and act as agent for others.

6F.—The Bank may engage agents, and act as agent for other persons.

Financial and administrative matters

General fund of the Bank.

6G.—(1) The Bank shall continue to keep and operate the fund called the general fund.

(2) The Bank shall pay into the general fund all money received by the Bank and shall pay from that fund all amounts that it is required to pay.

(3) The Bank shall pay its surplus income as and when determined under this section into the Exchequer in such manner as the Minister directs and may at any time pending such determination pay into the Exchequer such sums on account of surplus income as may be agreed on by the Minister and the Bank.

(4) The expenses incurred by the Bank in performing functions or exercising powers under this or any other Act or law are payable out of the general fund of the Bank, except where otherwise provided by or under this or any other Act.

(5) Any claims on or liabilities to the European Central Bank are to be treated as assets or liabilities of the general fund or any other fund established by order made by the Minister for that purpose.

(6) The Minister may, after consultation with the Bank, make regulations providing for the periodic determination of the Bank's surplus income and, in particular, such regulations may—

(*a*) enable provision to be made for reserves, depreciation and other similar matters before the surplus income is determined, and

23.—The Principal Act is amended by repealing section 30.

Repeal of section 30 of the Principal Act (operation of disqualification of Governor or Director).

24.—The Principal Act is amended by substituting the following section for section 32:

Substitution of section 32 of the Principal Act.

"Meetings and procedure of the Board.

32.—Schedule 1 has effect with respect to meetings and procedure of the Board.".

25.—The Principal Act is amended by repealing section 33.

Repeal of section 33 of the Principal Act.

26.—The Principal Act is amended by inserting the following Parts before Part IV:

Insertion into the Principal Act of new Parts IIIA and IIIB.

"PART IIIA

Irish Financial Services Regulatory Authority

Chapter 1

Constitution, functions and powers of Regulatory Authority

Interpretation: Part IIIB and Schedule 3.

33A.—In this Part and Schedule 3—

'Chairperson' means Chairperson of the Regulatory Authority;

'member' means a member of the Regulatory Authority;

'other members of the Regulatory Authority'—

(*a*) when used in a provision relating to the Chief Executive — means a majority of the members of the Regulatory Authority other than the Chief Executive or a person acting as such, and

(*b*) when used in a provision relating to the Consumer Director — means a majority of the members of the Regulatory Authority other than the Consumer Director or a person acting as such.

Establishment of Regulatory Authority.

33B.—(1) There is established by this section a body called 'Údarás Rialála Seirbhísí Airgeadais na hÉireann' or in the English language the 'Irish Financial Services Regulatory Authority'.

(2) The Regulatory Authority is a constituent part of the Bank.

(3) The Regulatory Authority is separate from its members and continues in existence

despite any vacancy or change in its membership.

Functions and powers of Regulatory Authority.

33C.—(1) The Regulatory Authority has the following functions:

(*a*) to perform the functions the Bank has under or in respect of the enactments and statutory instruments specified in Schedule 2;

(*b*) in respect of functions of the Bank under sections 18 and 23 of the Central Bank Act 1971—

(i) in so far as relates to the performance of functions imposed on the Regulatory Authority by this section, to perform those functions of the Bank, and

(ii) in any other case and by agreement with the Governor, to contribute to the performance of those functions of the Bank;

(*c*) whenever requested to do so, to provide the Governor and the Board with advice, information and assistance with respect to the performance of their respective functions under the Central Bank Acts;

(*d*) to perform such other functions as are expressly imposed on it by this or under any other Act or law.

(2) (*a*) The Minister may, after consulting the Bank, by order notified in *Iris Oifigiúil*, add—

(i) to Part 1 of Schedule 2 any specified enactment, or

(ii) to Part 2 of that Schedule any specified statutory instrument,

under or in respect of which functions of the Bank are to be performed by the Regulatory Authority.

(*b*) An order under paragraph (*a*) may be limited to specified entities, or categories of entities, to which the enactments or statutory instruments apply.

(3) In performing its functions and exercising its powers, the Regulatory Authority is required to promote the best interests of users of financial services in a way that is consistent with— Pt.2 S.26

(*a*) the orderly and proper functioning of financial markets, and

(*b*) the orderly and prudent supervision of providers of those services.

(4) Without limiting subsection (3), the Regulatory Authority shall take such action as it considers appropriate to increase awareness among members of the public of available financial services and the cost to consumers, risks and benefits associated with the provision of those services. None of the following is liable to pay damages arising out of a failure to comply with this subsection:

(*a*) the Bank;

(*b*) a member of the Board;

(*c*) an employee of the Bank;

(*d*) a member of the Regulatory Authority;

(*e*) the Registrar of Credit Unions;

(*f*) an agent of the Bank or of its constituent parts.

(5) So far as consistent with Part II and this Part, the Regulatory Authority has power to do whatever is necessary for or in connection with, or reasonably incidental to, the performance of its functions.

(6) The Regulatory Authority may, in relation to the functions and powers of the Bank that the Authority is to perform or may exercise, bring and defend legal proceedings, and do any other thing, in the name of the Bank. This subsection does not apply to prosecutions for offences arising under the designated enactments and designated statutory instruments or proceedings for the recovery of amounts of levies or fees prescribed under section 33J or 33K.

(7) The Regulatory Authority is required to perform its functions and exercise its powers in a way that is consistent with the Rome Treaty and the ESCB Statute.

(8) In performing its functions and exercising its powers, the Regulatory Authority has a duty to act in a way that is consistent with the performance by the Governor

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and the Board of their respective functions in relation to the Bank. For the purpose of verifying compliance with that duty, the Regulatory Authority shall provide the Governor or the Board with such information as the Governor or the Board reasonably require or as it considers appropriate.

(9) If any matter relating to the financial stability of the State's financial system arises in connection with the performance or exercise by the Regulatory Authority of its functions or powers, that Authority shall consult the Governor on that matter. Where the Regulatory Authority considers it prudent in the circumstances it may send a report to the Minister on any matter to which this subsection relates. The Regulatory Authority may otherwise act on that matter only with the agreement of the Governor. For the purpose of this subsection, 'matter' includes (but is not limited to) the issue, revocation and suspension of a licence or other authority.

(10) The Regulatory Authority can perform its functions and exercise its powers both within the State and elsewhere.

(11) If—

(*a*) the performance of a function or the exercise of a power by the Bank is dependent on its opinion, belief or state of mind in relation to a matter, and

(*b*) the function or power is, by this section, to be performed by the Regulatory Authority,

that Authority is required to perform the function or exercise the power in relation to the matter on the basis of its own opinion, belief or state of mind.

(12) Any act, matter or thing done in the name of, or on behalf of, the Bank by the Regulatory Authority in the performance or exercise of that Authority's functions or powers is taken to have been done by the Bank.

(13) The fact that the Regulatory Authority is required to perform functions, and is authorised to exercise powers, of the Bank by virtue of this section does not affect the status of the Bank as a competent authority for the purposes of any European Union directive or regulation under which the Bank is such an authority.

Regulatory Authority to comply with certain guidelines.

33D.—(1) Either the Governor or the Board may, with respect to the functions of the Governor or the Board, issue to the Regulatory Authority guidelines as to the policies and principles that that Authority is required to implement in performing functions, or exercising powers, of the Bank. Pt.2 S.26

(2) The Regulatory Authority is required to comply with guidelines issued to it under this section.

(3) Guidelines issued by the Governor or the Board under this section shall be in writing and the Governor or the Board, as the case may be, shall cause them to be published in *Iris Oifigiúil* as soon as practicable after they are issued.

Membership of Regulatory Authority.

33E.—(1) The Regulatory Authority comprises no fewer than 8 and no more than 10 members, of whom—

(*a*) one is the Chief Executive, and

(*b*) one is the Consumer Director, and

(*c*) no fewer than 6 and no more than 8 are persons appointed by the Minister for Finance after consulting the Minister for Enterprise, Trade and Employment.

(2) Instead of appointing a person under subsection (1)(*c*), the Minister may designate the holder of a specified office as an official member of the Regulatory Authority. Whoever is for the time being the holder of such an office is an official member of that Authority.

(3) A person is not eligible for appointment under subsection (1)(*c*) if the person—

(*a*) is a member of either House of the Oireachtas or is, with the person's consent, nominated as a candidate for election as such a member or is nominated as a member of Seanad Éireann, or

(*b*) is a member of the European Parliament or is, with the person's consent, nominated as a candidate for election as such a member or to fill a vacancy in the membership of that Parliament, or

(*c*) is a member of a local authority or is, with the person's consent, nominated as a candidate for election as such a member.

(4) Schedule 3 has effect with respect to the Regulatory Authority and its members.

Appointment of Chief Executive of the Regulatory Authority.

33F.—(1) The other members of the Regulatory Authority shall appoint a person as the Chief Executive of that Authority. Other than the appointment of the first Chief Executive (which is provided for by *paragraph 4* of *Schedule 3* to the *Central Bank and Financial Services Authority of Ireland Act 2003*), the appointment of a Chief Executive under this section shall only be made after the holding of a public open competition for that position.

(2) A person appointed as Chief Executive holds office for such period, not exceeding 5 years, as is specified in the document of appointment, unless the person previously ceases to hold that office as provided by this section.

(3) The other members of the Regulatory Authority may appoint a person holding office as the Chief Executive for a further period, not exceeding 5 years, to take effect at the end of the person's current period of appointment. This subsection applies whether the person was appointed under subsection (1) or this subsection.

(4) An appointment under this section does not take effect until the Minister approves it.

(5) A person is not eligible for appointment as Chief Executive if the person—

(*a*) is a member of either House of the Oireachtas or is, with the person's consent, nominated as a candidate for election as such a member or is nominated as a member of Seanad Éireann, or

(*b*) is a member of the European Parliament or is, with the person's consent, nominated as a candidate for election as such a member or to fill a vacancy in the membership of that Parliament, or

(*c*) is a member of a local authority or is, with the person's consent, nominated as a candidate for election as such a member.

(6) A person appointed under this section holds office on such conditions of employment as are specified in the person's document of appointment or are later agreed between the person and the other members of the Regulatory Authority.

(7) The Chief Executive may engage in other remunerative employment only with the consent of the other members of the Regulatory Authority. Pt.2 S.26

(8) The Chief Executive is subject to the control of the other members of the Regulatory Authority and, except as regards voting at meetings of that Authority, is required to comply with any lawful directions given by those members with respect to the carrying out of the Chief Executive's responsibilities.

(9) A person ceases to hold office as Chief Executive if the person—

(*a*) dies, or

(*b*) completes a term of office and is not re-appointed, or

(*c*) resigns the office by notice in writing addressed to the Chairperson, or

(*d*) is, with the person's consent, nominated as a candidate for election as a member of either House of the Oireachtas or is nominated as a member of Seanad Éireann, or

(*e*) is, with the person's consent, nominated as a candidate for election as a member of the European Parliament or to fill a vacancy in the membership of that Parliament, or

(*f*) is, with the person's consent, nominated as a candidate for election as a member of a local authority, or

(*g*) is adjudged bankrupt (either in the State or elsewhere) or enters into a composition with the person's creditors, or

(*h*) becomes physically or mentally incapable of performing the duties of Chief Executive, or

(*i*) is convicted of an offence (either in the State or elsewhere) and sentenced to serve a term of imprisonment for the offence, or

(*j*) is removed from office under subsection (10).

(10) The other members of the Regulatory Authority may remove or suspend the Chief Executive from office, but only for

reasons notified in writing to the Chief Executive.

Appointment of acting Chief Executive in certain cases.

33G.—(1) The other members of the Regulatory Authority may appoint a qualified person to act in the office of the Chief Executive—

(*a*) during the illness or absence of a holder of that office, or

(*b*) while the holder is suspended from office, or

(*c*) during a vacancy in that office.

A person so appointed has, while acting as Chief Executive, all the responsibilities and powers of that office.

(2) The other members of the Regulatory Authority may, at any time, remove from office a person who is acting as Chief Executive.

(3) If a person is to be appointed under this section for a period of more than 6 months, the appointment does not take effect until the Minister approves it.

(4) An acting Chief Executive is entitled to be paid such remuneration (including travelling and subsistence allowances) as the other members of the Regulatory Authority determine from time to time.

(5) A person is a qualified person for the purposes of this section if the person is—

(*a*) an officer of the Bank, or

(*b*) an employee of the Bank.

Responsibilities of Chief Executive of the Regulatory Authority.

33H.—(1) The Chief Executive is responsible for—

(*a*) bringing proceedings for offences arising under the designated enactments and designated statutory instruments, and

(*b*) exercising the day-to-day management of the Regulatory Authority, and

(*c*) performing the functions expressly imposed on the Chief Executive by other provisions of this Part, and

(*d*) carrying out such other responsibilities with respect to the functions and powers of the Regulatory Authority as may be imposed on the Chief Executive by that Authority. Pt.2 S.26

(2) The Chief Executive has power to do whatever is necessary for or in connection with, or reasonably incidental to, carrying out the Chief Executive's responsibilities.

(3) In carrying out or exercising the Chief Executive's responsibilities or powers, the Chief Executive shall, as far as reasonably practicable, ensure that the resources of the Regulatory Authority allocated for carrying out those responsibilities or exercising powers are used effectively, efficiently and economically.

Chairperson of the Regulatory Authority.

33I.—(1) The Minister for Finance is to appoint one of the members, other than the Chief Executive or the Consumer Director, to be Chairperson of the Regulatory Authority.

(2) A member appointed as Chairperson holds office for 5 years from the date of the member's appointment as such, unless the member previously ceases to hold that office as provided by this section.

(3) A member holding office as Chairperson ceases to hold that office if the member—

(*a*) resigns from that office by notice in writing given to the Minister, or

(*b*) ceases to be a member.

(4) A person who ceases to be Chairperson because the person has ceased to be a member is eligible for re-appointment as Chairperson if the person is re-appointed as a member.

Power to impose levies.

33J.—(1) The purpose of this section is to enable the Regulatory Authority to have sufficient funds to enable it to perform its functions and exercise its powers.

(2) The Chief Executive, with the agreement of the other members of the Regulatory Authority, may make regulations prescribing levies to be paid by persons who are subject to regulation under the designated enactments and designated statutory instruments.

(3) In particular, regulations under subsection (2) may provide for any of the following matters:

(*a*) the activities, services or other matters for which specified kinds of levies are payable;

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(*b*) the persons, or classes of persons, who are required to pay specified kinds of levies;

(*c*) the amounts of specified kinds of levies;

(*d*) the periods in respect of which, or the dates by which, specified levies are to be paid to the Regulatory Authority;

(*e*) penalties that are payable by a person who fails to pay a levy on time;

(*f*) the keeping of records, and the making of returns to the Regulatory Authority, by persons who are liable to pay a specified levy;

(*g*) the collection and recovery of levies.

(4) Regulations made under this section do not take effect until approved by the Minister.

(5) A levy prescribed in respect of credit unions is to be fixed so that the total amounts of levies collected or recovered from credit unions does not exceed the total amount of costs incurred in performing the functions and exercising the powers of the Bank under the Credit Union Act 1997.

(6) The Chief Executive may, by proceedings brought in a court of competent jurisdiction, recover as a debt an amount of levy payable under regulations in force under this section.

(7) The Chief Executive may refund the whole or a part of a levy prescribed under this section, but only with the agreement of the other members of the Regulatory Authority.

(8) The Chief Executive can amend or revoke a regulation made under this section, but only with the agreement of the other members of the Regulatory Authority.

(9) An amendment or revocation of regulations made under this section does not take effect until approved by the Minister.

(10) In this section, 'levy' does not include a fee.

Power of Chief Executive to prescribe fees.

33K.—(1) The Chief Executive may, with the agreement of the other members of the Regulatory Authority, make regulations prescribing fees for the purpose of any enactment that provides for the payment of a fee by reference to this section.

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(2) The Chief Executive may, with the agreement of the other members of the Regulatory Authority, make regulations providing for all or any of the following matters:

(*a*) the persons, or classes of persons, who are required to pay specified kinds of fees;

(*b*) the amounts of specified kinds of fees;

(*c*) the collection of fees.

(3) Regulations of the kind referred to in subsection (2) may be included in regulations made under subsection (1).

(4) Regulations made under this section do not take effect until approved by the Minister.

(5) The Chief Executive may, by proceedings brought in a court of competent jurisdiction, recover as a debt an amount of fee payable under regulations in force under this section.

(6) The Chief Executive may refund the whole or a part of a fee prescribed under this section, but only with the agreement of the other members of the Regulatory Authority.

(7) The Chief Executive may amend or revoke a regulation made under this section, but only with the agreement of the other members of the Regulatory Authority.

(8) An amendment or revocation of regulations made under this section does not take effect until approved by the Minister.

(9) The Public Offices Fees Act 1879 does not apply to fees prescribed under this section.

Provision of funds by Bank to Regulatory Authority to meet shortfall.

33L.—(1) If at any time it appears to the Board that the funds raised from levies and fees prescribed by regulations in force under sections 33J and 33K are, or are likely to be, insufficient to enable the Regulatory Authority to properly perform its functions and exercise its powers, the Bank may provide the Authority with such funds as the Board considers necessary to enable the Authority to perform its functions and exercise its powers.

(2) The provision of funds under this section is subject to such conditions as the Board thinks fit to impose.

(3) (*a*) The Board may provide funds under this section only after the

Minister has approved the amount of the funds concerned and the conditions (if any) subject to which those funds are to be provided.

(*b*) Before deciding whether or not to give approval under paragraph (*a*), the Minister is required to consult with the Governor and the Governor may express his or her opinion on the amount of funds concerned, so far as it could affect—

(i) the carrying out by the Bank of its obligations with respect to the promotion of the financial stability of the State, and

(ii) the performance of the functions of the Bank in its capacity as a member of the European System of Central Banks.

(4) In approving any amount of funds under subsection (3), the Minister is required to have regard to the functions and powers of the Bank under the Rome Treaty and the ESCB Statute.

Regulatory Authority to keep proper accounts.

33M.—(1) The Regulatory Authority shall keep accounting records that properly record and explain its transactions.

(2) The Regulatory Authority shall, as soon as practicable after the end of each financial year, provide the Bank with sufficient information about that Authority's financial affairs as will enable the Bank to comply with section 6H(2) for that year.

(3) The Regulatory Authority shall ensure that its accounting records comply with any accounting standards notified to that Authority in writing by either the Board or the Governor.

(4) The Regulatory Authority shall keep its accounting records for 6 years after the transactions to which they relate are completed and may, at the end of that period, either retain those records or dispose of them in such manner as it considers appropriate. This subsection has effect despite any other enactment to the contrary.

(5) The Regulatory Authority is required to make the records available at all reasonable times for inspection—

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(*a*) by any member of the Board, or

(*b*) by any member of that Authority who is not a member of the Board, or

(*c*) by the Comptroller and Auditor General that is required for the performance of that officer's functions or by a person employed in the Office of the Comptroller and Auditor General.

Regulatory Authority to prepare annual estimate of income and expenditure.

33N.—(1) Not later than 3 months before the beginning of each financial year, or within such extended period as the Minister may allow, the Regulatory Authority shall—

(*a*) prepare a statement setting out estimates of its income and expenditure for that year, and

(*b*) submit the statement to the Minister for approval of so much of the statement as relates to paragraphs (*a*) and (*b*) of subsection (2).

(2) The statement must—

(*a*) specify the amounts expected to be collected and recovered during the financial year concerned from the imposition of levies under section 33J, and

(*b*) specify any other sources from which funds are expected to be obtained during that year to finance the Regulatory Authority's activities and the amounts expected to be raised from those sources, and

(*c*) specify the activities that the Regulatory Authority proposes to undertake during that year.

(3) Before submitting the statement to the Minister for approval for the purposes of subsection (1)(*b*), the Regulatory Authority shall provide the Governor with particulars of the estimates referred to in subsection (1)(*a*). As soon as practicable after being provided with those particulars, the Governor shall give the Regulatory Authority the Governor's views on those estimates, but only in so far as they affect—

(*a*) the carrying out by the Bank of its obligations with respect to the promotion of the financial stability of the State, and

(*b*) the performance of the functions of the Bank in its capacity as a member of the European System of Central Banks.

(4) The Minister is required to consult both the Governor and the Board before giving approval for the purposes of subsection (1)(*b*).

(5) In giving approval for the purposes of subsection (1)(*b*), the Minister may so approve either without amendment or with such amendment as may be agreed with the Regulatory Authority. The statement, as may be so amended, shall be laid before each House of the Oireachtas as soon as may be after it has been approved. In exercising the power conferred by this subsection, the Minister is required to have regard to the functions and powers of the Bank under the Rome Treaty and the ESCB Statute.

Regulatory Authority to provide Minister with annual report and other reports.

33O.—(1) (*a*) The Regulatory Authority is required to prepare and provide the Minister with—

(i) an annual report, and

(ii) from time to time, such other reports,

relating to the performance of its functions and the exercise of its powers as the Minister may from time to time specify.

(*b*) As soon as practicable after receiving a copy of the Regulatory Authority's annual report, the Minister shall arrange for a copy of that report to be laid before each House of the Oireachtas.

(2) The Regulatory Authority may not provide information in a report under subsection (1) relating to a matter if to do so would contravene a provision of a law of the State or would be inconsistent with the Rome Treaty or the ESCB Statute. However, this subsection does not prevent that Authority from including confidential information in such a report if the information—

(*a*) is included with the consent of the person who provided the information, or

(*b*) relates to a Director, a member of the Regulatory Authority or a person employed by or within the Bank. Pt.2 S.26

Regulatory Authority to prepare strategic plan.

33P.—(1) The Regulatory Authority shall, at least 3 months before the beginning of each financial year—

(*a*) prepare for the year a strategic plan that complies with this section, and

(*b*) submit the plan to the Minister.

(2) A strategic plan must specify—

(*a*) the objectives of the Regulatory Authority's activities for the financial year concerned, and

(*b*) the nature and scope of the activities to be undertaken, and

(*c*) the strategies and policies for achieving those objectives, and

(*d*) targets and criteria for assessing the performance of the Authority, and

(*e*) the uses for which it is proposed to apply the Authority's resources.

(3) If the Minister has in writing notified the Regulatory Authority of any requirements with respect to the form in which its strategic plan is to be prepared, the plan must comply with those requirements.

(4) As soon as practicable after receiving the Regulatory Authority's strategic plan, the Minister shall arrange for the plan to be laid before both Houses of the Oireachtas.

(5) As soon as practicable after becoming aware that subsection (4) has been complied with, the Regulatory Authority shall publish its strategic plan and take all reasonably practical steps to implement it.

Chapter 2

Consumer Director

Appointment of Consumer Director.

33Q.—(1) The other members of the Regulatory Authority shall appoint a person as the Consumer Director of that Authority.

(2) A person appointed as Consumer Director holds office for a period not exceeding 5 years from the date of appointment, unless the person previously ceases to hold that office as provided by this section.

(3) The other members of the Regulatory Authority may appoint a person holding office as the Consumer Director for a further period, not exceeding 5 years, to take effect

Licensing and Supervision Requirements and Standards For Credit Institutions

Preface

The Central Bank is statutorily charged with the licensing and supervision of banks and building societies, which are collectively termed credit institutions[1]. The Bank's powers in this respect are derived from the Central Bank Acts, 1971 and 1989, the Building Societies Act, 1989, the Trustee Savings Banks Act, 1989, the ACC Bank Act, 1992, the ICC Bank Act, 1992 and various provisions implementing EU Banking Directives[2].

The relevant legislation contains extensive provisions relating to, inter alia, the granting and revocation of licences; the obtaining of information from credit institutions; the undertaking of on-site inspections and the supervision generally of the activities of credit institutions. As many of the provisions are of a discretionary nature, the Bank has set down requirements and standards which it uses to guide it in the assessment of applications for licences and in the supervision of the business carried on by credit institutions.

The requirements and standards are non-statutory requirements which are applied by the Bank to credit institutions as a supplement to the statutory requirements contained in the legislation referred to in paragraph 1 above and the Appendix to this document. This document contains summary references to the main statutory provisions for the purposes of setting a context for the non-statutory requirements.

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1 The credit institutions supervised by the Bank comprise licensed banks, building societies, Trustee Savings Bank, ACC Bank, ICC Bank and ICC Investment Bank.

2 A list of the principal EU Banking Directives, together with details of the their transposition into Irish law, is contained in the Appendix.

It is emphasised that this document does not purport to interpret or comprehensively refer to the statutory provisions applicable to credit institutions. Interested parties should directly consult the various sources of statutory law applicable to credit institutions, seeking legal advice, where appropriate, for a definitive understanding of the scope and application of such law.

The requirements and standards were last published in the Bank's Quarterly Bulletin of Autumn 1987. They have now been revised to take account of the considerable changes that have taken place in both the domestic and international banking environments since that time, in particular the enactment of a significant body of legislation.

The requirements and standards apply to all credit institutions authorised by the Bank including branches in the State of credit institutions incorporated outside the European Economic Area (EEA)[3]. They have limited application to branches of credit institutions incorporated in other EEA Member States the supervision of which, under the EU Second Banking Co-ordination Directive and the EEA Agreement, is almost exclusively the responsibility of the supervisory authority in that Member State, i.e. home country supervision.

The requirements and standards apply to the totality of each institution's operations and, in addition, where relevant, the various ratios and limits will apply to the consolidated position of each institution.

Credit institutions are required to comply with the Bank's supervision requirements at all times. Compliance with the requirements and standards, however, does not relieve the boards and management of credit institutions of the fundamental responsibility to conduct the operations of their institutions in accordance with the relevant laws and in a prudent manner with full and primary regard for the safety of depositors' funds.

[3] The European Economic Area (EEA) refers to the Member States of the EU and the Member States of EFTA (except Switzerland). Membership of the EEA currently comprises: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, The Netherlands, Norway, Portugal, Spain, Sweden and The United Kingdom.

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8.1 Each credit institution shall have in place appropriate policies relating to the management and control of lending. These shall include policies relating to credit assessment, credit review, risk management, the monitoring and control of large exposures and prudent provisioning for loan losses.

8.2 The Bank's requirements relating to the monitoring and control of large exposures are set out in a Notice published in the Bank's Quarterly Bulletin No. 1 of 1994, implementing the EU Directive on the Monitoring and Control of Large Exposures. This Notice was amended by a further Notice published in the Bank's Quarterly Bulletin No. 3 of 1995. This Notice requires that every credit institution shall have sound administrative and accounting procedures and adequate internal control mechanisms for the purpose of identifying and recording all large exposures and subsequent changes to them and also for the purpose of monitoring those exposures in the light of its own exposure policies.

8.3 Under the Notice, a credit institution incorporated in the State should not employ assets (both on and off balance sheet) amounting to more than 25 per cent. of its own funds with any one client or what is considered by the Bank to be a connected group of clients. The aggregate of large exposures - defined as an exposure equal to or in excess of 10 per cent. of the own funds of the credit institution - should not exceed 800 per cent. of own funds. A credit institution should notify the Bank of all large exposures on a quarterly basis.

8.4 In its implementation Notice, the Bank has largely adhered to the limits set out in the Directive. However, in certain instances, the Bank is applying more stringent criteria as follows:

(a) a credit institution's exposure to any one of its directors, including any exposures to any business in which the director has a major interest, may not exceed 2 per cent. of own funds; the aggregate of all such exposures may not exceed 10 per cent. of own funds;

(b) a credit institution's exposure to any one of its significant shareholders, including exposures to businesses in which the significant shareholder has a major interest, as defined, may not exceed 10 per cent. of own funds, unless such shareholders or businesses are also credit institutions; the aggregate of all such exposures may not exceed 30 per cent. of own funds; and

(c) a credit institution's exposure to a client or group of connected clients, other than a credit institution or financial institution, in which the credit institution has what is considered by the Bank to be a major interest may not exceed 10 per cent. of own funds; the aggregate of all such exposures may not exceed 30 per cent. of own funds.

(For the purposes of this section, a major interest is defined as a holding by a person, either on his own or in concert with another person, of 10 per cent. or more of the shares or voting rights in an undertaking.)

8.5 The large exposures of branches in the State of credit institutions incorporated outside the EEA will be monitored and assessed in relation to the own funds and exposures of the credit institution as a whole, as well as in relation to the balance sheet of the branch itself.

8.6 A credit institution, incorporated in the State, shall not have the risk assets amounting to more than 200 per cent. of own funds concentrated in any one sector of business or economic activity which is subject to a common predominant risk factor; where a common risk could be considered to apply to two or more separate sectors (as, for example, the property development and building sectors) not more than 250 per cent. of own funds shall be employed with such sectors in aggregate.

8.7 A credit institution shall not grant an advance, loan or other facility against the security of its own shares or the shares of any subsidiary, fellow subsidiary, or parent company unless such shares are quoted on a Stock Exchange.

9 ANNUAL ACCOUNTS OF CREDIT INSTITUTIONS

CENTRAL BANK OF IRELAND

ITEM 23

A DOCUMENT DETAILING THE PROCESS OF SUPERVISORY ENGAGEMENT BY THE BANK WITH EACH OF THE RELEVANT BANKS DURING THE PERIOD 2003 TO 2013, (SAVE AS OTHERWISE DISCLOSED UNDER 12 ABOVE), WITH AN EMPHASIS ON ENGAGEMENTS AT THE MOST SENIOR LEVELS BETWEEN THE BANK AND EACH OF THE RELEVANT BANKS DURING THE PERIOD AND ALL MATERIAL AND/OR SIGNIFICANT CHANGES IN THE PROCESS OF SUPERVISORY ENGAGEMENT DURING THAT PERIOD, TO INCLUDE DETAILS ON ENHANCED REPORTING OBLIGATIONS OF THE RELEVANT BANKS ARISING UNDER THE ELIGIBLE LIABILITIES GUARANTEE, AND DETAILS OF THE PROCESS OF SUPERVISORY ENGAGEMENT BETWEEN THE BANK AND EACH OF THE RELEVANT BANKS ARISING FROM THE PRISM MODEL AS INTRODUCED IN 2011.

6. Supervisory Approach 2011 – 2013

Following the implementation of the Central Bank Reform Act, 2010, the Central Bank changed its regulatory approach from "principles based" to a "*more assertive, risk based and challenging approach*" to banking supervision. In 2011 the Central Bank implemented its new risk based framework for the supervision of regulated firms called PRISM. Summary detail is included below under Supervisory Engagement.

6.1 Engagements at the "most senior levels" between the Bank and each of the relevant banks

Senior Central Bank management engagement with the remainder of the Covered Banks and [redacted] became more routine during this period. There were regular meetings with the banks and these moved towards approximately quarterly meetings in 2012/2013. These covered both supervisory and non-supervisory matters and were supplemented by issue specific meetings. For example, the Governor held meetings with the main mortgage banks on occasions during this period to drive improvements in the resolution of mortgage arrears. Each of the Covered Banks was met following the PCAR / PLAR 2011 and also following the Balance Sheet Assessment (see below) exercises, with a particular focus on adequacy of provisioning in the latter meeting.

These meetings had become much more joined up with the overall supervisory engagement with the banks, and were often attended by the Head of the relevant Supervision Division to ensure that there was consistency of message and understanding of discussions.

6.2 Supervisory Regime

a) PRISM

The financial crisis and its aftermath led the Central Bank to revisit approaches to financial regulation in Ireland and elsewhere. Having reviewed international best practice together with its own experience, the Central Bank developed the Probability Risk and Impact SysteM (PRISM) to provide a structured framework for firm supervision. PRISM was introduced in November 2011 and it is the Central Bank's risk-based supervision framework for supervising regulated firms. PRISM enhances the Central Bank's ability to deliver judgement-based, outcome-focused regulation. It provides a tool for supervisors to continually challenge themselves and the firms they regulate in order to safeguard financial stability and protect consumers. It provides supervisors with a consistent way of thinking about risk whilst ensuring a minimum level of engagement for firms.

PRISM establishes an engagement model for the supervision of regulated firms and a tool to facilitate a detailed probability risk assessment of these firms. PRISM requires supervisors to challenge firms, to form judgements about the risks each firm presents and then to develop appropriate outcome-focused risk mitigation programmes to reduce unacceptable risks to an acceptable level with those risk mitigation programmes subject to appropriate quality control mechanisms.

PRISM enables supervisors and management to see the risks posed by firms in any sector at any point, facilitating frequent review of the evolving financial risks at a micro level, allowing high quality risk-based resource allocation and risk mitigation decisions to be taken, as well as clear communication to firms of the Central Bank's views of their risk profiles and its expectations regarding same. It also provides senior management with additional information to assess macro-prudential risks both within and across sectors.

- *PRISM – Impact and engagement*

One of the lessons from the financial crisis was that it is always vital to know a lot about significant financial services firms because they have a great capacity to adversely affect the economy. Thus, understanding the impact of failure on the economy or consumers of the firms that the Central Bank regulates is crucial. PRISM segments all the firms regulated by the Central Bank into distinct impact categories on the basis of quantitative data. Each firm is allocated to one of four impact categories reflecting its relative importance based on size, turnover, client base, the degree of prudential or customer harm it could cause if it failed etc. The five categories are high, ultra-high[4], medium-high, medium-low and low. A firm's categorisation may be revised as these metrics change over time.

To match the four impact categories, there are four engagement models. The higher impact firms have dedicated supervisory teams following a pro-active programme of supervision - to ensure a good knowledge of a firm's strategy and business model. This analysis focusses on, amongst other things, business models, financial risk analysis and governance. The Central

[4] Ultra High is a subset of High

Bank considers it to be crucial that the substance and sustainability of the business model of a firm is examined, a key lesson from the crisis.

Under PRISM, the most significant firms – those with the ability to have the greatest impact on financial stability and the consumer – will receive a high level of supervision under structured engagement plans, leading to early interventions to mitigate potential risks. The following table shows the minimum engagement tasks for Ultra High / High Impact firms.

[redacted]

Oireachtas

By way of example of the level of engagement undertaken under the PRISM framework the table below summarises the supervisory engagement with all the supervised banks in 2013:

PRISM ENGAGEMENTS	Banking
Full Risk Assessment (SREP)	7
Risk Governance Panels	13
Meeting with Chief Executive Officer (CEO)	72
Meeting with Chief Financial Officer (CFO)	45
Meeting with Chief Risk Officer (CRO)	82
Meetings with Chairman	31
Meetings with Senior Non-Executive Directors (NEDs)	21
Meetings with Internal Auditor	37
Meetings with External Auditor	25

PRISM ENGAGEMENTS	Banking
Board Meeting Attendance	7
Attendance at Board Committees	9
Meetings with other Senior Management	316
Meetings with Actuary	0
Other On-Site Meetings	31
Meetings with Board Independent Non-Executive Directors (INEDs)	36
Meetings with Group NEDs	10
Meetings with Compliance Officer	54
Financial Risk Review (FRR)	24
Other (not incl. FRR meetings)	13
Reviews/Inspections	38
Meetings with Supervisory Committee	1
Thematic Review	12
Authorisation Team Meetings	0
Other Meetings (not as part of engagement model)	55
1-day engagements	1
Other Reviews – non-PRISM	87
TOTAL	1027

Supervisors are resourced to have a deep knowledge of the financials as well as the corporate and internal governance structure of these firms in addition to being supported by credit and treasury expertise in this period. The Central Bank expects firms' leaders to co-operate with an intensive supervisory programme. It makes judgements on firms' leadership and the judgement shown by that leadership and takes action where required.

In terms of outcomes, the Central Bank is seeking to ensure that firms always have sufficient capital to cover the risks they are taking as well as having responsible individuals in charge. The Central Bank accepts some failures in financial services will occur from time to time, however, the main point is that finite resources are deployed in a way which mitigates the risk of problems occurring where they would have the most impact.

High impact firms will have a high level of continuous supervisory engagement – an irreducible minimum that will not fall, no matter how plausible the business plan, how good the apparent treatment of consumers or how large the corporate profits. PRISM went live for credit institutions and insurance companies on 1 December 2011. The following table shows the banks within the scope of the inquiry and how they are rated under PRISM. As they are all High or Ultra High, they were subject to the same engagement model during the period 2011 to 2013.

	Notes	Impact Rating
[redacted]	[redacted]	Ultra High
[redacted]	[redacted]	Ultra High
[redacted]	[redacted]	n/a
[redacted]	[redacted] Oireachtas	High
[redacted]	[redacted]	High (until liquidation)
[redacted]	[redacted]	n/a
[redacted]		High

As none of the in-scope banks had a medium or low impact rating, a description of the PRISM methodology is not included for medium or low impact rating firms.

- *Assessing probability risk and mitigating risk*

Understanding the capacity for a firm to cause harm – impact – is a critical component in PRISM. The other key part of risk assessment is understanding the probability that any given firm is going to cause harm at a given time. The Central Bank regularly assesses the risk profile of a high impact firm. As part of PRISM, a structured approach was introduced to assess the probability of a problem occurring by seeking to identify issues that could cause prudential or consumer failures. When risks exceed the Central Bank's risk appetite - where the probability of an adverse event is high or medium-high – the supervisor requires action to be taken by the firm to mitigate the risks.

In terms of deciding which risks supervisors should routinely look at in their probability risk assessment, international best practice has been considered. Based on this international review and the Central Bank's own experience the following risks in firms are assessed: governance risk, strategy/business model risk, credit risk, market risk, operational risk, insurance risk, liquidity risk, capital risk, environmental risk and conduct risk.

For each risk category, the supervisor is required to make a judgement as to the risk, based on the engagement tasks he or she has undertaken to assess the firm and supported by key information on the various risk types. For example, the engagement model for high impact firms requires six financial risk reviews to be conducted over every two-year period on key prudential risk elements. After each of these in-depth reviews, the supervisor will be required to re-evaluate the probability risk of the probability risk categories on which information has come to light as a result of the review. The supervisor will, having conducted the financial risk review, log into PRISM and be guided through the probability risk rating process. PRISM has detailed guidance available on what is covered by a particular risk, how it should be examined, and the key questions for the supervisor to consider in coming to a judgement about the appropriate risk score.

The rating of any risk category as medium-high or high probability will lead to the supervisor having to devise a plan for the firm - a risk mitigation programme (RMP) - to lower the risk to an acceptable level. Supervisors devise risk mitigation actions which are outcome-focused and result in problems being sorted out rather than simply analysed further. If firms continue to be non-compliant, supervisors can use the various financial penalties and other enforcement tools available to them in order to reflect the seriousness of the issue at hand and to serve as a meaningful deterrent to others.

- *Ensuring challenge*

One common theme of the Honohan, Nyberg and other reports was a lack of credible challenge, both within firms and by supervisors. Challenge is an essential aspect of risk assessment. Processes can help by prompting required challenge and setting up peer review or governance systems that are supposed to provide challenge. But effective challenge has an important cultural element, encouraging genuine discussion and debate, awkwardness even.

As Nyberg puts it, *"It must become respectable and welcome to express professionally argued contrarian views; neither this crisis nor many others have been or will be foreseen by the consensus view of professionals or managers ... authorities as well as bank boards and management need to remain particularly vigilant and professionally suspicious during extended good times..."*. Part of a supervisor's job, when assessing a firm, is to ensure that the firm has such a culture of challenge. Part of the Central Bank's role is to ensure that the culture and processes of banking supervision embrace and encourage challenge.

- *Governance*

Risk Governance Panels, which include senior representatives from the Consumer, Financial Stability and Risk Divisions, as well as divisional management and risk advisers are used to promote independent challenge to the supervisors' views and findings on a supervised entity. The forum is explicitly designed to robustly review the risk assessment put forward by the supervisors and the quality of the outcome-focused risk mitigation programme. This makes it structurally more likely that difficult questions will be asked, wider perspectives offered, and constructive proposals and amendments made to risk mitigation proposals.

In addition to this, the Supervisory Risk Committee, consisting of all the Directors and Divisional Heads reporting to the Deputy Governor (Financial Regulation), reviews urgent firm issues and PRISM firm risk and activity profile reports. Furthermore, the Central Bank Commission is also informed of key firm risk issues.

This structure is augmented by management information (MI) produced by PRISM which gives supervisors, managers and senior management tailored views of the risks by firm, sector and risk category (credit risk, market risk, governance risk, etc.). Such MI facilitates informed discussion with respect to the mitigation of key risks, as knowledge which is currently embedded within discrete groups of supervisors can be more widely shared and analysed.

Please see the following documents for further information on PRISM (attached at Appendix 11):

- Introduction to PRISM;
- Press release - Central Bank launches new risk-based supervision framework; and
- Matthew Elderfield's PRISM speech to the ACCA, Dec 2011

- *Actual Engagement with banks*

The following table provides a summary of the main engagement tasks under PRISM for High Impact firms and the additional tasks carried out in each area (over and above the minimum):

Supervisory Tasks	High – PRISM minimum engagement	Additional work carried out
Business Model Analysis	Every 2 years	On-going review of financials and board packs
Governance Reviews	Every 2 years	At least one if not two reviews carried out in each of 2011, 2012 and 2013
Stress tests	Annual and regular	
Financial Risk Reviews	6 every 2 years	Over the period in question a large number

Supervisory Tasks	High – PRISM minimum engagement	Additional work carried out
		of thematic reviews and inspections were carried out – see sections on credit risk and liquidity risk above
Full Risk Assessments	Continuous (see above)	
ICAAP/ORSA	Yes	
Risk Governance Panel	At least once a year	
Meeting with CEO	At least annual	At least six per annum and anything up to 12 in each of 2011, 2012 and 2013 at least for the main banks – Oireachtas [redacted]
Meeting with CFO	At least annual	
Meeting with CRO	At least annual	At least six per annum and anything up to 12 in each of 2011, 2012 and 2013 at least for the main banks – Oireachtas [redacted]
Meeting with Chairman	At least annual	
Meeting with Senior Non-Exec Directors	At least annual	
Meeting with Internal Auditor	At least annual	Quarterly
Meeting with External Auditor	At least annual	Three times a year as part of Auditor Protocol
Trigger Based Supervision	No	
Group Supervision (Lead)	Yes	One general college meeting per year and core college meeting every six weeks, quarterly conference calls, monthly telephone calls for core college
Co-Co/EU Meeting	Yes	
Model Approval (Group)	Yes	A number of Pillar 1 and Pillar II model reviews during period.
Board Meeting Attendance	Possible	No longer
Regulatory Returns Analysis	Yes	On a quarterly basis, also review management accounts on a monthly basis and CIFS reporting
Consumer Focused Thematic work	Yes	n/a
Skilled Persons Reviews on Issues	Yes	n/a

In addition to the above minimum engagement tasks as dictated by PRISM, the Central Bank also carries out a significant level of additional engagement tasks for the Covered Banks as follows:

- Significantly more meetings held with banks than PRISM minimum engagement – see table above for examples;
- Troika programme reviews;
- Review of Mortgage Arrears Resolution Strategies and banks' compliance with Mortgage Arrears Resolution Targets;
- Policy development;
- Recovery and resolution planning;
- Additional reviews of arrears and provisioning;
- Additional reviews of new lending;
- Review of queries relating to the Corporate Governance Code, consideration of Corporate Governance Code derogation requests;
- Review of annual compliance statements;
- Assessment of proposed appointees to the board and senior management of banks (PCF positions) in conjunction with the Regulatory Transactions Division;
- PCAR/PLAR/Financial Measures Projects;
- Review of board and board sub-committee packs; and
- Reviews of various proposals including outsourcing arrangements, new activities, capital arrangements etc.

b) Fitness & Probity *(see also response to Item 14, regarding governance)*

A new Fitness and Probity Regime came into effect on 1 December 2011 for all regulated financial service providers other than credit unions. 47 senior positions are prescribed as Pre-Approval Controlled Functions for regulated financial service providers. The prior approval of the Central Bank is required before an individual can be appointed to a Pre-Approval Controlled Function. The individual must complete an online Individual Questionnaire which is endorsed by the proposing entity and then submitted electronically to the Central Bank for assessment. Since 2011 the Central Bank's Regulatory Transactions Division ("RTD") has been responsible for receiving and assessing these on line applications however the supervisory team also has responsibility for assessing these with an emphasis on the following :

- Reviewing the application to ensure that it is in compliance with the Corporate Governance Code, for example ensuring that a proposed director does not exceed the permitted level of directorships, ensuring that the director will bring required skills to the board, etc.;

- Deciding whether or not an interview is necessary and if so, preparing for and holding the interview; and
- Liaising with the bank in relation to the appointment and following up on any issues arising from the review of the application.

c) Remuneration

Reports that issued following the 2007 financial crisis referred to the fact that excessive risk taking by credit institutions contributed to the financial crisis. One of the issues was rewarding directors, management and staff for short term profitability which gave incentives to staff to pursue riskier activities which provided higher short-term income and profit. Therefore in late 2009 the Central Bank requested banks to comply with CEBS high level recommendations on Remuneration and we subsequently wrote to banks in 2011 advising them that the EU legislation on remuneration had been transposed into Irish legislation effective 1 November 2011. Following the transposition of the requirements into Irish legislation the Central Bank carried out at least two detailed reviews of remuneration, one in 2010 and another in 2011.

In addition, banks are required under CIFS reporting to report on an annual basis the remuneration paid to the "Identified" staff. These reports are reviewed and issues raised with the bank where required.

d) Credit Risk

As noted in previous sections, credit risk became a significant focus of the supervisory work from 2008 onwards. Additional focus was given to analysis and challenging banks on their credit policies, exposures, arrears and levels of provisions. Several reviews were carried out and additional credit returns received. Between 2011 and 2013, the credit team undertook a number of rolling **loan file reviews** to assess the adequacy of provisions, the accuracy of credit risk grading, and the collateral valuations of the following institutions:

Bank	Reviews
[redacted]	• Three inspections of exposures to SME and commercial real estate ("CRE") exposures; • One mortgage loan file review of new modifications (2013).
[redacted]	• Two SME/CRE inspections, including one inspection of 90 days past due but not impaired commercial loans; • One mortgage loan file review of new modifications (2013).
[redacted]	• Two SME/CRE inspections; • mortgage loan file review of new modifications (2013).
[redacted]	• Two SME/CRE inspections, plus one inspection of [redacted] (and its management of [redacted] SME/CRE loans), • One mortgage loan file review of new modifications (2013)
[redacted]	• One SME/CRE inspection, • Two mortgage inspections

e) Liquidity Risk

In 2011 the Central Bank required the Covered Banks to commence new liquidity reporting requirements, including projected ECB funding requirements, and Loan to Deposit Ratios ("LDR") and Net Stable Funding Ratio ("NSFR") targets to be met by specified dates.

In September 2012 a further letter was issued to the Covered Banks which updated the 2011 requirements. A new Advanced Monitoring Framework was required to be implemented, the LDR was no longer required and a Liquidity Coverage Ratio (LCR) requirement was imposed. In addition to the above, a number of thematic reviews of each of the Covered Banks were also carried out as follows:

Treasury	Thematic Reviews
2011	Trading
2012	Asset Liability Committee Role
2013	Contingency Funding Plans Funding Strategies Interest Rate Risk in the Banking Book Liquidity Stress Testing Funds Transfer Pricing (FTP)
2014	Asset Encumbrance Market Risk CRD Preparedness Retail Deposit Outflows Structural Market Risk

f) Financial Strength/Reporting Requirements

Throughout the period 2011 to 2013 the Central Bank continued to engage on a consistent basis with banks in relation to their financial strength. This is achieved via a review of the annual Financial Statements, management accounts and a range of regulatory returns such as COREP, FINREP, liquidity reports, large exposure reports etc. The Central Bank monitored compliance with prudential standards, primarily through examining prudential returns (weekly, monthly and annual), financial statements and annual reports, conducting regular review meetings and on-site inspections.

g) Other Engagements

In addition to the above the Central Bank also carried out the following engagement tasks in the period 2011 to 2013:

Date	Engagement
2011	The Financial Measures Programme, under the Troika programme (see section 6.3 below), incorporated an Asset Quality Review ("AQR"), Prudential Liquidity Assessment Review, PCAR 2011 and the European Banking Authority ("EBA") stress test. The 2011 PCAR highlighted key findings in respect of credit risk (see below). A series of detailed desktop reviews and interviews [were carried out?] with key credit personnel in the banks in 2011 [addressing?]: • credit approval processes; • credit monitoring processes; • credit control and collections; and • impairment and provisioning oversight. The Mortgage Arrears Resolution Strategies ("MARS") programme was initiated in late 2011. The project assessed the banks' strategies to manage their distressed private dwelling house (PDH) and buy-to-let (BTL) portfolios and required improvements where deficiencies were identified. As part of the MARS requirements, the strategies developed by banks had to address, inter alia, resourcing, up skilling and training of staff, loan modification options, system developments, decision trees, policies/procedures and treatment of customers. The Asset Quality Review ("AQR"): conducted by Oireachtas to review the asset quality of the CRE, SME, Corporate and the first time buyer residential portfolios. The findings related to inconsistent collateral valuations, overdue case file reviews and insufficient financial information on borrower files. Other related work undertaken during 2011 included: • Data Integrity Verification; • Drawing up of revised Provisioning and Disclosure Guidelines; and • Work regarding Income Recognition and Re-ageing.

Date	Engagement
2012	• Continuation of the MARS Programme; • SME Distressed Credit Operations Review ("DCOR"): the Central Bank engaged [redacted] in 2012 to complete a specific review of non-mortgage commercial loans in Q2, 2012 - these reviews resulted in a number of findings which were followed up with the banks;
2013	Focus was given to evaluating (i) banks' strategies for managing SME and mortgage arrears; and (ii) the operational effectiveness of banks' arrears management and (iii) adequacy of provisioning. The following reviews were carried out: • On-going review of banks' progress against MARS targets, on-site testing of the sustainability of restructures and assessing any proposed new/amended restructuring products/options • Monitoring arrears, (re)default levels and market conditions • Audit of banks reported completion of proposed and concluded sustainable mortgage resolutions under the Mortgage Arrears and Resolution Targets (MART) framework • Onsite operational assessments of arrears support units • On-site Distressed Credit Review • Loan file reviews were carried out to test the durability of end state distressed credit solutions • A 90 Days Past Due (90DPD) review of non-impaired non-retail portfolios The Financial Measures Programme incorporated very significant levels of engagement with the banks in completion of the balance sheet assessment exercise (see below).

6.3 Financial Measures Programme (FMP)

The FMP actions agreed with the Troika topped and tailed this period of supervisory engagement with the relevant banks. The EU-IMF Programme (the Programme) aimed to restore Irish sovereign credit worthiness by the end of 2013. The main objectives of the Programme were to restore the domestic banking system to health, to create jobs, restore economic growth and place the public finances on a sustainable path. Under the terms of agreement of the Programme, Ireland committed to taking the necessary actions to achieve recapitalisation, downsizing, and reorganisation of the banking system.

The PCAR 2011 and Prudential Liquidity Assessment Review (PLAR), carried out as part of the overall FMP, were undertaken in 2011, together with an independent loan loss assessment exercise performed by [redacted]. These comprised the following:

- The PCAR 2011 was a stress test of the capital resources of [redacted] in order to calculate the cost of recapitalisation required to meet Central Bank imposed requirements.

- An independent loan assessment exercise performed by [redacted] which fed into the PCAR requirements.
- The Prudential Liquidity Assessment Review (PLAR) 2011 which established funding and de-leveraging targets for the banks participating in PCAR in order to: reduce the leverage of the banking system, reduce the banks' reliance on short-term and largely central bank funding, and ensure a more stable path to convergence with Basel III liquidity standards over time.
- The PCAR 2011 assessed the capital resilience of the banks versus an assumed base case scenario with a risk tolerance of 10.5% core tier 1 (CT1) and an extreme but plausible adverse (or stress) case with a risk tolerance of 6% CT1. The required recapitalisation was therefore determined on the basis of the projected capital shortfall using both of these scenarios and thresholds.
- These thresholds resulted in an additional capital requirement of €18.7bn. An additional equity capital buffer of €2.3bn and a contingent capital buffer of €3bn were also required. In addition, the banks subject to PCAR were required to maintain 10.5% CT1 on an ongoing basis. The new levels were based not just on expected loan losses but on potential losses in a stressed situation.

The 2013 FMP required multiple actions including a point in time balance sheet assessment (BSA), incorporating an Asset Quality Review (AQR)[5], of the three remaining Covered Banks [redacted]). The AQR, conducted by [redacted] for [redacted] and [redacted] and [redacted] for [redacted] comprised a quantitative assessment of the adequacy of provisions on an incurred loss basis and against the Central Bank's Impairment Provisioning and Disclosure Guidelines, a review of risk classifications with respect to impairment status and an evaluation of the calculation of risk weighted assets (RWAs) for credit risk. A Data Integrity Verification (DIV) exercise was also conducted to ensure the integrity of the data used in the AQR exercise. In addition [redacted] was appointed as the independent assessors of the overall exercise.

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5 (see http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Pages/FinancialMeasuresProgramme.aspx for more details).

The pro forma results were shared with the banks to help inform their financial planning and preparations for SSM. In addition the results were also used by the Central Bank to inform its Risk Mitigation Programmes as part of the SREP.

By way of illustration of the extent of the engagement with the banks and the programme of work undertaken and completed by the Central Bank during this period, the key items delivered under the Programme by the Central Bank to end 2013, including structural benchmarks, are listed below.

No.	Area	Action / Measure
1	**Capital Assessment**	The Central Bank provided the staff of the European Commission, the ECB and the IMF a review of developments in the PCAR banks relative to PCAR 2011. Overall results of this work were published in early March 2013. The Central Bank agreed with the staff of the European Commission, the ECB and the IMF on the specific details of the review.
2	**Deleveraging**	The Central Bank, in consultation with the Troika, assessed banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures Programme.
3	**Funding and Liquidity Monitoring**	The Central Bank provided staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.
4	**Asset Quality**	The Central Bank published banks' reported data on loan modifications, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.
5	**Asset Quality**	The Central Bank established a public target requiring the principal mortgage banks to offer durable restructuring arrangements for a substantial share of problem mortgage loans during 2013. (Structural benchmark)
6	**Financial Supervision**	The Central Bank provided a comprehensive report on progress in implementing the Central Bank's action plan for strengthening supervision of credit institutions.
7	**Financial Supervision**	The Central Bank reported on banks' progress with the implementation of strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.
8	**Financial Supervision**	The Central Bank engaged with each bank to ensure appropriately prudent provisioning including on key inputs, such as for estimating cure rates for originally performing, forborne, and modified loans, to ensure these cures reflect durable modifications.
9	**Financial Supervision**	Following completion of annual model performance reviews assessing banks' risk-weighted asset calculations forecasting and stress testing in advance of PCAR 2013, the Central Bank reported to the staff of the European Commission, the IMF and the ECB on progress with implementation of the findings from the credit regulatory capital review process and with the specific mitigating actions communicated to the banks. (Structural benchmark)

No.	Area	Action / Measure
10	Financial Supervision	Banking supervision and securities regulation: The Central Bank began an internal self-assessment of Ireland's observance of the recently revised Basel Core Principles (BCP) for Effective Banking Supervision. The Bank requested an external BCP assessment, with the aim of completing it by end-December 2013.
11	Asset Quality	In consultation with staff of the European Commission, ECB, and IMF, the Central Bank updated, where necessary, by end-May 2013 the 2011 Impairment Provisioning and Disclosure Guidelines. (Structural benchmark)
12	Capital Assessment	The Central Bank reported to the External Partners on the evolution of regulatory capital within the PCAR banks up to the end of December 2012.
13	Asset Quality	The Central Bank issued guidance to the credit institutions on the definition of a sustainable restructuring arrangement.
14	Asset Quality	The Central Bank proposed a public target requiring the principal mortgage banks to complete durable restructuring arrangements on a substantial share of problem mortgage loans during 2013.
15	Asset Quality	While ensuring that balanced incentives and debtors' sustainability are maintained, the Central bank completed a review of the Code of Conduct on Mortgage Arrears (CCMA), and published a revised Code.
16	Financial Supervision	The Central Bank reviewed the implementation of the 2011 CBI Provisioning and Disclosure guidelines by the Covered Banks with reference to the end-2012 published financial statements.
17	Financial Supervision	As a stock-taking of progress in addressing mortgage arrears, the authorities prepared a comprehensive review. (Structural benchmark)
18	Financial Supervision	The Bank reported on the exploration of options to lower the funding cost of banks' tracker mortgage portfolios.
19	Capital Assessment	Taking into account progress in developing the relevant SSM methodology, the Central Bank agreed with staff of the European Commission, the IMF, and the ECB other methodological aspects of the asset quality review on an incurred loss basis.
20	Capital Assessment	With regards to the assessment of balance sheets, the Central Bank agreed with the staff of the European Commission, the IMF and the ECB: the engagement of independent third parties to, respectively: (i) contribute to the implementation of the exercise including through on-site loan file reviews, and (ii) to validate the exercise.
21	Capital Assessment	The Central Bank agreed with the staff of the European Commission, the IMF and the ECB a detailed roadmap for the completion of the exercise specifying regular engagement, with the staff of the European Commission, ECB, and IMF, on an ongoing basis on progress, methodology, inputs, outputs, and findings.
22	Asset Quality	Based on consultations with the staff of the EC, ECB, and IMF, the Central Bank published a target for the conclusion by end-2013 of sustainable solutions of no less than 15% of mortgage loans in arrears for more than 90 days, consistent with largely completing sustainable solutions by end-2014 (prior action). We announced Q1 2014 targets for proposed solutions of 70% and for concluded solutions of no less than 25%.
23	Capital Assessment	The Central Bank agreed with staff of the European Commission, the IMF, and the ECB: the test parameters for benchmarking provisioning.

No.	Area	Action / Measure
24	Deleveraging	The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, assessed banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures
25	Funding and Liquidity Monitoring	The Central Bank provided staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.
26	Profitability	The Central Bank conducted a forward looking analysis of the operating profit for each of the PCAR banks, including sensitivity analysis to funding costs, to end 2015. (Structural Benchmark).
27	Profitability	The Central Bank reported on the exploration of options to lower the funding cost of banks' tracker mortgage portfolios.
28	Asset Quality	(i) The Central Bank provided staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage and SME portfolios in accordance with the agreed key performance indicators. (ii)The Central Bank monitored each PCAR bank's performance relative to already-defined key performance indicators for progress in resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.
29	Asset Quality	The Central Bank published banks' reported data on loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.
30	Financial Supervision	The Central Bank presented a comprehensive report on progress in implementing the it's action plan for strengthening supervision of credit institutions and discussed it together with the staff of the European Commission, the ECB and the IMF.
31	Financial Supervision	The Bank reported on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.
32	Capital Assessment	The Central Bank prepared a preliminary assessment of the balance sheets of the PCAR banks by end-October. (Structural Benchmark)
33	Capital Assessment	The Central Bank analysed current eligible regulatory capital under Basel III/CRD IV by end October.
34	Asset Quality	The Central Bank reported to staff of the EC, ECB, and IMF by early-November on the number and nature of mortgage solutions proposed in Q3 with a preliminary assessment of sustainability issues.
35	Asset Quality	The Central Bank reported on the outcome of the audit of banks' proposed mortgage solutions for Q2, which included an assessment of the sustainability of banks' solutions.
36	Capital Assessment	The balance sheet assessment was finalised and the pro forma results were communicated to the banks.
37	Deleveraging	The authorities produced a final report of the banks' implementation of their deleveraging plans under the PLAR 2011.
38	Financial Supervision	The authorities prepared a final comprehensive report on the remaining steps towards the full and timely implementation of the Central Credit Register.
39	Asset Quality	The Central Bank devised a system for lenders to report on legal proceedings with a view to ensuring progress towards achieving sustainable solutions.

No.	Area	Action / Measure
40	Asset Quality	The Central Bank will require lenders to have in place a strategy to address any potential shortfall from the repossession of the property.
41	Funding and Liquidity Monitoring	The Central Bank provided staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III liquidity and funding requirements using the advanced monitoring framework, along with a final report on progress towards compliance with Basel III liquidity and funding requirements by the relevant dates.
42	Asset Quality	The Central Bank published banks' reported data on loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.
43	Asset Quality	The Central Bank announced Q2 2014 targets for the principal mortgage banks to propose and conclude restructuring solutions for mortgage loans in arrears for more than 90 days.
44	Asset Quality	The Central Bank provided staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage and SME portfolios in accordance with the agreed key performance indicators. The Central Bank also monitored each PCAR bank's performance relative to already-defined key performance indicators for progress in resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.
45	Financial Supervision	The Central Bank presented a final comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the IMF, and the ECB.
46	Financial Supervision	The Bank completed an International Organisation of Securities Commissions, (IOSCO) Objectives and Principles of Securities Regulation self-assessment and requested an external assessment by the IMF with the aim to be completed by end-December 2013. The Bank also completed a BCP assessment and requested an external assessment by the IMF, with the aim to be completed by end-December 2013.

6.4 Beyond 2013

The approach to the supervision of the banking system in Ireland has continued to evolve. As well as addressing the findings of the IMF assessment, the Central Bank undertook a major change programme in 2014 to prepare itself for the commencement of the Single Supervisory Mechanism on 4 November. Banking Supervision was restructured in 2014. Formerly two divisions, Banking Supervision is now organised into three divisions:

Banking Supervision: Analysis Division (BSAD):

BSAD has been structured to create clear linkages, relationships, organisational workflows and seniority of engagement between the Central Bank and the SSM, and in particular Directorate General (DG) IV. DGIV has 10 divisions: Risk Analysis, Supervisory Policies, Planning and Coordination of Supervisory Examination Programmes, Centralised On-site Inspections, Internal Models, Enforcement and Sanctions, Authorisations, Crisis Management, Supervisory Quality Assurance, and Methodology and Standards Development.

BSAD continues to further strengthen its analytics capability, backed by robust data, such that it can deliver insightful analysis and, where required, decisive action. BSAD will also play a crucial role in assessing risks across the Irish banking system and ensuring that they are understood and proactively addressed. BSAD will be working closely with the other banking supervision divisions and the Central Bank's Financial Stability Division in this regard.

Banking Supervision: Inspections Division (BSID):

Onsite inspections of the banks' operations are much more intensive under the SSM methodology than was the case under the Central Bank's PRISM approach. They have a larger breadth and depth in terms of scope required. Consequently, it was determined that a separate Inspections Division was required, mandated to complete independent and in-depth inspections in the banks. The purpose of such in-depth inspections is, to assess the:

- level, nature and features of the inherent risks and the risk culture;
- appropriateness and quality of the bank's corporate governance and internal control framework;
- control systems and risk management processes, focusing on detecting weaknesses or vulnerabilities that may have an impact on the capital and liquidity adequacy of the bank;
- quality of balance sheet items and the financial situation of the bank; and
- compliance with banking regulations.

Banking Supervision: Supervision Division (BSSD):

The responsibilities of supervisory teams remain sizeable further to the implementation of the SSM. Working with SSM DGI, DGII and DGIII, BSSD is required to continue to assess the strategies, key risks, processes, procedures, governance and control structures of the banks. In conducting this work, supervisors will be required to continue reviewing and analysing the banks' various regulatory reports, internal capital and liquidity assessment and management processes, risk appetite statements etc., and will continue to be required to verify and challenge the banks' estimates, risk assessment outcomes, the outcome of stress tests and to determine overall risk priorities.

Supervisors are also expected to continue to hold regular and ad hoc meetings with the supervised banks at various levels of staff seniority, conduct on-going risk analysis, on-going analysis of approved risk models, and analyse and assess banks' recovery plans.

EUROPEAN CENTRAL BANK

INSTITUTIONAL PROVISIONS

STATUTE OF THE ESCB AND OF THE ECB

RULES OF PROCEDURE

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PUB00268-001

PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK*

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the Statute of the European System of Central Banks and of the European Central Bank provided for in Article 8 of the Treaty establishing the European Community,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community.

CHAPTER I

CONSTITUTION OF THE ESCB

Article 1

The European System of Central Banks

1.1. The European System of Central Banks (ESCB) and the European Central Bank (ECB) shall be established in accordance with Article 8 of this Treaty; they shall perform their tasks and carry on their activities in accordance with the provisions of this Treaty and of this Statute.

1.2. In accordance with Article 107(1) of this Treaty, the ESCB shall be composed of the ECB and of the central banks of the Member States ('national central banks'). The Institut monétaire luxembourgeois will be the central bank of Luxembourg.

CHAPTER II

OBJECTIVES AND TASKS OF THE ESCB

Article 2

Objectives

In accordance with Article 105(1) of this Treaty, the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price

* Protocol annexed to the Treaty establishing the European Community (OJ C 191, 29.7.1992, p. 68), as amended by the Treaty of Amsterdam (OJ C 340, 10.11.1997, p.1), the Treaty of Nice (OJ C 80, 10.3.2001, p. 1), Council Decision 2003/223/EC (OJ L 83, 1.4.2003, p. 66) and the Act concerning the conditions of Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded (OJ L 236, 23.9.2003, p. 33) – unofficial consolidated version.

stability, it shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of this Treaty. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4 of this Treaty.

Article 3

Tasks

3.1. In accordance with Article 105(2) of this Treaty, the basic tasks to be carried out through the ESCB shall be:

– to define and implement the monetary policy of the Community;

– to conduct foreign-exchange operations consistent with the provisions of Article 111 of this Treaty;

– to hold and manage the official foreign reserves of the Member States;

– to promote the smooth operation of payment systems.

3.2. In accordance with Article 105(3) of this Treaty, the third indent of Article 3.1 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.

3.3. In accordance with Article 105(5) of this Treaty, the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

Article 4

Advisory functions

In accordance with Article 105(4) of this Treaty:

(a) the ECB shall be consulted:

– on any proposed Community act in its fields of competence;

– by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 42;

(b) the ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.

Article 5

Collection of statistical information

5.1. In order to undertake the tasks of the ESCB, the ECB, assisted by the national central banks, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents. For these purposes it shall cooperate with the Community institutions or bodies and with the competent authorities of the Member States or third countries and with international organizations.

5.2. The national central banks shall carry out, to the extent possible, the tasks described in Article 5.1.

5.3. The ECB shall contribute to the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its fields of competence.

5.4. The Council, in accordance with the procedure laid down in Article 42, shall define the natural and legal persons subject to reporting requirements, the confidentiality regime and the appropriate provisions for enforcement.

Article 6

International cooperation

6.1. In the field of international cooperation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented.

6.2. The ECB and, subject to its approval, the national central banks may participate in international monetary institutions.

6.3. Articles 6.1 and 6.2 shall be without prejudice to Article 111(4) of this Treaty.

CHAPTER III

ORGANIZATION OF THE ESCB

Article 7

Independence

In accordance with Article 108 of this Treaty, when exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and this Statute, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

Article 8

General principle

The ESCB shall be governed by the decision-making bodies of the ECB.

Article 9

The European Central Bank

9.1. The ECB which, in accordance with Article 107(2) of this Treaty, shall have legal personality, shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under its law; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.

9.2. The ECB shall ensure that the tasks conferred upon the ESCB under Article 105(2), (3) and (5) of this Treaty are implemented either by its own activities pursuant to this Statute or through the national central banks pursuant to Articles 12.1 and 14.

9.3. In accordance with Article 107(3) of this Treaty, the decision making bodies of the ECB shall be the Governing Council and the Executive Board.

Article 10

The Governing Council

10.1. In accordance with Article 112(1) of this Treaty, the Governing Council shall comprise the members of the Executive Board of the ECB and the governors of the national central banks.

10.2. [1] Each member of the Governing Council shall have one vote. As from the date on which the number of members of the Governing Council exceeds 21, each member of the Executive Board shall have one vote and the number of governors with a voting right shall be 15. The latter voting rights shall be assigned and shall rotate as follows:

– as from the date on which the number of governors exceeds 15, until it reaches 22, the governors shall be allocated to two groups, according to a ranking of the size of the share of their national central bank's Member State in the aggregate gross domestic product at market prices and in the total aggregated balance sheet of the monetary financial institutions of the Member States which have adopted

1 As amended by Council Decision 2003/223/EC.

the euro. The shares in the aggregate gross domestic product at market prices and in the total aggregated balance sheet of the monetary financial institutions shall be assigned weights of 5/6 and 1/6, respectively. The first group shall be composed of five governors and the second group of the remaining governors. The frequency of voting rights of the governors allocated to the first group shall not be lower than the frequency of voting rights of those of the second group. Subject to the previous sentence, the first group shall be assigned four voting rights and the second group eleven voting rights;

– as from the date on which the number of governors reaches 22, the governors shall be allocated to three groups according to a ranking based on the above criteria. The first group shall be composed of five governors and shall be assigned four voting rights. The second group shall be composed of half of the total number of governors, with any fraction rounded up to the nearest integer, and shall be assigned eight voting rights. The third group shall be composed of the remaining governors and shall be assigned three voting rights;

– within each group, the governors shall have their voting rights for equal amounts of time;

– for the calculation of the shares in the aggregate gross domestic product at market prices Article 29.2 shall apply. The total aggregated balance sheet of the monetary financial institutions shall be calculated in accordance with the statistical framework applying in the European Community at the time of the calculation;

– whenever the aggregate gross domestic product at market prices is adjusted in accordance with Article 29.3, or whenever the number of governors increases, the size and/or composition of the groups shall be adjusted in accordance with the above principles;

– the Governing Council, acting by a two-thirds majority of all its members, with and without a voting right, shall take all measures necessary for the implementation of the above principles and may decide to postpone the start of the rotation system until the date on which the number of governors exceeds 18.

The right to vote shall be exercised in person. By way of derogation from this rule, the Rules of Procedure referred to in Article 12.3 may lay down that members of the Governing Council may cast their vote by means of teleconferencing. These rules shall also provide that a member of the Governing Council who is prevented from attending meetings of the Governing Council for a prolonged period may appoint an alternate as a member of the Governing Council.

The provisions of the previous paragraphs are without prejudice to the voting rights of all members of the Governing Council, with and without a voting right, under Articles 10.3, 10.6 and 41.2.

Save as otherwise provided for in this Statute, the Governing Council shall act by a simple majority of the members having a voting right. In the event of a tie, the President shall have the casting vote.

In order for the Governing Council to vote, there shall be a quorum of two-thirds of the members having a voting right. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum.

10.3. For any decisions to be taken under Articles 28, 29, 30, 32, 33 and 51, the votes in the Governing Council shall be weighted according to the national central banks' shares in the subscribed capital of the ECB. The weights of the votes of the members of the Executive Board shall be zero. A decision requiring a qualified majority shall be adopted if the votes cast in favour represent at least two thirds of the subscribed capital of the ECB and represent at least half of the shareholders. If a Governor is unable to be present, he may nominate an alternate to cast his weighted vote.

10.4. The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberations public.

10.5. The Governing Council shall meet at least 10 times a year.

10.6. [2] Article 10.2 may be amended by the Council meeting in the composition of the Heads of State or Government, acting unanimously either on a recommendation from the ECB and after consulting the European Parliament and the Commission, or on a recommendation from the Commission and after consulting the European Parliament and the ECB. The Council shall recommend such amendments to the Member States for adoption. These amendments shall enter into force after having been ratified by all the Member States in accordance with their respective constitutional requirements.

A recommendation made by the ECB under this paragraph shall require a decision by the Governing Council acting unanimously.

Article 11

The Executive Board

11.1. In accordance with Article 112(2)(a) of this Treaty, the Executive Board shall comprise the President, the Vice-President and four other members.

The members shall perform their duties on a full-time basis. No member shall engage in any occupation, whether gainful or not, unless exemption is exceptionally granted by the Governing Council.

2 As inserted by Article 5 of the Treaty of Nice.

11.2. In accordance with Article 112(2)(b) of this Treaty, the President, the Vice-President and the other members of the Executive Board shall be appointed from among persons of recognized standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council.

Their term of office shall be eight years and shall not be renewable.

Only nationals of Member States may be members of the Executive Board.

11.3. The terms and conditions of employment of the members of the Executive Board, in particular their salaries, pensions and other social security benefits shall be the subject of contracts with the ECB and shall be fixed by the Governing Council on a proposal from a Committee comprising three members appointed by the Governing Council and three members appointed by the Council. The members of the Executive Board shall not have the right to vote on matters referred to in this paragraph.

11.4. If a member of the Executive Board no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Governing Council or the Executive Board, compulsorily retire him.

11.5. Each member of the Executive Board present in person shall have the right to vote and shall have, for that purpose, one vote. Save as otherwise provided, the Executive Board shall act by a simple majority of the votes cast. In the event of a tie, the President shall have the casting vote. The voting arrangements shall be specified in the Rules of Procedure referred to in Article 12.3.

11.6. The Executive Board shall be responsible for the current business of the ECB.

11.7. Any vacancy on the Executive Board shall be filled by the appointment of a new member in accordance with Article 11.2.

Article 12

Responsibilities of the decision-making bodies

12.1. The Governing Council shall adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under this Treaty and this Statute. The Governing Council shall formulate the monetary policy of the Community including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB, and shall establish the necessary guidelines for their implementation.

The Executive Board shall implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. In doing so the

Executive Board shall give the necessary instructions to national central banks. In addition the Executive Board may have certain powers delegated to it where the Governing Council so decides.

To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB.

12.2. The Executive Board shall have responsibility for the preparation of meetings of the Governing Council.

12.3. The Governing Council shall adopt Rules of Procedure which determine the internal organization of the ECB and its decision-making bodies.

12.4. The Governing Council shall exercise the advisory functions referred to in Article 4.

12.5. The Governing Council shall take the decisions referred to in Article 6.

Article 13

The President

13.1. The President or, in his absence, the Vice-President shall chair the Governing Council and the Executive Board of the ECB.

13.2. Without prejudice to Article 39, the President or his nominee shall represent the ECB externally.

Article 14

National central banks

14.1. In accordance with Article 109 of this Treaty, each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation, including the statutes of its national central bank, is compatible with this Treaty and this Statute.

14.2. The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank shall be no less than five years.

A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or of any rule of law relating to its application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

14.3. The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.

14.4. National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.

Article 15

Reporting commitments

15.1. The ECB shall draw up and publish reports on the activities of the ESCB at least quarterly.

15.2. A consolidated financial statement of the ESCB shall be published each week.

15.3. In accordance with Article 113(3) of this Treaty, the ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year to the European Parliament, the Council and the Commission, and also to the European Council.

15.4. The reports and statements referred to in this Article shall be made available to interested parties free of charge.

Article 16

Banknotes

In accordance with Article 106(1) of this Treaty, the Governing Council shall have the exclusive right to authorize the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.

The ECB shall respect as far as possible existing practices regarding the issue and design of banknotes.

– hold and manage the assets referred to in this Article;

– conduct all types of banking transactions in relations with third countries and international organizations, including borrowing and lending operations.

Article 24

Other operations

In addition to operations arising from their tasks, the ECB and national central banks may enter into operations for their administrative purposes or for their staff.

CHAPTER V

PRUDENTIAL SUPERVISION

Article 25

Prudential supervision

25.1. The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.

25.2. In accordance with any decision of the Council under Article 105(6) of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

CHAPTER VI

FINANCIAL PROVISIONS OF THE ESCB

Article 26

Financial accounts

26.1. The financial year of the ECB and national central banks shall begin on the first day of January and end on the last day of December.

26.2. The annual accounts of the ECB shall be drawn up by the Executive Board, in accordance with the principles established by the Governing Council. The accounts shall be approved by the Governing Council and shall thereafter be published.

26.3. For analytical and operational purposes, the Executive Board shall draw up a consolidated balance sheet of the ESCB, comprising those assets and liabilities of the national central banks that fall within the ESCB.

CHAPTER IX

TRANSITIONAL AND OTHER PROVISIONS FOR THE ESCB

Article 43

General provisions

43.1. A derogation as referred to in Article 122(1) of this Treaty shall entail that the following Articles of this Statute shall not confer any rights or impose any obligations on the Member State concerned: 3, 6, 9.2, 12.1, 14.3, 16, 18, 19, 20, 22, 23, 26.2, 27, 30, 31, 32, 33, 34, 50 and 52.

43.2. The central banks of Member States with a derogation as specified in Article 122(1) of this Treaty shall retain their powers in the field of monetary policy according to national law.

43.3. In accordance with Article 122(4) of this Treaty, 'Member States' shall be read as 'Member States without a derogation' in the following Articles of this Statute: 3, 11.2, 19, 34.2 and 50.

43.4. 'National central banks' shall be read as 'central banks of Member States without a derogation' in the following Articles of this Statute: 9.2, 10.1, 10.3, 12.1, 16, 17, 18, 22, 23, 27, 30, 31, 32, 33.2 and 52.

43.5. 'Shareholders' shall be read as 'central banks of Member States without a derogation' in Articles 10.3 and 33.1.

43.6. 'Subscribed capital of the ECB' shall be read as 'capital of the ECB subscribed by the central banks of Member States without a derogation' in Articles 10.3 and 30.2.

Article 44

Transitional tasks of the ECB

The ECB shall take over those tasks of the EMI which, because of the derogations of one or more Member States, still have to be performed in the third stage.

The ECB shall give advice in the preparations for the abrogation of the derogations specified in Article 122 of this Treaty.

Article 45

The General Council of the ECB

45.1. Without prejudice to Article 107(3) of this Treaty, the General Council shall be constituted as a third decision-making body of the ECB.

45.2. The General Council shall comprise the President and Vice-President of the ECB and the Governors of the national central banks. The other members of the

Executive Board may participate, without having the right to vote, in meetings of the General Council.

45.3. The responsibilities of the General Council are listed in full in Article 47 of this Statute.

Article 46

Rules of Procedure of the General Council

46.1. The President or, in his absence, the Vice-President of the ECB shall chair the General Council of the ECB.

46.2. The President of the Council and a Member of the Commission may participate, without having the right to vote, in meetings of the General Council.

46.3. The President shall prepare the meetings of the General Council.

46.4. By way of derogation from Article 12.3, the General Council shall adopt its Rules of Procedure.

46.5. The Secretariat of the General Council shall be provided by the ECB.

Article 47

Responsibilities of the General Council

47.1. The General Council shall:

– perform the tasks referred to in Article 44;

– contribute to the advisory functions referred to in Articles 4 and 25.1.

47.2. The General Council shall contribute to:

– the collection of statistical information as referred to in Article 5;

– the reporting activities of the ECB as referred to in Article 15;

– the establishment of the necessary rules for the application of Article 26 as referred to in Article 26.4;

– the taking of all other measures necessary for the application of Article 29 as referred to in Article 29.4;

– the laying down of the conditions of employment of the staff of the ECB as referred to in Article 36.

47.3. The General Council shall contribute to the necessary preparations for irrevocably fixing the exchange rates of the currencies of Member States with a derogation against the currencies, or the single currency, of the Member States without a derogation, as referred to in Article 123(5) of this Treaty.

47.4. The General Council shall be informed by the President of the ECB of decisions of the Governing Council.

Article 48

Transitional provisions for the capital of the ECB

In accordance with Article 29.1 each national central bank shall be assigned a weighting in the key for subscription of the ECB's capital. By way of derogation from Article 28.3, central banks of Member States with a derogation shall not pay up their subscribed capital unless the General Council, acting by a majority representing at least two thirds of the subscribed capital of the ECB and at least half of the shareholders, decides that a minimal percentage has to be paid up as a contribution to the operational costs of the ECB.

Article 49

Deferred payment of capital, reserves and provisions of the ECB

49.1. The central bank of a Member State whose derogation has been abrogated shall pay up its subscribed share of the capital of the ECB to the same extent as the central banks of other Member States without a derogation, and shall transfer to the ECB foreign reserve assets in accordance with Article 30.1. The sum to be transferred shall be determined by multiplying the ECU value at current exchange rates of the foreign reserve assets which have already been transferred to the ECB in accordance with Article 30.1, by the ratio between the number of shares subscribed by the national central bank concerned and the number of shares already paid up by the other national central banks.

49.2. In addition to the payment to be made in accordance with Article 49.1, the central bank concerned shall contribute to the reserves of the ECB, to those provisions equivalent to reserves, and to the amount still to be appropriated to the reserves and provisions corresponding to the balance of the profit and loss account as at 31 December of the year prior to the abrogation of the derogation. The sum to be contributed shall be determined by multiplying the amount of the reserves, as defined above and as stated in the approved balance sheet of the ECB, by the ratio between the number of shares subscribed by the central bank concerned and the number of shares already paid up by the other central banks.

49.3. [4] Upon one or more countries becoming Member States and their respective national central banks becoming part of the ESCB, the subscribed capital of the ECB and the limit on the amount of foreign reserve assets that may be transferred to the

4 As inserted by Article 17 of the Act concerning the conditions of Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded.

DECISION OF THE EUROPEAN CENTRAL BANK

OF 19 FEBRUARY 2004

ADOPTING THE RULES OF PROCEDURE OF THE EUROPEAN CENTRAL BANK (ECB/2004/2)*

THE GOVERNING COUNCIL OF THE EUROPEAN CENTRAL BANK,

Having regard to the Statute of the European System of Central Banks and of the European Central Bank, and in particular to Article 12.3 thereof;

HAS DECIDED AS FOLLOWS:

Sole Article

The Rules of Procedure of the European Central Bank as amended on 22 April 1999, as further amended by Decision ECB/1999/6 of 7 October 1999 amending the Rules of Procedure of the European Central Bank[1], shall be replaced by the following which shall enter into force on 1 March 2004.

RULES OF PROCEDURE OF THE EUROPEAN CENTRAL BANK

PRELIMINARY CHAPTER

Article 1

Definitions

These Rules of Procedure shall supplement the Treaty establishing the European Community and the Statute of the European System of Central Banks and of the European Central Bank. The terms in these Rules of Procedure shall have the same meaning as in the Treaty and the Statute. The term 'Eurosystem' shall mean the European Central Bank (ECB) and the national central banks of those Member States whose currency is the euro.

CHAPTER I

THE GOVERNING COUNCIL

Article 2

Date and place of Governing Council meetings

2.1 The Governing Council shall decide on the dates of its meetings on a proposal from the President. The Governing Council shall, in principle, meet regularly

* OJ L 80, 18.3.2004, p. 33.

1 OJ L 314, 8.12.1999, p. 32.

following a schedule that it shall determine in good time before the start of each calendar year.

2.2 The President shall convene a meeting of the Governing Council if a request for a meeting is submitted by at least three members of the Governing Council.

2.3 The President may also convene meetings of the Governing Council whenever he/she deems it necessary.

2.4 The Governing Council shall normally hold its meetings on the premises of the ECB.

2.5 Meetings may also be held by means of teleconferencing, unless at least three Governors object.

Article 3

Attendance at Governing Council meetings

3.1 Except as provided herein, attendance at meetings of the Governing Council shall be restricted to its members, the President of the Council of the European Union and a member of the Commission of the European Communities.

3.2 Each Governor may normally be accompanied by one person.

3.3 If a Governor is unable to attend, he/she may appoint, in writing, an alternate without prejudice to Article 4. This written communication shall be sent to the President in due time before the meeting. Such an alternate may normally be accompanied by one person.

3.4 The President shall appoint a member of staff of the ECB as Secretary. The Secretary shall assist the Executive Board in preparing the meetings of the Governing Council and shall draft the minutes thereof.

3.5 The Governing Council may also invite other persons to attend its meetings if it deems it appropriate to do so.

Article 4

Voting

4.1 In order for the Governing Council to vote, there shall be a quorum of two-thirds of the members. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum.

4.2 The Governing Council shall proceed to vote at the request of the President. The President shall also initiate a voting procedure upon request from any member of the Governing Council.

4.3 Abstentions shall not prevent the adoption by the Governing Council of decisions under Article 41.2 of the Statute.

4.4 If a member of the Governing Council is prevented from voting for a prolonged period (i.e. more than one month), he/she may appoint an alternate as a member of the Governing Council.

4.5 In accordance with Article 10.3 of the Statute, if a Governor is unable to vote on a decision to be taken under Articles 28, 29, 30, 32, 33 and 51 of the Statute, his/her appointed alternate may cast his/her weighted vote.

4.6 The President may initiate a secret ballot if requested to do so by at least three members of the Governing Council. If members of the Governing Council are personally affected by a proposal for a decision under Articles 11.1, 11.3 or 11.4 of the Statute, a secret ballot shall be held. In such cases the members of the Governing Council concerned shall not participate in the vote.

4.7 Decisions may also be taken by written procedure, unless at least three members of the Governing Council object. A written procedure shall require: (i) normally not less than five working days for consideration by every member of the Governing Council; and (ii) the personal signature of each member of the Governing Council (or his/her alternate in accordance with Article 4.4); and (iii) a record of any such decision in the minutes of the subsequent meeting of the Governing Council.

Article 5

Organisation of Governing Council meetings

5.1 The Governing Council shall adopt the agenda for each meeting. A provisional agenda shall be drawn up by the Executive Board and shall be sent, together with the related documents, to the members of the Governing Council and other authorised participants at least eight days before the relevant meeting, except in emergencies, in which case the Executive Board shall act appropriately having regard to the circumstances. The Governing Council may decide to remove items from or add items to the provisional agenda on a proposal from the President or from any other member of the Governing Council. An item shall be removed from the agenda at the request of at least three of the members of the Governing Council if the related documents were not submitted to the members of the Governing Council in due time.

5.2 The minutes of the proceedings of the Governing Council shall be submitted to its members for approval at the subsequent meeting (or where necessary earlier by written procedure) and shall be signed by the President.

5.3 The Governing Council may lay down internal rules on decision-making in emergency situations.

6.10 The President shall inform the General Council, in accordance with Article 47.4 of the Statute, of decisions adopted by the Governing Council.

Article 7

Relationship between the General Council and the Executive Board

7.1 The General Council of the ECB shall be given the opportunity to submit observations before the Executive Board:

– implements legal acts of the Governing Council for which, in accordance with Article 12.1 of the Rules of Procedure of the European Central Bank, the contribution of the General Council is required,

– adopts, by virtue of powers delegated by the Governing Council in accordance with Article 12.1 of the Statute, legal acts for which, in accordance with Article 12.1 of the Rules of Procedure of the European Central Bank, the contribution of the General Council is required.

7.2 Whenever the General Council is requested to submit observations under the first paragraph of this Article, it shall be given a reasonable period of time within which to do so, which may not be less than ten working days. In a case of urgency to be justified in the request, the period may be reduced to five working days. The President may decide to use written procedure.

Article 8

European System of Central Banks Committees

8.1 Within its field of competence the General Council may request studies of specific topics by committees established by the Governing Council under Article 9 of the Rules of Procedure of the European Central Bank.

8.2 The national central bank of each non-participating Member State may appoint up to two staff members to take part in the meetings of a committee whenever it deals with matters falling within the field of competence of the General Council and whenever the chairperson of a committee and the Executive Board deem this appropriate.

CHAPTER III

SPECIFIC PROCEDURAL PROVISIONS

Article 9

Legal instruments

9.1 ECB Decisions under Article 46.4 and Article 48 of the Statute and under these Rules of Procedure, as well as ECB Recommendations and ECB Opinions adopted by the General Council under Article 44 of the Statute, shall be signed by the President.

9.2 All ECB legal instruments are numbered, notified and published in accordance with Article 17.7 of the Rules of Procedure of the European Central Bank.

Article 10

Confidentiality of and access to the ECB's documents

10.1 The proceedings of the General Council, and of any committee or group dealing with matters falling within its competence, shall be confidential unless the General Council authorises the President to make the outcome of their deliberations public.

10.2 Public access to documents drawn up by the General Council, and by any committee or group dealing with matters falling within its competence, shall be governed by a Governing Council decision adopted under Article 23.2 of the Rules of Procedure of the European Central Bank.

10.3 Documents drawn up by the General Council, and by any committee or group dealing with matters falling within its competence, shall be classified and handled in accordance with the rules laid down in the Administrative Circular adopted under Article 23.3 of the Rules of Procedure of the European Central Bank. They shall be freely accessible after a period of 30 years unless decided otherwise by the decision-making bodies.

Article 11

End of applicability

When, in accordance with Article 122(2) of the Treaty, all derogations are abrogated by the Council of the European Union and when the decisions provided for in the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland are taken, the General Council shall be dissolved and these Rules of Procedure shall no longer apply.

Done at Frankfurt am Main, 17 June 2004.

The President of the ECB

Jean-Claude TRICHET

FINANCIAL SERVICES REGULATION IN IRELAND – THE ACCOUNTABILITY DIMENSION

Jonathan Westrup

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2

Regulators and accountability

2.1 The role of regulators

The Irish political and administrative system is slowly coming to terms with the establishment of independent regulatory agencies. The focus on the role of regulators has been triggered by the creation of two utility regulators: the Office of the Director of Telecommunications Regulation (ODTR); and the Commission for Energy Regulation (CER).[3] The debate has tended to neglect the role of the Central Bank, which as a financial regulator has had responsibility for the prudential supervision of the banking system since 1971.

The government decision to remove the state monopoly in the telecommunication and electricity markets made the decision to establish independent regulators inevitable because of the conflict between the state's ownership of the utilities and its regulatory role. Article 157 of the Treaty of Rome instructs European regulators 'to neither seek nor take instruction from any government or from any other body' in the performance of their duties (Majone, 1996: 5-18).

The Irish political system is not alone in coming to terms with the role of regulators. The United States established its first independent regulatory commission, the Interstate Commerce Commission, as far back as 1887, but has a political system with a clear separation of powers (Keller, 1990). This means a different accountability structure from a Westminster system of government, because the regulatory commissions are accountable to Congress.

It was the privatisation programme of the public utilities in Britain, beginning with British Telecom in 1984, and the European Union's adoption of a policy of market liberalisation for the utility sector, that has brought the debate to Ireland. In the utility area, the European Union has determined that the state cannot be both the owner and the regulator of the utility.

[3] The government also established the Commission for Aviation Regulation in 2001. The Communications Regulation Bill (2002) incorporates the ODTR into the Communications Commission.

The remainder of this chapter outlines why independence and accountability are essential features of a regulatory system.

2.2 Independence

Majone (1996) summarises the reasons for the independence of regulators:

- a regulator has rule-making or adjudicative functions that would not be appropriate for either a government department or court
- a regulator needs access to a high level of expertise because of the complexity of regulatory issue
- a regulator can provide greater stability and continuity because it is removed from the electoral cycle.[4]

Fingleton (1999:10) defines independence in a regulatory context as meaning that

> regulation is carried out free of direction, influence or pressure and is guaranteed by statute in respect of the day-to-day responsibilities and functions of a regulator, within a legal framework that sets out policy objectives, duties and responsibilities.

The ODTR and the CER are both defined as independent in their enabling legislation. A financial regulator has the same requirement of independence as the utility regulators because it too has rule-making and adjudicative functions that require the level of independence defined by Majone.

2.3 Accountability

The perceived lack of accountability of the utility regulators has triggered debate and concern about who regulates the regulators. Former Attorney General David Byrne stated 'legislators should not stand over any system which takes away the rights of citizens to

[4] The political science academic literature increasingly uses a principal/agent framework to explain a government's decision to delegate powers to independent agencies such as regulators. For example, Thatcher and Stone Stewart (2002) argue that the government (as the principal) gains in delegating power to the regulator (as agent) because: it improves the credibility of policy; helps to overcome information asymmetries in technical areas of governance; enhances the efficiency of rule making; and helps the government to avoid taking the blame for unpopular decisions.

hold to account individuals who make decisions that affect their everyday lives' (Byrne, 1998). Michael McDowell, the Attorney General (1997-2002), declared 'the age of non-accountable power is over' (McDowell, 1999).

As Verheijen and Millar (1998: 97) point out, accountability has 'become one of the dominant themes in studies of public policy' as the structure of governance becomes increasingly complex and it becomes therefore more difficult to separate institutional responsibility for policy decisions. March and Olsen (1995: 152) state that the 'general principle is that anyone who has power within a democratic state should ultimately be accountable to the people for the exercise of that power'. They must 'report, explain and justify any exercise of authority; and submit to sanctions if necessary' (March and Olsen, 1995: 59).

Rhodes (1997) distinguishes between *political, managerial and legal* accountability.[5] Political accountability is defined as 'those with delegated authority being answerable for their actions to the people' while managerial accountability is defined as 'making those with delegated authority answerable for carrying out agreed tasks according to agreed criteria of performance' (Day and Klein, 1987: 27). Managerial accountability is often described as administrative accountability. Legal accountability is ensuring that those with delegated authority adhere to both Irish and international law. Peters divides accountability mechanisms between *ex ante* and *ex post*, with *ex ante* defined as the 'traditional rule-based' methods of specifying the duties and responsibilities of those with delegated authority, while *ex post* mechanisms are those designed to ensure that the duties and responsibilities have been carried out (Peters, 1996).

Rhodes (1997) argues that what he terms as the 'traditional mechanisms of accountability in representative democracy' are not designed to cope with 'multi-organizational, fragmented policy systems'. Western democracies have reacted in different ways to this challenge but Peters (1996) argues that a general theme has been an attempt to strengthen the role of *ex post* mechanisms such as audit offices, parliamentary committees and ombudsmen. These efforts can be understood as part of what Kettl describes as the 'global

[5] The focus of this paper is on the political and managerial accountability of the new financial regulator. It recognises that the McDowell Report and the Department of Finance have proposed mechanisms designed to ensure legal accountability.

public management revolution' (Kettl, 2000) and an attempt to improve and refine the methods of accountability described by Rhodes. An important example is an attempt to increase the level of citizen participation in policy-making and to create what Peters describes as 'the participatory state'.[6] Examples include the establishment of citizens' charters and the creation of consumer panels for regulatory agencies in Britain. Underpinning these efforts is Day and Klein's assertion that accountability has to be understood not only as the *right* to call people to account but also must be complemented 'by the notion of power as the *ability* to call people to account' (Day and Klein, 1987: 9).

2.4 Accountability in the Irish political system

The Irish political system has seen considerable change to both its *ex post* and *ex ante* mechanisms of accountability. The Strategic Management Initiative (SMI) was introduced in 1994 and foreshadowed the Public Services Management Act (1997). The rationale behind the SMI and the PSM was an attempt to define the *ex ante* responsibilities of those with delegated authority, because it asserted that ministers are responsible for choosing outputs and that public servants are responsible for producing the outputs (Boyle, 1998). The Act also determined that each department of state or scheduled office must publish a strategy statement every three years or within six months of the appointment of a new minister, '*that comprise the key objectives, outputs and related strategies (including use of resources)*' (Public Service Management Act 1997, Section 5.1 (a)). The Department of Public Enterprise proposed in March 2000 that strategy statements be extended to the utility regulators.[7]

The *ex post* mechanisms have also changed. The Ombudsman Act 1980 gave citizens a mechanism by which administrative actions can be investigated. The Comptroller and Auditor General (Amendment) Act 1993 widened the remit of the Comptroller and Auditor General (C&AG). The Oireachtas committee system has been strengthened by the Compellability of Witnesses Act 1997[8] and

[6] Peters (1996:47) describes it as 'the search for more political, democratic, and collective mechanisms for sending signals to government'.

[7] 'It is proposed that each regulator be required to adopt at regular intervals, strategy statements that reflect its statutory mandate and submit them to the minister'; Department of Public Enterprise (2000a:23).

[8] The full title of the Act is: Committees of the Houses of the Oireachtas (Compellability, Privileges and Immunities of Witnesses) Act, 1997.

the high visibility of the Public Accounts Committee report on the Deposit Interest Retention Tax controversy in 1999.[9] The Freedom of Information Act (1997) gives citizens powers to access certain government information.[10] The cumulative effect of these reforms is open to debate, but they provide the context in which the proposed accountability structure of the new financial regulatory structure can be analysed.

In the context of a regulator, similar issues of accountability arise whenever the state delegates specific powers to agencies. These are assessed in this paper in an analysis of both an *ex ante* and *ex post* framework of accountability. In general terms, they can be described as

> *ex ante:* the Oireachtas defines the authority that is delegated to the regulator in legislation. The legislation also determines the *ex post* mechanisms
> *ex post*: these are the control mechanisms by which the government and the Oireachtas attempts to ensure that the regulator fulfils its delegated functions. These include a requirement to report to the relevant government department, appear before certain Oireachtas committees and a requirement to account to the C&AG for the spending of public money. The decisions of a regulator are also subject to judicial review by the courts to ensure it does not exceed its legal authority.

This paper discusses the evolution of these mechanisms in relation to the utility regulators and attempts to assess their effectiveness as a means for ensuring both the accountability and independence of the new financial regulator. For a regulator to be accountable but also independent, the paper argues that the state must

1 define the role that the regulator is expected to perform, and clarify the differences between the role of government and the role of the regulator
2 ensure that there are mechanisms that function effectively, where the regulator can be asked to 'report,

[9] The Deposit Interest Retention Tax controversy arose over allegations in 1998 of widespread evasion of the tax by the use of non-resident deposits. See the Public Accounts Committee's Report *Parliamentary Inquiry into DIRT: First Report 1999* for a full description.
[10] Verheijen and Millar (1998) and Dooney and O'Toole (1999) describe, in detail, the changes to these accountability mechanisms.

explain and justify' the exercise of its authority (Majone, 1996: 59).

2.5 Regulatory risks

It is clear from the experience of the utility regulators in Britain that defining the respective roles of the government and a regulator is not an easy task.[11] However, with the appropriate *ex ante* and *ex post* accountability mechanisms, three potential risks to good governance from regulation can be minimised:

1. the danger to which Byrne and McDowell refer of unaccountable authority (see Section 2.3)
2. the risk of inappropriate government intervention in the regulatory process
3. the risk of 'regulatory capture'

A regulator that is not accountable to the political process is at variance with the basic tenet of democratic theory as described earlier: 'the general principle is that anyone who has power within a democratic state should ultimately be accountable to the people for the exercise of that power' (March and Olsen, 1995: 152). As both the comments of Byrne and McDowell indicate and the government's explicit remit to the Implementation Advisory Group on the establishment of a Single Regulatory Authority confirms, the objective of accountability for the financial regulator has had a high political priority.[12]

A clearly defined structure of accountability will also minimise the risk of inappropriate political intervention in financial regulation. There may be little or no evidence of such political intervention in the past but, given the significance and sensitivity of financial regulation, it is important to design a structure to ensure that it cannot occur. A clearly defined structure also reduces the need for what the OECD terms 'the command and control reflex', which it describes as 'looking first to regulatory solutions rather than other types of policy instruments (or no intervention), [that] is still present among [Irish] parliamentarians and regulators' (OECD, 2001: 49). An accountability structure that has clearly defined

[11] For an excellent exposition of the controversies in Britain, see Vogel (1996).

[12] *Report of the Implementation Advisory Group on the Establishment of a Single Regulatory Authority for the Financial Services Sector* (1999); its remit included 'the organisational structure for the authority including the manner of its public accountability' (p. 91).

responsibilities should reduce the desire or the apparent need to intervene.

Regulatory capture, where a regulator is 'captured' by producer interests is a recognised phenomenon in the regulatory literature.[13] Fingleton, Evans and Hogan (1998: 26) define regulatory capture as a 'situation in which a market regulator largely reflects the interests of the regulated industry in its actions instead of the interests of consumers'. The OECD (2001) considers that the Irish regulatory bodies 'need to be vigilant to avoid capture by producer interests' which 'tend to take precedence over consumer interests'.

2.6 Conclusion

This chapter argues that the accountability structure of the financial regulator must be designed to ensure a delicate balance between independence and accountability. A financial regulator must be independent because of its specific rule-making and adjudicative functions. However, with the appropriate *ex ante* and *ex post* mechanisms, independence does not imply that a regulator cannot be accountable to the political process.

While the design of such mechanisms is not straightforward, the chapter asserts that they will minimise the risk of a regulator assuming unaccountable authority, of political interference in the regulatory process and of the emergence of regulatory capture.

[13] See Stigler (1971).

3.4 The evolution of the existing regulatory framework

The structure of regulation of the financial sector, prior to the government's February 2001 decision and subsequent legislation to reorganise the sector, is best described as fragmented. The responsibility for the legal framework, and therefore policy formulation, for financial regulation has been divided primarily between the Department of Finance and the Department of Enterprise, Trade and Employment. Table 2 itemises their specific responsibilities.

Table 2: Framework of financial regulation

Department of Finance	• Responsible for the legal framework for the Central Bank (regulator) • Supervises directly banks and building societies. (1) • Authorises and supervises investment intermediaries, stockbrokers and exchanges.
Department of Enterprise, Trade and Employment	• Legal framework • Legislative framework for Director of Consumer Affairs • Regulator for insurance undertakings

Source: Report of the Implementation Advisory Group on the Establishment of a Single Regulatory Authority for the Financial Services Sector (1999), Dublin: Stationery Office.
Note: (1) The Department of Environment and Local Government is responsible for the overall legislative framework for building societies.

The Department of Enterprise, Trade and Employment has been responsible for both policy formulation and regulation in the insurance area.[18] The IMF states 'this location of the supervisor (regulator) within a Ministry means that it is not a fully independent entity' (International Monetary Fund, 2001; quotation from Table 1, 'Ireland: Observance of IAIS Insurance Supervisory Principles–Summary Assessment'). An important part of the

[18] This combination of responsibilities is extremely unusual in an international context.

financial regulatory system has therefore not been independent as Majone (1996) and Fingleton (1999) define the term.

The Central Bank has had statutory responsibility for the direct supervision of virtually all financial institutions in Ireland with the exception of insurance undertakings with 'a trend in recent years to concentrate the prudential regulation of financial institutions in the Bank' (McDowell Report, 1999: 5). The Central Bank, according to the C&AG, considers that its regulatory objectives are to ensure as far as possible that

- individual financial institutions comply with a set of rules that are designed to ensure their continuing solvency and liquidity (prudential supervision)
- risks to the financial system as a whole are minimised (systemic supervision)
- there is a degree of protection for depositors with credit institutions and for clients of investment firms (conduct of business supervision) (Comptroller and Auditor General, 1999b, Section 1.7).

There has been no one institution with responsibility for consumer regulation, which has been divided between the Central Bank, the Director of Consumer Affairs and the Department of Enterprise, Trade and Employment. In this capacity, the Central Bank has had a very limited role in consumer regulation. It is responsible for conduct of business rules, various compensation schemes and maintains registers 'to enable the consumer to determine which firms are authorised' (McDowell Report: 11). The Director of Consumer Affairs has a range of powers under various Acts of the Oireachtas, in particular the Consumer Credit Act of 1995. This gives the Director the power to regulate the level of bank charges. The Department of Enterprise, Trade and Employment administers the Consumer Credit Act and the Consumer Information Act of 1978 that prohibits misleading advertising.

3.5 Assessment of prudential regulatory structure

The focus on the need for a change in the regulatory structure has concentrated on the role of the consumer. There has been little public discussion about the prudential side of regulation because the rate of failure among financial institutions has been low.

However, as the C&AG's report on the Central Bank argued, the fact that there has been a very low level of prudential failure does not mean that it can be assumed that prudential regulation is beyond criticism. The report recommended that 'a more comprehensive set of measures should be developed' to identify 'the contribution of the Bank's risk management activities to the level of stability achieved' (Comptroller and Auditor General, 1999b: 40).

The Central Bank responded to the C&AG's review and set up a Financial Services Policy Committee in January 2000 'to better coordinate supervisory activities' and 'additional steps were taken to enhance the "risk-based approach" to supervision' (International Monetary Fund 2001, Paragraph 32). The IMF in its inspection found the Central Bank to be fully compliant with the Basle Core Principles for effective banking supervision (IMF 2001).[19]

However, the IMF report considered that in the area of insurance regulation, Ireland 'may need to consider more stringent requirements to address the risks that could be inherent in a rapidly growing and increasingly complex insurance sector' (IMF, 2001, Executive Summary, Review of IAIS Insurance Supervisory Principles). The report specifically mentions 'the location of a supervisor within a Ministry means that it is not a fully independent entity'. It also comments on 'the limited resources to carry out a formal inspection programme' and that 'there is no formal programme in place and limited capacity in practice to direct and monitor the internal control systems of insurers'.

Given the importance of financial regulation, the government's decision to set up a single regulator should include a commitment to subject the IFSRA to a regular external audit of its regulatory capability.

3.6 The recent evolution of financial regulation

Given the 'multiplicity of bodies' that has made up the structure of the financial regulatory framework, it is no surprise that a 'consumer gap' emerged (John Corcoran, quoted in *Report of the Oireachtas Joint Committee on Finance and the Public Service*, 1999). The recognition of such a gap in financial regulation for the consumer was recognised as far back as the Oireachtas debate on the Central Bank Act of 1989 as the following quotes indicate.

[19] The Bank for International Settlements (BIS), through its Basel Committee, has outlined twenty-five core principles for effective banking supervision. See http://www.big.org.

by no means the last word on banking crisis, it highlights an approach to regulation that in effect tries to work with market forces, rather than supplant them.

Prevention would be easier if the onset of crises could be predicted, but models are better at showing fragility than predicting timing (Demirgűç-Kunt and Detragiache, 2005). With no effective forecasting system, good containment and resolution policies are also needed to deal with the next crisis when it comes.

Financial Stability Reports

The Financial Stability reports of the Central Bank and Financial Services Authority of Ireland for 2006 and 2007 and the Annual Report of the Financial Regulator 2007 are relevant in relation to how problems were then identified and issues addressed. Aspects of the 2006 report are outlined below for illustration.

In the Financial Stability Report for 2006 the opening statement in the Summary was as follows:

The overall assessment of this Report is that financial stability risks may be seen to have increased since the Financial Stability Report 2005"

From the same paragraph:

While the central expectation remains that the current shock-absorption capacity of the banking system leaves it well placed to withstand pressures from possible adverse economic and sectoral developments, nonetheless these signs of a further build-up in vulnerabilities are a cause for concern.

The vulnerabilities included strong credit growth, high indebtedness levels (private sector debt-to-income ratio set to reach about 192% by end 2006 at then growth rates), and house price increases though a soft landing in the residential property market was still seen as the most likely outcome.

The summary of the report also noted that these risks had heightened "at a time when risks to the macro economy arising from both domestic and international developments are also apparently increasing". There was seen to be disproportionally large dependence on the construction sector, downward pressure on Ireland's competitiveness, and areas such as high and volatile energy prices, and "potential adverse financial market and exchange rate developments and the heightened risk of an abrupt slowing in the US housing market".

However, the report went on to say, "Currently the stability and health of the Irish banking system remains robust when assessed by the usual indicators of financial health such as asset quality, profitability, solvency liquidity and credit ratings".

The report stated that the Irish banking sector's funding gap – the ratio of private sector deposits to private sector loans – had widened further and was the largest in the euro area. The funding of domestic lending by Irish credit institutions via domestic retail deposits declined from 76.9% in 2000 to 54% in the second quarter of 2006. The inter bank market (48.9%) accounted for the sourcing of the largest share of the non retail funds of Irish institutions with the issuance of debt securities (32.1%) next. The aggregated euro area ratio of private sector deposits to loans was approximately 85%.

It was remarked that continued reliance on wholesale funding was of concern for two reasons: it is generally more expensive, and with increased competition domestically could place further pressure on net-interest margins and profitability, and secondly "the nature of wholesale funding, which is generally more volatile than deposit based funding, could exacerbate any potential shock to the Irish economy. In the event of such a shock to the Irish economy, a withdrawal of international funds could constrain the ability of Irish banks to advance further credit with possible adverse implications for economic growth".

Articles on specific topics "Systemic Consequences of Long-Run Trends in Banking" and "Bottom-up Stress Testing - the Key Results" were published in the 2006 Financial Stability Report. The article on systemic trends is relevant to issues discussed in Chapter One. One extract is directly relevant to what ensued later in 2008 in Ireland:

> *The liberalisation of the banking system may therefore have transformed it from an industry that assumed insufficient risk to one that now tends to assume too much risk.*
>
> *Unfortunately, this latter situation is exactly the type in which bank management will tend to meet whatever borrowing requirements are registered by those endeavouring to satisfy their investment exuberance in financial markets. Although lending for asset purchase, where there may clearly be a speculative element involved, may not be in the long-run interest of bank shareholders, it may well be in the short-run interests of bank management. This kind of incentive structure is therefore a congenial one for promoting asset price misalignment. In the kind of environment in which accommodating monetary policies have ensured that liquidity is in ample supply and banks have little, or no, funding constraints (such as has been the case over the last number of years) and in which the demand for leverage for financial asset acquisition is strong, these incentive effects can result in excess lending that can dramatically under-price risk.*

It may not therefore be an environment congenial to financial stability. It is evident therefore that agency problems can constitute an important ingredient to financial instability.

The view was also expressed there was a specific risk to which banks might become increasingly vulnerable which would arise from the tendency for liquidity to behave chaotically in financially stressed conditions which might provide a testing environment for banks as "it can dramatically change the level of funding available to banks in a short space of time".

Overall, however, the assessment in the Article was that the overall repercussions of developments in the financial markets for financial stability could be profound, and the "view taken here is that they would be mainly benign".

The article on stress testing referred to the round of 'bottom-up' testing conducted in 2006 by CBFSAI with 11 domestic retail credit institutions and that the "institution's assessment of then financial position in a serious economic downturn suggests that the banking system's shock-absorption capacity is strong". Shock Scenario 1 assumed a GDP decline of -0.3 in 2007 and – 4.8 in 2008. The broad finding of the bottom-up exercise was supported in general by a second-stress-testing exercise in 2006 (a top-down stress test) conducted in-house in CBFSAI. It suggested that "banks shock absorption capacity is strong with respect to the key risks namely, credit, liquidity, foreign exchange, equity price and interest rate risks. The data suggest that the banking system could cope with a realisation (in a significant way) of each of these risks individually".

The limitations to both approaches to stress testing were stated: the measuring of initial impact only and not accounting explicitly for second round effects, assumptions, for example on loss-given default rates and the realisability of collateral in a downturn, and in the in-house analysis the assessment of the vulnerability of the system to each risk sequentially. It was stated that while the broadly positive outcome of the bottom up test was welcome, that the results of the bottom-up tests were likely to have understated the adverse effects of shocks which would be mainly due "to the fact that the stress tests are relatively mechanical in nature and do not capture behaviour in circumstances where uncertainty increases significantly and rapidly".

In the 2007 Financial Stability Report (based on data available up to end September 2007) the Governor in a Foreword stated that:

Our overall assessment is that financial stability risks have, on balance, increased since the 2006 report. Nevertheless, the overall conclusion is that the Irish financial system's shock absorption capacity remains robust and the system is well placed to cope with emerging issues.

In the Summary of the 2007 report, it was noted that the domestic banks reported no significant direct exposures to US subprime mortgages. In addition, there was an easing in residential house-price growth, and "the underlying fundamentals of the residential market continue to appear strong. The central scenario is therefore for a soft, rather than a hard, landing". Overall, it was stated that the health of the banking system remained robust "when measured by the usual indicators, solvency, profitability, liquidity, asset quality and market indicators".

2007 Report of the Comptroller and Auditor General

An examination of the Financial Regulator by the Comptroller and Auditor General was published in May 2007. This report found that in practice the standards for financial service providers were a combination of principles, rules and guidance. It referred back to earlier times of Central Bank control stating that in a value for money report on financial regulation published by the C and AG in 1999, "it was noted that supervision effort was not based on an assessment of the risk associated with regulated entities". The Financial Regulator had since its establishment been devoting considerable effort to developing a formal risk-rating model and significant progress in achieving such a model had been made.

The report concluded that there should be further development of the risk rating model, with the definition of thresholds for discrete risk categories and the appropriate supervisory stance to be followed for each such category.

It noted that the Financial Regulator is obliged to implement requirements specified in domestic and EU legislation, "but may have a choice in the manner in which it does so". Costs and benefits were discussed. Costs can be categorised mainly as the levies imposed by the Financial Regulator on individual financial service providers, the administrative costs of regulation for such providers, and the policy costs of regulation (for example, holding a "level of liquidity" over and above what a service provider might otherwise hold).

Reference was then made to a report commissioned by the UK's Financial Services Authority in June 2006 (Oxera Consulting Ltd) which identified a wide range of potential benefits of regulation including:

- Benefits to consumers such as better choice, reduced prices, more equitable access etc;
- Benefits to producers such as low costs, for example by avoiding expenses needed in monitoring counterparties etc;
- Benefits to the wider economy such as higher output due to reductions in systemic risk, lower costs of financial services for businesses etc

ANNEX ONE

The Existing Legal Powers of Regulation and Supervision

It is a worthwhile exercise, both in analysing the reasons for the Financial Crisis and in the consideration of future remedies, to analyse the existing legal powers of regulation and supervision. The Crisis, both in its domestic and international manifestation, is self evidently a failure, of either regulation and supervision, or of regulation or supervision. The question is whether, or to what extent, that failure resulted from an inadequate framework or from the inadequate application of a largely adequate framework.

In the face of events such as the Financial Crisis it is perhaps in human nature for both reflexive reaction and a reactive rearguard rationalisation to join in the leap to the unexamined conclusion that extensive changes in the law relating both to the structure and the substance of financial regulation and supervision are required. It is however a conclusion to which some examination and analysis is owed.

Such examination and analysis as is here conducted is carried out in the context of the Irish system, save where the European and International systems have caused or contributed to a lack or defect in the Irish system.

In assessing the adequacy of powers of regulation and supervision (and of the structure in, and through which, those powers are exercised) it is a sound principle to require concrete evidence of the inadequacy or inefficiency of existing powers either through a failed attempt to deploy these powers or, at least, a concrete demonstration of an attempt, or wish, to act, frustrated for the want of adequacy of these powers.

At base, in terms of the activities of banks, two principal factors lie at the root of the Financial Crisis – excessive lending in excessive concentrations and liquidity practices which proved inadequate to the stresses encountered.

In examining and analysing the existing legal powers of regulation and supervision the point, which first and foremost requires to be made, is that banking is a licensed activity – that is it requires the grant from the State - in this instance in the form of the Central Bank and Financial Services Authority of Ireland ("the Central Bank")[7] - of a license to be lawfully conducted[8]. Thus, to carry on banking business, or hold out, or

[7] The Central Bank may not refuse to grant a licence without the consent of the Minister for Finance and unless it is satisfied that the grant of the licence would not be in the interest of the orderly and proper regulation of banking, and the Minister is not to grant his consent to a refusal of a licence unless he is satisfied that the grant of the licence would not be in the interest of the orderly and proper regulation of banking – Section 9 (2) of the Central Bank Act, 1971 ("the 1971 Act").

[8] Interestingly this is a point to which the new Governor of the Central Bank, Dr. Patrick Honohan, has averted more than once recently.

represent one's self as a banker, or as carrying on banking business, is prohibited[9] and any person who contravenes this prohibition is guilty of an offence[10].

Where that offence is committed by a company, or by a person purporting to act on behalf of a company, and it is proved to have been so committed with the consent or approval of, or to have been facilitated by any wilful neglect on the part of, any director, manager, secretary, member of any committee of management or other controlling authority or official of such company, then that other person, as well as the company, or the person so purporting to act, are also guilty of an offence and liable to be proceeded against and punished accordingly.

Not alone has the Central Bank, in granting a banking licence, power to impose on the licence any conditions which, in the opinion of the Bank, are calculated to promote the orderly and proper regulation of banking[11] but, more pertinently for our purposes, the conditions of a banking licence may be amended, revoked or added to and conditions may be imposed from time to time by the Central Bank if, in its opinion, the amendment, revocation, addition or imposition is calculated to promote the orderly and proper regulation of banking[12].

The holder of a licence committing, by act or omission, a breach of a duly imposed condition relating to a banking licence is guilty of an offence and, again, where that offence is committed by a company, the directors, managers, officers etc of the company consenting to, approving or facilitating such a breach, by any wilful neglect, are themselves guilty of an offence[13].

True it is that any such imposition, amendment or additions to the conditions of a licence require, as might be expected, adherence to procedural steps with, quite properly, a right for the licence holder to make representations. Undoubtedly, as with the exercise of any regulatory function, the administrative law provisions for judicial review apply to any exercise by the Bank of these powers. There could be difficulties in terms of discrimination between Irish institutions licensed by the Bank and those exercising their "passport" rights under EU law and whose licence to conduct banking business in Ireland stemmed from the authorisation of their home regulator and, in certain instances, these considerations might have restricted the Bank even in relation to Irish institutions. Nonetheless, the fundamental, far reaching and flexible nature of the power of the Bank to impose conditions on banking licences poses a powerful

[9] Section 7 (1) of the 1971 Act (as amended by Section 70 (a) of the Central Bank Act 1997 ("the 1997 Act")).

[10] Section 58 of the 1971 Act (as amended by Section 9 of the Central Bank Act, 1989 ("the 1989 Act")). The offence is punishable, on summary conviction, with a fine not exceeding €1,104.58 or, at the discretion of the Court, to imprisonment for a term not exceeding 12 months or to both, or, on conviction on indictment, to a fine not exceeding €55,217.92, or imprisonment up to five years, or both.

[11] Section 10 (1) of the 1971 Act.

[12] Section 10 (2).

[13] Section 58 (1) (c) of the 1971 Act (as amended by Section 9 of the 1989 Act) and Section 11 of the 1989 Act.

argument requiring to be answered by those asserting a deficiency in the existing powers of regulation and supervision of banks.

Licensing and Supervision Requirements and Standards for Credit Institutions

These were first published in Autumn 1971[14], in the context of the coming into force, on 1 September 1971, of the Central Bank Act, 1971 ("the 1971 Act"). They were subsequently revised in 1975[15], 1981[16], 1987[17] and 1995[18]. The constitute requirements which the Bank uses to guide it in the assessment of applications for banking licences and in the supervision of the business carried on by credit institutions. They are stated to be made because many of the statutory provisions are of a discretionary nature and the Requirements and Standards are non-statutory requirements applied by the Bank to credit institutions as a supplement to the statutory requirements. They apply to all credit institutions authorised by the Bank, including branches in Ireland of credit institutions incorporated outside the European Economic Area ("the EEA"). They have limited application to branches of credit institutions incorporated in other EEA Member States, the supervision of which, under EU Banking Directives, is almost exclusively the responsibility of the supervisory authority in that Member State, i.e. home country supervision.

The Requirements and Standards are stated to apply to the totality of each institution's operations and, in addition, where relevant, the various ratios and limits are to apply to the consolidated position of each institution. Credit institutions are required to comply with the Bank's supervision requirements at all times although compliance is not to relieve the boards and management of credit institutions of the fundamental responsibility to conduct the operations of their institutions in accordance with the relevant laws and in a prudent manner, with full and primary regard for the safety of depositors' funds.

The Requirements and Standards contain provisions on the authorisation and ownership of credit institutions, the board and management of credit institutions, internal controls, consolidated supervision, capital adequacy, liquidity, funding, lending, annual accounts, external auditors, money laundering, acquisitions, asset securitisation, branching and cross-border services and deposit protection.

The provisions range from the very broad and general:-

> "Credit institutions should establish appropriate and prudent policies for the management of their liquidity. They should ensure, to the satisfaction of the

[14] *Central Bank of Ireland, Quarterly Bulletin*, Autumn 1971.

[15] *Central Bank of Ireland, Annual Report, 1975* (1).

[16] *Central Bank of Ireland, Quarterly Bulletin,* Autumn 1981 (3).

[17] *Central Bank of Ireland, Quarterly Bulletin,* Autumn 1987.

[18] *Central Bank of Ireland, Quarterly Bulletin,* Winter 1995.

> Bank, that adequate internal systems exist to monitor maturity mismatches between their assets and liabilities[19]"

to quite specific and direct rules:-

> "a credit institution's exposure to any one of its directors, including any exposures to any business in which the director has a major interest may not exceed 2% of own funds; the aggregate of all such exposures may not exceed 10% of own funds[20]."

Their significance for our purpose lies in their capacity for allowing the Bank, in the exercise of its broader statutory functions, to be specific in relation to particular areas of concern and to impose further requirements.

Revocation of Licences

It has sometimes been suggested that the Central Bank's actions in the field of regulation and supervision were constrained, in that it had (at least prior to 2004) few if any options short of the revocation of a banking licence and this, clearly, would be a "nuclear option". In fact, while, as has been seen, the Central Bank has relatively wide, far reaching and flexible powers to impose conditions in respect of a banking licence, with breaches of such conditions constituting offences, its power to deploy revocation as a disciplinary or control sanction is actually quite limited. The revocation of a banking licence (other than upon the request of the licence holder) can only be effected by the Central Bank with the consent of the Minister for Finance and mostly for reasons relating to solvency. Apart from the situation where a licence has been obtained through false statements or any other irregular means, the only "quasi disciplinary" revocation which can be effected is where a licence holder is convicted on indictment of an offence under the Central Bank Acts or of an offence involving fraud, dishonesty or breach of trust[21].

Continuing Routine Supervision of Credit Institutions

The Central Bank, in the due discharge of its functions, can specify from time to time different kinds of records which the holder of a banking licence (and each related body) is then obliged to keep at an office within Ireland. This is in addition to any other requirements of law with respect to the keeping of records (such as those, for example, imposed under the Companies Acts or the Taxes Acts).

Since 1 May 2003, either the Governor of the Central Bank or the Chief Executive of the Irish Financial Services Regulatory Authority ("the Regulatory Authority"), may, in writing, authorise an employee of the Central Bank, or a suitably qualified person

[19] Paragraph 6.1, Licensing and Supervision Requirements and Standards for Credit Institutions.

[20] Paragraph 8.4 (a).

[21] Section 11 of the 1971 Act (as amended by Section 34 of the 1989 Act).

to investigate the business, or any aspect of the business, of the holder of a banking licence, or of a related body to such a holder[22].

An authorised person so appointed has the power to enter upon the licence holder's premises and then has powers to request the production of records for inspection, the inspection of such records (or those found in the course of inspection), the taking of copies of the records and to request the answering of questions with respect to records[23]. A person, to whom a request to answer questions with respect to records is made, is obliged to comply with that request, so far as it is possible to do so and also to give such other assistance and information to the authorised person, with respect to the business of the licence holder (or the related body), as is reasonable in the circumstances[24]. To fail to comply with such a request as far as it is possible to do so, or to fail to give assistance and information, is an offence punishable as set out above[25] and, once more, the provision in relation to directors, managers or officials of a company applies to such a contravention[26].

Since the 1971 Act the holders of banking licences have had wide obligations, renewed and extended by the 1989 Act, the Central Bank Act, 1998 ("the 1998 Act") and the Central Bank and Financial Services Authority of Ireland Act 2004 ("the 2004 Act") to provide the Central Bank, at such times and within such period, as the Bank specifies from time to time, with such information and returns concerning the banking business of the licence holder (and of associated companies) as the Bank specifies from time to time[27]. Apart from this power, which appears designed to provide for regular information returns, there is a separate obligation to provide other information or returns as may be requested in writing by the Central Bank concerning the banking business of the licence holder.[28]

The Central Bank also has power from time to time to require the holder of a licence to maintain either a specified ratio, a ratio which does not exceed a specified ratio, or a ratio which is not less than a specified ratio, between the assets and liabilities of the licence holder and this specified ratio can be expressed as a percentage of the assets or

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[22] Section 17A of the 1971 Act (as inserted by Section 35 (1) and Item 2 of Part 6 of Schedule 1 of the Central Bank and Financial Services Authority of Ireland Act 2003 ("the 2003 Act").

[23] Ibid.

[24] Ibid (4).

[25] See note 4 above and Section 58 of the 1971 Act (as amended by Section 9 of the 1989 Act and Section 35 (1) and Item 5 of Part 6 of Schedule 1 of the Central Bank Financial Services Authority of Ireland Act 2003 ("the 2003 Act")).

[26] Section 58 of the 1971 Act (as amended by Section 9 of the 1989 Act).

[27] Section 18 (2) of the 1971 Act (as last amended by Section 33 and Item 7 of Part 4 of Schedule 3 to the 2004 Act).

[28] Section 18 (3) of the 1971 Act (as last amended by Section 33 and Item 7 of Part 4 of Schedule 3 to the 2004 Act).

liabilities concerned[29]. A requisition to this effect may be expressed to apply in relation to all holders of licences or to the holders of a specified category or specified categories and can also be expressed to apply in relation to the total assets or total liabilities of the holders of licences concerned or to specified assets or assets of a specified kind or specified liabilities or liabilities of a specified kind of those holders and also in relation to a specified time or times during a specified period or periods[30].

A person who fails to comply with such a requisition is guilty of an offence and liable to punishment as set out above and the provision in relation to directors, officials etc. of a company also applies[31].

The Administrative Sanctions Regime

To this not insignificant body of regulatory and supervisory powers and provisions, the 2004 Act added a parallel and alternative level of administrative sanctions.

The 2003 Act, in establishing the regulatory authority as a constituent part of the Central Bank, confers on the Authority the principal function of performing the functions which the Central Bank has under or in respect of the whole or specified parts of a list of Acts of the Oireachtas[32] (which now stands at 32 in number) across the whole field of financial regulation ranging from the Insurance Act 1936 to the Consumer Protection Act 2007, and a list of specified Statutory Instruments (which now stands at 44 in number) ranging from the Actuary (Qualification) Regulations 1940 to the European Communities (Cross-Border Payments in Euro) Regulations 2002[33].

The legislation refers to these as the "Designated Enactments" and the "Designated Statutory Instruments" and the 2004 Act[34]. This introduces the notion of a "prescribed contravention" which embraces not merely a contravention of a provision of a Designated Enactment or a Designated Statutory Instrument but also a contravention of

- A code made, or a direction given, under a Designated Enactment or Designated Statutory Instrument, or
- Any condition or requirement imposed under a provision of a Designated Enactment, Designated Statutory Instrument, code or direction, or

[29] Section 23 (1) of the 1971 Act.
[30] Section 23 (2) of the 1971 Act.

[31] Section 58 (1) (d) of the 1971 Act (as amended by Section 9 of the 1989 Act).

[32] And one Act of the Parliament of the late United Kingdom of Great Britain and Ireland – the Assurance Companies Act 1909.

[33] Section 33C(1)(a) and Schedule 2 of the 1942 Act (as inserted by Section 26 of the 2003 Act).

[34] Section 10(1) introduces a new Part IIIC to the 1942 Act dealing with their enforcement.

- Any obligation imposed on any person by Part IIIC or imposed by the Regulatory Authority in the exercise of a power conferred on it under that Part[35].

Further, "contravene" is defined as including not simply failure to comply, but also as including –

(a) attempting to contravene, and

(b) aiding and abetting and counselling and procuring a person to commit a contravention, and

(c) inducing, or attempting to induce, a person (whether by threats or promises or otherwise) to commit a contravention, and

(d) being (directly or indirectly) knowingly concerned in, or a party to, a contravention, and

(e) conspiring with others to commit a contravention[36].

Whenever the Regulatory Authority suspects on reasonable grounds that a regulated financial service provider (a concept a great deal wider than, but including, a credit institution[37]) committing or has committed a "prescribed contravention", it may hold an inquiry to determine whether or not the financial service provider is committing or has committed the contravention[38].

In addition, whether as a separate inquiry or as part of such an inquiry, whenever the Regulatory Authority suspects on reasonable grounds that a person concerned in the management of a regulated financial service provider is participating or has participated in the commission of a "prescribed contravention" by the financial service provider, it may hold an inquiry to determine whether or not the person is participating or has participated in the contravention[39].

As would be expected, procedures are laid down for the conduct of such inquiries[40]. They are normally to be held in public[41] power to someone witnesses and take

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35 Section 33AN of the 1942 Act (as inserted by Section 10(1) of the 2004 Act).
36 Ibid.

37 As a person who carries on a business of providing one or more financial services whose business is subject to regulation by the Bank of a Regulatory Authority under the 1942 Act or under a Designated Enactment or a Designated Statutory Instrument – Section 2 of the 1942 Act (as substituted by Section 3of the 2003 Act and amended by Section 2 of the 2004 Act).

38 Section 33AO of the 1942 Act (as inserted by Section 10(1) of the 2004 Act).

39 Ibid (2).

40 They are to be conducted with as little formality and technicality, and with as much expedition as a proper consideration of the matters allow and while the rules of procedural fairness are to be observed such enquiries are not bound by the rules of evidence – Section 33AY.

41 Section 33AZ.

evidence[42] and to publish the finding together with details of any sanction imposed[43]. Decisions are normally appealable[44], questions of law may be referred to the High Court[45] and the period within which traditional review of a decision of the Regulatory Authority under the Part must be made is abridged, in normal circumstances, to two months after the date of the decision[46].

Where a regulated financial service provider is found to be committing, or to have committed, a prescribed contravention one or more of the following sanctions may be imposed:

(a) a caution or reprimand;

(b) a direction to refund or withhold all or part of an amount of money charged or paid, or to be charged or paid, for the provision of a financial service by the financial service provider;

(c) a direction to pay to the Regulatory Authority a monitory amount, in the case of a company, of up to €5,000,000;

(d) in the case of a continuing contravention, a direction ordering the cessation of the contravention;

(e) a direction to pay to the Regulatory Authority all or a specified part of the costs incurred in holding the inquiry and in investigating the matter to which the inquiry relates[47].

In the case of a person concerned in the management of a regulated financial service provider where there is a finding that such person is participating or has participated in the commission by the financial service provider of a prescribed contravention, one or more of the following sanctions may be imposed:

(a) a caution or reprimand

(b) a direction to pay to the Regulatory Authority a monetary penalty more generally not in excess of €500,000;

(c) a direction disqualifying the person from being concerned in the management of a regulated financial service provider for a specified period;

(d) in the case of a continuing contravention, a direction ordering the person to cease participating in the commission of the contravention;

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[42] Section 33BA.

[43] Section 33BC.

[44] Section 33AX – to the Irish Financial Services Appeals Tribunal established by Part VIIA of the 1942 Act (as inserted by Section 28 of the 2003 Act).

[45] Section 33BB.

[46] Section 33BF.

[47] Section 33AQ(3).

(e) a direction to pay to the Regulatory Authority all or a specified part of the costs incurred in holding the inquiry and in investigating the matter to which the inquiry relates[48].

There is provision for an abbreviated procedure where the regulated financial service provider concerned, or, as the case may be, the person concerned in the management of a regulated financial service provider, acknowledges the contravention[49]. Where a monetary penalty has been imposed by the Regulatory Authority and the prescribed contravention is also an offence under the law of the State then the relevant person is not liable to be prosecuted or punished for the offence under that law[50] and, conversely, the administrative sanction regime cannot result in a monetary penalty where the person concerned has been charged with an offence which involves the prescribed contravention[51].

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[48] Section 33AQ(5).

[49] Section 33AR.

[50] Section 33AT(1).
[51] Section 33AT(2).

Financial Services Consultative Industry Panel

Painéal Comhairleach Tionscail na Seirbhísí Airgeadais.

Industry Panel Annual Report

2005

Chairman's Statement

This is the first Annual Report of the Financial Services Consultative Industry Panel ("the Panel"), a body established under the Central Bank and Financial Services Authority of Ireland Act 2004. The role of the Panel is to act in an advisory capacity to the Irish Financial Services Regulatory Authority (the Financial Regulator) as it seeks to build a balanced and competitive financial services regulatory environment in Ireland.

This is a major undertaking for both the Financial Regulator and the Irish financial services industry. Established in May 2003, the Financial Regulator is one of the newest modern integrated regulatory authorities in existence. The period 2003-2006 has been primarily about development and establishment, but current expectations are that a mature "steady state" will be achieved in the near future, with a consequent leveling-off of expenditure growth.

Achieving Regulatory Balance

Building a balance between over-regulation and under-regulation across the range of financial service sectors operating in Ireland is no easy task. Over-regulation creates the potential to so anaesthetise the delivery of financial service products in Ireland that consumer choice and competition in the market is reduced. Under-regulation leads to sub-standard processes and services to the detriment of the consumer and the market. Over-regulation and under-regulation create major inherent issues for any financial services market, and in seeking to achieve the right balance in the Irish market, there is absolutely no conflict between the Financial Regulator and the financial services industry.

Balanced regulation in a principles-based competitive market cannot create a "zero failure" regime, in Ireland or in any other country. This fundamental reality requires broad, industry-wide, regulatory, and political understanding. Ireland is recognised as a well-regulated jurisdiction, but if regulations are broken, the answer is neither necessarily nor invariably extra regulation.

The Irish Market is Unique

The Financial Regulator is responsible for a financial services market that is unique in an international context. This generates particular challenges for the Financial Regulator which are not always well understood. In a domestic context, the Financial Regulator is responsible for a market that is as sophisticated as any developed European retail financial services market. However, at the same time, the Irish domestic market lacks the economies of scale that exist with larger countries, and this in itself results in particular cost-of-service pressures. The Irish domestic market also has unique features such as a Credit Union movement with a market penetration greater than any country in the world.

The Role of the Financial Regulator.

It is worth outlining the generic scope and nature of the work of financial regulation, to ensure a clear understanding of the objectives of the Financial Regulator on the part of regulated entities and stakeholders such as the public, the media and the public sector.

Fundamentally, financial regulation has two intertwined objectives, namely to ensure that industry operates in a cost effective and responsive regulatory system that facilitates innovation, competitiveness and growth, and that consumers can make well-informed decisions in a safe financial market. The work of a Financial Regulator can therefore be broken down into four core activities:

- **Authorisation**
  Who can operate in the Irish market whether as an entity providing financial services or as an individual employed in the industry. Authorisation may also include the approval of individual financial services products, especially new initiatives.

- **Conduct of Business**
  Setting out the principles and rules applying in the market so that financial services providers act in a fair and transparent manner in their dealings with their customers.

- **Supervision & Inspection**
  Subjecting supervised entities to a range of requirements in respect of, inter alia, capital adequacy, regulatory reporting, client money, fitness and probity of staff, and ensuring that these requirements are being addressed, including on-site inspections

- **Sanctions**
  The power to impose sanctions where financial services providers have been found to be noncompliant with legislation or regulatory requirements. Examples of sanctions include formal cautions, fines, and disqualification.

The actual structure of the Financial Regulator follows this schematic, with functional departments in place headed by senior managers to deliver these objectives.

The Panel is anxious to ensure that the process of financial regulation operates in a timely way, with speedy response and guidance, especially for the wholesale sector. In this context, the Panel is pleased that agreement has been reached for the introduction of service protocols between the Financial Regulator and industry.

In a principles-base regulatory environment, company directors must behave correctly. In the competitive arena in which Ireland operates, it is, however, understandable that international corporate management will seek guidance from the Financial Regulator, whether in the application process, or in terms of conduct of business rules or supervision. The Panel believes that in order for Ireland to remain competitive in the international market for financial services, such guidance combined with speed of response must be a fundamental part of the core values of the Financial Regulator.

These four pillars of the regulatory regime must also be seen in the context of their impact on the cost of regulation. The budgeted direct cost of the Financial Regulator for 2006 is €48 million. The total cost to industry of implementing the regulatory environment in which it must operate is a multiple of this, potentially in excess of twenty times the direct cost, particularly when applied to the retail sector.

The Panel is conscious of the increasing prevalence of regulatory impact assessment. We urge the Financial Regulator to commit to bringing forward soon proposals which set out clearly the policies and methodologies which will underpin its commitment to the application of RIA and the principles of Better Regulation, as enunciated by the Government in its recent initiative.

Survey of Regulated Entities

In seeking to carry out its mandate in the most effective way, the Panel commissioned a survey of all regulated entities in the first quarter of 2006, the first such survey of the financial services industry in Ireland. The purpose of the survey is to obtain information for both the Financial Regulator and the Panel in order to identify the optimum regulatory environment, especially the achievement of regulatory balance, and to guide the Panel in its work in 2006.

The survey was carried out in two phases. The first phase consisted of confidential in-depth interviews with senior industry executives, professional advisors and the Financial Regulator. In the second phase, postal questionnaires were sent to all regulated firms to seek industry views and feedback on the performance of the Financial Regulator, and to measure the impact on industry of current and prospective financial regulation.

The specific objectives of the survey were:

- to obtain the views of senior executives and senior compliance managers of the impact of financial regulation on their businesses;
- to seek their views on the priorities and approach the Financial Regulator should take in the years ahead;
- to comment on service standards and operational efficiency of the Financial Regulator, with a particular emphasis on whether (and what) approaches are working well and whether (and what) approaches could be improved; and
- to provide views on how the Financial Regulator can achieve its vision of a regulatory system that facilitates innovation and competitiveness.

The findings of the survey, which will be available on the Panel's website by the end of the second quarter, will also inform our discussions with the Financial Regulator concerning the Strategic Plan for 2007-2009.

Consumer Issues

The Panel engaged constructively with the Financial Regulator on a range of aspects of the proposed Consumer Protection Code. The Panel deliberated on the Regulatory Impact Assessment and advocated Financial Regulator-led workshops on central concepts within the Code. It urged the Financial Regulator to address the potential overlap between the Code and the Markets in Financial Instruments Directive and also to ensure that realistic implementation periods are set for the code.

The Panel also considered the Financial Regulator's proposals on advertisements for the consolidation of mortgage debt and highlighted the anomaly which exists whereby not all mortgage lenders come within the Financial Regulator's remit. The Panel recommends that the Financial Regulator review this situation and make appropriate policy proposals to the Department of Finance.

Regulatory Performance

A considerable amount of the Panel's time is devoted to high-level issues such as the development of a model for dialogue between the Panel and the Financial Regulator, and concerns over erosion of principles-based regulation. One of the most important components of such high-level considerations was the Panel's decision to commission the first annual survey of the Financial Regulator, currently underway, which will help inform the Panel and the Financial Regulator of industry concerns and aspirations for the future of the regulatory environment. Activity under this heading in 2005 comprised:

- Development of a relationship model with the Financial Regulator
- Interaction with Financial Regulator on Service Level Agreements
- Discussions on Regulatory Impact Analysis / Principles Based Regulation / Cost of Regulation
- Survey of Financial Regulator
- Response to Department of Finance concerning Consolidation of Financial Legislation

Competitiveness

A key area of Panel responsibility is to foster and encourage innovation and product development and to ensure that the regulatory regime sponsors the international competitiveness of the Irish financial services industry. In 2005, the Panel was actively involved in this objective through detailed discussions on:

- Input to Financial Regulator's Strategic Plan 2006-2008
- Response to Department of Finance on Financial Regulator's budgets for 2005 & 2006

The dialogue concerning the Strategic Plan was especially productive, with a number of the Panel's suggestions being accepted by the Financial Regulator. These included the establishing of a protocol between the Financial Regulator and industry which would outline service targets, the articulation of policy on innovation and product development, and the regulatory approach to wholesale and retail business. Other suggestions included undertaking regulatory impact analysis in advance of new regulations, and international benchmarking.

1. Panel Functions

Section 57DB of the Central Bank Act 1942 (as inserted by the Central Bank and Financial Services Authority of Ireland Act 2004) sets out the functions of the Consultative Industry Panel as follows:

(a) when the Regulatory Authority so requests, to comment on a policy document or regulatory document, or a proposed policy document or proposed regulatory document, prepared by that Authority;

(b) to provide that Regulatory Authority with comments on levies and fees that that Authority proposes to prescribe under section 33J or 33K;

(c) to provide the Regulatory Authority with comments on that Authority's draft estimate of income and expenditure for each financial year;

(d) to provide the Regulatory Authority with comments on the impact that the conditions and restrictions imposed by that Authority on financial service providers have on the competitiveness of those providers;

(e) to provide the Regulatory Authority with comments with respect to changing trends within the financial services industry that have implications for the functions and responsibilities of that Authority.

Section 57DB above should be read in conjunction with Section 57DF of the Central Bank Act 1942 (as inserted by the Central Bank and Financial Services Authority of Ireland Act 2004), which is set out below.

Section 57DF

(1) Before making or issuing a policy document or a regulatory document, the Regulatory Authority shall consult each Consultative Panel, unless that Authority believes that the document must be made or issued without delay. In that case, the Regulatory Authority shall consult each of the Panels as soon as possible after the document is made or issued.

(2) In making or issuing a policy document or regulatory document, the Regulatory Authority shall take into account the advice (if any) provided by a Consultative Panel on any aspect of the document. If the Regulatory Authority declines to give effect to any particular advice provided by the Panel, it shall provide the Panel with a written statement setting out its reasons for declining to give effect to the advice and shall, if the Panel so requires, publish the statement.

(3) The Minister shall consult each Consultative Panel before approving the Regulatory Authority's draft estimate of income and expenditure for a financial year.

(4) If the Regulatory Authority makes or issues a policy document or a regulatory document, a failure of that Authority to comply with subsection (1) in relation to the document does not of itself invalidate the document.

It is important to point out that the Panel neither duplicates nor replaces existing industry / representative body relationships with the Financial Regulator, but may be seen to stand alone as a "lender of last resort" in a regulatory context for the Financial Services industry in its dealings with the Financial Regulator.

[ibc-r-98]

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Patrick Honohan Governor

T +353 1 224 6001 F +353 1 671 6528

Bosca OP 559, Sráid an Dáma, Baile Átha Cliath 2, Éire.
PO Box No. 559 Dame Street, Dublin 2, Ireland.

www.centralbank.ie

Ciarán Lynch T.D
Chairman
Joint Committee of Inquiry into the Banking Crisis
Leinster House
Dublin 2

12 February 2015

Dear Deputy Lynch,

I am writing to follow up on a few points that arise out of my evidence to the Banking Inquiry on January 15.

1. **Powers of Governor in period up to 2008**

I undertook to provide a considered response to the legal question: "Did the Governor have the power to issue specific directions relating to a wide range of micro-prudential policies, including credit concentration limits, during the time prior to the guarantee?"

Two legislative provisions are relevant. Section 23 of the Central Bank Act 1971 provides that the Bank has a general power to require banks or a particular bank to maintain specific ratios; this power could conceivably have been used to impose a wide range of limits, including minimum capital and liquidity requirement etc. (Note that Section 23 of the 1971 Act was not a designated enactment until 2010 and breaches of Section 23 would not have been liable to administrative sanctions until then). As with most of these long-standing powers, this power has long been delegated to the Governor.

Another provision, specifically Section 33D of the 1942 Central Bank Act, gave the Governor (having regard to his ESCB tasks) or the Board of the Bank (in relation to its objectives and most appropriately the objective of contributing to financial stability (at 6A (2) of the 1942 Act) power to issue guidelines to the IFSRA as to policies and principles it was required to implement in performing functions, or exercising powers, of the Bank. (Reference to this provision was made in Paragraph 3.8 of my 2010 Report.)
Accordingly it was open to the Board of the Bank to issue guidelines for the exercise of functions and powers of the Authority, including:

- in relation to the statutory power of the Authority to impose conditions on licences of banks for the orderly and proper regulation of banking (e.g., financial stability grounds) under Section 10 of the 1971 Act, including minimum liquidity requirements, or

- in relation to the power of the Authority to issue requirements on any bank under Section 23A of the 1971 Act as to the composition of its assets and its liabilities, including liquidity buffers, sectoral limits etc.

In addition, it may be relevant to add that the Governor was empowered, under Section 17A of the Central Bank Act 1971, to authorise a suitably qualified person to investigate the business of the holder of a licence or of a related body.

While these powers existed, it is only right to add that the normal operation of the Central Bank and Financial Services Authority at the time did not entail the Central Bank's board or the Governor intervening to second-guess the Regulatory Authority or its Chief Executive, who had numerous specific powers.

2. Best options at end-September 2008

In light of the discussions during my evidence at the Inquiry on January 15, I have been asked whether my views on what should have been done with Anglo Irish Bank in September 2008 have changed since completion of the 2010 Report. It is possible to speak more plainly about these matters now than five years ago, but I do not think that there has been much evolution in my thinking on this. However, reading the official record, I can see that a different impression might have been conveyed.

In evaluating decisions taken at end-September 2008 it is especially important to distinguish between a hindsight scenario and the actual information available to Government decision-makers at that time. The discussion at my session with the Inquiry moved between these two scenarios in a manner that may not have been altogether clear (especially pp. 113-4). So let me rephrase my views as follows.

Scenario 1 (Hindsight): Suppose the consultants from international investment banks had advised the Government in September 2008 that a blanket guarantee of Anglo and INBS would cost the Government €35 billion in the long run. (Of course they did not so advise).
Government's best available response given this information: Had it been known, a €35 billion cost would, in my opinion, have made guaranteeing these two banks too expensive relative to the reputation and confidence damage that would have been caused to Ireland by a liquidation involving bail-in. Therefore although Anglo was clearly a systemically important bank at that time (despite the modest role it played in the Irish credit and payments system), had it had that information, the Government would have done better by not including those two banks in a guarantee. Instead, it could have advised the ECB and European Commission that it intended to liquidate these banks protecting only insured depositors.[1] (At the same time it would have been wise to guarantee new senior liabilities of the other banks.) On hearing the Government's intentions, European officials would have been shocked; they might possibly have agreed to some risk-sharing arrangement to induce the Government to

[1] A variant, under which uninsured personal and small business depositors would have been protected, while other creditors lose, is an option available under the subsequently enacted BRRD, but not evidently available in 2008.

refrain from bail-in given its destabilizing confidence effect beyond Ireland. Absent such a risk-sharing agreement, and notwithstanding the associated significant reputational damage, on balance some bail-in should have been applied. [This option was adumbrated in the 2010 report, footnote 162]

Scenario 2 (Actual): In reality, the investment bank consultants' advice was that the market had no confidence in the business model of Anglo and INBS, and that that explained the liquidity crisis. They advised that loan losses could eat into bank capital but their central estimates did not suggest that the banks had significant negative equity.

Government's best available response, given their limited information: Given this information, the two failed banks should, in my opinion, have been intervened by the public authorities, replacing top management, likely through nationalization (this corresponds to Minister Lenihan's stated preference). ELA should have been provided to allow time for consultation with European officials (including on the potential for risk-sharing). A more limited systemic guarantee should have been provided (no old – i.e. existing – bonds, no sub debt). [Cf. my answer to Deputy McGrath at the Inquiry on January 15, and the 2010 report: paragraphs 8.39, 8.40 and 8.46]

Actual response: These two responses are to be contrasted with the steps actually taken by Government. Existing top management was left in place for several months, creating a potential risk (though in practice there has been no evidence of management looting of the two failed banks). There was no prior consultation with European partners, resulting in annoyance on their part and no risk-sharing. The blanket guarantee included old debt and sub debt, increasing net fiscal costs. The guarantee also implied accelerated payments in case of an event of liquidation; this inhibited steps to effect a more extensive corporate restructuring of the failed banks for two years because of the Government's inability to meet the large cash call that would have been triggered such action.

In this context and throughout the discussion, it is useful to bear in mind that the terms failure, liquidation, intervention, nationalization, all have specific meanings and none of them necessarily implies anything about whether the Government will make payments to bank creditors.

As I have often remarked, none of the courses of action available at the end of September 2008 would have relieved the State of *all* of the costs that resulted from the bank failures.

3. Meeting note from Document 6

I would like also to refer to the discussion between myself and Senator Susan O'Keeffe (page 148) and later with Deputy Pearse Doherty (pages 161-2) about the contemporaneous note made, I think, by Kevin Cardiff in September 2008 of a meeting in which David Doyle is reported to have referenced a possible sum of €8.5 bn in relation to Anglo Irish Bank. (It is Document6 in a set of documents on the website of the Public Accounts Committee http://www.oireachtas.ie/documents/committees30thdail/pac/reports/documentsregruarantee/document6.pdf).

Examining the record, my evidence to the Inquiry has likely created a misleading impression here in regard to one point, which I would like to correct. I do not believe that I have spoken to Mr. Doyle specifically about that note. I probably did speak to Mr. Cardiff about it. My understanding of Mr. Doyle's perceptions of the state of Anglo Irish Bank in September 2008 is based on other, previous, conversations.

4. The Official Record 15 January 2015

I have not attempted to correct inaccuracies or clarify ambiguities in the official record of what was certainly a very complex and fast-moving conversation. I hope that nevertheless, my testimony is fully intelligible if taken in conjunction with the video record.

Yours sincerely,

Pa ... Ilhr

R2b: Nature and effectiveness of the operational implementation of the macroeconomic and prudential policy

Information Summary (Section 33 AK)

Note: All references are aggregated

Categories of Documents summarised:	Letter from the Financial Regulator to all covered banks in Q4 2008
Time period covered:	Q4 2008

Document Name: 1432_Letter re use of Government Guarantee for marketing.pdf
Bates No.: 000000

In Q4 2008 the Financial Regulator issued a letter to all the covered banks informing them that the guarantee could not be used as a marketing or advertisement tool to attract funding from customers or potential customers. This also applied to all subsidiaries or affiliates of a covered bank. The covered banks were instructed to confirm this in writing back to the regulator.
The FR was concerned about any liquidity distortions between institutions in the banking markets.

MEMORANDUM OF UNDERSTANDING ON FINANCIAL STABILITY BETWEEN THE GOVERNOR AND BOARD OF THE CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND (CBFSAI) AND THE IRISH FINANCIAL SERVICES REGULATORY AUTHORITY (IFSRA)

1. This Memorandum of Understanding (MoU) sets out principles for cooperation between the Governor and Board of the CBFSAI (hereinafter referred to as "the Bank") and IFSRA (hereinafter referred to as "the Financial Services Regulator") in the field of financial stability. It sets out the role of each party and explains how they will work together towards the common objective of financial stability.

2. Financial stability is a situation where the components of the financial system (financial markets, payments and settlements systems and financial institutions) function smoothly and without interruption, with each component resilient to shock. A financial stability matter may include, but would not be restricted to, any event which could threaten the stability of an important financial institution or number of institutions; disrupt the workings of financial markets and/or the payment system, or undermine the soundness of, or public confidence in, the financial system.

3. Three guiding principles will govern cooperation between the parties:

   i) ***clear accountability and transparency:*** each party will be accountable for its actions as set out in this MoU;

   ii) ***no duplication:*** each party will ensure that duplication does not occur, as far as is reasonably possible; and

   iii) ***data and information exchange:*** both parties will ensure that the content and frequency of exchange of data and information will enable each party to discharge its responsibilities as efficiently and effectively as possible.

4. **The Bank's Responsibilities for Financial Stability**

   The Bank is responsible for contributing to the overall stability of the Irish financial system. This mandate for financial stability is derived from:

   i) the Bank's statutory duty under the CBFSAI Act of 2003. The Act specifies that "the Bank has … the objective of contributing to the stability of the financial system"; and

ii) the mandate of the European System of Central Banks, which requires the European Central Bank and National Central Banks to contribute to financial stability in the euro area. This, therefore, requires that the Bank contribute to financial stability, both in Ireland and, as far as is practicable, elsewhere, through its involvement in international fora.

To carry out the Bank's mandates for financial stability, the Governor and the Board's responsibilities therefore involve:

i) ***stability of the monetary system***. This will be monitored as part of the ESCB monetary policy function. As necessary, actions will be taken in the markets and fluctuations in liquidity dealt with;

ii) ***financial system infrastructure, in particular the payments and securities settlements system***. The Governor and/or Board will advise the Minister and Financial Services Regulator on any significant matter affecting these systems. The Governor and/or Board will continue to promote the smooth operation of the payments and securities settlement systems and will also seek to strengthen these systems to reduce systemic risk;

iii) ***overview of the domestic financial system as a whole***. The Governor and/or Board will advise all relevant parties on the implications for financial stability of developments in domestic and international markets and payments systems and assess the impact on monetary conditions of events in the financial sector;

iv) ***analysis of the micro-prudential – where appropriate – as well as macro-prudential health of the financial sector***. In this context, the Governor and/or Board's objective is to identify developments which could endanger the stability of the system as a whole and will advise accordingly;

v) ***undertaking official financial operations***. The Governor and/or Board may authorise official financial operations in exceptional circumstances, in order to limit the risk of difficulties affecting particular institutions spreading to other parts of the financial system; and

vi) in addition to the above mainly domestic responsibilities, they ***contribute to promoting improvements in the international financial system,*** mainly through involvement in international fora.

5. The Financial Services Regulator's Role in contributing to Financial Stability

The Financial Services Regulator is responsible for contributing to the maintenance of proper and orderly functioning institutions and exchanges and protecting depositors, insurance policy holders and clients of investment firms. In carrying out these functions, the Financial Services Regulator will support the Bank's objective of contributing to financial stability.

The Financial Services Regulator's responsibilities in this area therefore include:

i) the ***prudential supervision*** of banks, building societies, insurance companies, stockbrokers, exchanges, investment firms, retail intermediaries (both investment and insurance intermediaries), credit unions and collective investment schemes (managed funds); and

ii) providing ***advice, information and assistance*** in relation to the Bank's functions to the Bank's Board and the Governor, both on request and at other times as may seem appropriate.

6. Data and Information Exchange

There will be close and regular contact between the parties and a framework of cooperation will be developed with regard to financial stability matters. Information sharing arrangements will be established, to ensure that all information relevant to the discharge of their respective responsibilities will be shared fully and freely between the parties. Each party will seek to provide the other with any additional information on request and as appropriate.

7. Crisis Management

The parties will immediately inform and consult with each other in relation to any matter which either party deems to have the potential to threaten the stability of the financial system. The general procedures to follow in such an event will continue to be for agreement between the parties.

8. Consultation on Policy Changes affecting Financial Stability Matters

The parties will consult and inform each other about any policy changes which will have a bearing on the responsibilities of the other.

9 Financial Stability and Membership of Committees

The parties will cooperate fully in their relations with and participation in international fora on financial stability issues. In some cases, this will involve dual representation in certain fora. In cases where only one party is represented, the other undertakes to contribute information and advice in advance of any meeting. The party attending will fully brief the other after the meeting.

10. Records

The Financial Services Regulator will be responsible for the custody of all records relating to the prudential supervision of authorised institutions. The Governor and Board of the Bank will have free and open access to these records on matters relating to financial stability.

Joint Committee of Inquiry into the Banking Crisis

Statement by Patrick Neary

28 May 2015

Joint Committee of Inquiry into the Banking Crisis: Statement by Patrick Neary: 28 May 2015

Good morning Chairman and Members of the Committee.

My name is Patrick Neary and I held the position of Prudential Director of the Irish Financial Services Regulatory Authority from 1 May 2003 until 31 January 2006 after which I was appointed to the position of its Chief Executive from 1 February 2006 until 31 January 2009. Before I begin my statement, I would like to say that, with hindsight, the supervisory measures taken by the Authority, which I will be outlining in this statement, were not sufficient to meet the challenges posed by the crisis and the recession that emerged and I am deeply sorry for that.

The Authority, from the date of its establishment on 1 May 2003, initially referred to itself as IFSRA, an acronym of its official name "The Irish Financial Services Regulatory Authority" but after the first two years of its operations rebranded itself as "The Financial Regulator". It used this name in its publications and public references. Despite the fact that it had its own Board and staff and was a constituent entity within the Central Bank, the use of its new name over time affected its standing with the public, as the impression was created, through the press and public representatives, that the Financial Regulator was an individual. I wish to correct this. The Financial Regulator was not an individual and any reference to an individual as the financial regulator is simply wrong.

The content of this statement addresses the fifteen themes and lines of inquiry to which the Committee has requested that I respond. It also describes the various regulatory actions and initiatives taken by the Authority over the period up to end 2008, such as higher capital requirements; new liquidity requirements; new requirements for impaired loans; new fitness and probity tests; new consumer protection requirements; better regulation policy; and oversight by the IMF and OECD. I will begin with the regime of prudential supervision.

Prudential Supervision

The Central Bank Act, 1971 first established the prudential supervision of banks in Ireland. The primary purpose of prudential supervision is to safeguard, as far as possible, depositors in banks. In fact, no prudential supervision of any entity involved in lending activities is required if that entity does not also take deposits.

The approach to supervision by the Authority derived from EU banking supervision legal requirements. The Authority's approach, in the same way as that of other country's banking supervisors, was subject to ongoing best practice review and external assessment by international bodies such as the IMF and OECD. These agencies benchmarked, in detail, the Authority against a framework of principles entitled "Basel Core Principles for Effective Banking Supervision". The conclusions of all these assessments by these independent expert bodies in relation to the Authority were very favourable, such as would indicate that the approach of the Authority was at least as good if not better than other authorities reviewed by those agencies.

The five key constituents of the Basel Core Principles which are fundamental to the prudential supervision of banks are referred to as the CAMEL principles—Capital adequacy; Asset quality; Management; Earnings ; Liquidity.

A bank's capital is the ultimate protector of depositors and there are international rules setting minimum requirements for all banks which have been enshrined into EU and Irish law. It provides the cushion to absorb losses that arise in the loans made by a bank. EU law requires that an EU bank must hold a level of capital to a value of at least 8 per cent of the value of its risk assets.

I would like to make the following observations here:

- All loans made by a bank have a risk weighting attached to them to determine its total risk assets;

- Loans to EU Governments attract a zero per cent weight, meaning, under EU law, a bank has to hold no capital whatsoever in respect of these loans; put differently, it is assumed by the law that these loans will not default—this practice continues today;
- Loans to other EU banks with a maturity of less than one year attract a 20 per cent weight, which may go some way to explaining the attraction to EU and international banks of funding the activities of Irish banks during the boom period.

Recognising that the EU legal requirements were minimum standards, the Authority required the Irish banks to hold capital within a range of 8.5 per cent to 11 per cent of risk weighted assets.

On 1 January 2007, the Capital Requirements Directive, commonly known as Basel 2, came into effect. This directive afforded supervisory authorities some discretion to tailor capital requirements to reflect national circumstances. Using this discretion, the Authority introduced a more stringent capital regime for property transactions to counter the growing exposure of Irish banks to the property sector. I am not aware of any other instance where an EU banking supervisor imposed tougher requirements on their banks than the basic minimum requirements of Basel 2.

At the requirement of the Authority, the Irish banks were subject to much higher capital requirements than the EU demanded, for instance:

- Basel 2 assigned a risk weighting of 35 per cent for residential mortgages irrespective of the loan–to-value of those mortgages; the Authority set a 75 per cent weighting for such loans by Irish banks having a loan to value ratio in excess of 75 per cent;
- For residential investment mortgages, Basel 2 also assigned a risk weighting of 35 per cent; the Authority made the entire loan subject to a weighting of 75 per cent;
- Basel 2 allowed a 50 per cent risk weighting for secured commercial real estate; the Authority required 100 per cent;

- Basel 2 applied a 100 per cent weighting to speculative real estate loans; the Authority demanded 150 per cent.

Staying with residential property, the Authority's decisions reflected the economic and growth forecasts from the Central Bank which it was obliged to follow. These predicted a soft landing and if that prediction had been fulfilled, there would not have been a banking crisis. In mid-2007, the Authority introduced a number of additional supervisory requirements on the banks as a response to the strong appetite for credit for residential property purchase:

- Stress-testing of individual mortgage applications to gauge repayment ability at a level 2.75 per cent above the ECB rate;
- Introducing the Consumer Protection Code with measures to address aggressive lending including suitability;
- A ban on pre-approved credit; and
- Obligations to engage early with customers in arrears.

Eleven separate press campaigns were carried out in relation to debt as well as numerous interviews and published articles. I have to stress that these were the minimum standards expected of banks. The Authority did not run the banks and these minimum standards did not excuse the Boards from their duties to set appropriate policies.

In July 2005, well before the crisis in financial markets began to take hold, the Authority imposed new conditions on the licences of the Irish banks in relation to credit risk management policies and procedures which required each bank to have specified arrangements in place to monitor and control credit risk, with particular focus on impairments and provisions. Each bank was obliged to comply with International Financial Reporting Standards and was obliged to advise the Authority of deterioration in the credit quality of its loans. These reports formed part of the quarterly statutory returns submitted by each bank to the Authority and never indicated deterioration in loan quality. It is worth mentioning in this context that it is an offence to submit a false return to the Authority.

In line with Basel supervisory best practice and corporate governance codes, the Authority required that all appointments to the Board of a bank and any of its subsidiaries should be subject to its approval. This was to ensure that all directors of a bank, both executive and non-executive, and later, Heads of all business critical functions, should be fit and proper persons with the necessary competence and experience in banking to contribute to the proper running of the bank. A final framework was introduced by the Authority in January 2007 and applied to all new appointments from that date. Existing persons were "grandfathered" under the new arrangements.

In January 2007, the Authority imposed new liquidity rules by way of conditions on the licences of the Irish banks. This made Ireland a leader in Europe in introducing a forward looking system of liquidity management. Ireland was the only EU country to have updated its liquidity requirements in advance of the liquidity crisis. The reporting frequency was increased from monthly to weekly reporting in August 2007 to coincide with the onset of the international liquidity crunch.

In relation to all of the foregoing, I should mention that the OECD in its "Economic Survey of Ireland 2008", commented that the Authority had introduced the new consumer code to limit the scope for predatory lending practices and introduced a forward looking liquidity regime just before the international financial market turmoil struck.

Regulatory Strategy

The Authority adopted a "principles led" approach to supervision from its inception in 2003, which essentially placed Boards and Management of banks at the centre of responsibility for the prudent conduct of business. The Authority was legally obliged, at least 3 months before the beginning of each year, to prepare a strategic plan and submit this plan to the Minister of Finance. The plan had to specify the objectives of the Authority for the financial year concerned, the nature and scope of the activities to be undertaken and the strategies for achieving these objectives. As soon as possible after receiving this plan, the Minister had to arrange for it to be laid before both Houses of the Oireachtas. When this had been done, the Authority was required to publish the plan and take all reasonable steps to implement it. So, to reiterate, the process was Authority, Minister, Houses of the Oireachtas. The principles-led approach was thus not the sole decision of the Authority. This approach to supervision was followed by all EU countries. The USA is the main proponent of rules-based regulation but this did not protect it from issues with Bear Stearns, Lehman Brothers, AIG, Wachovia and others.

The strategy also set down the objectives of the Authority. One of its objectives was that its regulatory approach would facilitate innovation and competitiveness. It is clear that both of these elements played an important part in the increased availability of credit in Ireland in the years before the crisis, through a combination of more banks entering the market and more innovative types of lending products being developed.

To have taken measures to stifle these developments would have conflicted a fundamental strategic objective of the Authority as mandated by the Minister and the Oireachtas.

In January 2004, a white paper entitled "Regulating Better" was issued by Government to improve national competitiveness. The paper called for wider consultation and more regulatory impact assessment on any new regulations. This illustrates the context in which all supervisory initiatives of the Authority required extensive consultation with a wide range of what were termed "stakeholders"-

-Govt. depts., representative bodies, the Industry and Consumer Panels, banking schools in the Universities. Detailed regulatory impact analysis was extensive. In fact, the Authority also put in place an arrangement with industry called the "Stakeholder Protocol" with enshrined time commitments by the Authority to respond to industry requests for regulatory approvals, issuance of the findings of inspection reports etc. I can understand that initiatives such as this formed a perception of the Authority as a "can do" entity, willing to prioritise industry demands rather than appearing more detached and discerning. This is something which I believe, in hindsight, the Authority got wrong.

In September 2006, the Government published a review of the future of the financial services industry in Ireland entitled "Building on Success". I want to bring two items from the report to your attention:

i. The paper asserted a growing awareness in both Ireland and Europe that poor quality or unnecessary regulation could be a barrier to competitiveness and growth and such regulation could alienate citizens and enterprises through imposing disproportionate compliance costs.
ii. The paper did not propose any increased prudential supervision or suggest a tougher, more burdensome regulatory regime.

The growth in private sector credit arose mainly from the appetite for property acquisition and associated construction activity. This expansion in these areas was due to a number of factors including strong economic growth, an increase in the level of household formation, very low interest rates, lower personal tax rates, a vast range of tax incentives for property investment, the desire of Irish people for property ownership, a "feel-good-element" generated by increasing property values which quickly seasoned loan-to-value ratios, and all supported by readily available bank loans. A further and extremely important factor was the consistent pattern of very positive economic commentary in relation to the performance and prospects for the economy and the property market from the Economic and Social Research Institute, the Central Bank and the Department of Finance.

In formulating its strategy, the Authority always took full account of the output of these authoritative sources, which predicted that the Irish economy would continue to show growth above the EU average and that the property market would experience a soft landing. The Authority relied on the Central Bank which maintained an economic services division with 86 staff, including a dedicated Financial Stability Department, to monitor and assess the overall health of the financial system; there were no economists in Banking Supervision Department. Had these predictions held, there would not have been a bailout.

I do not think, even with the benefit of hindsight, that the Authority, in the context of the time, would have assumed a different approach to supervision. I have come to this conclusion bearing in mind the following:

- The capital requirements in Ireland were higher than the EU demanded;
- The absence of any strong views from the financial stability perspective that a more draconian regime of supervision was warranted;
- The fact that the introduction of a tougher supervisory regime in Ireland compared to other jurisdictions would have conflicted with Government policy to promote the strength and profitability of the financial services industry in Ireland and its attractiveness as an international financial services location.

Powers of the Authority

The Central Bank Act, 1971 introduced a limited range of statutory powers for the prudential supervision of banks and the 2003 Act gave the Authority the power to impose administrative sanctions for breaches of specified regulatory requirements.The Authority approved the introduction of the new regime from 1 July 2005 and began to codify the new arrangements. In the case of Banking Supervision Department, priority was given to codify elements related to breaches of requirements enshrined in law and elements relating to the conditions on banking licences such as capital ratios, liquidity and impaired loans. A substantial part of the project-to codify governance and professional behavioural items- made little progress as scarce resources were deployed to meet legally bound commitments such as the implementation of Basel 2. While there never was any reluctance to press ahead with this work, comfort was taken that the well- established prudential regulatory relationships would be effective as an interim measure in managing these governance and professional behavioural items.

Resources

Questions have been rightly asked in relation to the number, skill set and experience of resources devoted to the supervision of banks. As mentioned in the Honohan Report, staff numbers in the banking supervision department increased marginally from 44 at end 2005 to 48 at end 2008, and were allocated in teams to supervise portfolios of banks. Apart from considerable day-to-day contact with their respective banks, staff in banking supervision carried out over 50 inspections of banks between 2003 and 2008.

The Authority had approved higher staff; however, the HR Department of the Central Bank, which performed recruitment activities on behalf of the Authority, experienced difficulty in attracting persons with banking experience to the department. This reflected constraints on salary levels available to public servants and very strong salary competition for such persons in a market operating at a high level of economic activity. I agree with the conclusion in the Honohan Report that the Authority did not have the mix of skills necessary for a more intrusive style of supervision. The difficulty in attracting new staff with good experience in banking and the rapid pace of evolution of the new regulatory directives which had to be implemented, stretched existing staff to the limit to both engage in ongoing supervision work while at the same time having to maintain training programs for newer staff transferring in from other departments in the Authority. There is little doubt that staff were stretched very thinly in banking supervision and thus the capacity to react to the unfolding crisis was made more difficult.

I would like to take the opportunity to note the dedication displayed by the staff of the banking supervision department and the long hours worked during the period before, during and after the crisis.

Notwithstanding the above, it would be overly simplistic to single out the level of penetration of banking supervision staff into systems, practices and governance arrangements of the banks as a single major element in the banking collapse. The contact between supervision staff and their bank counterparties had been in place for many years and was useful in sourcing data and solving issues as they arose. I believe this remains the approach taken by the Central Bank today. Let us not lose sight of the fact that the primary responsibility resided with the banks themselves who were best placed of all to assess their own risks and business models, to strike the right balance between their risk and reward and have skilled, responsible people in place.

Again, by way of hindsight, I would accept the view that the Authority, as well as focussing acutely on the key prudential supervisory fundamentals I set out earlier in this statement, could have had more regard to the systemic risk that was accumulating in the banking sector and whether it was being adequately quantified and assessed. Within the Authority, and consistent with its mandate, there was the belief that the discharge of its obligation to contribute to financial stability would be achieved by adherence to the prudential fundamentals. The Authority relied on the Central Bank's work on financial stability to identify, monitor and assess risks and to be proactive in providing a choice of possible remedies which would be implemented by both the Central Bank and the Authority to mitigate these risks.

In hindsight, this approach was flawed and I believe now, that a clearer, more direct and specific allocation of responsibility for the oversight of financial stability within the organisational structure of the Central Bank would have been more appropriate.

A stricter, well defined allocation of such responsibility may have facilitated a move away from a supervisory approach grounded on point-in-time facts towards an approach grounded on an assessment of the future. Instead, the main sources of data for the Authority were the quarterly prudential returns and weekly liquidity reports provided directly by the banks as well as the ongoing regulatory engagement by the banking supervision staff. It is clear now that this was not sufficient.

It is important to note that whilst these data submissions and the more regular touchpoints between senior executives of the banks and the Central Bank and the Authority pointed to concerns about access to liquidity, there was, at no stage, any indication of difficulties with solvency.

Moreover, major work by Authority staff on the internal arrangements in banks for risk assessment mandated by preparations for the implementation of Basel 2, revealed no matters of concern in relation to asset quality. As you are aware, these are demanding global standards, yet, to reiterate, they revealed no matters of concern in relation to asset quality.

It is also worth noting that the annual loan reviews required to be carried out by senior bank management in advance of the publication of their accounts and their presentation to shareholders and ratings agencies and which in turn were subject to audit oversight did not bring to light any significant pattern of impairment across the loan portfolios of the banks. Regular stress testing carried out both by the Central Bank and the banks themselves, using a range of shock scenarios and adverse economic assumptions, did not identify concerns relating to solvency but rather went some way to confirming the robust nature of the banking system.

Relationship with Department of Finance

The relationship between staff of the Authority and officials of the Department of Finance, while cordial, was highly professional with both sides being highly conscious of their duty always to act in the public interest. Engagement took the form of regular meetings of the Domestic Standing Group as well as frequent and ad-hoc meetings and correspondence to do with regulatory strategy, funding and implementation of the EU financial services action plan. No request for a meeting or assistance by the Department was ever declined. At senior level, the Chairman of the Authority held periodic meetings with the Minister—on average twice a year – while the Governor had more regular engagement with him. The Secretary-General of the Department was an ex-officio member of the Board of the Central Bank and in that capacity had access to all economic and supervisory information available within the overall organisation.

Professional Advice

The Authority obtained professional advice and analysis from PWC in relation to the financial condition of each of the banks at the time of the guarantee, which work enabled the joint confirmation by the Governor of the Central Bank and the Chairman of the Authority on 18 November 2008 that each bank was in excess of its minimum solvency requirement as of 30 September 2008. I am unable to comment on the degree to which this assessment remained valid, and to what extent, into 2009 and beyond as my retirement as Chief Executive of the Authority had taken place by that time.

Statutory Auditors

In relation to information and reporting from statutory auditors, all banks received unqualified audit reports throughout each of the years before the crisis and I am not aware of any instances where supervisory issues uncovered by the Auditors were escalated to the Authority.

Domestic Standing Group

In July 2007, an MOU was put in place between the Central Bank, the Authority and the Department of Finance to establish a committee, called the Domestic Standing Group to help in the management of financial stability issues and to prepare to handle a financial crisis. Frequent and regular meetings of the group were held and a number of workstreams emerged, dealing with emergency liquidity, deposit protection, draft legislation for nationalisation/transfer of ownership of banks as well as the updating of a manual to be used in the event of a crisis. As the crisis deepened the Department of Finance retained consultants to assist in preparations to nationalise a bank/building society and work to determine to what extent there may have been a need for further capital injections to meet market expectations. I see no reason to call the adequacy of the DSG process into question. Its operations meant that that many issues that could arise in a crisis were identified and examined and several initiatives relating to emergency liquidity arrangements, draft bank resolution legislation and capitalisation of banks were undertaken.

The Bank Guarantee Decision

At around 5.30pm in the evening of 29 September 2008, I accompanied the Chairman of the Authority to the Department of An Taoiseach. We joined a meeting which had already commenced and which was attended by An Taoiseach, the Minister for Finance, the Secretaries-General of both the Department of An Taoiseach and the Department of Finance, The Deputy Secretary-General of the Department of Finance as well as a senior partner from Arthur Cox, Solicitors. The Governor and the Director-General of the Central Bank were also in attendance. The meeting seemed to have only recently begun when we arrived and was in the process of discussing the serious liquidity position of Anglo and what facilities could be made available to it to help it survive until the weekend. Mention was also made of the fact that the two larger banks had sought a guarantee for their deposit holders from the Government earlier that afternoon.

The Chairman and I were asked to advise the meeting in relation to the solvency position of each bank from the point of view of the Authority. We advised the meeting that on the basis of the information available to the Authority, all banks were in compliance with their required capital ratios, were in a position to meet their obligations on a going concern basis, but liquidity was becoming a critical issue for them, especially Anglo.

Both the Chairman and I left this meeting after about an hour and were asked by the Secretary-General of the Department of Finance to remain on in the offices of the Department in case our presence was required later. We rejoined the meeting some hours later, possibly around 11pm. On our way back to the meeting room, we were met by the Governor of the Central Bank who indicated that the discussions that had occurred since we had left the meeting had narrowed things down to two options, either nationalisation of Anglo coupled with a guarantee of the five remaining banks or a guarantee of all the banks. He suggested to us that our view was likely to be sought in relation to these options.

Following a brief discussion with the Governor, who indicated that he had no difficulty with the proposed response to these options which the Chairman and I discussed with him, we rejoined the meeting which now included the Attorney-General. In relation to the options to which the Governor had alerted us earlier, the Chairman and I raised a concern about whether there would be confusion in the minds of the market practitioners the following morning as to who was or was not guaranteed and that making a distinction between nationalised banks and guaranteed banks ran the risk of being very confusing. (Some two weeks earlier, confusion had arisen in relation to the increase in the deposit guarantee limit to €100,000, especially as regards whose deposits it covered and the eligibility criteria.) Both the Chairman and I raised the concern that this would neither encourage the inflow of liquidity that would be expected to occur, nor would it stem outflows of deposits; questions would undoubtedly arise whether the nationalised bank was stronger or weaker than the guaranteed bank and in that situation all banks would risk being adversely affected. The Chairman and I expressed the view that if a guarantee was going to be put in place, we would be inclined to favour it being extended to cover the depositors in all banks concerned in the same manner.

Following this discussion, we left the meeting and remained on in a nearby waiting room. I was advised by the Chairman after some time that he had learned of the decision to guarantee the deposit holders in all the banks.

I returned to my office in Dame Street around 3am on the morning of the 30th September 2008 and as requested by the Deputy Director-General of the Department of Finance, I made phonecalls to representatives of Irish Life and Permanent, EBS Building Society and Irish Nationwide Building Society to advise them of the Government decision. I tried but was unable to make contact with representatives of Anglo Irish Bank.

The effects of the guarantee were evident immediately. The daily liquidity reports being submitted by the banks to the Central Bank showed inflows of both market and retail resources and an end to the pattern of outflows which had been occurring prior to the guarantee. The guarantee was viewed positively by market commentators and was seen as addressing satisfactorily the concerns of depositors and thus the funding and liquidity difficulties that had been affecting the banks.

Summary and Conclusion

This statement has addressed the menu of headings requested by the Inquiry and has focussed heavily on the supervisory approach of the Authority. I have set out for you the Authority's approach to the prudential supervision of banks as well as the various initiatives taken by it to strengthen its oversight of banks, such as the higher capital requirements, liquidity, impaired loans, fitness and probity, consumer code and the influence of the white papers on regulatory policy.

I also acknowledge, with the benefit of hindsight, that the supervisory measures introduced by the Authority were not sufficient to meet the challenges posed by the crisis and the recession that emerged.

I regret that very deeply.

Thank you Chairman and Members of the Committee for your attention.

R1a: Appropriateness of regulatory regime

Information Summary (Section 33AK)

Note: All references are aggregated.

Categories of Documents summarised:	• **Minutes of Audit Committee**
Time period covered:	• **Q4 2013**

Audit Committee: 2013

CB01272

Update on PRISM and whether the original findings in the Report on PRISM in Banking Supervision remained valid after a survey which was concluded after the audit. Audit focuses on guidelines and not user friendliness. Majority of audit recommendations implemented. Risk Advisors are performing a review which includes user friendliness. Await outcome of review before taking any further action.

5.2 Supervisory Approach

In addition to reviewing and understanding these reports made under the Scheme, supervisory teams also spent a lot of time reviewing the business plans of the banks. Banks were required to submit detailed information on their business plans including the underlying assumptions, the sensitivities of the profit, capital and funding to the underlying assumptions, as well as quarterly projections for profit, capital, funding and deleveraging. Several iterations of business plans were received and opined on. During this period the Financial Regulator was also involved in reviewing and opining on various initiatives regarding bank mergers and acquisitions.

Supervisory teams spent a lot of 2009 and 2010 on site at the banks carrying out the following tasks:

- attending board and sub-committee meetings, ALCO and credit committee meetings;
- meeting with Heads of Treasury, Credit, Capital, etc.;
- receiving management information various indicators and review of same;
- engaging with banks on their business models, understanding their strategies and challenging their plans to rectify the business model failures experienced; and
- additional reviews of remuneration.

There was increased focus on the quality of governance structures (including in relation to risk) within the banks with reviews of board packs and attendance at meetings as referred to above. Banks were required to submit additional information relating to business plans and performance, treasury reports, credit reports and capital reports. Supervisory teams were in constant dialogue with the banks, trying to understand the extent of the problems being experienced by the banks during this period.

In addition to the above, there was a lot more focus on remuneration requirements and lending to directors. Correspondence was issued by the Central Bank requiring banks to be compliant with CEBS[2] High Level Principles for remuneration policies and with new requirements on directors' loans. There were also several reviews of these areas carried out by the Financial Regulator/Central Bank and queries issued to the banks regarding same.

[2] Committee of European Banking Supervisors.

The approach to supervisory engagement with the banks had, therefore, fundamentally changed after the commencement of the Government Guarantee. This was not explicitly formalised in a new documented and published supervisory approach until mid-2010, but the engagement in practice was markedly different. For the period through 2009 and early-2010 the supervisory engagement can be summarised as follows:

a) *Day-to-day supervisory engagement with the banks*

A decision was taken for supervisors to be much more present on site at the banks, i.e. the day-to-day supervisory teams were primarily located at the banks, attended all board meetings and many board committee meetings and met with bank executives much more frequently (i.e., monthly).

The supervisory focus also shifted to the necessary implementation measures; including consideration of the treatment of foreign subsidiaries, the conditions to be placed on banks' executive remuneration; the fees to be paid for the guarantee by the banks; and ensuring that the Government Guarantee was not abused (INBS were fined in this regard under the administrative sanctions procedure) .

Supervisory engagement also included loan book quality and capital strength. As a result of the continued losses experienced ([redacted] Oireachtas) the Financial Regulator commissioned the following two reviews in 2009:

- an analysis by PricewaterhouseCoopers (PwC) of selected exposures of the Covered Banks at 30 September 2008, including the top 20 borrower exposures, the top 20 land and development exposures, financial assets in excess of €20m and the top 10 exposures to financial institutions (PwC had already carried out some preliminary work prior to the Guarantee); and
- an analysis by Merrill Lynch of possible recapitalisation requirements.

b) *Reactive supervisory engagement with the banks*

Internal and external investigations were carried out, as the Financial Regulator and the Central Bank responded and reacted to the crisis, including, *inter alia:*

- work arising from the Government announcement of a recapitalisation programme of up to €10bn across the Irish banks;

[redacted]

During this period there were a number of breaches of the Central Bank's liquidity requirements and there was ongoing dialogue between the Central Bank and the banks on the steps being taken by the banks to address these breaches. There was also ongoing dialogue regarding funding and collateral concentration and the need for diversified funding strategies.

c) *Building capability to engage with the banks on a more technical expert level*

Recognising some of the technical gaps in Banking Supervision's engagement with the banks, significant recruitment was undertaken to build specialised credit and treasury expertise, to equip the Financial Regulator with a better ability to challenge the banks' operations and identify deficiencies in their management of related risks and to review and challenge the banks' restructuring plans (see also a separate paper on resourcing for Item 19).

5.3 Engagements at the "most senior levels" between the Bank and each of the relevant banks

[redacted]	2009	2010
[redacted]	16	15
	13	13
	14	9

Oireachtas	8	1
	7	2
	8	10
	4	6
	3	6
	73	**62**

The table summarises the meetings held between the senior management of the Central Bank (as defined in section 4.1 of this response) and senior bank officials. As with the overall supervisory engagement, summarised above, this engagement would have been focused on both issue/investigation specific matters and the increased intensity of supervision. There was also a significant amount of engagement in 2010 due to the Prudential Capital Assessment Review (PCAR) and the additional requirements imposed on banks due to same. There was also engagement regarding the restructuring plans submitted to the EU and significant challenge provided to same. As noted in the previous section, engagement would also have included significant levels of correspondence (see Appendix 9 for examples).

5.4 Structure

On 1 May 2010, following the implementation of the Central Bank Reform Act, 2010 the Central Bank replaced the the Central Bank and Financial Services Authority of Ireland (CBFSAI) (that is the former Central Bank and the Financial Regulator). With effect from the same date, the CBFSAI's statutory consumer information and education functions transferred to the National Consumer Agency and the Central Bank resumed responsibility for both central banking and financial regulation. The Central Bank is headed by a Commission, chaired by the Governor. The Governor is supported by a Deputy Governor (Central Banking) and a Deputy Governor (Financial Regulation).

5.5 Supervisory Engagement

The changes to the banking supervision processes and approach to engaging with the banks during this period were formally articulated in "Banking Supervision: our new approach, published in June 2010, and further updated in June 2011.[3] These papers provide a response to the Banking Inquiry request to outline ***"All material and/or significant changes in the process of supervisory engagement during that period".***

[3] See http://www.centralbank.ie/publications/Documents/Banking%20Supervision%20-%20Our%20New%20Approach.pdf and http://www.centralbank.ie/publications/Documents/Banking%20Supervision%20-%20Our%20approach,%202011%20update.pdf).

The June 2010 publication outlined a more intrusive and challenging approach to banking supervision and a fundamental and far reaching shift in the relationship between the banks and the Central Bank. The paper outlined the key work to be carried out to address the lessons learnt from the banking crisis as follows:

1) Changes to supervisory structures:
   - Restructure the organisation to deliver more intrusive and challenging supervision, recruit additional staff and establish a Risk Experts Panel (a pool of expert resources which could be drawn from to provide ongoing support, advice and challenge to supervisors and to attend Risk Governance Panels) to assist and advise the supervision divisions.

2) Changes to supervisory culture and approach:
   - Complete prudential capital adequacy review;
   - Strengthen supervisory review and evaluation process;
   - Implement an "interview and assessment" process for senior appointments in banks and extend to other institutions;
   - Implement a new risk assessment model;
   - Revised approach to handling overcharging issues;
   - Review process and methodology for assessing consumer charges; and
   - Prudential supervision themes for 2010 are – new mortgage credit standards, remuneration, risk management and governance and bank strategies.

3) Changes to the regime within which we supervise:
   - Consult on and implement new corporate governance requirements for banks and insurers; regulations on related party lending; a revised framework for ensuring that the managers and directors of regulated institutions are fit and proper; internal governance requirements and remuneration standards for financial institutions; new rules on large exposures; new standards on credit risk management, valuation and liquidity; revised minimum competency requirements, consumer protection code and possibly on the code of conduct on mortgage arrears; statutory switching code.

- Consult on and implement the Comptroller and Auditor General's recommendation on auditor attestation regarding the functioning of the internal governance regime in institutions.

4) A greater focus on international supervisory cooperation.

5) Broadening the approach to financial stability:
   - Undertake assessment of data needs for reviews of financial stability;
   - Develop an enhanced financial stability systemic risk assessment framework and an associated communications strategy;
   - Conduct in-depth comparative analysis of the performance of the Irish banking sector to inform discussions on the future structure of banking in Ireland;
   - Implement further development of banks' specific quantitative risk assessment models;
   - Undertake detailed micro-level analysis of important counterparts of the financial sector; non-financial corporations and households; and
   - Publish the Financial Stability Report in a new format.

The Central Bank also committed to four major work items in 2010 to understand the progress banks had made in reforming themselves, engaging with the banks to examine:

- Governance and risk management;
- Lending standards:
- Individual bank strategies; and
- Remuneration practices within the banks.

Dedicated Prudential Policy and Enforcement Directorates were also set up during this period.

The governance and risk management reviews are illustrative of both the changes to banking supervision and the nature of the supervisory engagements with the banks. During the second half of 2010 an in-depth review of governance and risk management arrangements were commissioned at the major retail banks. These reviews informed the results of the

Supervisory review and evaluation process (SREP) for the purposes of Pillar 2. The reviews which were carried out by independent third parties covered the following:

- The skills and experience of bank board members;
- The effectiveness of non-executive board members;
- The skills, experience and independence of staff in risk management positions;
- The effectiveness of risk management arrangements;
- The adequacy of measures banks had taken to address weaknesses in practices and processes exposed during the crisis; and
- Whether banks had taken sufficient measures to address deficiencies in attitudes amongst staff at all levels towards risk management as well as compliance with internal policies and regulatory requirements.

In addition to the above the Central Bank also carried out the following engagement tasks:

- Detailed review of new mortgage lending to establish the soundness of credit risk practices and the adequacy of the management of associated funding risks. This involved a detailed review of policies, pricing, risk appetite, levels of exceptions to policy, arrears levels etc.
- As a result of issues arising in certain banks from lending to directors and related parties, the Central Bank issued a Code of Practice on Lending to Related Parties in 2010 (effective 1 November 2011). This was subsequently amended in 2013. Related-party lending returns were required to be submitted on a quarterly basis from 2011 onwards and these are analysed and queried where necessary. In addition, banks have to obtain the Central Bank's approval for certain types of related-party transactions as outlined in the Code and this can sometimes involve a significant amount of engagement with the banks.

The Central Bank's 2010 to 2012 strategic plan also included the strategic priorities for banking supervision. It had a significant change of focus from previous plans. This plan was focused on the major task of resolving the banking crisis and the development and implementation of a new model of regulation, an assertive risk-based model, underpinned by a credible threat of enforcement. It also referred to the need for this to be coupled with an enhanced assessment of financial stability and the careful on-going management of liquidity support.

The plan referred to the following exceptional steps which had been taken, the recapitalisations of banks, the deposit guarantee extensions, the provision of liquidity to banks and the programmes put in place to deal with distressed assets. The plan also referred to the following goals:

- the key task of assessing banks' restructuring proposals to ensure that they meet both their prudential and financial stability objectives and that sustainable models are being proposed;
- the new capital requirements which had been set for banks to meet by end-2010;
- key action to gradually reduce the need for reliance of domestic banks on central banking liquidity provided through the Eurosystem;
- to manage the transition from the current government guarantee; and
- that all banks had been asked to review their contingency liquidity and funding plans to ensure preparedness for the transition to any guarantee structure that may be put in place and ultimately to operate in the absence of any Government guarantee.

High Level Goal 3 for this period was to ***"Ensure proper and effective regulation of financial institutions and markets"*** and the following strategies and actions were set out (banking related only):

Strategic Aim	Action
Strengthen the prudential supervisory framework for financial institutions through the implementation of new EU regulations	• Prepare for the implementation of new EU directives for credit institutions and investment firms: CRD II, CRD III, CRD IV and CRD V • Introduce revised large exposure limits for systemically important credit institutions
Improve the domestic regulatory framework applying to financial institutions	• Consult on corporate governance requirements for credit institutions and insurance undertakings • Consult on new code for related-party lending • Consult on requirements relating to remuneration in the financial services industry • Strengthen fitness and probity framework • Consider the need for additional requirements in respect of internal governance and risk management when international initiatives in these areas are published • Issue Valuation Guidelines outlining requirements for adequate internal controls • Assess the capital plans of credit institutions and monitor compliance with the capital targets that have been set for

Strategic Aim	Action
	each under the Prudential Capital Assessment Review • Assess requirement for Compulsory Mortgage Indemnity Insurance in the context of the Government's Working Group on Mortgages • Research the feasibility and desirability of imposing predetermined standard sectoral concentration limits on systemically important credit institutions • Explore credit information deficiencies and implications and potential solutions
Ensure that supervisory resources are allocated to areas of greatest risk	• Improve analysis of predominant risk factors including enhanced forward looking indicators of bank specific and systemic risk • Develop a new risk model to target the deployment of supervisory resources • Develop an engagement model for financial institutions based on their risk profile and our policy of more intensive supervision, involving close engagement with firms and increased number of onsite inspections • Apply the appropriate intensity of supervision appropriate to the risk profile of the financial service provider
Provide compliance assistance to financial institutions	• Issue guidance on regulatory issues • Influence the development of guidance and practice notes by other regulatory bodies
Improve compliance through the application of enforcement powers	• Develop enforcement strategy to support compliance • Investigate alleged instances of unauthorised activity or non-compliance with regulatory requirements and take appropriate enforcement action, including use of supervisory directions and administrative sanctions • Complete programme of special investigations arising from the financial crisis
Assist with the prevention of money laundering and financing of terrorism (AML – CTF)	• Assist in the preparation of guidance for industry • Undertake programme of themed inspections to increase probability of detection • Report suspicious transactions to the Gardai and/or Revenue Commissioners as appropriate • Sanction financial institutions with inadequate risk management and control mechanisms

The follow through of these actions carried on into 2011 and beyond and also were updated to reflect the Financial Measures Programme ("FMP") agreed with the Troika following Ireland's entry into a programme of financial assistance in late-2010.

5.6 Prudential Capital Assessment Review ("PCAR") 2010

The most significant engagement between the banks and the Central Bank and Financial Regulator during this period is also described in detail in the Annex to ***Banking Supervision: a New Approach.*** PCAR was an exercise carried out to determine the forward-looking prudential capital requirements of certain of the Irish credit institutions covered by the Government Guarantee.

PCAR 2010 assessed the capital requirements arising for expected base and potential stressed loan losses, and other financial developments, over a three year (2010-2012) time horizon. It involved the Central Bank and Financial Regulator making an assessment of the recapitalization requirements of the credit institutions in order to satisfy both a base case and stressed target capital requirement. The PCAR was undertaken to determine the recapitalisation requirements of the credit institutions with reference to both:

- A target level of 8% core tier 1 capital should be attained after taking account of the realisation of future expected losses and other financial developments under a base case scenario. This test was designed to ensure the credit institutions were capitalised to a level which reflected prudential requirements and current market expectations, after taking account of forecast loan losses through to 2012. As a further prudent requirement, the capital used to meet the base case target was determined as needing to be principally in the form of equity, the highest quality form of capital, with 7% equity as the target level. In calculating the requirements, individually specified amounts were added to the institutions' estimates of expected losses to take account of the uncertainty of loss forecasts for particular portfolios.

- A target level of 4% core tier 1 capital that should be maintained to meet a stress scenario or a portfolio level sensitivity analysis. This capital test, similar to that employed by US and UK supervisory authorities at that time, was designed to ensure that the credit institutions had a sufficient capital buffer to withstand losses under an adverse scenario significantly worse than anticipated at that time.

The Financial Regulator required the credit institutions that completed the exercise to prepare recapitalisation plans to comply with the additional capital specified by the PCAR. The level of additional capital required for each institution under the PCAR 2010 analysis is set out below. This amount of capital set by the PCAR process was required to be put in place by the end of 2010.

A team of prudential supervisors, credit and treasury specialists in the Financial Regulator, supported by Central Bank economists and financial stability specialists, conducted the PCAR by:

- Assessing the provisioning estimates of each credit institution, their Basel capital model outputs, expected loss forecasts, funding costs and projected operating income;
- Reviewing independent third party estimates of provisions and expected losses conducted on specific credit institutions' portfolios;
- Reviewing likely and stressed scenario loan loss projections for portfolio categories by credit rating agencies and other sources including regulatory agencies;
- Reviewing the outcome of modelled base and stress macro-economic scenarios that were specified and the credit institutions mandated to calculate;
- Using information received from NAMA in respect of the first tranche of "haircuts" as the basis for estimating the NAMA loan losses;
- Applying prudent adjustments to base case and stress scenario funding costs and treasury asset losses;
- Applying knowledge of the quality of loan portfolios gained through more intensive supervisory interaction with the banks, including observation of Credit Committee deliberations; and
- Benchmarking the analysis to the approaches taken by other leading international financial supervisors.

The PCAR 2010 Results by bank are a matter of public record and are therefore not repeated here.

Report of the Implementation Advisory Group on the establishment of a Single Regulatory Authority

Press Release 24 June 1999

The Board of the Central Bank welcomes the publication of the Report of the Implementation Advisory Group on the establishment of a Single Regulatory Authority. The Bank will facilitate and contribute in every possible way to public debate on the complex issues involved.

The Board has assured the Minister for Finance of its readiness to discharge whatever functions may be assigned to it by the Government. The Bank has made substantial contributions to the work of the Advisory Group over several months and it submitted several working papers to the Group covering all aspects of regulation.

The Board would like to express concern that the Report contains a deeply flawed argument concerning accountability to support the case for moving the Bank's regulatory functions elsewhere. The Governor and Board of the Bank are accountable to the Oireachtas in the exercise of their regulatory functions.

The Bank has an excellent record on prudential regulation and enjoys a high status internationally, which is hugely important to the continuing development of the International Financial Services Centre. There are major challenges ahead in the financial services industry, both worldwide and in the euro area. These developments will have important implications for this country and the Bank has the necessary expertise and experience to adapt these changes to Irish conditions.

The Bank fully recognises the need to rationalise and improve significantly the protection of consumers of financial services. Reflecting this it has put forward constructive proposals in this respect to the Advisory Group.

The Bank disagrees strongly with the main recommendation of the Advisory Group report. No convincing reasons have been put forward as to why existing regulatory functions should be transferred elsewhere. The 'green field' option represents a high risk strategy. The main risks include:

- loss of regulatory expertise;
- difficulty in establishing an international reputation as any new authority would lack international contacts and a proven track record;
- duplication of supervisory effort as the Bank must, under the Maastricht Treaty, continue to monitor the stability of the banking system and act as lender of last resort;
- loss of the important interaction and transfer of expertise between the Bank's regulatory and non-regulatory functions;
- high start-up and operating costs.

The Board would wish to see a full debate on financial regulation. This should promote solutions that further enhance the standards and safety of Irish financial institutions and the services provided to consumers.

http://www.centralbank.ie/press-area/press-releases/Pages/ReportoftheImplementationAdvisoryGroupontheestablishmentofaSingleRegulatoryAuthority.aspx

Number 23 of 2010

CENTRAL BANK REFORM ACT 2010

ARRANGEMENT OF SECTIONS

PART 1

PRELIMINARY

PART 13

AMENDMENT OF PERSONAL INJURIES ASSESSMENT BOARD ACT 2003

PART 14

ENACTMENTS AMENDED BY SUBSTITUTING "CENTRAL BANK OF IRELAND" FOR "CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND"

SCHEDULE 3

AMENDMENTS OF STATUTORY INSTRUMENTS

PART 1

AMENDMENTS OF ETHICS IN PUBLIC OFFICE (PRESCRIBED PUBLIC BODIES, DESIGNATED DIRECTORSHIPS OF PUBLIC BODIES AND DESIGNATED POSITIONS IN PUBLIC BODIES) REGULATIONS 2004

PART 2

AMENDMENTS OF EUROPEAN COMMUNITIES (CONSUMER CREDIT AGREEMENTS) REGULATIONS 2010

PART 3

AMENDMENTS OF EUROPEAN COMMUNITIES (COOPERATION BETWEEN NATIONAL AUTHORITIES RESPONSIBLE FOR THE ENFORCEMENT OF CONSUMER PROTECTION LAWS) REGULATIONS 2006

PART 4

AMENDMENTS OF EUROPEAN COMMUNITIES (UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES) REGULATIONS 2003

PART 5

AMENDMENTS OF MARKET ABUSE (DIRECTIVE 2003/6/EC) REGULATIONS 2005

PART 6

AMENDMENTS OF PROSPECTUS (DIRECTIVE 2003/71/EC) REGULATIONS 2005

PART 7

AMENDMENT OF TRANSPARENCY (DIRECTIVE 2004/109/EC) REGULATIONS 2007

PART 8

PROVISIONS OF STATUTORY INSTRUMENTS AMENDED BY SUBSTITUTING "CENTRAL BANK OF IRELAND" FOR "CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND"

Acts Referred to

Adoptive Leave Acts 1995 and 2005	
Anglo Irish Bank Corporation Act 2009	2009, No. 1
Asset Covered Securities Act 2001	2001, No. 47
Assurance Companies Act 1909	9 Edw 7, c. 49
Building Societies Act 1989	1989, No. 17
Carbon Fund Act 2007	2007, No. 12
Carer's Leave Act 2001	2001, No. 19
Central Bank Act 1942	1942, No. 22
Central Bank Act 1971	1971, No. 24
Central Bank Act 1989	1989, No. 16
Central Bank Act 1997	1997, No. 8
Central Bank Act 1998	1998, No. 2
Central Bank and Financial Services Authority of Ireland Act 2003	2003, No. 12
Central Bank and Financial Services Authority of Ireland Acts 1942 to 2009	
Commissions of Investigation Act 2004	2004, No. 23
Companies (Amendment) Act 1990	1990, No. 27
Companies (Auditing and Accounting) Act 2003	2003, No. 44
Companies Act 1963	1963, No. 33
Companies Act 1990	1990, No. 33
Company Law Enforcement Act 2001	2001, No. 28
Consumer Credit Act 1995	1995, No. 24
Consumer Protection Act 2007	2007, No. 19
Council of Europe Development Bank Act 2004	2004, No. 37
Credit Institutions (Financial Support) Act 2008	2008, No. 18
Credit Union Act 1997	1997, No. 15
Criminal Justice (Money Laundering and Terrorist Financing) Act 2010	2010, No. 6
Criminal Justice (Mutual Assistance) Act 2008	2008, No. 7
Criminal Justice (Terrorist Offences) Act 2005	2005, No. 2
Development Banks Act 2005	2005, No. 34
Disability Act 2005	2005, No. 14
Dormant Accounts Act 2001	2001, No. 32
European Communities Act 1972	1972, No. 27
European Communities Act 2009	2009, No. 33
Financial Emergency Measures in the Public Interest Act 2009	2009, No. 5
Financial Services (Deposit Guarantee Scheme) Act 2009	2009, No. 13
Financial Transfers Act 1992	1992, No. 27
Health (Repayment Scheme) Act 2006	2006, No. 17
Housing (Miscellaneous Provisions) Act 1992	1992, No. 18
Insurance (Amendment) Act 1978	1978, No. 30
Insurance (No. 2) Act 1983	1983, No. 29
Insurance Act 1936	1936, No. 45
Insurance Act 1953	1953, No. 7
Insurance Act 1964	1964, No. 18
Insurance Act 1989	1989, No. 3
International Criminal Court Act 2006	2006, No. 30

Investment Funds, Companies and Miscellaneous Provisions Act 2005	2005, No. 12
Investment Funds, Companies and Miscellaneous Provisions Act 2006	2006, No. 41
Investment Intermediaries Act 1995	1995, No. 11
Investment Limited Partnerships Act 1994	1994, No. 24
Investor Compensation Act 1998	1998, No. 37
Markets in Financial Instruments and Miscellaneous Provisions Act 2007	2007, No. 37
Maternity Protection Acts 1994 and 2004	
Minimum Notice and Terms of Employment Acts 1973 to 2005	
National Asset Management Agency Act 2009	2009, No. 34
National Oil Reserves Agency Act 2007	2007, No. 7
Netting of Financial Contracts Act 1995	1995, No. 25
Official Languages Act 2003	2003, No. 32
Organisation of Working Time Act 1997	1997, No. 20
Parental Leave Acts 1998 and 2006	
Personal Injuries Assessment Board Act 2003	2003, No. 46
Postal and Telecommunications Services Act 1983	1983, No. 24
Protection of Employees (Fixed-Term Work) Act 2003	2003, No. 29
Protection of Employees (Part-Time Work) Act 2001	2001, No. 45
Redundancy Payments Acts 1967 to 2007	
Sea Pollution (Hazardous Substances) (Compensation) Act 2005	2005, No. 9
Sea Pollution (Miscellaneous Provisions) Act 2006	2006, No. 29
Solicitors (Amendment) Act 1994	1994, No. 27
Statutory Instruments Act 1947	1947, No. 44
Terms of Employment (Information) Acts 1994 and 2001	
Trustee Savings Banks Act 1989	1989, No. 21
Unclaimed Life Assurance Policies Act 2003	2003, No. 2
Unfair Dismissals Acts 1977 to 2007	
Unit Trusts Act 1990	1990, No. 37

Number 23 *of* 2010

CENTRAL BANK REFORM ACT 2010

AN ACT TO ESTABLISH THE CENTRAL BANK OF IRELAND AS A SINGLE FULLY-INTEGRATED STRUCTURE WITH A UNITARY BOARD — THE CENTRAL BANK COMMISSION — REPLACING THE BOARDS OF THE CENTRAL BANK AND IRISH FINANCIAL SERVICES REGULATORY AUTHORITY; TO ENHANCE THE SYSTEM OF REGULATORY CONTROL AND TO CONFER ADDITIONAL POWERS ON THE CENTRAL BANK, THE GOVERNOR AND THE HEAD OF FINANCIAL REGULATION TO PREVENT POTENTIAL SERIOUS DAMAGE TO THE FINANCIAL SYSTEM IN THE STATE, SUPPORT THE STABILITY OF THAT SYSTEM AND TO PROTECT USERS OF FINANCIAL SERVICES; TO TRANSFER CERTAIN FUNCTIONS OF THE CENTRAL BANK TO THE NATIONAL CONSUMER AGENCY; TO AMEND THE ENACTMENTS RELATING TO THE CENTRAL BANK AND CERTAIN OTHER ACTS CONSEQUENTIAL ON THAT REORGANISATION; TO AMEND THE LAW RELATING TO THE REGULATION OF LENDING BY CREDIT UNIONS; TO EXTEND THE RANGE OF PERSONS WHO CAN BE AUTHORISED TO INVESTIGATE THE AFFAIRS OF AN INSURER; AND TO PROVIDE FOR RELATED MATTERS.

[17*th July*, 2010]

BE IT ENACTED BY THE OIREACHTAS AS FOLLOWS:

PART 1

Preliminary

Short title and collective citation.

1.—(1) This Act may be cited as the Central Bank Reform Act 2010.

(2) The Central Bank and Financial Services Authority of Ireland Acts 1942 to 2009 and this Act may be cited together as the Central Bank Acts 1942 to 2010.

Commencement.

2.—(1) This Act comes into operation on such day or days as the Minister may appoint by order or orders either generally or with reference to a particular purpose or provision. Different days may be so appointed for different purposes or different provisions.

(2) An order under *subsection (1)* may, in relation to the amendments of Acts and statutory instruments set out in *Schedules 1* to *3*, appoint different days for the amendment of different Acts or statutory instruments or different provisions of them.

Interpretation.

3.—(1) In this Act—

"Act of 1942" means the Central Bank Act 1942;

"cessation date" means the last day on which section 33B of the Act of 1942 is in operation.

(2) An expression used in this Act and also in the Act of 1942 has, unless the contrary intention appears, the same meaning in this Act as in the Act of 1942.

PART 2

Reform of the Central Bank of Ireland — transitional and saving provisions

Transitional arrangements in relation to certain office-holders.

4.—(1) The person who held, on the cessation date, the office of Chief Executive of the Regulatory Authority (within the meaning then given by the Act of 1942) shall be taken, on the following day, to be appointed as Head of Financial Regulation.

(2) Subject to *subsection (5)*, the person referred to in *subsection (1)* holds the office of Head of Financial Regulation until the time at which his or her appointment as Chief Executive of the Regulatory Authority would have expired.

(3) The person who held, on the cessation date, the office of Director General of the Bank shall be taken, on the following day, to be appointed as Head of Central Banking.

(4) Subject to *subsection (5)*, the person referred to in *subsection (3)* holds the office of Head of Central Banking until the time at which his or her appointment as Director General of the Bank would have expired.

(5) A person referred to in *subsection (1)* or *(3)* may be removed from office for the same reasons, and in the same way, as a person appointed to hold office as a Head of Function under section 23B of the Act of 1942.

(6) This section has effect notwithstanding sections 23B(2) and 23C(2) of the Act of 1942.

Preservation of rights of employees.

5.—Other than the holder of a statutory office that ceases to exist because of amendments to the Act of 1942 by this Act, nothing in this Act affects the terms and conditions of the employment of any officer or employee of the Bank.

6.—(1) In this section— Arrangements for secondment of certain employees.

"secondee" means an employee seconded from the Bank to the Agency under arrangements referred to in *subsection (2)*.

(2) The Bank and the Agency may make arrangements for the secondment of employees of the Bank to the Agency for the purposes of any function transferred from the Bank to the Agency pursuant to amendments to the Act of 1942 by this Act.

(3) A secondee may elect to become an employee of the Agency at any time until 29 February 2012.

(4) A secondee who does not make an election under *subsection (3)* continues to be an employee of the Bank until 29 February 2012. His or her terms of employment (including any term conferring a right to an increase in remuneration) continue to be those applicable to his or her employment by the Bank.

(5) On 1 March 2012, a secondee who has not made an election under *subsection (3)* shall be taken to have elected to continue to be an employee of the Bank.

(6) An election under *subsection (3)* to become an employee of the Agency has effect if and only if the chief executive officer of the Agency, the Minister for Finance and the Minister for Enterprise, Trade and Innovation all consent. If all of them so consent, the election has effect immediately after the latest of those consents is given. Until that time the employee concerned continues to be an employee of the Bank.

(7) If a secondee elects to become an employee of the Agency, the terms of employment by the Agency at the time the election has effect shall not be less favourable than the terms at that time of his or her employment by the Bank (subject to any provision in any enactment).

(8) If a person's employment is transferred under this section, the person's previous service with the Bank is to be counted as service for the purposes of the following Acts:

(*a*) the Redundancy Payments Acts 1967 to 2007;

(*b*) the Protection of Employees (Part-Time Work) Act 2001;

(*c*) the Protection of Employees (Fixed-Term Work) Act 2003;

(*d*) the Organisation of Working Time Act 1997;

(*e*) the Terms of Employment (Information) Acts 1994 and 2001;

(*f*) the Minimum Notice and Terms of Employment Acts 1973 to 2005;

(*g*) the Unfair Dismissals Acts 1977 to 2007;

(*h*) the Maternity Protection Acts 1994 and 2004;

(*i*) the Parental Leave Acts 1998 and 2006;

(*j*) the Adoptive Leave Acts 1995 and 2005;

(*k*) the Carer's Leave Act 2001.

Saving of certain regulations, rules, codes, etc.

7.—(1) Any instrument (whether described as a rule, regulation, order or code of practice or in any other way, and whether or not a statutory instrument to which the Statutory Instruments Act 1947 primarily applies) made or issued by or on behalf of the Regulatory Authority or the Consumer Director and in force on the cessation date has, after that date, the same force and effect as it had on that date.

(2) An instrument referred to in *subsection (1)* may be revoked or amended by the Bank as if made by the Bank.

Saving of certain schemes.

8.—(1) The repeal of section 33 of the Act of 1942 by this Act does not affect the operation of any scheme made by the Bank or the Governor under that section and still in operation, or any rights of any person under such a scheme.

(2) A scheme referred to in *subsection (1)* may be amended by the Bank as if section 33 of the Act of 1942 had not been repealed.

Applications, etc., made to Regulatory Authority.

9.—(1) An application for a licence, authorisation or permission (however described) made to the Regulatory Authority on or before the cessation date has, after that date, the effect that it would have if made to the Bank.

(2) Nothing in *subsection (1)* is taken to alter the date on which an application referred to in that subsection was made.

Information in possession of Regulatory Authority.

10.—(1) On the day after the cessation date, the records of the Regulatory Authority and information that was, on the cessation date, in the possession of the Regulatory Authority come into the possession of the Bank.

(2) The Bank has the same rights, powers, duties and obligations in relation to records and information referred to in *subsection (1)* as the Regulatory Authority had on the cessation date.

(3) In particular, without prejudice to the generality of *subsection (2)*, the Bank—

(*a*) may have regard, in carrying out its regulatory functions under the Act of 1942 as amended by this Act, to any record or information referred to in *subsection (1)*,

(*b*) specifically, may have regard to any such record or information for the purpose of deciding whether a person may have committed an offence (whether against the *Central Bank Acts 1942 to 2010* or any other law), and

(*c*) has the same powers and obligations to deal with such records and information (including that of disclosing such information to another authority in accordance with section 33AK of the Act of 1942) as the Regulatory Authority had on the cessation date.

11.—(1) A regulatory action taken by the Regulatory Authority on or before the cessation date, and not already spent, continues to have effect according to its terms. The Bank may enforce such a regulatory action.

Regulatory action taken by Regulatory Authority.

(2) In *subsection (1)* "regulatory action" includes any direction, order, requirement, sanction, condition, appointment or request (however described) of a regulatory nature made, given or imposed by the Regulatory Authority.

12.—(1) An inquiry undertaken by the Regulatory Authority under Chapters 2 and 3 of Part IIIC of the Act of 1942 on or before the cessation date, and not already completed, may be continued by the Bank. The Bank may take regulatory action on the basis of such an inquiry.

Inquiries, etc., undertaken by Regulatory Authority.

(2) An assessor appointed by the Regulatory Authority on or before the cessation date under—

(*a*) Part 5 of the Market Abuse (Directive 2003/6/EC) Regulations 2005,

(*b*) Part 5 of the Prospectus (Directive 2003/71/EC) Regulations 2005, or

(*c*) Part 10 of the Transparency (Directive 2004/109/EC) Regulations 2007,

may continue, if the assessment for which he or she was appointed is not completed at that date, to carry out that assessment. The Bank may take regulatory action on the basis of such an assessment.

(3) In *subsections (1)* and *(2)* "regulatory action" includes any direction, order, requirement, sanction, condition, appointment or request (however described) of a regulatory nature that the Bank may make, give or impose.

13.—(1) If on the cessation date the Regulatory Authority is a party to any legal proceedings, then the Bank is taken, immediately after that date, to be substituted for the Regulatory Authority as such a party.

Legal proceedings to which Regulatory Authority is party.

(2) Nothing in *subsection (1)* makes available against the Bank any right (including, in particular, any right to seek discovery of documents) that was not or is no longer available against the Regulatory Authority.

(3) An order by a court or the Appeal Tribunal against the Regulatory Authority has effect, after the cessation date, as an order against the Bank.

(4) In this section "legal proceedings" includes—

(*a*) an appeal to the Appeal Tribunal, and

(*b*) a prosecution where the Regulatory Authority is prosecutor.

Amendments of Central Bank Acts.

14.—(1) The Act of 1942 is amended as set out in *Part 1* of *Schedule 1*.

(2) Parts IIIC, VIIA and VIIB of the Act of 1942 are further amended as follows:

(*a*) by deleting "Regulatory Authority" and substituting "Bank" in each place where it occurs;

(*b*) by deleting "that Authority" and substituting "the Bank" in each place where it occurs.

(3) The provisions of the Act of 1942 set out in *Part 2* of *Schedule 1* are repealed.

(4) The Central Bank Act 1971 is amended as set out in *Part 3* of *Schedule 1*.

(5) The Central Bank Act 1989 is amended as set out in *Part 4* of *Schedule 1*.

(6) The Central Bank Act 1997 is amended as set out in *Part 5* of *Schedule 1*.

(7) The Central Bank Act 1998 is amended as set out in *Part 6* of *Schedule 1*.

Amendments of other Acts.

15.—(1) The Anglo Irish Bank Corporation Act 2009 is amended as set out in *Part 1* of *Schedule 2*.

(2) The Companies (Auditing and Accounting) Act 2003 is amended as set out in *Part 2* of *Schedule 2*.

(3) The Company Law Enforcement Act 2001 is amended as set out in *Part 3* of *Schedule 2*.

(4) The Consumer Credit Act 1995 is amended as set out in *Part 4* of *Schedule 2*.

(5) The Consumer Protection Act 2007 is amended as set out in *Part 5* of *Schedule 2*.

(6) The Credit Institutions (Financial Support) Act 2008 is amended as set out in *Part 6* of *Schedule 2*.

(7) The Credit Union Act 1997 is amended as set out in *Part 7* of *Schedule 2*.

(8) The Disability Act 2005 is amended as set out in *Part 8* of *Schedule 2*.

(9) The Health (Repayment Scheme) Act 2006 is amended as set out in *Part 9* of *Schedule 2*.

(10) The Insurance Act 1989 is amended as set out in *Part 10* of *Schedule 2*.

(11) The National Asset Management Agency Act 2009 is amended as set out in *Part 11* of *Schedule 2*.

(12) The Official Languages Act 2003 is amended as set out in *Part 12* of *Schedule 2*.

(13) The Personal Injuries Assessment Board Act 2003 is amended as set out in *Part 13* of *Schedule 2*.

(14) Each enactment specified in *Part 14* of *Schedule 2* is amended by deleting "Central Bank and Financial Services Authority of Ireland" and substituting "Central Bank of Ireland".

Amendments of statutory instruments.

16.—(1) The Ethics in Public Office (Prescribed Public Bodies, Designated Directorships of Public Bodies and Designated Positions in Public Bodies) Regulations 2004 (S.I. No. 699 of 2004) are amended as set out in *Part 1* of *Schedule 3*.

(2) The European Communities (Consumer Credit Agreements) Regulations 2010 (S.I. No. 281 of 2010) are amended as set out in *Part 2* of *Schedule 3*.

(3) The European Communities (Cooperation between National Authorities Responsible for the Enforcement of Consumer Protection Laws) Regulations 2006 (S.I. No. 290 of 2006) are amended as set out in *Part 3* of *Schedule 3*.

(4) The European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003 (S.I. No. 211 of 2003) are amended as set out in *Part 4* of *Schedule 3*.

(5) The Market Abuse (Directive 2003/6/EC) Regulations 2005 (S.I. No. 342 of 2005) are amended as set out in *Part 5* of *Schedule 3*.

(6) The Prospectus (Directive 2003/71/EC) Regulations 2005 (S.I. No. 324 of 2005) are amended as set out in *Part 6* of *Schedule 3*.

(7) The Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. No. 277 of 2007) are amended as set out in *Part 7* of *Schedule 3*.

(8) If a provision of an Order made pursuant to section 4 of the Financial Transfers Act 1992 provides that the Central Bank and Financial Services Authority of Ireland may give directions or issue instructions for any purpose, the provision is amended by deleting "Central Bank and Financial Services Authority of Ireland" and substituting "Central Bank of Ireland".

(9) If a provision of Regulations made pursuant to section 3 of the European Communities Act 1972 (being Regulations made for the purpose of a Regulation of the European Commission or the Council of the European Union imposing financial sanctions) provides that the Central Bank and Financial Services Authority of Ireland may give directions or issue instructions for any purpose, the provision is amended by deleting "Central Bank and Financial Services Authority of Ireland" and substituting "Central Bank of Ireland".

(10) If a provision of Regulations made pursuant to section 42(6) of the Criminal Justice (Terrorist Offences) Act 2005 provides that the Central Bank and Financial Services Authority of Ireland may give directions or issue instructions for any purpose, the provision is amended by deleting "Central Bank and Financial Services Authority of Ireland" and substituting "Central Bank of Ireland".

(11) Each provision of a statutory instrument specified in *Part 8* of *Schedule 3* is amended by deleting "Central Bank and Financial Services Authority of Ireland" and substituting "Central Bank of Ireland" in each place where it occurs.

(12) The amendment of a statutory instrument by this section does not prevent or restrict the subsequent amendment or revocation of the instrument by another statutory instrument.

Construction of certain references.

17.—(1) After the cessation date, a reference in an enactment or a provision of a statutory instrument to the Board of the Central Bank and Financial Services Authority of Ireland shall be construed as a reference to the Commission.

(2) After the cessation date, a reference in an enactment or a provision of a statutory instrument to a member of the Board of the Central Bank and Financial Services Authority of Ireland shall be construed as a reference to a member of the Commission.

(3) After the cessation date, a reference in an enactment or a provision of a statutory instrument to the Chief Executive of the Irish Financial Services Regulatory Authority shall be construed as a reference to the Head of Financial Regulation.

(4) After the cessation date, any other reference in an enactment or a provision of a statutory instrument to the Central Bank and Financial Services Authority of Ireland shall be construed as a reference to the Bank.

(5) After the cessation date, any other reference in an enactment or a provision of a statutory instrument to the Irish Financial Services Regulatory Authority (as "the Regulatory Authority" or in any other way) shall be construed as a reference to the Bank.

PART 3

Powers of Bank in relation to officers, etc., of financial service providers

Chapter 1

Preliminary

Definitions (*Part 3*).

18.—(1) In this Part—

"Court" means the High Court;

"evidentiary notice" means a notice under *section 32*;

"controlled function" means a function prescribed in regulations made under *section 20*;

"pre-approval controlled function" shall be construed in accordance with *section 22*;

"suspension notice" means a notice under *section 26*.

(2) This Part applies to and in relation to regulated financial service providers other than credit unions.

(3) On and from a date to be fixed by the Minister by order, this Part applies to and in relation to all regulated financial service providers, including credit unions.

CHAPTER 2

Controlled functions

19.—In this Chapter "relevant obligations" has the same meaning as in Part IV of the Central Bank Act 1997.

Definition (*Chapter 2*).

20.—(1) The Bank may make regulations prescribing functions that are to be controlled functions.

Controlled functions.

(2) The Bank may prescribe a function under *subsection (1)* if and only if the function is a function in relation to the provision of a financial service and—

(*a*) is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the affairs of a regulated financial service provider,

(*b*) is related to ensuring, controlling or monitoring compliance by a regulated financial service provider with its relevant obligations, or

(*c*) is likely to involve the person responsible for its performance in the provision of a financial service by a regulated financial service provider in one or more of the following ways:

(i) the giving of advice or assistance to a customer of the regulated financial service provider in the course of providing, or in relation to the provision of, the financial service;

(ii) dealing in or having control over property of a customer of the regulated financial service provider to whom a financial service is provided or to be provided, whether that property is held in the name of the customer or some other person;

(iii) dealing in or with property on behalf of the regulated financial service provider, or providing instructions or directions in relation to such dealing.

(3) A controlled function that is carried on by a person who, or a partnership or an entity that, is not a regulated financial service provider remains a controlled function.

(4) A controlled function remains a controlled function even if—

(*a*) it is carried on at an office or location outside the State,

(*b*) it is carried on at the office or location of another person, whether or not the other person is a regulated financial service provider, or

(*c*) it relates to a business of a regulated financial service provider established in the State conducted by that provider outside the State.

(5) A function may be prescribed as a controlled function in relation to a specified class or classes of regulated financial service

providers or in relation to regulated financial service providers generally.

(6) The Bank shall give to the Minister a copy of any regulations made by it under this section as soon as practicable after the regulations are made and the Minister shall, as soon as may be, cause a copy of the regulations to be laid before each House of the Oireachtas.

Application of standards of fitness and probity.

21.—(1) A regulated financial service provider shall not permit a person to perform a controlled function unless—

(*a*) the regulated financial service provider is satisfied on reasonable grounds that the person complies with any standard of fitness and probity in a code issued under *section 50*, and

(*b*) the person has agreed to abide by any such standard.

(2) The Bank may take into account standards of fitness and probity referred to in *subsection (1)* when performing its functions and exercising its powers.

Pre-approval controlled functions.

22.—(1) A function is a pre-approval controlled function if—

(*a*) it is prescribed as such in regulations made pursuant to *subsection (2)*, or

(*b*) it has been declared by the Bank to be a pre-approval controlled function by written notice pursuant to *subsection (8)*.

(2) The Bank may prescribe by regulation a controlled function as a pre-approval controlled function if the function is one by which a person may exercise a significant influence on the conduct of a regulated financial service provider's affairs. In prescribing such a function, the Bank may describe or identify the function by reference to a title commonly used for a person who performs the function.

(3) Without prejudice to the generality of *subsection (2)*, the Bank may, pursuant to that subsection, prescribe a controlled function as a pre-approval controlled function if—

(*a*) the person who performs the function reports directly to—

(i) a person who holds an office or position mentioned in a subparagraph of *subsection (4)(a)*, or

(ii) a person referred to in *paragraph (b)* or *(c)* of *subsection (4)*,

and

(*b*) the Bank is satisfied that the prescription of the function as a pre-approval controlled function—

(i) is warranted on the grounds of the size or complexity of the regulated financial service provider or its business, and

(ii) is necessary or prudent in order to verify the compliance by the regulated financial service provider with its relevant obligations.

(4) For the purposes of *subsection (2)*—

(*a*) in the case of a regulated financial service provider that is a body corporate of a prescribed class, a person who holds or performs the duties of any of the following positions or offices in a regulated financial service provider shall be taken to exercise a significant influence on the conduct of the regulated financial service provider's affairs:

(i) the office of director;

(ii) the office of chief executive;

(iii) the office of secretary;

(iv) subject to *subsection (3)*, an office or position the holder of which reports directly to—

(I) a person who holds an office or position referred to in *subparagraph (i)*, *(ii)* or *(iii)*, or

(II) a person referred to in *paragraph (b)* or *(c)*,

(*b*) each member of a partnership that is a regulated financial service provider of a prescribed class shall be taken to exercise a significant influence on the conduct of the regulated financial service provider's affairs, and

(*c*) if a natural person is a regulated financial service provider of a prescribed class, he or she shall be taken to exercise a significant influence on the conduct of the regulated financial service provider's affairs.

(5) For the purposes of *subsection (4)(a)*, the Bank may prescribe bodies corporate of a specified class or may prescribe all bodies corporate to be a class. In prescribing bodies corporate of a particular class, the Bank may define the class by reference to any common characteristic of the class, including in particular the kind of business engaged in or the size of the balance sheets of the bodies corporate.

(6) For the purposes of *paragraph (b)* or *(c)* of *subsection (4)*, the Bank may prescribe regulated financial service providers that are partnerships or natural persons, as the case may be, of a specified class or may prescribe all regulated financial service providers that are partnerships or natural persons to be a class. In prescribing regulated financial service providers that are partnerships or natural persons of a particular class, the Bank may define the class by reference to any common characteristic of the class, including in particular the kind of business engaged in or the annual turnover of the partnerships or natural persons concerned.

(7) Regulations made under this section may be made in the same instrument as regulations made under *section 20*.

(8) The Bank may declare by notice in writing served on a regulated financial service provider that a function performed by, for or on behalf of the regulated financial service provider is a pre-approval controlled function if—

(*a*) the person who performs the function is concerned in the management of the regulated financial service provider,

(*b*) the function is not prescribed as a pre-approval controlled function in regulations made pursuant to *subsection (2)*, and

(*c*) no other person in the regulated financial service provider performs a pre-approval controlled function.

Appointment of persons to perform pre-approval controlled functions.

23.—(1) A regulated financial service provider shall not offer to appoint a person to perform a pre-approval controlled function unless the Bank has approved in writing the appointment of the person to perform the function. An offer made in contravention of this subsection does not create any contractual obligation.

(2) For the purposes of considering whether or not to approve a person under *subsection (1)*, the Bank may request the person, or a specified officer or employee of the regulated financial service provider that proposes to appoint the person to perform a controlled function, by notice in writing to do any one or more of the following:

(*a*) produce a specified document or documents to the Bank;

(*b*) provide specified information to the Bank;

(*c*) produce to the Bank documents of a kind described in the notice;

(*d*) answer a question or questions set out in the notice;

(*e*) attend before a specified officer or employee of the Bank for interview.

(3) A notice under *subsection (2)* shall specify a date and time by which, and a place at which, the person shall provide the document or documents or information, provide answers to the question or questions, or attend for interview, as the case may be.

(4) Nothing in *subsection (2)* or any notice given by the Bank under that subsection requires a person—

(*a*) to produce to the Bank a document that the person could not have been compelled to produce to a court,

(*b*) to give the Bank information that the person could not have been compelled to give a court, or

(*c*) to answer a question (either in writing or at interview) that the person could not have been compelled to answer in a court.

(5) The Bank may refuse to approve the appointment of a person for the purposes of *subsection (1)* where—

(*a*) the Bank is of the opinion that the person is not of such fitness and probity as is appropriate to perform the function for which he or she is proposed to be appointed, or

(*b*) the Bank is unable to decide, on the basis of the information available to it, whether the person is of such fitness and probity.

(6) Without prejudice to the generality of *subsection (5)*, the Bank may refuse to approve the appointment of a person under *subsection (1)* if—

(*a*) the person, or an officer or employee of the regulated financial service provider concerned, has failed to comply with a request under *subsection (2)*, or

(*b*) any of the grounds set out in *paragraphs (a)* to *(g)* of *section 25(3)* apply.

(7) A refusal pursuant to *subsection (5)* is an appealable decision for the purposes of Part VIIA of the Act of 1942.

CHAPTER 3

Suspension and investigation of fitness and probity of persons performing controlled functions, etc.

Definition (*Chapter 3*).

24.—In this Chapter "suspended person" means a person who is the subject of a suspension notice.

Head of Financial Regulation may investigate persons' fitness and probity.

25.—(1) If in relation to a person to whom *subsection (2)* applies, the Head of Financial Regulation is of the opinion that—

(*a*) there is reason to suspect the person's fitness and probity to perform the relevant controlled function, and

(*b*) in the circumstances an investigation is warranted into the person's fitness and probity,

the Head of Financial Regulation may conduct an investigation, in accordance with this Chapter, in relation to the fitness and probity of the person to perform the controlled function.

(2) This subsection applies to a person—

(*a*) if the person performs a controlled function in relation to a regulated financial service provider,

(*b*) if, to the knowledge of the Head of Financial Regulation, a regulated financial service provider proposes to appoint the person to carry out a controlled function (other than a pre-approval controlled function), or

(*c*) if the Head of Financial Regulation has reason to believe that a regulated financial service provider is considering the appointment of the person to perform a controlled function (other than a pre-approval controlled function).

(3) Without prejudice to the generality of *subsection (1)*, the Head of Financial Regulation may form the opinion referred to in that subsection if there is reason to suspect that—

(*a*) the person does not have the experience, qualifications or skills necessary to perform properly and effectively the controlled function, the part of a controlled function or any controlled function, as the case may be,

(*b*) the person does not satisfy an applicable standard of fitness and probity in a code issued pursuant to *section 50*, (*c*) the person has participated in serious misconduct in relation to the business of a regulated financial service provider,

(*d*) the person has directly or indirectly provided information to the Bank, the Governor or the Head of Financial Regulation (whether pursuant to this Part or otherwise) that the person knew or ought to have known was false or misleading,

(*e*) the person has directly or indirectly provided information that the person knew or ought to have known was false or misleading to another person in order for it to be provided to the Bank, the Governor or the Head of Financial Regulation,

(*f*) the person has caused or sought to cause information requested by the Head of Financial Regulation by evidentiary notice from a regulated financial service provider or a person who is carrying out a controlled function not to be provided by the due date,

(*g*) the person has failed to comply with an evidentiary notice, or

(*h*) the person has been convicted of an offence (whether in the State or outside the State) of money laundering or terrorist financing or an offence involving fraud, dishonesty or breach of trust.

Head of Financial Regulation may issue suspension notice, etc.

26.—(1) If a person's fitness and probity is or has been the subject of an investigation under *section 25*, and the Head of Financial Regulation is satisfied that it is necessary in the interests of the proper regulation of a regulated financial service provider concerned that the person not perform the relevant controlled function, or any controlled function, while the Head of Financial Regulation, the Bank or the Governor, as the case may be, is carrying out any function in relation to the person under this Chapter or *Chapter 4*, the Head of Financial Regulation may issue a notice (in this Part called a "suspension notice") in relation to the person.

(2) When considering whether to issue a suspension notice, the Head of Financial Regulation shall have particular regard, where appropriate, to—

(*a*) the need to prevent potential serious damage to the financial system in the State and ensure the continued stability of that system, and

(*b*) the need to protect users of financial services.

(3) Before issuing a suspension notice in the circumstances referred to in *section 25(2)(c)*, the Head of Financial Regulation shall ask the regulated financial service provider concerned in writing whether it is actually considering the appointment of the person concerned to perform the relevant controlled function. If the regulated financial service provider confirms in writing that it is not considering such an appointment, the Head of Financial Regulation shall not issue the notice unless there is reason to believe that such an appointment will nevertheless be made, or has been made.

(4) A suspension notice—

(*a*) is required to be in writing,

(*b*) shall set out the grounds on which the Head of Financial Regulation holds the opinion referred to in *section 25(1)*,

(*c*) shall specify whether the suspended person is suspended from performing—

(i) a particular specified controlled function,

(ii) a specified part of a particular specified controlled function, or

(iii) all controlled functions,

(*d*) shall require the suspended person and the regulated financial service provider concerned to show cause, in writing, within 5 days after service of the notice, why the suspension order should not be confirmed, and

(*e*) shall set out any condition imposed under *subsection (8)* on the regulated financial service provider.

(5) The Head of Financial Regulation shall serve a copy of a suspension notice on each of the following:

(*a*) the suspended person;

(*b*) each regulated financial service provider for whom, to the knowledge of the Head of Financial Regulation, the suspended person performs the specified controlled function, the specified part of a controlled function, or any controlled function, as the case requires;

(*c*) any regulated financial service provider that—

(i) to the knowledge of the Head of Financial Regulation, proposes to appoint the suspended person to perform the specified controlled function, the specified part of a controlled function, or any controlled function, as the case requires, or

(ii) the Head of Financial Regulation believes to be considering appointing the suspended person to perform the specified controlled function, the specified part of a controlled function, or any controlled function, as the case requires.

(6) A suspension notice may be served on a person (including a regulated financial service provider)—

(*a*) by delivering it to the person,

(*b*) by leaving it at the address at which the person ordinarily resides or, in a case in which an address for service has been furnished, at that address,

(*c*) by sending it by post in a prepaid letter to the address at which the person ordinarily resides or, in a case in which an address for service has been furnished, to that address, or (*d*) electronically (by electronic mail to an email address, or by facsimile to a facsimile number, furnished by the person to, or otherwise known to, the Head of Financial Regulation).

(7) A regulated financial service provider on which a suspension notice is served shall immediately—

(*a*) give a copy of the notice to the suspended person (unless it is impracticable to do so), and

(*b*) after it has done so, certify in writing to the Head of Financial Regulation that it has done so.

(8) In a suspension notice the Head of Financial Regulation may impose on any regulated financial service provider concerned any terms and conditions relating to the enforcement of, or compliance with, the notice that the Head of Financial Regulation thinks fit (including any condition as to the cessation, restriction or conduct of all or part of the business of the regulated financial service provider concerned until the regulated financial service provider complies with the notice).

(9) A suspended person, and a regulated financial service provider on which a suspension notice is served, may, within the period mentioned in *subsection (4)(d)*, make a written submission to the Head of Financial Regulation in relation to the fitness and probity of the suspended person concerned or any terms or conditions imposed.

(10) Where a person on whom a suspension notice has been served asks the Head of Financial Regulation to decide, before the end of the period provided by *section 28(b)(i)*, whether or not to confirm the suspension notice, and provides material that the Head of Financial Regulation is satisfied allows him or her to make a proper and fair decision, the Head of Financial Regulation shall make all reasonable efforts to make that decision as soon as reasonably practicable.

Effect of suspension notices.

27.—(1) A regulated financial service provider on whom a suspension notice is served—

(*a*) shall immediately remove the suspended person concerned from performing—

(i) the particular controlled function concerned,

(ii) the specified part of the controlled function concerned, or

(iii) all controlled functions,

as specified in the notice, or

(*b*) shall not appoint the suspended person to carry out the controlled function or part, or any controlled function, as specified in the notice,

as the case requires.

(2) A regulated financial service provider on whom a suspension notice is served shall comply with any condition imposed on the regulated financial service provider by the notice.

(3) A suspended person on whom a suspension notice in relation to him or her is served, or who has been given a copy of such a notice by a regulated financial service provider shall cease performing, or (as the case requires) shall not begin to perform—

(*a*) the particular controlled function concerned,

(*b*) the specified part of the controlled function concerned, or

(*c*) all controlled functions,

as specified in the relevant suspension notice.

(4) A suspension notice does not alter the contractual rights of any person to remuneration or benefits. Those rights shall continue to be determined in accordance with the relevant contract.

Suspension notices that have not been confirmed — period of effect.

28.—A suspension notice that has not been confirmed by the Head of Financial Regulation pursuant to *section 29*—

(*a*) takes effect on its service on the regulated financial service provider for whom the suspended person performs the relevant controlled function, and

(*b*) ceases to have effect—

(i) at the end of the 10th day after that service, unless within that period it is confirmed in accordance with *section 29*, or

(ii) if before the end of that day the Head of Financial Regulation revokes the notice, when the notice is revoked.

Confirmation of suspension notices.

29.—(1) If the Head of Financial Regulation, having considered any written submissions made pursuant to *section 26* within the period mentioned in *section 26(4)(d)* by a person on whom, or a regulated financial service provider on which, a suspension notice has been served, is satisfied that—

(*a*) there is still reason to believe that the person is not of such fitness and probity as is appropriate to perform the relevant controlled function,

(*b*) in the circumstances an investigation is still warranted into the person's fitness and probity, and

(*c*) it is necessary in the interests of the proper regulation of the financial service provider that the person not perform the controlled function, or any controlled function, while the matter is investigated,

the Head of Financial Regulation may confirm the suspension notice.

(2) To avoid any doubt, the Head of Financial Regulation may confirm a suspension notice at the end of the period mentioned in *section 26(4)(d)* even if no submission has been made in relation to it by either or both of the suspended person and any regulated financial service provider concerned.

(3) If a suspended person makes a submission in relation to a suspension notice after the end of the period mentioned in *section 26(4)(d)*, and the Head of Financial Regulation is satisfied that there was good reason why the submission could not have been made within that period, or that it is necessary to do so in the interests of justice, the Head of Financial Regulation shall—

(*a*) consider the submission, and

(*b*) if after doing so he or she is satisfied that any condition in *paragraph (a)*, *(b)* or *(c)* of *subsection (1)* is no longer satisfied, revoke the notice.

(4) A suspension notice that has been confirmed in accordance with *subsection (1)* has effect for 3 months (unless sooner revoked) from the date upon which the suspension notice would otherwise have ceased to have effect under *section 28(b)*.

(5) The Head of Financial Regulation shall serve a notice of the confirmation of a suspension notice on each person on whom the suspension notice was served.

(6) The Head of Financial Regulation may revoke a suspension notice at any time if he or she considers that—

(*a*) there is no longer any reason to suspect the person's fitness and probity to perform the relevant controlled function, or

(*b*) although the investigation continues, it is no longer necessary in the interests of the proper regulation of the regulated financial service provider concerned that the person not perform the relevant controlled function, or any controlled function, during the investigation.

Enforcement of suspension notice.

30.—If—

(*a*) a person performs a controlled function or part of a controlled function in contravention of a suspension notice, or

(*b*) a regulated financial service provider permits a suspended person to perform a controlled function or part of a controlled function in contravention of a suspension notice,

the Head of Financial Regulation may apply *ex parte* to the Court for an order directing the person or regulated financial service provider to comply with the notice.

Court's power to extend validity of suspension notices.

31.—(1) During the period of validity of a suspension notice that has been confirmed by the Head of Financial Regulation, the Head of Financial Regulation may apply to the Court, on notice to the suspended person and any regulated financial service provider on which the notice was served, for an order extending the period of validity of the notice.

(2) If the Court is satisfied, having regard to the reasons for the issue and confirmation of the notice stated by the Head of Financial Regulation, that there are sufficient grounds to extend the period of validity of the notice, the Court may extend the notice for such

further period (but not longer than a further 3 months) as the Court orders.

(3) When considering whether to make an order under *subsection (2)*, the Court shall give particular regard to—

(*a*) the need to prevent potential serious damage to the financial system in the State and ensure the continued stability of that system, and

(*b*) the need to protect users of financial services.

Head of Financial Regulation may require persons to give evidence or produce documents.

32.—(1) The Head of Financial Regulation may serve a notice (in this Part called an "evidentiary notice") on a person requiring the person—

(*a*) to appear before the Head of Financial Regulation to give evidence about a matter,

(*b*) to provide information to the Head of Financial Regulation, or

(*c*) to produce a document for examination,

if—

(i) the Head of Financial Regulation is investigating the person's fitness and probity under this Chapter, or

(ii) the Head of Financial Regulation believes on reasonable grounds that the person may be able to give evidence, or to produce a document, that relates to a matter concerning the fitness or probity of a person whose fitness and probity is being investigated under this Chapter.

(2) Without prejudice to the generality of *subsection (1)*, the Head of Financial Regulation may serve a notice under *subsection (1)* on—

(*a*) a regulated financial service provider,

(*b*) a former regulated financial service provider, or

(*c*) an officer or employee, or former officer or employee, of a regulated financial service provider or a former regulated financial service provider.

(3) An evidentiary notice shall—

(*a*) specify the matter to which the evidence relates, or specify or describe the document to be produced or the information to be provided, as the case requires,

(*b*) in the case of a notice to appear before the Head of Financial Regulation to give evidence—

(i) specify the date, time and place at which the person is required to appear before the Head of Financial Regulation, and

(ii) state whether and to what extent the evidence is to be given orally or on affidavit, and

(*c*) in the case of a notice to provide information or produce a document for examination, specify—

(i) the date and time by which, and the place at which, the information is to be provided or the document is to be produced, and

(ii) the officer or employee of the Bank to whom the information is to be provided or the document produced.

(4) The Head of Financial Regulation may take a copy or copies of a document produced pursuant to an evidentiary notice, and may retain any such copy.

(5) Nothing in this section affects any power of the Bank, the Governor or the Head of Financial Regulation to obtain documents or information otherwise than under this section.

Offence of failing to appear.

33.—(1) A person commits an offence if, having been required to appear before the Head of Financial Regulation in compliance with an evidentiary notice, the person fails to comply with the requirement, and has not been excused, or released from further attendance, by the Head of Financial Regulation.

(2) *Subsection (1)* does not apply if the person has a reasonable excuse.

Investigation into fitness and probity — conduct of proceedings.

34.—(1) The Head of Financial Regulation may hear oral evidence where he or she is satisfied that it is necessary to do so for the proper conduct of an investigation.

(2) The Head of Financial Regulation may permit a person giving oral evidence to be cross-examined.

(3) The Head of Financial Regulation shall determine the procedures for the conduct of proceedings in an investigation, subject to any regulations made by the Bank under *section 53(2)*.

Proceedings normally to be in private.

35.—(1) Except as provided by this section, evidence to be given, or a document to be produced, to the Head of Financial Regulation by a person who appears before the Head of Financial Regulation in compliance with an evidentiary notice shall be given or produced in private.

(2) If a person who appears before the Head of Financial Regulation in compliance with an evidentiary notice requests that the matter or any part of it be dealt with in public, the Head of Financial Regulation shall comply with the request unless—

(*a*) the matter raises issues that, in the opinion of the Head of Financial Regulation, should be dealt with in private, or

(*b*) the Head of Financial Regulation considers that it is necessary or desirable to deal with the matter or part of it in private in order to avoid the disclosure of information of the kind referred to in section 33AK(1A) of the Act of 1942.

(3) Subject to *subsections (1)* and *(2)*, if the Head of Financial Regulation is satisfied that it is desirable in the public interest that the evidence to be given should be given, or the document to be produced should be produced, in public, the Head of Financial Regulation may direct accordingly.

(4) If the evidence is to be given, or the document is to be produced, in private, the Head of Financial Regulation may do either or both of the following:

(*a*) give directions as to the persons (other than the Head of Financial Regulation or an officer or employee of the Bank) who may be present during the proceeding;

(*b*) give directions preventing or restricting the publication of the whole or any part of the evidence or of matters contained in the document.

(5) If the evidence is to be given, or the document is to be produced, in private, a person (other than the person required to appear before the Head of Financial Regulation, the Head of Financial Regulation or an officer or employee of the Bank) may be present only if entitled to be present because of a direction given under *subsection (4)(a)*.

(6) A person who contravenes a direction of the Head of Financial Regulation under *subsection (4)(b)* commits an offence.

Offence of failing to produce document, etc.

36.—(1) A person commits an offence if, having been required to produce a document or provide information to the Head of Financial Regulation in compliance with an evidentiary notice, he or she fails to comply with the requirement and has not been excused by the Head of Financial Regulation.

(2) *Subsection (1)* does not apply if the person has a reasonable excuse.

(3) It is a reasonable excuse for the purposes of *subsection (2)* that—

(*a*) the person does not have the document or information and cannot by any reasonable effort obtain it; or

(*b*) the person could not be compelled to produce the document in, or provide the information to, a court of law.

(4) *Subsection (3)* does not limit what is a reasonable excuse for the purposes of *subsection (2)*.

Offence of refusing to answer question, etc.

37.—(1) A person appearing before the Head of Financial Regulation in compliance with an evidentiary notice commits an offence if the person—

(*a*) refuses or fails to give evidence in compliance with the evidentiary notice, or

(*b*) refuses or fails to answer a question put to the person by the Head of Financial Regulation or in cross-examination with the permission of the Head of Financial Regulation.

(2) *Subsection (1)* does not apply if the person has a reasonable excuse.

(3) It is a reasonable excuse for the purposes of *subsection (2)* for a person to refuse or fail to answer a question that the answer might tend to incriminate the person.

(4) *Subsection (3)* does not limit what is a reasonable excuse for the purposes of *subsection (2)*.

(5) If a person alleges that he or she has a reasonable excuse for refusing or failing to give evidence, or refusing or failing to answer a question, he or she shall provide a written statement setting out details of the excuse to the Head of Financial Regulation.

(6) The Bank may have regard to the contents of a statement under *subsection (5)* for the purposes of the exercise of its powers and the performance of its functions under the *Central Bank Acts 1942 to 2010*.

(7) A statement under *subsection (5)* is not admissible in evidence, against the person who made it, in proceedings in relation to an offence.

Privilege for evidence given under this Chapter, etc.

38.—Evidence given to the Head of Financial Regulation in accordance with this Chapter, and any report prepared pursuant to *section 41* on the basis of such evidence, is absolutely privileged.

Payment of allowances and expenses to persons who appear before Head of Financial Regulation.

39.—(1) A person (other than a person to whom *subsection (2)* applies) who appears before the Head of Financial Regulation in compliance with an evidentiary notice is entitled to be paid such allowances and travelling or other expenses as the Head of Financial Regulation may reasonably allow.

(2) This subsection applies to—

(*a*) a person whose fitness and probity is being investigated under this Part,

(*b*) a regulated financial service provider or a former regulated financial service provider, and

(*c*) a person called or put forward by a person referred to in *paragraph (a)* or *(b)* to give evidence.

(3) All allowances and expenses payable under *subsection (1)* are payable by the Bank.

Head of Financial Regulation may certify failure to produce document, etc.

40.—(1) If a person refuses or fails—

(*a*) to produce a document to the Head of Financial Regulation in accordance with an evidentiary notice,

(*b*) to provide information to the Head of Financial Regulation,

(*c*) to attend before the Head of Financial Regulation in accordance with an evidentiary notice, or (*d*) to answer a question put to him or her by the Head of Financial Regulation,

the Head of Financial Regulation may certify the refusal or failure to the Court.

(2) The Court may, after hearing any witnesses who may be produced against or on behalf of the person alleged to have so refused or failed and any statement which may be offered in defence, make any order or give any direction it thinks fit.

(3) Without prejudice to the generality of *subsection (2),* the Court may—

(*a*) order the person concerned to attend or re-attend before the Head of Financial Regulation, or to produce a particular document, provide particular information or answer a particular question put to him or her by the Head of Financial Regulation, or

(*b*) order that the person concerned need not produce a particular document, provide particular information or answer a particular question put to him or her by the Head of Financial Regulation.

Head of Financial Regulation to prepare report.

41.—(1) After carrying out an investigation under this Chapter, the Head of Financial Regulation shall prepare a report for consideration by the Bank and the Governor.

(2) The Head of Financial Regulation shall serve a copy of a report prepared in accordance with *subsection (1)* on each of—

(*a*) the person whose fitness and probity was the subject of the relevant investigation, and

(*b*) any regulated financial service provider concerned.

(3) A copy of a report may be served in any of the ways that a suspension notice may be served.

(4) A person (including a regulated financial service provider) on whom a copy of a report is served pursuant to *subsection (2)* may make, within the period specified in accordance with *subsection (5)*, a submission in writing to the Head of Financial Regulation in relation to any matter in the report.

(5) When the Head of Financial Regulation serves a copy of a report on a person (including a regulated financial service provider) pursuant to *subsection (2)*, the Head of Financial Regulation shall inform the person in writing of the person's right under *subsection (4)* to make a submission in relation to any matter in the report, and shall specify the period within which the person may do so. The period specified shall be 7 days, or such longer period as the Head of Financial Regulation considers reasonable in all the circumstances.

Chapter 4

Prohibition of certain persons from performing controlled functions

Definitions (*Chapter 4*).

42.—In this Chapter—

"prohibited person" means a person forbidden, by a prohibition notice, to carry out a controlled function;

"prohibition notice" means a notice under *section 43*.

Bank may prohibit person from carrying out controlled function, etc.

43.—(1) Subject to *subsection (4)*, if the Bank or the Governor has reasonably formed the opinion that a person is not of such fitness and probity as is appropriate to perform a particular controlled function, a specified part of a controlled function or any controlled function, the Bank or the Governor, as the case may be, may issue a notice in writing (in this Part called a "prohibition notice") forbidding the person—

(*a*) to carry out the controlled function, the specified part of a controlled function or any controlled function, as the case requires, or

(*b*) to carry out the controlled function, the specified part of such a function or any controlled function, as the case requires, otherwise than in accordance with a specified condition or conditions,

either for a specified period or indefinitely.

(2) Without prejudice to the generality of *subsection (1)*, the Bank or the Governor may form the opinion referred to in that subsection if satisfied that—

(*a*) the person does not have the experience, qualifications or skills necessary to perform properly and effectively the controlled function, the specified part of a controlled function or any controlled function, as the case may be,

(*b*) the person does not satisfy an applicable standard of fitness and probity in a code issued pursuant to *section 50*,

(*c*) the person has participated in serious misconduct in relation to the business of a regulated financial service provider,

(*d*) the person has directly or indirectly provided information to the Bank, the Governor or the Head of Financial Regulation (whether pursuant to this Part or otherwise) that the person knew or ought to have known was false or misleading,

(*e*) the person has directly or indirectly provided information that the person knew or ought to have known was false or misleading to another person in order for it to be provided to the Bank, the Governor or the Head of Financial Regulation,

(*f*) the person has caused or sought to cause information requested by the Head of Financial Regulation by evidentiary notice from a regulated financial service provider or a person who is carrying out a controlled function not to be provided by the due date,

(*g*) the person has failed to comply with an evidentiary notice or a suspension notice, or (*h*) the person has been convicted of an offence (whether in the State or outside the State) of money laundering or terrorist financing or an offence involving fraud, dishonesty or breach of trust.

(3) The Bank or the Governor shall not issue a prohibition notice in relation to a person unless—

(*a*) either—

(i) all of the following requirements have been satisfied:

(I) the Head of Financial Regulation has conducted an investigation into the person's fitness and probity in accordance with this Chapter;

(II) *section 41* has been complied with in relation to that investigation and the report of it;

(III) the Bank or the Governor, as the case may be, has considered the report and any submissions made (within the period specified pursuant to *section 41(4)*) to the Head of Financial Regulation in relation to any matter in the report,

or

(ii) there are undisputed facts that in the reasonable opinion of the Bank or the Governor render an investigation unnecessary, and the person and any regulated financial service provider concerned have been afforded a reasonable opportunity to make a submission in relation to the matter,

(*b*) the person and the regulated financial service provider have been afforded such a hearing in relation to the proposed issue of the prohibition notice as is necessary to do justice in the circumstances, and

(*c*) the Bank or the Governor, as the case may be, is satisfied that the issue of a prohibition notice is necessary in the circumstances.

(4) When considering whether to issue a prohibition notice, the Bank or the Governor, as the case may be, shall have particular regard to—

(*a*) the need to prevent potential serious damage to the financial system in the State and ensure the continued stability of that system, and

(*b*) the need to protect users of financial services.

(5) A prohibition notice may be expressed to apply—

(*a*) to one or more specified controlled functions or parts of controlled functions or all controlled functions, and

(*b*) in relation to the performance of any such controlled function or part of a controlled function for one or more regulated financial service providers, a class of regulated financial service providers or every regulated financial service provider.

(6) A prohibition notice may be served in any of the ways that a suspension notice may be served.

(7) A prohibition notice—

(*a*) takes effect on first service on either the prohibited person or the regulated financial service provider concerned, and

(*b*) if an application is made to the Court under *section 45* before the notice ceases to have effect, continues to have effect until that application is determined by the Court or withdrawn.

Subject to *section 46*, a prohibition notice ceases to have effect at the end of 2 months (or a shorter period specified in the notice) beginning on the day after it is first served as mentioned in *paragraph (a)* if no application is made to the Court within that period.

(8) A prohibited person shall not perform a controlled function if doing so would require the person to contravene a prohibition notice served on the person.

(9) A regulated financial service provider shall not permit a prohibited person to perform a controlled function if doing so would require the person to contravene a prohibition notice served on the regulated financial service provider.

(10) The Bank may publish a prohibition notice if, in the opinion of the Governor, it is necessary to do so in order to achieve the purposes of this Part.

(11) A prohibition notice does not alter the contractual rights of any person to remuneration or benefits. Those rights shall continue to be determined in accordance with the relevant contract.

(12) The Bank or the Governor, as the case may be—

(*a*) shall not continue a prohibition notice for longer than is necessary to achieve those purposes, and

(*b*) shall not make an application to the Court under *section 45* in relation to a prohibition notice unless the Bank or the Governor is satisfied that it is necessary that the notice continue for longer than 2 months to achieve the purposes referred to in *subsection (4)*.

Enforcement of certain prohibition notices.

44.—(1) Subject to *subsection (2)*, if—

(*a*) a person performs a controlled function in contravention of a prohibition notice, or

(*b*) a regulated financial service provider permits a prohibited person to perform a controlled function in contravention of a prohibition notice,

the Head of Financial Regulation may apply *ex parte* to the Court for an order directing the person or regulated financial service provider to comply with the notice.

(2) This section does not apply in relation to a prohibition notice that has been confirmed by the Court under *section 45*.

45.—(1) The Bank may apply to the Court in accordance with this section for an order confirming a prohibition notice. Where such an application is made with the consent of the prohibited person concerned, the Court may make an order under this section *ex parte*. Application to Court to confirm prohibition notice.

(2) Without limiting the exercise of the judicial function with respect to a particular case, it shall be the duty of the High Court, in so far as it is practicable, to hear and determine an application under this section within 3 months after the date on which the application is made to it.

(3) If when hearing an application under *subsection (1)* the Court is satisfied that, for reasons of confidentiality or commercial sensitivity or in order to avoid the disclosure of information of the kind referred to in section 33AK(1A) of the Act of 1942, the hearing of the Court should be held otherwise than in public, the Court may so order.

(4) The Court may, on the hearing of an application under *subsection (1)*, consider evidence not adduced or hear an argument not made to the Bank or the Governor, if the Court is satisfied that—

(*a*) there are cogent reasons justifying the failure to adduce the evidence or make the argument to the Governor or the Bank, and

(*b*) it is just and equitable for the Court to consider the evidence or hear the argument, as the case may be.

(5) On an application under this section—

(*a*) if the Court is satisfied that there is a reasonable basis (as set out in *subsection (6)*) for the opinion of the Bank or the Governor, as the case may be, that the prohibited person concerned is not of such fitness and probity as is appropriate to perform the relevant controlled function or part of a controlled function, or any controlled function (as the case may be), the Court may make—

(i) an order confirming the relevant prohibition notice,

(ii) if the Court considers that it is necessary in the interests of justice, or for any other good reason, to vary the prohibition notice, an order varying or limiting it (including by imposing a condition or conditions on the prohibited person or a regulated financial institution concerned), and

(iii) any other additional or ancillary order it thinks fit,

and

(*b*) if the Court is not satisfied as provided for in *paragraph (a)*, the Court may make—

(i) an order setting aside the notice,

(ii) an order remitting the matter to the Bank or the Governor for reconsideration in accordance with any directions by the Court (whether or not the Court also sets aside the notice), or

(iii) any other order it thinks fit.

(6) For the purposes of *subsection (5)(a)*, there is a reasonable basis for an opinion if, taking into account the expertise and specialist knowledge possessed by the Bank or the Governor, as the case requires, the opinion (and the process that led to its formation) was not vitiated by—

(*a*) any significant and serious error or series of such errors,

(*b*) a mistake of law, or

(*c*) the evidence, taken as a whole, not supporting the finding.

(7) When considering whether to make an order under *subsection (5)*, the Court shall have particular regard to—

(*a*) the need to prevent potential serious damage to the financial system in the State and ensure the continued stability of that system, and

(*b*) the need to protect users of financial services.

(8) An order under *subsection (5)* may be expressed to have effect—

(*a*) indefinitely, or for a particular period that the Court thinks appropriate, or

(*b*) until further order of the Court.

(9) A prohibition notice that has been confirmed by the Court (whether or not also varied by the Court) has effect as an order of the Court and may be enforced accordingly.

(10) *Section 43* applies to any prohibition notice made by the Bank after reconsideration in accordance with an order referred to in *subsection (5)(b)(ii)*.

(11) The setting aside by the Court of a prohibition notice does not of itself prevent the further exercise of the powers of the Bank, the Governor or the Head of Financial Regulation under this Part.

Agreement between Bank or Governor, prohibited person and regulated financial service provider.

46.—(1) Where the Bank or the Governor has issued a prohibition notice in relation to a person, the person (and, where at the time of issue of the prohibition notice, the person is performing a controlled function, the regulated financial service provider concerned) may agree in writing with the Bank or the Governor that the person and, where applicable, the regulated financial service provider shall continue to comply with the prohibition notice for such period as is agreed.

(2) Where a person and the Bank or the Governor have agreed as set out in *subsection (1)*, then—

(*a*) nothing in *section 45* requires the Bank or the Governor to apply for an order under that section,

(*b*) subject to *subsection (3)*, and notwithstanding *subsection 43(6)*, the prohibition notice shall continue in effect in accordance with its terms, and

(*c*) in the event of a contravention of the agreement—

(i) the Bank may apply to the Court for an order under *section 44*, and

(ii) the prohibition notice shall continue in effect in accordance with its terms.

(3) If the Bank or the Governor, as the case may be, considers that there is no further need to continue a prohibition notice that is the subject of an agreement under *subsection (1)*, the Bank or the Governor, as the case may be, may terminate the agreement by written notice to that effect to the prohibited person and any regulated financial service provider concerned. On the giving of such a notice the prohibition notice ceases to have effect.

Chapter 5

Miscellaneous

Use of information.

47.—The Bank may make use of—

(*a*) information and evidence gathered by the Head of Financial Regulation in the course of an investigation under *Chapter 3*,

(*b*) anything in any submission made to the Head of Financial Regulation pursuant to *section 41*, and

(*c*) anything in any document or evidence placed before the Court in the course of proceedings under *Chapter 3* or *4*,

for the purposes of any statutory function of the Bank (including, in particular, an inquiry pursuant to Part IIIC of the Act of 1942 and the imposition of sanctions as a result of such an inquiry).

Offences of providing false or misleading information, etc.

48.—(1) A person shall not provide to the Head of Financial Regulation or the Bank, for the purposes of this Part, information that the person knows or ought to know is false or misleading.

(2) A person who is carrying out, or proposes to carry out, a controlled function shall not provide information or a document that the person knows or ought to know is false or misleading to a regulated financial service provider with a view to the information or document being provided to the Head of Financial Regulation or the Bank for the purposes of this Part.

(3) A person shall not give the Head of Financial Regulation or the Bank, for the purposes of this Part, a document (whether in response to an evidentiary notice or otherwise) that the person knows or ought to know is false or misleading or is not what it purports to be.

(4) A person (in this subsection called the "examinee") who is appearing before the Head of Financial Regulation shall not, in an answer to a question put by the Head of Financial Regulation or another person with the consent of the Head of Financial Regulation, make a statement that the examinee knows or ought to know is false or misleading in a material particular.

(5) A person who contravenes *subsection (1)*, *(2)*, *(3)* or *(4)* commits an offence.

Penalties for offences under this Part.

49.—A person guilty of an offence under this Part is liable—

(*a*) on summary conviction, to a fine not exceeding €5,000 or imprisonment for a term not exceeding 12 months or both, or

(*b*) on conviction on indictment, to a fine or imprisonment for a term not exceeding 5 years or both.

Standards of fitness and probity.

50.—The Bank may issue a code setting out standards of fitness and probity for the purposes of this Part.

Effect of this Part.

51.—(1) Nothing in this Part affects any other power of the Bank in relation to the fitness and probity of persons who are officers of, or responsible for the management of, financial service providers.

(2) The Bank may have regard to a document or information gathered or received otherwise than under this Part for any purpose under this Part.

Appointment of nominees, etc., for purposes of this Part.

52.—(1) The Governor may at his or her discretion appoint a suitably qualified person (including a person who is not an officer or employee of the Bank) to perform a function of the Governor under this Part if the Governor considers it necessary or appropriate to do so to ensure that the functions of the Governor under this Part are performed efficiently and effectively.

(2) The Head of Financial Regulation may at his or her discretion appoint a suitably qualified person (including a person who is not an officer or employee of the Bank) to perform a function (or any part of a function) of the Head of Financial Regulation under this Part if the Head of Financial Regulation considers it necessary or appropriate to do so to ensure that the functions of the Head of Financial Regulation under this Part are performed efficiently and effectively.

(3) Without prejudice to the generality of *subsections (1)* and *(2)*, the power to appoint a person to perform a function in accordance with either of those subsections includes the power to appoint the person to do any one or more of the following:

(*a*) form an opinion required by this Part to be formed by the Governor or the Head of Financial Regulation (as the case may be);

(*b*) make an application to the Court;

(*c*) certify a matter to the Court.

Regulations — facilitation of performance of functions.

53.—(1) The Minister may, in respect of any difficulty that arises in the operation of this Act during the period of 2 years beginning on the date this section comes into operation, make regulations to do anything that appears necessary or expedient for bringing this Act into operation.

(2) The Bank may make regulations setting out procedures to be followed in the exercise of the powers of the Bank, the Governor or the Head of Financial Regulation under this Part.

(3) Regulations made by the Bank under this section may contain such incidental, supplementary and consequential provisions as appear to the Bank to be necessary or expedient for the purposes of the regulations.

(4) Sections 61C and 61D of the Act of 1942 apply to regulations made under this Part.

Section 14.

SCHEDULE 1

Amendments of Central Bank Acts

Section 14(1).

PART 1

Amendments of Central Bank Act 1942

Item	Provision affected	Amendment
1	Section 2(1)	After the definition of "Appeals Tribunal", insert: " 'appointed member' or 'appointed member of the Commission' means a member of the Commission referred to in section 18CA(1)(*b*);".
2	Section 2(1), definition of "appointed Director"	Delete.
3	Section 2(1), definitions of "Bank" and "Board"	Substitute: " 'Bank' means the Central Bank of Ireland;".
4	Section 2(1), definition of "Chief Executive"	Substitute: " 'Commission' means the Central Bank Commission;".
5	Section 2(1), definitions of "constituent part" and "Consumer Director"	Delete.
6	Section 2(1), definition of "designated enactments"	Substitute: " 'designated enactments' means, subject to subsection (2A), the enactments specified in Part 1 of Schedule 2;".
7	Section 2(1), definition of "Director"	Delete.
8	Section 2(1), definition of "employee"	Delete "Secretary to the Bank", substitute "Secretary of the Bank".
9	Section 2(1)	After the definition of "ESCB Statute", insert: " '*ex-officio* member' or 'ex-officio member of the Commission' means a member of the Commission referred to in section 18CA(1)(*a*);".

Item	Provision affected	Amendment
10	Section 2(1), definition of "general fund"	Substitute: " 'general fund' means the fund referred to in section 32F;".
11	Section 2(1), definition of "Governor", paragraph (*b*)	Delete "Director General of the Bank", substitute "Head of Central Banking".
12	Section 2(1)	After the definition of "Governor", insert: " 'Head of Central Banking', 'Head of Financial Regulation' and 'Head of Function' shall be construed in accordance with section 23;".
13	Section 2(1)	After the definition of "local authority", insert: " 'member' or 'member of the Commission' means an appointed member or an *ex-officio* member;".
14	Section 2(1), definition of "officer"	Substitute: " 'officer' means each Head of Function, the Secretary of the Bank and the Registrar of Credit Unions;".
15	Section 2(1), definition of "official Director"	Delete.
16	Section 2(1), definition of "regulated financial service provider"	Substitute: " 'regulated financial service provider' means— (*a*) a financial service provider whose business is subject to regulation by the Bank under this Act or under a designated enactment or a designated statutory instrument, (*b*) a financial service provider whose business is subject to regulation by an authority that performs functions in an EEA country that are comparable to the functions performed by the Bank under this Act or under a designated enactment or designated statutory instrument, or (*c*) in relation to Part VIIB only, any other financial service provider of a class specified in the regulations for the purposes of this paragraph;".
17	Section 2(1), definition of "Regulatory Authority"	Delete.
18	Section 2(1), definition of "Rome Treaty"	Substitute: " 'Rome Treaty' means the Treaty on the Functioning of the European Union done at Rome on 25 March 1957, as amended by the Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community signed at Lisbon on 13 December 2007;".

Item	Provision affected	Amendment
19	Section 2	After subsection (2), insert: "(2A) Commission Regulations (EC) No. 1287/2006[1] and (EC) No. 924/2009[2] shall be taken to be designated enactments.".
20	Section 5	Substitute: "*Establishment of Central Bank of Ireland.* 5.—(1) The body corporate formerly called the Central Bank and Financial Services Authority of Ireland is continued in existence under the name 'Central Bank of Ireland'. (2) The Bank— (*a*) has perpetual succession, and (*b*) may take legal proceedings and be proceeded against in its corporate name. (3) The Bank is required to have a seal. The seal shall be judicially noticed. (4) Except as expressly provided by this Act, the affairs and activities of the Bank are to be managed and controlled by the Central Bank Commission.".
21	Section 5A	Substitute: "*General functions and powers of the Bank.* 5A.—(1) The Bank has the following functions: (*a*) to carry out the efficient and effective co-ordination of— (i) the activities of the Bank, (ii) activities undertaken by persons who provide services to, or receive services from, the Bank, and (iii) the exchange of information between the Bank and any of those persons; (*b*) where appropriate, to represent and co-ordinate the representation of the Bank on international financial bodies and at international meetings relating to financial or economic matters; (*c*) to establish and maintain, either directly or indirectly, contact with the monetary authorities established in other countries and in territories; (*d*) whenever it thinks fit, to provide governments of, and financial institutions and other bodies established in, other countries and in territories with advice or other assistance on matters within its expertise; (*e*) the function of holding an inquiry under Part IIIC; (*f*) the function of monitoring the provision of financial services to consumers of those services to the extent that the Bank considers appropriate, for the purposes of protecting the public interest and the interests of consumers; (*g*) to provide for the collection and study of data that deal with monetary and credit problems and to publish information about that data;

[1]OJ L 241, 2.9.2006, pp. 1-25.
[2]OJ L 266, 9.10.2009, pp. 11-18.

Item	Provision affected	Amendment
		(*h*) to provide advice and assistance to the Central Statistics Office about the collection, compilation, analysis and interpretation of statistics relating to the balance of payments, national accounts and other financial statistics and, where appropriate, to collect data for that purpose; (*i*) to perform such other functions as are imposed on it by or under this and any other Act or law. (2) The Bank has power to do whatever is necessary for or in connection with, or reasonably incidental to, the performance of its functions. (3) In particular, the powers of the Bank include powers of a kind that, in accordance with normal banking practice, may be exercised by a bank. (4) The functions of the Agency specified in subsection (5) are, in so far as they relate to a financial service provided by a regulated financial service provider, also functions of the Bank and subsections (6) to (8) have effect for the purposes of this subsection. (5) The functions of the Agency referred to in subsection (4) are the following functions of it under the Consumer Protection Act 2007, namely, functions under— (*a*) subsections (1), (4), (5) and (6) of section 8 of that Act in relation to— (i) sections 41 to 49 and 51 to 56 of that Act, and (ii) the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 and 2000 (S.I. No. 27 of 1995 and S.I. No. 307 of 2000), and (*b*) sections 30, 71, 72, 73, 75, 81, 82, 84, 86, 88 and 90 of that Act. (6) Subsection (4) operates to vest in the Bank, concurrently with the vesting in the Agency of those functions by the Consumer Protection Act 2007, the functions specified in subsection (5). (7) Accordingly— (*a*) the functions so specified are, subject to any relevant co-operation agreement entered into under section 21 of the Consumer Protection Act 2007, capable of being performed by either the Agency or the Bank, and (*b*) subject to subsection (9), references to the Agency in the provisions of that Act specified in subsection (5) are to be read as including references to the Bank and those provisions otherwise apply. (8) Subject to subsection (9), sections 80, 85 and 87 of the Consumer Protection Act 2007 apply to the Bank as they apply to the Agency and, accordingly, references to the Agency in those sections are to be read as including references to the Bank. (9) Where any section of the Consumer Protection Act 2007 specified in subsection (5) or (8) provides for anything to be done in relation to the Agency (whether the giving of notice to it, the submitting of a thing to it or the doing of any

Item	Provision affected	Amendment
		other thing) then, if a co-operation agreement entered into under section 21 of that Act so specifies, it is sufficient compliance with the section concerned if the thing is done in relation to the Agency or the Bank as is specified in that agreement. (10) The Bank is required to perform its functions and exercise its powers in a manner consistent with the Rome Treaty and the ESCB Statute. (11) Subject to subsection (10), the Bank shall perform its functions and exercise its powers in a way that is consistent with— (*a*) the orderly and proper functioning of financial markets, (*b*) the prudential supervision of providers of financial services, and (*c*) the public interest and the interest of consumers. (12) The Bank can perform its functions and exercise its powers both within the State and elsewhere.”.
22		After section 5B, insert: *“Supplementary powers of Bank with respect to certain responsibilities.* 5C.—(1) To enable the Bank to carry out its responsibilities, the Bank may— (*a*) undertake studies, analyses and surveys with respect to the provision of relevant financial services to consumers, (*b*) collect and compile information for that purpose, and (*c*) publish the results of any such studies, analyses or surveys. (2) In undertaking such a study, analysis or survey, the Bank— (*a*) may, by notice in writing, require any person who, in the opinion of the Bank, has information, or has control of a record or other thing, that is relevant to the study, analysis or survey, to provide the information, record or thing to the Bank, and (*b*) may, by the same or another notice in writing, require the person to attend before an officer or employee of the Bank for that purpose. (3) Subject to section 33AK, if the Agency is of the opinion that information obtained by the Bank pursuant to subsections (1) and (2) is relevant to the exercise of that Agency’s functions under section 8(3)(*ha*) of the Consumer Protection Act 2007, the Bank shall provide the requested information to the Agency at the Agency’s request. (4) A person commits an offence if the person— (*a*) intentionally prevents the Bank from exercising a power conferred by subsection (1), (*b*) intentionally obstructs or hinders the Bank in the exercise of such a power, (*c*) without reasonable excuse, fails to comply with a requirement made to the person in accordance with subsection (2), or (*d*) in purporting to comply with a requirement made under subsection (2) to provide information,

Item	Provision affected	Amendment
		provides the Bank with information that the person knows, or ought reasonably to know, is false or misleading in a material respect. (5) The Head of Financial Regulation may, in writing, authorise an officer or employee of the Bank to investigate the business, or any aspect of the business, of a financial service provider who has been required under this section to provide information, or a record or other thing. Such an officer or employee may take whatever steps are necessary for or in connection with carrying out such an investigation. (6) A financial service provider who— (*a*) without reasonable excuse, fails to co-operate with an investigation carried out under subsection (5), or (*b*) intentionally prevents such an investigation from being carried out, or intentionally obstructs or hinders the investigation, commits an offence. (7) A person who is convicted of an offence under this section is liable— (*a*) on conviction on indictment, to a fine not exceeding €30,000 or to imprisonment for a term not exceeding five years, or to both, or (*b*) on summary conviction, to a fine not exceeding €3,000 or to imprisonment for a term not exceeding 12 months, or to both. (8) Summary proceedings for an offence under this section may be brought and prosecuted by the Bank, but not to the exclusion of any other person who is authorised to bring and prosecute summary offences.”.
23	Section 6	After subsection (1), insert: “(1A) Nothing in the *Central Bank Acts 1942 to 2010* affects the independence of the Bank, the Governor and the Commission required by the Rome Treaty and the ESCB Statute. (1B) Without limiting the generality of subsection (1A), nothing in the *Central Bank Acts 1942 to 2010* authorises any person or authority to give any direction to, or require any action (including the provision of information) by, the Bank, the Governor or the Commission if compliance by the Bank, the Governor or the Commission (as the case may be) with the direction or requirement would be inconsistent with the Rome Treaty or the ESCB Statute.”.
24	Subsections (2) and (3) of section 6A	Substitute: “(2) The Bank also has the following objectives: (*a*) the stability of the financial system overall; (*b*) the proper and effective regulation of financial service providers and markets, while ensuring that the best interests of consumers of financial services are protected; (*c*) the efficient and effective operation of payment and settlement systems; (*d*) the provision of analysis and comment to support national economic policy development; (*e*) the discharge of such other functions and powers as are conferred on it by law.

Item	Provision affected	Amendment
		(3) The Minister may, from time to time, request the Governor or the Commission to consult with the Minister, in relation to their respective functions, as regards the performance by the Bank of any function of the Bank (other than one imposed on it by the Rome Treaty or the ESCB Statute).”.
25	Section 6A(5)	Substitute: “(5) The Governor or the Commission (as the case requires) shall comply with a request to the Governor or the Commission under subsection (3) or (4) in so far as the request is consistent with the Rome Treaty, the ESCB Statute and the law of the State.”.
26	Sections 6B to 6E	Substitute: *“Bank’s power to hold and deal in land, etc.* 6B.— (1) For the purpose of enabling the Bank to perform its functions, the Bank— (*a*) may acquire and hold land, and (*b*) may build, establish, equip and maintain offices and other premises, in such places, whether in the State or elsewhere, as it considers appropriate. (2) The Commission is responsible for administering the provision of accommodation and office and other equipment with a view to enabling the Bank to perform and exercise its functions and powers. (3) The Bank may sell, lease or otherwise dispose of land held by the Bank whenever the Commission considers that the land is no longer required for the purpose of enabling the Bank to perform its functions. (4) In this section ‘acquire’ includes acquire by purchase, lease or exchange. *Staff of Bank.* 6D.—(1) Subject to this section, the Commission shall appoint a Secretary of the Bank and such other employees of the Bank as they consider necessary for the effective performance and exercise of the functions and powers of the Bank. (2) The Commission is responsible for administering the staff of the Bank with a view to enabling the Bank to perform and exercise its functions and powers. (3) Except as regards the appointment of a Secretary of the Bank, the Governor has the same power to appoint employees of the Bank as the Commission has under subsection (1), but that power is only exercisable in relation to responsibilities specified in paragraphs (*a*) and (*b*) of subsection (1), and subsection (2), of section 19A. (4) Employees appointed under subsection (3) are taken, for the purposes of this Act, to have been appointed under subsection (1). (5) The employees of the Bank are to be employed on such conditions (including conditions as to remuneration and allowances) as the Commission fixes from time to time. (6) Subject to subsection (8), an appointment under this section shall be made by competition to be conducted in accordance with rules made by the Commission. (7) The Commission may, in relation to a particular competition, impose conditions of entry, limitations and safeguards. (8) Subsection (6) does not apply to an appointment to a position if the Commission decides that appointment to the position by competition would be inappropriate.

Item	Provision affected	Amendment
		(9) The Commission shall establish and operate a policy under which provision is made for employees of the Bank to be given opportunities for training and experience in various activities of the Bank.”.
27	Section 10	Substitute: *“Seal of Bank.* 10.—(1) The seal of the Bank shall be kept in such custody as the Commission directs. (2) The seal of the Bank may be used only as authorised— (*a*) if the seal is to be used in relation to a function or power of the Bank that is to be performed or exercised by the Commission, by the Commission, or (*b*) if the seal is to be used in relation to a function or power of the Bank that is to be performed or exercised by the Governor, by the Governor. (3) The seal of the Bank shall be authenticated by— (*a*) the signature of the Governor or a member of the Commission authorised in that behalf by the Commission, and (*b*) the counter-signature of the Secretary of the Bank or some other officer or employee of the Bank authorised in that behalf by the Commission. (4) A document purporting to be made or issued by the Bank and to be sealed with the seal of the Bank authenticated in accordance with subsection (3) is admissible in evidence and shall be taken to have been made or issued by the Bank until the contrary is proved, without proof of the signature or authority of any person purporting to have signed or counter-signed it.”.
28	Sections 18B to 18D	Substitute: *“Functions of Central Bank Commission.* 18B.—(1) Except as expressly provided otherwise by this Act, the affairs and activities of the Bank shall be managed and controlled by the Central Bank Commission. (2) The Commission shall ensure that the Bank’s central banking functions and financial regulation functions are integrated and coordinated. (3) Without prejudice to section 19A, the Commission shall ensure that the powers and functions conferred on the Bank by sections 5A, 5B and 5C are properly exercised and discharged. (4) The performance and exercise of the functions and powers of the Commission are not affected by there being one or more vacancies in the membership of the Commission. *Acts, etc., of Commission to be acts, etc., of Bank.* 18C.—Any act, matter or thing done in the name of, or on behalf of, the Bank by the Commission in the performance or exercise of the Commission’s functions or powers shall be taken to have been done by the Bank. *Membership of Commission.* 18CA.—(1) The Commission comprises— (*a*) the persons for the time being holding or performing the duties of the following offices: (i) Governor;

Item	Provision affected	Amendment
		(ii) Head of Central Banking; (iii) Head of Financial Regulation; (iv) Secretary General of the Department of Finance, and (*b*) at least 6, but no more than 8, other members appointed by the Minister. (2) The Governor is the Chairperson of the Commission. *Additional powers of Commission.* 18D.—(1) The Commission has power to do whatever is necessary for or in connection with, or reasonably incidental to, the performance of its functions. (2) Without prejudice to the generality of subsection (1) and subject to subsection (3), the Commission— (*a*) may establish committees of the Commission consisting of one or more members of the Commission either solely or together with one or more officers or employees of the Bank, and (*b*) may determine the procedure and define the functions and powers of such committees. (3) Subsection (2) does not authorise the Commission to delegate to a committee any function of the Bank that a provision of this Act requires to be performed by the Governor. *Bank may establish advisory groups.* 18E.—(1) Subject to subsection (2), the Bank may establish an advisory group or groups to advise it on the performance of its functions and the exercise of its powers and shall in particular establish the following: (*a*) an advisory group to advise the Bank on the performance of its functions and the exercise of its powers in relation to consumers of financial services; (*b*) an advisory group to advise the Bank, where the Bank so requests, on the performance of its functions and the exercise of its powers in relation to credit unions. (2) The Bank shall not establish an advisory group in relation to the Governor's ESCB-related functions. (3) Subject to subsection (4), an advisory group established under subsection (1) shall be made up of persons who have expertise, knowledge or experience relevant to the functions of the advisory group concerned, and may include members of the Commission, officers of the Bank or employees of the Bank. (4) The advisory group (in this section called 'the consumer advisory group') established to advise the Bank on the performance of its functions and the exercise of its powers in relation to consumers of financial services shall not include members of the Commission, officers of the Bank or employees of the Bank. (5) The consumer advisory group shall advise the Bank on the exercise of the Bank's powers and the performance of the Bank's functions in relation to the consumers of financial services and in particular in relation to— (*a*) the effects of the Bank's Strategic Plans on consumers of financial services, (*b*) initiatives aimed at further enhancing the protection of consumers of financial services, and

Item	Provision affected	Amendment
		(*c*) if the Bank so requests, documents, consultation papers or other materials prepared by the Bank. (6) The period for which a member of the consumer advisory group is appointed may be up to 3 years. A member is eligible for re-appointment. (7) The Bank shall determine the manner in which, and the reasons for which, a member of an advisory group may be removed from membership of the advisory group. (8) The Bank shall provide an advisory group with such administrative services and funds as the Bank believes necessary to carry out its functions. *Delegation of certain functions of Commission, etc.* 18F.—(1) Subject to subsection (3), the Commission may delegate to the Governor, a Head of Function or an employee of the Bank any function or power of the Commission, if the Commission considers it appropriate to do so in the interests of the efficient and effective management of the Bank and the exercise of its powers and functions. (2) Without prejudice to the generality of subsection (1), the Commission may in particular— (*a*) delegate to a specified person or body (including a committee established under section 18D(2)) the performance or exercise of any one or more of the functions and powers of the Commission; (*b*) impose conditions, limitations, or restrictions on the performance or exercise by any such person or body of functions or powers delegated under this subsection; (*c*) provide in appropriate cases for the review by the Commission of decisions taken or things done by any such person or body in the performance or exercise of any function or power so delegated. (3) Subsection (2) does not authorise the Commission to delegate to a committee any function of the Bank that a provision of this Act requires to be performed by the Governor.”.
29	Section 19A(3)	Substitute: “(3) Subject to the requirements of the Rome Treaty and the ESCB Statute, the Governor shall provide the Commission with information about, and may discuss with the Commission, the performance by the Governor of the functions and powers referred to in subsections (1) and (2).”.
30	Section 19B	Substitute: “*Decisions about certain issues involving Treaties governing European Union and ESCB Statute.* 19B.—Where the Commission is considering a budgetary or funding issue relating to the Bank, and in the opinion of the Governor the issue has implications for the independence of the Bank or the performance by the Governor of the functions conferred on the Governor and the Bank by or under the treaties governing the European Union (within the meaning given by section 1 of the European Communities Act 1972 as amended by section 2 of the European Communities Act 2009) or the ESCB Statute, the Governor shall so inform the Commission and thereafter— (*a*) the Commission shall cease to consider the issue, (*b*) the Governor has the sole right to determine the issue, and (*c*) the Governor’s decision is final.”.

Item	Provision affected	Amendment
31	Section 21(2)	Delete "if the other members of the Board have passed a unanimous resolution requesting the President to remove the Governor from office".
32	Section 22(1)	Delete "Directors", substitute "members".
33	Section 22(2)	Delete "Directors", substitute "members".
34	Subsections (3) to (7) of section 22	Substitute: "(3) If the office of Governor becomes vacant, the Commission may appoint another member of the Commission to act as Governor to carry out the designated responsibilities of the Governor during the vacancy. A member so appointed shall not continue to act after the end of 3 months from the occurrence of the vacancy which occasioned his or her appointment. (4) A member appointed under this section, while acting as Governor, has the designated responsibilities of the office of Governor and also the powers relating to the carrying out of those responsibilities. (5) A member appointed under this section to act as Governor is entitled to be paid such remuneration (including travelling and subsistence allowances) as the Commission determines from time to time. (6) A member appointed under this section to act as Governor does not, by reason of that appointment, vacate his or her office as a member. (7) This section does not apply to responsibilities of the Governor that are required, by virtue of section 22A, to be carried out by the Head of Central Banking in any of the circumstances specified in that section.".
35	Section 22A	Delete "Director General of the Bank", substitute "Head of Central Banking".
36	Sections 23 to 25	Substitute: "*Heads of Function.* 23.—(1) In this Act a reference to the Heads of Function is a reference to the Head of Central Banking and the Head of Financial Regulation. (2) With the consent of the Minister, the Commission may substitute another title for either or both of the titles 'Head of Central Banking' and 'Head of Financial Regulation'. If the Commission does so, the Commission shall cause a notice of the substitution to be published in the *Iris Oifigiúil*. The substitution has effect only on and after the date of that publication. (3) If the Commission substitutes a title in accordance with subsection (2), a reference in this Act or in any other enactment or statutory instrument to the title 'Head of Central Banking' or 'Head of Financial Regulation', as the case may be, shall be construed in accordance with the substitution. *Responsibilities of Heads of Function.* 23A.—Subject to section 22A, the responsibilities of a Head of Function are those assigned to the office concerned by the Commission. *Appointment of Heads of Function.* 23B.—(1) The Commission shall, with the consent of the Minister, appoint suitably qualified persons as Heads of Function. (2) Subject to subsection (3), an appointment as a Head of Function shall be made by open competition.

Item	Provision affected	Amendment
		(3) Subsection (2) does not apply to the appointment of a Head of Function if the Commission, with the consent of the Minister, decides that appointment to the office by open competition would be inappropriate. (4) A person is not eligible for appointment as a Head of Function if he or she— (*a*) is a member of either House of the Oireachtas, (*b*) is, with his or her consent, nominated as a candidate for election as such a member or is nominated as a member of Seanad Éireann, (*c*) is a member of the European Parliament or is, with his or her consent, nominated as a candidate for election as such a member or to fill a vacancy in the membership of that Parliament, or (*d*) is a member of a local authority or is, with his or her consent, nominated as a candidate for election as such a member. *Terms of appointment of Heads of Function.* 23C.—(1) An appointment as a Head of Function has effect from the date on which the Minister consents to the appointment or a later date agreed between the Commission and the person appointed. (2) Subject to subsections (3) and (6), a Head of Function holds office for up to 5 years, as the Minister approves at the time of the Head of Function's appointment, and is eligible for reappointment provided that the total term in office of a person appointed as a Head of Function shall not exceed 10 years. (3) The following do not count towards determining the period for which a person has held office as a Head of Function: (*a*) any period during which the person was acting in either office of Head of Function; (*b*) any period during which the person held the other office of Head of Function. (4) A Head of Function shall receive such remuneration and allowances, and is subject to such conditions of service, as the Commission from time to time determines. (5) A person appointed as a Head of Function may engage in other remunerative employment only with the consent of the Commission. (6) A person ceases to hold office as a Head of Function if he or she— (*a*) dies, (*b*) completes a term of office and is not re-appointed, (*c*) resigns the office by notice in writing addressed to the Governor, (*d*) is, with his or her consent, nominated as a candidate for election as a member of either House of the Oireachtas or is nominated as a member of Seanad Éireann, (*e*) is, with his or her consent, nominated as a candidate for election as a member of the European Parliament or to fill a vacancy in the membership of that Parliament,

Item	Provision affected	Amendment
		(*f*) is, with his or her consent, nominated as a candidate for election as a member of a local authority, (*g*) is adjudged bankrupt (either in the State or elsewhere) or enters into a composition with the person's creditors, (*h*) becomes physically or mentally incapable of performing the duties of the relevant office of Head of Function, (*i*) is convicted of an offence (either in the State or elsewhere) and sentenced to serve a term of imprisonment for the offence, or (*j*) is removed from office under subsection (7). (7) The Commission may remove or suspend a Head of Function from office, but only for reasons previously notified in writing to the Head of Function concerned. *Acting Heads of Function.* 23D.—(1) In the event of— (*a*) the illness or absence of a Head of Function, (*b*) the suspension from office of the holder of such an office, or (*c*) a vacancy in such an office, the Governor, with the consent of the other members of the Commission, may appoint a member of the Commission or an officer or employee of the Bank to act in the relevant office. (2) A person acting as a Head of Function has, while acting in that office, all the responsibilities and powers of that office. (3) The other members of the Commission may at any time remove from office a person who is acting as a Head of Function. (4) If a person is to act as a Head of Function for a period of more than 6 months, the appointment does not take effect until the Minister approves it. A person acting as a Head of Function shall not continue to so act for more than 6 months without the consent of the Minister. (5) A person acting as a Head of Function is entitled to be paid such remuneration (including travelling and subsistence allowances) as the Commission determines from time to time. *Appointment of members of Commission.* 24.—(1) The Minister may appoint a person as a member of the Commission if and only if the Minister is of the opinion that the person has relevant knowledge of— (*a*) accountancy, (*b*) actuarial science, (*c*) banking, (*d*) consumer interests, (*e*) corporate governance, (*f*) economics, (*g*) financial control, (*h*) financial regulation, (*i*) financial services,

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		(*j*) insurance, (*k*) law, (*l*) social policy, or (*m*) systems control. (2) A person is not eligible for appointment as a member of the Commission if he or she— (*a*) is a member of either House of the Oireachtas, (*b*) is, with his or her consent, nominated as a candidate for election as such a member or is nominated as a member of Seanad Éireann, (*c*) is a member of the European Parliament or is, with his or her consent, nominated as a candidate for election as such a member or to fill a vacancy in the membership of that Parliament, or (*d*) is a member of a local authority or is, with his or her consent, nominated as a candidate for election as such a member. *Remuneration, etc., of appointed members of Commission.* 24A.—An appointed member of the Commission is entitled to receive such remuneration and allowances, and is subject to such conditions of service, as the Minister from time to time determines. *Tenure of office of members of Commission.* 24B.—(1) An *ex-officio* member of the Commission holds office as such for as long as he or she holds or performs the duties of the office by virtue of which he or she is such a member. (2) Subject to subsections (3) and (4), an appointed member of the Commission holds office as such for a period of 5 years unless he or she previously ceases to hold that office in accordance with a provision of this Part. (3) Of the first 8 persons appointed as members of the Commission— (*a*) 2 or 3 of those persons shall be appointed for a first term of 5 years, (*b*) 2 or 3 of those persons shall be appointed for a first term of 4 years, and (*c*) 2 or 3 of those persons shall be appointed for a first term of 3 years. (4) An appointed member of the Commission shall not be entitled to serve more than 2 terms of office. *Vacation of office of members of Commission.* 25.—(1) A person ceases to be an *ex-officio* member of the Commission if he or she ceases to hold or perform the duties of the office by virtue of which he or she is such a member. (2) An appointed member of the Commission ceases to be an appointed member if he or she— (*a*) dies, (*b*) completes a term of office and is not re-appointed, (*c*) resigns the office by notice in writing addressed to the Governor,

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		(*d*) has, without the permission of the other members, been absent from meetings of the Commission for a consecutive period of 6 months, (*e*) is, with his or her consent, nominated as a candidate for election as a member of either House of the Oireachtas or is nominated as a member of Seanad Éireann, (*f*) is, with his or her consent, nominated as a candidate for election as a member of the European Parliament or to fill a vacancy in the membership of that Parliament, (*g*) is, with his or her consent, nominated as a candidate for election as a member of a local authority, (*h*) is adjudged bankrupt (either in the State or elsewhere) or enters into a composition with the person's creditors, (*i*) becomes physically or mentally incapable of performing the duties of a member of the Commission, (*j*) is convicted of an offence (either in the State or elsewhere) and sentenced to serve a term of imprisonment for the offence, or (*k*) is removed from office under subsection (3). (3) The Minister may remove an appointed member of the Commission from office— (*a*) for proven misconduct or incompetence, or (*b*) if in the Minister's opinion it is necessary or desirable to do so to enable the Commission to function effectively.".
37	Section 28	Substitute: "*Filling of vacancies in Commission.* 28.—As soon as practicable after an appointed member of the Commission ceases to hold office, the Minister shall appoint a person to fill the vacancy.".
38	Section 32	Delete "Board", substitute "Commission".
39	Part IIIA, Chapters 1 and 2	Substitute: "PART IIIA MANAGEMENT, FINANCE, AND ACCOUNTABILITY Chapter 1A *Management* *Framework for assignment of responsibilities.* 32A.—(1) The Governor shall propose to the Commission a plan of the assignment of responsibility for specified powers and functions of the Bank to himself or herself, a Head of Function or an officer or employee of the Bank. (2) Where appropriate, the assignment of the responsibility for the performance of a function requires the person to whom the function is assigned— (*a*) to provide policy advice in relation to the subject matter of the assignment and related matters,

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		(*b*) to achieve any outputs specified in the assignment, (*c*) to accept responsibility for the operation of statutory schemes or programmes specified in the assignment, (*d*) to accept responsibility for the delivery of quality services pursuant to the assignment, (*e*) to ensure that the expenditure in relation to the area of the assignment accords with the purpose for which the expenditure is appropriate and chargeable to the accounts of the Bank and that value for money is obtained, and (*f*) to perform, on behalf of the Commission, functions in relation to appointments, performance and discipline of personnel in the area of the assignment. (3) A Head of Function or an employee to whom the responsibility for the performance of a function has been assigned is accountable for the performance of the function to the Governor and to any other person specified for the purpose in the assignment. *Bank to prepare strategic plan.* 32B.—(1) At least 3 months before the beginning of each period specified in subsection (2), the Bank shall— (*a*) prepare for the period a strategic plan that complies with this section, and (*b*) submit the plan to the Minister. (2) The periods referred to in subsection (1) are— (*a*) the period of 3 financial years that begins on 1 January 2011, and (*b*) each subsequent period of 3 financial years. (3) A strategic plan shall specify— (*a*) the objectives of the Bank's activities for the relevant period, (*b*) the nature and scope of the activities to be undertaken, (*c*) the strategies and policies for achieving those objectives, (*d*) targets and criteria for assessing the performance of the Bank, and (*e*) the uses for which the Bank proposes to apply its resources. (4) If the Minister has notified the Bank in writing of any requirements with respect to the form in which a strategic plan is to be prepared, such a plan shall comply with those requirements. (5) As soon as practicable after receiving the Bank's strategic plan, the Minister shall arrange for the plan to be laid before each House of the Oireachtas. (6) As soon as practicable after becoming aware that a strategic plan has been laid before both Houses of the Oireachtas, the Bank shall publish the strategic plan and take all reasonably practical steps to implement it.

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		Chapter 2A *Finance and accounting* *Annual estimates in relation to financial regulation functions.* 32C.—No later than one month before the end of each financial year, the Bank shall prepare and submit to the Minister an estimate of— (*a*) its income from levies and fees imposed by regulations under sections 32D and 32E, (*b*) any other source of funds for the purposes of its powers and functions under the designated enactments and designated statutory instruments, and (*c*) its expenditure in relation to the exercise of those powers and functions, during the next financial year. *Power to impose levies.* 32D.—(1) The Commission may make regulations prescribing levies to be paid by persons who are subject to regulation under the designated enactments and designated statutory instruments. (2) In particular, regulations under subsection (1) may provide for any of the following matters: (*a*) the activities, services or other matters for which specified kinds of levies are payable; (*b*) the persons, or classes of persons, who are required to pay specified kinds of levies; (*c*) the amounts of specified kinds of levies; (*d*) the periods for which, or the dates by which, specified levies are to be paid to the Bank; (*e*) penalties payable by a person who does not pay a levy on time; (*f*) the keeping of records, and the making of returns to the Bank, by persons who are liable to pay a specified levy; (*g*) the collection and recovery of levies. (3) Regulations made under this section do not take effect until approved by the Minister. (4) A levy prescribed in relation to credit unions is to be fixed so that the total amount of levy collected or recovered from credit unions does not exceed the total costs incurred by the Bank in performing its functions and exercising its powers under the Credit Union Act 1997. (5) The Bank may, by proceedings in a court of competent jurisdiction, recover as a debt an amount of levy payable under regulations in force under this section. (6) The Bank may refund the whole or a part of a levy paid or payable under regulations in force under this section. (7) The Commission may amend or revoke a regulation made under this section. (8) An amendment or revocation of regulations made under this section does not take effect until approved by the Minister. (9) In this section ‘levy’ does not include a fee.

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		Power to prescribe fees. 32E.—(1) The Commission may make regulations prescribing fees for the purpose of any enactment that provides, by reference to this section or to section 33K (as in force at any time before the coming into operation of this section), for the payment of a fee. (2) The Commission may make regulations providing for all or any of the following matters: (*a*) the persons, or classes of persons, who are required to pay specified kinds of fees; (*b*) the amounts of specified kinds of fees; (*c*) the collection of fees. (3) Regulations of the kind referred to in subsection (2) may be included in regulations made under subsection (1). (4) Regulations made under this section do not take effect until approved by the Minister. (5) The Bank may, by proceedings in a court of competent jurisdiction, recover as a debt an amount payable as a fee under regulations in force under this section. (6) The Bank may refund the whole or a part of a fee paid pursuant to regulations made under this section. (7) The Commission may amend or revoke a regulation made under this section. (8) An amendment or revocation of regulations made under this section does not take effect until approved by the Minister. *General fund.* 32F.—(1) The Bank shall continue to keep and operate the fund called the general fund. (2) The Bank shall pay into the general fund all money received by the Bank and shall pay from that fund all amounts that it is required to pay. (3) The expenses incurred by the Bank in performing functions or exercising powers under this or any other Act or law are payable out of the general fund of the Bank, except where otherwise provided by or under this or any other Act. (4) Any claims on or liabilities to the European Central Bank are to be treated as assets or liabilities of the general fund or any other fund that the Minister by order establishes for that purpose. *Surplus or deficiency in income of Bank during financial year.* 32G.—(1) If the total sum received by the Bank on account of levies and fees prescribed under sections 32D and 32E during a financial year is greater than the Bank's expenditure on the performance of its functions and the exercise of its powers during that financial year, the Bank— (*a*) shall apply the surplus to the performance of those functions and the exercise of those powers in the following financial year, and (*b*) shall reduce the levies and fees prescribed in relation to the latter financial year accordingly. (2) If the sum received by the Bank on account of levies and fees prescribed under sections 32D and 32E during a financial year is less than the Bank's expenditure on the performance of its functions and the exercise of its powers during that financial year, the Bank may prescribe levies and fees in relation to the following financial year sufficient to— (*a*) make good the deficiency, and

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		(*b*) ensure that the sum received by the Bank on account of such levies and fees during the following financial year fully covers the performance of its functions and the exercise of its powers during both those financial years. *Bank's surplus income.* 32H.—(1) The Bank shall pay its surplus income as and when determined under this section into the Exchequer in such manner as the Minister directs and may at any time pending such determination pay into the Exchequer such sums on account of surplus income as may be agreed on by the Minister and the Bank. (2) The Minister may, after consultation with the Bank, make regulations providing for the periodic determination of the Bank's surplus income and, in particular, such regulations may— (*a*) enable provision to be made for reserves, depreciation and other similar matters before the surplus income is determined, and (*b*) provide for any matter arising from the implementation of Chapters VI, VIII and IX of the ESCB Statute. (3) In exercising the powers conferred by this section, the Minister is required to have regard to the functions imposed and the powers conferred on the Bank by or under the Rome Treaty and the ESCB Statute. *Provision of funds by Bank to meet shortfall.* 32I.—(1) If at any time it appears to the Commission that the funds raised from levies and fees prescribed by regulations in force under sections 32D and 32E are, or are likely to be, insufficient to enable the Bank to properly perform its regulatory functions, the Bank may apply to the performance of those functions such amount as the Commission considers necessary. (2) The Bank may apply an amount under subsection (1) only if the Minister so approves. (3) Before deciding whether or not to give approval under subsection (2), the Minister shall consult the Governor. The Governor may express his or her opinion on the amount of funds concerned, so far as it could affect— (*a*) the carrying out by the Bank of its obligations with respect to the promotion of the financial stability of the State, and (*b*) the performance of the functions of the Bank in its capacity as a member of the European System of Central Banks. (4) In approving the application of an amount of funds under subsection (2), the Minister shall have regard to the functions and powers of the Bank under the Rome Treaty and the ESCB Statute. *Accounting and other records of Bank.* 32J.—(1) The Bank shall keep all proper accounting records of all its transactions. (2) The Bank's accounts shall show separately— (*a*) receipts from funds raised from levies and fees prescribed by regulations in force under sections 32D and 32E and expenditure on the performance of its functions and the exercise of its powers,

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		(*b*) its income from penalties imposed under paragraphs (*c*) and (*f*) of section 33AQ(3), and (*c*) other receipts and expenditure. (3) Within 6 months after the end of each financial year, the Bank shall prepare and transmit to the Comptroller and Auditor General a statement of accounts for the financial year concerned. The statement shall be in a form approved by the Minister after consulting the Bank. The approval of a form of statement of accounts under this subsection remains in force until superseded by the approval of another form of statement of accounts. (4) The statement shall show separately— (*a*) receipts from funds raised from levies and fees prescribed by regulations in force under sections 32D and 32E and expenditure on the performance of its functions and the exercise of its powers, and (*b*) other receipts and expenditure. (5) The Comptroller and Auditor General shall audit, certify and report on the statement of accounts and, as soon as practicable after completing the report, give it and the statement of accounts to the Minister. (6) As soon as practicable after being given the report and statement of accounts, the Minister shall arrange for copies of those documents to be laid before each House of the Oireachtas. (7) The accounts of the Bank may be audited in accordance with Article 27 of the ESCB Statute and, for that purpose, the Bank shall provide any auditors appointed in accordance with that Article with full information, books and records. (8) The Bank shall keep its accounting records for at least 6 years. *Report of operations, etc., by Bank.* 32K.—(1) Within 6 months after the end of each financial year, the Bank shall prepare a report of its operations during the year and present the report to the Minister. (2) The report shall include a statement of the role of each advisory group established by the Bank under section 18E, and a summary of the work of each such advisory group during the relevant financial year. (3) As soon as practicable after being given the report and statement of accounts, the Minister shall arrange for copies of those documents to be laid before each House of the Oireachtas, together with any other reports required to be included in or attached to the report. (4) The Bank shall give to the Minister for publication in the *Iris Oifigiúil* such periodical returns concerning the transactions of the Bank as the Minister directs from time to time. Chapter 2A *Accountability* *Annual performance statements.* 32L.—(1) No later than 30 April in each year, the Bank shall prepare a statement relating to the Bank's performance in regulating financial services (in this section called a 'performance statement').

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		(2) A performance statement is to be in 3 parts— (*a*) details, including the aims and objectives, of regulatory activity planned for the current year (in this subsection called a 'Regulatory Performance Plan'), (*b*) a review of the Bank's regulatory performance during the preceding year having regard to the Regulatory Performance Plan for that year and any other relevant matters, and (*c*) the report of any international peer review carried out during the preceding year under section 32M. (3) The review of the Bank's regulatory performance required by subsection (2)(*b*) shall include details of the activities carried out during the relevant year by— (*a*) the part of the Bank responsible for internal audit, and (*b*) the Registrar of Credit Unions. (4) A performance statement is to be in the form, and is to relate to the matters, that the Minister directs, but shall not relate to the exercise by the Governor of his or her functions under the ESCB Statute. (5) Within one month after receiving a performance statement, the Minister will lay it before each House of the Oireachtas. (6) If the Governor or a Head of Function is requested by a Committee of the Oireachtas to— (*a*) attend before the Committee, and (*b*) provide that Committee with information relating to the Bank's performance statement, the Governor or Head of Function shall— (i) appear before the Committee, and (ii) subject to section 33AK(1A), provide the Committee with such information relating to the performance statement as the Committee requires. (7) The reference in subsection (6) to a Committee of the Oireachtas is a reference to a Committee appointed by either House or by both Houses jointly to examine matters relating to the Bank and includes a subcommittee of such a Committee, but does not include the Committee on Members' Interests of Dáil Éireann or the Committee on Members' Interests of Seanad Éireann. *International peer review of regulatory performance.* 32M.—At least every 4 years the Bank shall make appropriate arrangements for— (*a*) another national central bank, or (*b*) another person or body certified by the Governor, after consultation with the Minister, as appropriate, to carry out a review of the Bank's performance of its regulatory functions.".
40	Section 33X(1)	Delete "Regulatory Authority is to", substitute "Bank shall".

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41	Section 33X(3)	Delete “Regulatory Authority”, substitute “Bank”.
42	Section 33X(6)	Delete “Regulatory Authority”, substitute “Bank”.
43	Section 33X(7)	Delete “members of the Regulatory Authority”, substitute “Bank”.
44	Section 33X(8)(*c*)	Delete “members of the Regulatory Authority”, substitute “Bank”.
45	Section 33X(9)	Delete “Regulatory Authority”, substitute “Bank”.
46	Section 33Y(1)	Delete “The Regulatory Authority”, substitute “The Governor, with the consent of the Commission,”.
47	Section 33Y(3)	Delete “The Regulatory Authority”, substitute “Bank”.
48	Section 33Y(4)	Delete “Regulatory Authority”, substitute “Bank”.
49	Section 33AA(1)(*a*)	Delete “Regulatory Authority”, substitute “Bank”.
50	Section 33AA(3)	Delete “Regulatory Authority”, substitute “Bank”.
51	Subsections (4) to (7) of section 33AA	Substitute: “(4) In carrying out the responsibilities and exercising the powers imposed or conferred by this section, the Registrar, through the Head of Financial Regulation, is subject to the control of the Bank and shall comply with any directions by the Commission with respect to the carrying out of those responsibilities or the exercise of those powers. (5) A direction given in accordance with subsection (4) shall not be inconsistent with— (*a*) in relation to a function or power to which subsection (1)(*a*) relates, the Credit Union Act 1997, and (*b*) in relation to a function or power the management of which stands delegated to the Registrar under subsection (1)(*b*), any other relevant Act or law. (6) In issuing directions to the Registrar under subsection (4) which relate to the exercise of the responsibilities and powers referred to in subsection (1)(*a*), the Bank shall have regard to the particular nature of credit unions, and in particular by reference to— (*a*) the conditions for the registration of a credit union set out in section 6 of the Credit Union Act 1997 and to the objects and common bonds referred to in that section, and (*b*) the voluntary ethos of credit unions. (7) The Bank may, from time to time, issue to the Registrar guidelines, not inconsistent with any law, in relation to consultation and co-operation with the bodies and persons specified in subsection (8) on matters concerning the functions and powers of those bodies and persons. The Registrar shall comply with any such guidelines. (8) The bodies and persons referred to in subsection (7) are the following: (*a*) the Bank; (*b*) the Commission; (*c*) the Governor;

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		(*d*) the officers and employees of the Bank. (9) The Registrar shall provide the Head of Financial Regulation with such information and assistance as the Head of Financial Regulation requests in relation to any complaint to the Bank about the conduct of a credit union.”.
52	Section 33AB	Substitute: “*Bank to provide Registrar with adequate funds.* 33AB.—(1) The Bank shall provide the Registrar with such funds as the Bank considers necessary to enable the Registrar to perform the functions and exercise the powers of the Registrar. (2) The provision of funds under this section is subject to such conditions as the Bank thinks fit to impose.”.
53	Section 33AC(1)(*b*)	Delete “Regulatory Authority”, substitute “Bank”.
54	Section 33AC(2)	Substitute: “(2) The Head of Financial Regulation may direct the Registrar as to the form of the report and the matters that the report shall deal with. The Registrar shall comply with any such direction.”.
55	Section 33AD	Substitute: “*Registrar to provide information, reports and advice to Head of Financial Regulation.* 33AD.—The Registrar shall provide the Head of Financial Regulation with such information relating to the performance and exercise of the Registrar’s responsibilities and powers as the Head of Financial Regulation requires from time to time. That information may include (but is not limited to) information relating to— (*a*) the use by the Registrar of the resources of the Bank that have been allocated for the performance and exercise of those responsibilities and powers, and (*b*) the value of outcomes and outputs derived from the use of those resources.”.
56	Section 33AE	Substitute: “*Registrar to prepare work plan.* 33AE.—(1) The Registrar shall, at least 3 months before the beginning of each financial year— (*a*) prepare for the year a draft work plan that complies with this section, and (*b*) submit the draft plan to the Bank for approval. (2) A draft work plan shall specify— (*a*) the objectives of the Registrar for the financial year concerned, (*b*) the nature and scope of the activities to be undertaken, (*c*) the strategies and policies for achieving those objectives and how the resources allocated to the Registrar are proposed to be used, and (*d*) targets and criteria for assessing the performance of the Registrar. (3) If the Head of Financial Regulation has notified the Registrar of any requirements with respect to the form in which a draft work plan is to be prepared, the Registrar shall

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		take such steps as are necessary to ensure that the plan complies with those requirements. (4) The Bank may approve a work plan either with or without amendment. (5) On being approved under subsection (4), a draft work plan prepared for a financial year becomes the work plan for the Registrar for that year. The Registrar shall take all reasonably practical steps to implement the plan.”.
57	Section 33AF(3)	Delete “Chief Executive”, substitute “Head of Financial Regulation”.
58	Section 33AF(5)	Delete “Regulatory Authority”, substitute “Commission”.
59	Paragraphs (*b*) and (*c*) of section 33AG(1)	Substitute: “(*b*) former Directors; (*ba*) appointed members and former appointed members of the Commission; (*bb*) *ex-officio* members of the Commission and former *ex-officio* members of the Commission; (*c*) former members of the Regulatory Authority; (*ca*) officers and former officers of the Bank;”.
60	Section 33AG(8), definition of “retirement”	Delete “subsection (1)(*a*), (*b*) or (*c*),”, substitute “paragraph (*a*), (*b*), (*ba*) or (*c*) of subsection (1),”.
61	Section 33AJ(1)(*b*)	Substitute: “(*b*) the Governor; (*ba*) the Heads of Function; (*bb*) the Secretary General of the Department of Finance, in his or her capacity as an *ex-officio* member of the Commission; (*bc*) the appointed members of the Commission;”.
62	Section 33AJ(1)(*f*)	Delete “or of any of its constituent parts”.
63	Section 33AJ(7)	Delete “Chief Executive”, substitute “Head of Financial Regulation”.
64	Section 33AK(1)	Substitute: “33AK.—(1) This subsection applies to the following persons: (*a*) the Governor and every former Governor; (*b*) every former Director of the Central Bank and Financial Services Authority of Ireland; (*c*) every former member of the Irish Financial Services Regulatory Authority; (*d*) every member and every former member of the Commission; (*e*) every Head of Function and every former Head of Function; (*f*) the Registrar of Credit Unions and every former Registrar of Credit Unions; (*g*) every other officer or employee and every other former officer or employee of the Bank;

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		(*h*) every person who is or was formerly employed as a consultant, auditor or in any other capacity by the Bank; (*i*) every person to whom this subsection (as in force immediately before the amendment of this section by the *Central Bank Reform Act 2010*) applied immediately before that coming into operation. (1A) A person to whom subsection (1) applies shall not disclose confidential information concerning— (*a*) the business of any person or body whether corporate or incorporate that has come to the person's knowledge through the person's office or employment with the Bank, or (*b*) any matter arising in connection with the performance of the functions of the Bank or the exercise of its powers, if such disclosure is prohibited by the Rome Treaty, the ESCB Statute or the Supervisory Directives.".
65	Section 33AK(5)	After paragraph (*ah*), insert: "(*aha*) to any Commission of Investigation established under the Commissions of Investigation Act 2004, or".
66	Section 33AK(5)(*al*)	Delete "functions.", substitute "functions, or".
67	Section 33AK(5)	Insert at the end: "(*am*) to a body or authority that is a competent authority for the purposes of a Regulation of the European Union or European Communities that imposes restrictive measures within the framework of the EU Common Foreign and Security Policy.".
68	Section 33AK(5)(*p*)	Delete "section 6H applies", substitute "subsections (3) and (4) of section 32I apply".
69	Section 33AL	Substitute: *"Bank to inform persons of obligations under section 33AK.* 33AL.—(1) Subject to subsection (2), the Commission shall inform a person who is about to be appointed— (*a*) as Governor, (*b*) as an appointed member of the Commission, (*c*) as a Head of Function, (*d*) as Registrar of Credit Unions, (*e*) as an officer or employee of the Bank, or (*f*) as a consultant or auditor or in any other capacity by the Bank, of the obligation imposed by section 33AK. (2) In the case of a person appointed as the Secretary General of the Department of Finance, the Commission shall inform him or her of the obligation imposed by section 33AK as soon as practicable after he or she is so appointed. (3) A person shall not accept office as Governor or as an appointed member of the Commission, as a Head of Function, or as an officer or employee of the Bank, unless he or she has acknowledged, in a form determined by the Commission, that he or she has been informed of the obligations imposed by section 33AK.".

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70	Paragraphs (*a*) to (*d*) of section 33AM(1)	Substitute: "(*a*) the Governor; (*b*) the Head of Central Banking; (*c*) the Head of Financial Regulation;".
71	Section 33AN, definition of "inquiry"	Substitute: " 'inquiry' means an inquiry held under section 33AO or section 33AR, and includes such an inquiry begun by the former Regulatory Authority and continued by the Bank;".
72	Section 33BE	Substitute: "*Performance and exercise of regulatory functions.* 33BE.—(1) Such officers and employees of the Bank and such suitably qualified persons as the Bank designates from time to time pursuant to subsection (2) are responsible for performing and exercising the functions and powers of the Bank under this Part. (2) Without prejudice to the generality of subsection (1), the Bank may for the purposes of that subsection designate a person who is not an officer or employee of the Bank. A person so designated is an agent of the Bank for performing and exercising the functions and powers of the Bank under this Part or the part of those functions and powers for which the Bank designated him or her.".
73	Paragraphs (*b*) and (*c*) of Section 57AV(1)	Substitute: "(*b*) in the case of a body corporate — by leaving it at, or by sending it by pre-paid post to, the head office, a registered office or a principal office of the body corporate.".
74	Section 57CQ(1)	Delete "(and in particular the Consumer Director)".
75	Section 57CQ(2)	Substitute: "(2) The Council and the Financial Services Ombudsman may make recommendations to the Bank and the Registrar of Credit Unions with respect to measures that the Bank and Registrar might take so as— (*a*) to effectively deal with persistent patterns of complaints made against specified regulated financial service providers or against a specified class of those financial service providers, (*b*) to improve the way in which regulated financial service providers deal with complaints that are made against them, or (*c*) to effectively deal with any other matter relating to promoting the interests of consumers of financial services.".
76	Section 61C	Delete "the Government, Minister or the Chief Executive", substitute "the Government, the Minister or the Bank".
77		Before section 61E, insert: "*Prosecution of offences.* 61DA.—Proceedings for an offence under this Act, a designated enactment or a designated statutory instrument may be brought and prosecuted summarily by the Bank.".
78	Section 61G(1)	Delete "or the Regulatory Authority".
79	Section 61G(3)(*a*)	Delete "or Regulatory Authority".

Item	Provision affected	Amendment
80		After section 61G, insert: "*Arrangements for collection of certain levies.* 61H.—(1) The Bank may enter into an arrangement with a prescribed body in relation to the collection of a levy. (2) An arrangement referred to in subsection (1) is to be for the purpose of enabling the Bank or prescribed body to collect the relevant levy from each person or body obliged to pay it and pay the collected levy to the entity entitled to receive it. (3) An arrangement referred to in subsection (1) shall provide for the costs associated with the collection of the levy concerned to be met by the entity entitled to receive the levy. (4) In this section— 'levy' means a levy imposed under section 32D or any other enactment; 'prescribed body' means the following: (*a*) the Pensions Board; (*b*) the Financial Services Ombudsman; (*c*) the Agency; (*d*) any other body prescribed by the Minister by regulations made for the purposes of this section.".
81	Schedule 1	Substitute: "Section 32. SCHEDULE 1 PROCEDURE OF THE COMMISSION *General procedure.* 1.—The procedure for the calling of meetings of the Commission and for the conduct of business at those meetings is, subject to this Schedule, to be as determined by the members. The members may determine that procedure by means of rules or standing orders or by any other means. *Quorum.* 2.—If there are 10 or 11 members of the Commission, 6 members constitute a quorum; if there are 12 members of the Commission, 7 members constitute a quorum. *Who is to preside at meetings of Commission.* 3.—(1) A meeting of the Commission is to be presided over by— (*a*) the Governor, or (*b*) in the absence of the Governor, or if there is no Governor— (i) the member appointed under section 22 to act as Governor, or (ii) if no member has been appointed under that section, a member elected by the members present at the meeting. (2) If the votes are equal on a motion put at a meeting of the Commission, the person who is presiding at the meeting has a casting as well as a deliberative vote.

Item	Provision affected	Amendment
		Voting at Commission meetings. 4.—A decision supported by a majority of the votes cast at a meeting of the Commission at which a quorum is present is the decision of the Commission. *Transaction of business otherwise than at ordinary meetings.* 5.—(1) The Commission may, if it thinks fit, transact any of its business by the circulation of papers among all its members for the time being. A resolution approved in writing by a majority of those members is taken to be a decision of the Commission. (2) The Commission may, if it thinks fit, transact any of its business at a meeting at which its members (or some of its members) participate by telephone, closed circuit television or other means, but only if any member who speaks on a matter being considered by the meeting can be heard by the other members. For the purposes of— (*a*) the approval of a resolution under subparagraph (1), or (*b*) a meeting held in accordance with subparagraph (2), the members have the same voting rights as they have at an ordinary meeting of the Commission. (3) Papers may be circulated among the members for the purposes of subparagraph (1) by the electronic transmission of the information in the papers. *Disclosure of members' pecuniary interests.* 6.—(1) If— (*a*) a member of the Commission has a direct or indirect pecuniary interest in a matter being considered or about to be considered at a meeting of the Commission, and (*b*) the interest appears to raise a conflict with the proper performance of the member's duties in relation to the consideration of the matter, the member shall, as soon as possible after the relevant facts have come to his or her knowledge, disclose the nature of the interest at a meeting of the Commission or to the Secretary of the Commission. (2) In the case of a disclosure under subparagraph (1) to the Secretary of the Commission, the Secretary shall inform the next meeting of the Commission of the disclosure. (3) A disclosure by a member that he or she— (*a*) is a director, or is in the employment, of a specified company or other body, (*b*) is a partner, or is in the employment, of a specified person, or (*c*) has some other specified interest relating to a specified company or other body or to a specified person, is a sufficient disclosure of the nature of the interest in any matter relating to that company or other body, or to that person, that may arise after the date of the disclosure and that is required to be disclosed under subparagraph (1). (4) The Secretary of the Commission shall make and keep a record of particulars of any disclosure made under this paragraph and, subject to section 33AK, shall make that record available for inspection at all reasonable hours by any person who asks to see it.

Item	Provision affected	Amendment
		(5) After a member has disclosed the nature of an interest in a matter, he or she may not, unless the other members otherwise determine— (*a*) be present during any deliberation of the Commission with respect to the matter, or (*b*) take part in any decision of the Commission with respect to the matter. (6) For the purposes of the making of a determination by the members under subparagraph (5)(*b*), a member who has a direct or indirect pecuniary interest in a matter to which the disclosure relates is not entitled— (*a*) to be present during any deliberation of the Commission for the purpose of making the determination, or (*b*) to take part in the making by the Commission of the determination. (7) A contravention of this paragraph does not invalidate a decision of the Commission. (8) This paragraph does not apply to or in relation to an interest of a member in a matter or thing that arises merely because he or she is a contributor to a retirement benefits scheme.”.

82	Schedule 2	Substitute: “Section 33C(1) and (2).

SCHEDULE 2

DESIGNATED ENACTMENTS AND DESIGNATED STATUTORY INSTRUMENTS

PART 1

ENACTMENTS

Item	Number and year	Short Title	Provisions
1	9 Edw 7, c.49	Assurance Companies Act 1909	The whole Act
2	No. 45 of 1936	Insurance Act 1936	The whole Act
3	No. 22 of 1942	Central Bank Act 1942	Section 5C
4	No. 7 of 1953	Insurance Act 1953	Section 4
5	No. 33 of 1963	Companies Act 1963	Section 213
6	No. 18 of 1964	Insurance Act 1964	The whole Act
7	No. 24 of 1971	Central Bank Act 1971	The whole Act, other than subsections (1) and (4) of section 7 and sections 44 to 46, 48 to 50 and 55
8	No. 30 of 1978	Insurance (Amendment) Act 1978	The whole Act
9	No. 24 of 1983	Postal and Telecommunic-ations Services Act 1983	Sections 67 and 104
10	No. 29 of 1983	Insurance (No. 2) Act 1983	The whole Act
11	No. 3 of 1989	Insurance Act 1989	The whole Act
12	No. 16 of 1989	Central Bank Act 1989	The whole Act other than sections 22 to 25 and 118 to 126
13	No. 17 of 1989	Building Societies Act 1989	The whole Act
14	No. 21 of 1989	Trustee Savings Banks Act 1989	The whole Act
15	No. 27 of 1990	Companies (Amendment) Act 1990	Sections 3, 3C, 18, 23, 24 and 27
16	No. 33 of 1990	Companies Act 1990	Part XIII
17	No. 37 of 1990	Unit Trusts Act 1990	The whole Act
18	No. 18 of 1992	Housing (Miscellaneous Provisions) Act 1992	Section 13

19	No. 24 of 1994	Investment Limited Partnerships Act 1994	The whole Act
20	No. 27 of 1994	Solicitors (Amendment) Act 1994	Section 78
21	No. 11 of 1995	Investment Intermediaries Act 1995	The whole Act
22	No. 24 of 1995	Consumer Credit Act 1995	The whole Act
23	No. 25 of 1995	Netting of Financial Contracts Act 1995	Sections 2 and 3
24	No. 8 of 1997	Central Bank Act 1997	The whole Act other than Parts II and III and section 77
25	No. 15 of 1997	Credit Union Act 1997	The whole Act
26	No. 37 of 1998	Investor Compensation Act 1998	The whole Act
27	No. 32 of 2001	Dormant Accounts Act 2001	The whole Act
28	No. 47 of 2001	Asset Covered Securities Act 2001	The whole Act
29	No. 28 of 2001	Company Law Enforcement Act 2001	Section 110A
30	No. 2 of 2003	Unclaimed Life Assurance Policies Act 2003	The whole Act
31	No. 12 of 2005	Investment Funds, Companies and Miscellaneous Provisions Act 2005	The whole Act
32	No. 41 of 2006	Investment Funds, Companies and Miscellaneous Provisions Act 2006	The whole Act
33	No. 19 of 2007	Consumer Protection Act 2007	The whole Act
34	No. 37 of 2007	Markets in Financial Instruments and Miscellaneous Provisions Act 2007	Part 1 and sections 9 to 11, 13 and 17
35	No. 1 of 2009	Anglo Irish Bank Corporation Act 2009	The whole Act other than section 2
36	No. 34 of 2009	National Asset Management Agency Act 2009	Part 12
37	No. 6 of 2010	Criminal Justice (Money Laundering and Terrorist Financing) Act 2010	Part 4

38	No. — of 2010	*Central Bank Reform Act 2010*	*Part 3*

PART 2

STATUTORY INSTRUMENTS

Item	Number and Year	Citation	Provisions
1	S.R.& O. No. 75 of 1940	Actuary (Qualifications) Regulations 1940	The whole instrument
2	S.R.& O. No. 76 of 1940	Industrial Assurance (Contents of Policies) Order 1940	The whole instrument
3	S.R.& O. No. 78 of 1940	Insurance (Deposits) Rules 1940	The whole instrument
4	S.R.& O. No. 80 of 1940	Insurance Regulations 1940	The whole instrument
5	S.R.& O. No. 81 of 1940	Industrial Assurance (Fees for Determination of Disputes) Regulations 1940	The whole instrument
6	S.I. No. 64 of 1971	Decimal Currency (Friendly Society and Industrial Assurance Contracts) Regulations 1971	The whole instrument
7	S.I. No. 115 of 1976	European Communities (Non-Life Insurance) Regulations 1976	The whole instrument
8	S.I. No. 178 of 1978	European Communities (Insurance Agents and Brokers) Regulations 1978	The whole instrument
9	S.I. No. 382 of 1978	European Communities (Insurance)(Non-life) Regulations 1978	The whole instrument
10	S.I. No. 65 of 1983	European Communities (Co-Insurance) Regulations 1983	The whole instrument

11	S.I. No. 57 of 1984	European Communities (Life Assurance) Regulations 1984	The whole instrument
12	S.I. No. 27 of 1987	Building Societies Regulations 1987	The whole instrument
13	S.I. No. 191 of 1990	Insurance (Bonding of Intermediaries) Regulations 1990	The whole instrument
14	S.I. No. 142 of 1991	European Communities (Non-Life Insurance) (Amendment) (No. 2) Regulations 1991	The whole instrument
15	S.I. No. 197 of 1991	European Communities (Non-Life Insurance) (Legal Expenses) Regulations 1991	The whole instrument
16	S.I. No. 244 of 1992	European Communities (Non-Life Insurance) (Amendment) Regulations 1992	The whole instrument
17	S.I. No. 294 of 1992	European Communities (Credit Institutions: Accounts) Regulations 1992	Regulations 8, 14 and 15
18	S.I. No. 395 of 1992	European Communities (Licensing and Supervision of Credit Institutions) Regulations 1992	The whole instrument
19	S.I. No. 359 of 1994	European Communities (Non-Life Insurance) Framework Regulations 1994	The whole instrument
20	S.I. No. 360 of 1994	European Communities (Life Assurance) Framework Regulations 1994	The whole instrument

21	S.I. No. 27 of 1995	European Communities (Unfair Terms in Consumer Contracts) Regulations 1995	The whole instrument
22	S.I. No. 168 of 1995	European Communities (Deposit Guarantee Schemes) Regulations 1995	The whole instrument
23	S.I. No. 202 of 1995	European Communities (Non-Life Insurance Accounts) Regulations 1995	The whole instrument
24	S.I. No. 23 of 1996	European Communities (Insurance Undertakings Accounts) Regulations 1995	The whole instrument
25	S.I. No. 25 of 1996	European Communities (Swiss Confederation Agreement) Regulations 1996	The whole instrument
26	S.I. No. 267 of 1996	Supervision of Credit Institutions Stock Exchange Member Firms and Investment Business Firms Regulations 1996	The whole instrument
27	S.I. No. 380 of 1997	Stock Exchange Act, 1995 (Determination Committees) Rules of Procedure 1997	The whole instrument
28	S.I. No. 381 of 1997	Rules entitled Investment Intermediaries Act 1995 (Determination Committee) Rules of Procedure 1997	The whole instrument
29	S.I. No. 307 of 2000	European Communities (Unfair Terms in Consumer Contracts) (Amendment) Regulations 2000	The whole instrument

30	S.I. No. 473 of 2000	Insurance Act, 1989 (Reinsurance) (Form of Notice) Regulations 2000	The whole instrument
31	S.I. No. 15 of 2001	Life Assurance (Provision of Information) Regulations 2001	The whole instrument
32	S.I. No. 221 of 2002	European Communities (Electronic Money) Regulations 2002	The whole instrument
33	S.I. No. 335 of 2002	European Communities (Cross Border Payments in Euro) Regulations 2002	The whole instrument
34	S.I. No. 168 of 2003	European Communities (Reorganisation and Winding-up of Insurance Undertakings) Regulations 2003	The whole instrument
35	S.I. No. 211 of 2003	European Communities (Undertakings for Collective Investments in Transferable Securities) Regulations 2003	The whole instrument
36	S.I. No. 198 of 2004	European Communities (Reorganisation and Winding-Up of Credit Institutions) Regulations 2004	The whole instrument
37	S.I. No. 727 of 2004	European Communities (Financial Conglomerates) Regulations 2004	The whole instrument
38	S.I. No. 853 of 2004	European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004	The whole instrument
39	S.I. No. 13 of 2005	European Communities (Insurance Mediation) Regulations 2005	The whole instrument

40	S.I. No. 324 of 2005	Prospectus (Directive 2003/71/EC) Regulations 2005	The whole instrument
41	S.I. No. 342 of 2005	Market Abuse (Directive 2003/6/EC) Regulations 2005	The whole instrument
42	S.I. No. 380 of 2006	European Communities (Reinsurance) Regulations 2006	The whole instrument
43	S.I. No. 660 of 2006	European Communities (Capital Adequacy of Investment Firms) Regulations 2006	The whole instrument
44	S.I. No. 661 of 2006	European Communities (Capital Adequacy of Credit Institutions) Regulations 2006	The whole instrument
45	S.I. No. 60 of 2007	European Communities (Markets in Financial Instruments) Regulations 2007	The whole instrument
46	S.I. No. 366 of 2007	European Communities (Insurance and Reinsurance Groups Supplementary Supervision) Regulations 2007	The whole instrument
47	S.I. No. 383 of 2009	European Communities (Payment Services) Regulations 2009	The whole instrument (other than Part 3)
48	S.I. No. 475 of 2009	European Communities (Credit Institutions) (Consolidated Supervision) Regulations 2009	The whole instrument
49	S.I. No. 183 of 2010	European Communities (Cross Border Payments in the Community) Regulations 2010	The whole instrument

		50	S.I. No. 281 of 2010	European Communities (Consumer Credit Agreements) Regulations 2010	The whole instrument

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Section 14(3).

PART 2

Provisions of the Central Bank Act 1942 repealed

1 Sections 6G, 6H and 6I

2 Section 33

3 Part VIIC (sections 57CV to 57DH)

4 Schedule 3

5 Schedule 8

Section 14(4).

PART 3

Amendments of Central Bank Act 1971

Item	Provision affected	Amendment
1	Section 2(1), definition of “Bank”	Delete “and Financial Services Authority”.
2	Section 2(1), definition of “Regulatory Authority”	Delete.
3	Section 17A(8), definition of “suitably qualified person”	Delete “or the Chief Executive”, substitute “or the Head of Financial Regulation”.
4	Section 33	Insert after subsection (2): “(3) Notwithstanding the periods specified in subsection (1) of this section, the Minister may, in any particular case, following consultation with the Governor, reduce one or more of those periods where, and to the extent, the Minister considers it necessary for the purpose of financial stability.”.

PART 4

Section 14(5).

AMENDMENTS OF CENTRAL BANK ACT 1989

Item	Provision affected	Amendment
1	Section 3(1), definition of "the Bank"	Delete "and Financial Services Authority".
2	Section 50(2)	Substitute: "(2) The Bank may, in writing, appoint a person to be a member of a committee of inspection appointed in respect of the holder or former holder of a licence.".

PART 5

Section 14(6).

AMENDMENTS OF CENTRAL BANK ACT 1997

Item	Provision affected	Amendment
1	Section 2(1), definition of "the Bank"	Delete "and Financial Services Authority".
2	Section 75(8), definition of "appropriate person", paragraph (*b*)	Delete.
3	Section 75(8), definition of "responsible authority"	Substitute: " '*responsible authority*' means the Head of Financial Regulation.".
4	Section 77(1)	Delete "or constituent part".

PART 6

Section 14(7).

AMENDMENT OF CENTRAL BANK ACT 1998

Item	Provision affected	Amendment
1	Section 2, definition of "Bank"	Delete "and Financial Services Authority".

Section 15.

SCHEDULE 2

Amendments of other Acts

Section 15(1).

PART 1

Amendments of Anglo Irish Bank Corporation Act 2009

Item	Provision affected	Amendment
1	Section 1, definition of “Central Bank”	Delete “and Financial Services Authority”.
2	Section 1, definition of “Regulatory Authority”	Delete.
3	Section 2(2)	Delete “and the Regulatory Authority”, substitute “and the Central Bank”.
4	Section 2(3)	Delete “or the Regulatory Authority”.
5	Section 21(2)(*f*)	Delete.
6	Section 21(2)(*g*)	Delete “or the Regulatory Authority”.

Section 15(2).

PART 2

Amendments of Companies (Auditing and Accounting) Act 2003

Item	Provision affected	Amendment
1	Section 26(12)	Delete “Irish Financial Services Regulatory Authority”, substitute “Central Bank of Ireland”.
2	Section 31(3)(*b*)(viii)	Delete “and Financial Services Authority”.

PART 3

Section 15(3).

AMENDMENTS OF COMPANY LAW ENFORCEMENT ACT 2001

Item	Provision affected	Amendment
1	Section 110A(1)(*e*)	Substitute: "(*e*) in relation to functions that, under the Companies Acts, are to be performed by the Central Bank of Ireland— (i) the Head of Financial Regulation (within the meaning given by the Central Bank Act 1942), or (ii) a person appointed by some other person to whom the Head of Financial Regulation has delegated responsibility for appointing persons for the purposes of this section;".
2	Section 110A(8A)	Substitute: "(8A) A document purporting to be a copy of, or an extract from, a document kept by the Central Bank of Ireland and certified by— (*a*) the Head of Financial Regulation of the Central Bank of Ireland, or (*b*) a person authorised by the Head of Financial Regulation, to be a true copy of, or an extract from, the document so kept is, without proof of the official position of the person purporting to so certify, admissible in evidence in all legal proceedings as of equal validity with the document so kept.".

PART 4

Section 15(4).

AMENDMENTS OF CONSUMER CREDIT ACT 1995

Item	Provision affected	Amendment
1	Section 1, definition of "Bank"	Delete "and Financial Services Authority".
2	Section 1, definition of "Regulatory Authority"	Delete.
3	Part 1B, heading	Delete "and Financial Services Authority".
4	Section 92(2)	Delete "a member of the Irish Financial Services Regulatory Authority,".

Section 15(5).

PART 5

AMENDMENTS OF CONSUMER PROTECTION ACT 2007

Item	Provision affected	Amendment
1	Section 3(2)	Delete "Every regulation", substitute "Subject to section 24B(5), every regulation".
2	Section 8(3)	After paragraph (*h*), insert: "(*ha*) shall promote the interests of consumers of financial services by— (i) 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 (ii) promoting the development of financial education and capability,".
3		After section 8, insert: "*Supplementary powers of Agency with respect to carrying out certain responsibilities.* 8A.—(1) To enable the Agency to perform the functions set out in section 8(3)(*ha*), the Agency may— (*a*) undertake studies, analyses and surveys with respect to the provision of relevant financial services to consumers, (*b*) collect and compile information for that purpose, and (*c*) publish the results of any such studies, analyses or surveys. (2) In undertaking such a study, analysis or survey, the Agency— (*a*) may, by notice in writing, require any person who, in the opinion of the Agency has information, or has control of a record or other thing, that is relevant to the study, analysis or survey to provide the information, record or thing to the Agency, and (*b*) may, by the same or another notice in writing, require the person to attend before an officer or employee of the Agency for that purpose. (3) A person commits an offence if the person— (*a*) intentionally prevents the Agency from exercising a power conferred by subsection (1), (*b*) intentionally obstructs or hinders the Agency in the exercise of such a power, (*c*) without reasonable excuse, fails to comply with a requirement made to the person in accordance with subsection (2), or (*d*) in purporting to comply with a requirement made under subsection (2) to provide information, provides the Agency with information that the person knows, or ought reasonably to know, is false or misleading in a material respect.

Item	Provision affected	Amendment
		(4) A person who is convicted of an offence under this section is liable— (*a*) on conviction on indictment, to a fine not exceeding €30,000 or to imprisonment for a term not exceeding five years, or to both, or (*b*) on summary conviction, to a fine not exceeding €3,000 or to imprisonment for a term not exceeding 12 months, or to both. (5) Summary proceedings for an offence under this section may be brought and prosecuted by the Agency, but not to the exclusion of any other person who is authorised to bring and prosecute summary offences.”.
4	Section 21(11)(*a*)(i)	Substitute: “(i) the Central Bank of Ireland;”.
5		After section 24, insert: “*Annual estimate of income for certain purposes.* 24A.—At least one month before the start of each financial year the Agency shall prepare, and shall submit to the Minister and the Minister for Finance, a statement of the expenditure required during the financial year for the purposes of the functions referred to in section 8(3)(*ha*). *Power to impose levies.* 24B.—(1) The Agency may make regulations prescribing levies to be paid by persons who are subject to regulation under the designated enactments and designated statutory instruments (within the respective meanings given by the Central Bank Act 1942). (2) A levy prescribed under subsection (1) shall relate only to the Agency’s performance of its functions referred to in section 8(3)(*ha*). (3) In particular, regulations under subsection (1) may provide for any of the following matters: (*a*) the activities, services or other matters for which specified kinds of levies are payable; (*b*) the persons, or classes of persons, who are required to pay specified kinds of levies; (*c*) the amounts of specified kinds of levies; (*d*) the periods for which, or the dates by which, specified levies are to be paid to the Agency; (*e*) penalties that are payable by a person who fails to pay a levy on time; (*f*) the keeping of records, and the making of returns to the Agency, by persons who are liable to pay a specified levy; (*g*) the collection and recovery of levies. (4) Regulations made under this section do not take effect until approved by the Minister with the consent of the Minister for Finance. (5) Section 3(2) does not apply to regulations made under subsection (1). (6) The Agency may refund the whole or a part of a levy paid or payable under regulations in force under this section.

Item	Provision affected	Amendment
		(7) The Agency may amend or revoke a regulation made under this section. (8) An amendment or revocation of regulations made under this section does not take effect until approved by the Minister with the consent of the Minister for Finance. (9) The Agency may, by proceedings in a court of competent jurisdiction, recover as a debt an amount of levy payable under regulations in force under this section. *Surplus or deficiency in certain income of Agency during financial year.* 24C.—(1) If the total sum received by the Agency on account of levies prescribed under section 24B during a financial year is greater than the Agency's expenditure on the performance of its functions referred to in section 8(3)(*ha*) during that financial year, the Agency— (*a*) shall apply the surplus to the performance of those functions and the exercise of those powers in the following financial year, and (*b*) shall reduce the levies prescribed in relation to the latter financial year accordingly. (2) If the sum received by the Agency on account of levies prescribed under section 24B during a financial year is less than the Agency's expenditure on the performance of its functions referred to in section 8(3)(*ha*) during that financial year, the Agency may prescribe levies in relation to the following financial year sufficient to— (*a*) make good the deficiency, and (*b*) ensure that the sum received by the Agency on account of such levies during the following financial year fully covers the performance of those functions during both those financial years. *Arrangements in relation to collection of levies.* 24D.—(1) The Agency may enter into an arrangement with a prescribed body in relation to the collection of a levy. (2) An arrangement referred to in subsection (1) is to be for the purpose of enabling the Agency or prescribed body to collect the relevant levy from each person or body obliged to pay it and pay the collected levy to the entity entitled to receive it. (3) An arrangement referred to in subsection (1) shall provide for the costs associated with the collection of the levy concerned to be met by the entity entitled to receive the levy. (4) Nothing in this section affects any other power of the Agency to enter into an arrangement for the collection of levies. (5) In this section— 'levy' means a levy imposed under section 24B or any other enactment; 'prescribed body' means the following: (*a*) the Pensions Board; (*b*) the Financial Services Ombudsman; (*c*) the Central Bank of Ireland; (*d*) any other body prescribed by the Minister by regulations made for the purposes of this section.

Item	Provision affected	Amendment
		Accounting for levies. 24E.—In its annual report and annual accounts, the Agency shall include statements of— (*a*) the amounts collected by way of levies under section 24B, and (*b*) how those amounts were expended.”.

PART 6

Section 15(6).

AMENDMENTS OF CREDIT INSTITUTIONS (FINANCIAL SUPPORT) ACT 2008

Item	Provision affected	Amendment
1	Section 2(2)	Delete “the Governor and the Regulatory Authority”, substitute “the Central Bank and the Governor”.
2	Section 2(3)	Delete “or the Regulatory Authority”.
3	Section 7(1)(*a*)	Delete “and the Regulatory Authority”.

PART 7

Section 15(7).

AMENDMENTS OF CREDIT UNION ACT 1997

Item	Provision affected	Amendment
1	Section 2, definition of “Bank”	Delete “and Financial Services Authority”.
2	Section 35(2)	Substitute: “(2) A credit union shall not make a loan to a member— (*a*) for a period exceeding 5 years if, were the loan to be made, the total gross amount outstanding in relation to all loans with greater than 5 years to the final repayment date would exceed— (i) 30 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or (ii) if the Bank so approves in writing, 40 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or (*b*) for a period exceeding 10 years if, were the loan to be made, the total gross amount outstanding in relation to all loans with greater than 10 years to the final repayment date would exceed— (i) 10 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or

Item	Provision affected	Amendment
		(ii) if the Bank so approves in writing, 15 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or (*c*) in the circumstances specified in subsection (3). (2A) The Bank may impose on an approval, for the purposes of paragraph (*a*)(ii) or (*b*)(ii) of subsection (2), any condition that the Bank considers appropriate. (2B) In subsection (2), 'final repayment date' for a loan means— (*a*) the date on which the loan is due to expire, as indicated on the relevant credit agreement in accordance with section 37C(1)(*j*), or (*b*) any subsequent date agreed between the credit union and the member to whom the loan has been made. (2C) Where the Bank considers it necessary for the adequate protection of the savings of members of a particular credit union, a class of credit unions or all credit unions, the Bank may by written notice impose on the credit union, the class of credit unions or all credit unions such requirements as the Bank considers appropriate in relation to any one or more of the following matters: (*a*) lending practices; (*b*) reporting loans to the Bank; (*c*) the holding of provisions, reserves or capital against loans or specified classes or types of loans; (*d*) the holding of liquid assets as a specified percentage based on the percentage of the total gross loan book balance outstanding for a period exceeding 5 years; (*e*) systems, controls and reporting arrangements in relation to any of the matters set out in paragraphs (*a*) to (*d*). (2D) In exercising the power conferred on it by subsection (2C), the Bank shall have regard to the lending framework provided for in subsection (2). (2E) A notice under subsection (2C) may describe a class of credit unions, or a class or type of loans, by reference to any common characteristic of the credit unions or loans concerned. (2F) A credit union shall ensure that it has appropriate processes, procedures, systems, controls and reporting arrangements to monitor compliance with the requirements of this section and any requirement imposed under this section.".

PART 8

Section 15(8).

AMENDMENTS OF DISABILITY ACT 2005

Item	Provision affected	Amendment
1	Section 43(2)(*c*)	Delete "Irish Financial Services Regulatory Authority", substitute "Central Bank of Ireland".
2	Section 44(2)	Delete "Irish Financial Services Regulatory Authority", substitute "Central Bank of Ireland".

PART 9

Section 15(9).

AMENDMENTS OF HEALTH (REPAYMENT SCHEME) ACT 2006

Item	Provision affected	Amendment
1	Section 2, definition of "Authority"	Delete.
2	Section 9(2)(*a*)(ii)(I)	Substitute: "(I) with a financial institution authorised by the Central Bank of Ireland;".
3	Section 11(12)(*a*)(i)	Substitute: "(i) with a financial institution authorised by the Central Bank of Ireland,".

PART 10

Section 15(10).

AMENDMENTS OF INSURANCE ACT 1989

Item	Provision affected	Amendment
1	Section 59(1)	After "employees" insert ", or other suitably qualified persons".
2	Section 59	Insert after subsection (3): "(4) In this section "*suitably qualified person*" means a person (other than an employee of the Bank) who, in the opinion of the Bank, has the qualifications and experience necessary to exercise the powers conferred on authorised officers by the Insurance Acts.".

Section 15(11).

PART 11

AMENDMENTS OF NATIONAL ASSET MANAGEMENT AGENCY ACT 2009

Item	Provision affected	Amendment
1	Section 3(*a*)	Delete "the Governor, the Central Bank or the Regulatory Authority", substitute "the Governor or the Central Bank".
2	Section 4(1), definition of "Central Bank"	Delete "and Financial Services Authority".
3	Section 4(1), definition of "Regulatory Authority"	Delete.
4	Section 15(2)(*j*)	Delete "director", substitute "member of the Commission".
5	Section 15(2)(*l*)	Delete.
6	Section 67(1)	Delete "and the Regulatory Authority".
7	Section 67(5)	Delete "Regulatory Authority", substitute "Central Bank".
8	Section 68(1)(*e*)	Delete "Regulatory Authority", substitute "Central Bank".
9	Section 69(1)	Delete "NAMA, the Governor and the Regulatory Authority", substitute "NAMA and the Governor".
10	Section 202(6)(*e*)	Substitute: "(*e*) the Central Bank,".
11	Section 203(*v*)	Substitute: "(*v*) the Central Bank,".
12	Section 205(1)	Delete "Regulatory Authority", substitute "Central Bank".
13	Section 205(4)	Delete "Regulatory Authority", substitute "Central Bank".
14	Section 206(1)	Delete "Regulatory Authority", substitute "Central Bank".
15	Section 207(1)	Delete "Regulatory Authority", substitute "Central Bank".
16	Section 207(2)	Delete "Regulatory Authority", substitute "Central Bank".
17	Section 207(4)	Delete "Regulatory Authority", substitute "Central Bank".
18	Section 208(1)	Delete "Regulatory Authority", substitute "Central Bank".
19	Section 208(3)	Delete "Regulatory Authority", substitute "Central Bank".
20	Section 208(6)	Delete "Regulatory Authority", substitute "Central Bank".
21	Section 208(8)	Delete "Regulatory Authority", substitute "Central Bank".
22	Section 209(1)	Delete "Regulatory Authority" (twice occurring), for each substitute "Central Bank".
23	Section 209(5)	Delete "Regulatory Authority", substitute "Central Bank".

PART 12

Section 15(12).

AMENDMENTS OF OFFICIAL LANGUAGES ACT 2003

Item	Provision affected	Irish text	English text
1	First Schedule	In the Irish text, delete “Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann”, substitute “Banc Ceannais na hÉireann”.	In the English text, delete “Central Bank and Financial Services Authority of Ireland”, substitute “Central Bank of Ireland”.
2	First Schedule	In the Irish text, delete “Údarás Rialála Seirbhísí Airgeadais na hÉireann”.	In the English text, delete “Irish Financial Services Regulatory Authority”.

PART 13

Section 15(13).

AMENDMENT OF PERSONAL INJURIES ASSESSMENT BOARD ACT 2003

Item	Provision affected	Amendment
1	Section 56(6)	Delete “the chief executive of the National Consumer Agency and the Consumer Director of the Irish Financial Services Regulatory Authority”, substitute “and the chief executive of the National Consumer Agency”.

PART 14

Section 15(14).

ENACTMENTS AMENDED BY SUBSTITUTING “CENTRAL BANK OF IRELAND” FOR “CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND”

1. Assurance Companies Act 1909, section 29 (definition of “Bank” (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

2. Insurance Act 1936, section 3(1) (definition of “the Bank” (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

3. Insurance Act 1953, section 1(1) (definition of “Bank” (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

4. Insurance Act 1964, section 1 (definition of “the Bank” (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

5. Insurance (No. 2) Act 1983, section 1(1) (definition of “the Bank” (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

6. Building Societies Act 1989, section 2(1) (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

7. Insurance Act 1989, section 2(1) (definition of "Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

8. Trustee Savings Banks Act 1989, section 3(1) (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

9. Companies (Amendment) Act 1990, section 1 (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

10. Companies Act 1990, section 3(1) (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

11. Unit Trusts Act 1990, section 1(1) (definition of "the Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

12. Investment Limited Partnerships Act 1994, section 3 (definition of "the Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

13. Solicitors (Amendment) Act 1994, section 78(17) (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

14. Netting of Financial Contracts Act 1995, section 1 (definition of "Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

15. Investor Compensation Act 1998, section 2(1) (definition of "Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

16. Dormant Accounts Act 2001, section 2(1) (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

17. Asset Covered Securities Act 2001, section 3(1) (definition of "Central Bank" (inserted by the Central Bank and Financial Services Authority of Ireland Act 2003))

18. Council of Europe Development Bank Act 2004, section 3(3)

19. Development Banks Act 2005, section 3(3)

20. Investment Funds, Companies and Miscellaneous Provisions Act 2005, section 6(1) (definition of "Bank")

21. Sea Pollution (Hazardous Substances) (Compensation) Act 2005, section 2(1) (definition of "the Central Bank")

22. International Criminal Court Act 2006, section 48(4)(*a*)

23. Sea Pollution (Miscellaneous Provisions) Act 2006, section 8(4)(*b*)

24. Markets in Financial Instruments and Miscellaneous Provisions Act 2007, section 3(1) (definition of "Bank")

25. Consumer Protection Act 2007, sections 8(2), 31(1)(*e*) and 31(2)(*e*)

26. Carbon Fund Act 2007, section 2(2)

27. National Oil Reserves Agency Act 2007, section 44(7)

28. Credit Institutions (Financial Support) Act 2008, section 1 (definition of "Central Bank")

29. Criminal Justice (Mutual Assistance) Act 2008, section 12(1) (definition of "financial institution", paragraph (*a*)(i))

30. Anglo Irish Bank Corporation Act 2009, section 1 (definition of "Central Bank")

31. Financial Emergency Measures in the Public Interest Act 2009, section 1 (definition of "public service body", paragraph (*f*))

32. Financial Services (Deposit Guarantee Scheme) Act 2009, section 1 (definition of "Bank")

33. Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, sections 25(3)(*b*), 40(1)(*a*)(vi), 60(2)(*a*) and 62(1)(*a*)

Section 16.

SCHEDULE 3

Amendments of statutory instruments

Section 16(1).

PART 1

Amendments of Ethics in Public Office (Prescribed Public Bodies, Designated Directorships of Public Bodies and Designated Positions in Public Bodies) Regulations 2004

Item	Provision affected	Amendment
1	Schedule, item 257	Delete the item, substitute: “257. Central Bank of Ireland Member of the Central Bank Commission ”
2	Schedule, item 271	Delete the item.

Section 16(2).

PART 2

Amendments of European Communities (Consumer Credit Agreements) Regulations 2010

Item	Provision affected	Amendment
1	Regulation 25(5)	Delete “and Financial Services Authority”.
2	Regulation 26	Delete “Irish Financial Services Regulatory Authority”, substitute “Central Bank of Ireland”.

Section 16(3).

PART 3

Amendments of European Communities (Cooperation between National Authorities Responsible for the Enforcement of Consumer Protection Laws) Regulations 2006

Item	Provision affected	Amendment
1	Regulation 2(1), definition of “Irish Financial Services Regulatory Authority”	Delete.
2	Schedule, item 3	Delete “Irish Financial Services Regulatory Authority”, substitute “Central Bank of Ireland”.
3	Schedule, item 13	Delete “Irish Financial Services Regulatory Authority”, substitute “Central Bank of Ireland”.

PART 4

Section 16(4).

AMENDMENTS OF EUROPEAN COMMUNITIES (UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES) REGULATIONS 2003

Item	Provision affected	Amendment
1	Regulation 2(1), definition of "Bank"	Delete "and Financial Services Authority".
2	Regulation 98(8), definition of "qualified person", paragraph (*a*)	Substitute: "(*a*) a member of the Central Bank Commission or an officer or employee of the Bank, or".
3	Regulation 98(8), definition of "responsible authority"	Substitute: " 'responsible authority' means the Governor of the Bank or the Head of Financial Regulation of the Bank;".

PART 5

Section 16(5).

AMENDMENTS OF MARKET ABUSE (DIRECTIVE 2003/6/EC) REGULATIONS 2005

Item	Provision affected	Amendment
1	Regulation 2(1) (definition of "Bank")	Delete "and Financial Services Authority".
2	Regulation 27, definition of "responsible authority"	Substitute: " 'responsible authority' means— (*a*) the Head of Financial Regulation of the Central Bank of Ireland, or (*b*) any person to whom the Head of Financial Regulation has delegated responsibility for appointing authorised officers.".
3	Regulation 28(4)(*d*)	Delete "Irish Financial Services Regulatory Authority", substitute "Central Bank of Ireland".

Section 16(6).

PART 6

AMENDMENTS OF PROSPECTUS (DIRECTIVE 2003/71/EC) REGULATIONS 2005

Item	Provision affected	Amendment
1	Regulation 80, definition of "responsible authority"	Substitute: " 'responsible authority' means— (*a*) the Head of Financial Regulation of the Central Bank of Ireland, or (*b*) any person to whom the Head of Financial Regulation has delegated responsibility for appointing authorised officers.".
2	Regulation 85(4)(*d*)	Delete "Irish Financial Services Regulatory Authority", substitute "Central Bank of Ireland".

Section 16(7).

PART 7

AMENDMENT OF TRANSPARENCY (DIRECTIVE 2004/109/EC) REGULATIONS 2007

Item	Provision affected	Amendment
1	Regulation 38, definition of "responsible authority"	Substitute: " 'responsible authority' means: (*a*) the Head of Financial Regulation of the Central Bank of Ireland, (*b*) the Chief Executive of IAASA, or (*c*) any person to whom that Head or that Chief Executive has delegated the responsibility for appointing authorised persons.".

Section 16(11).

PART 8

PROVISIONS OF STATUTORY INSTRUMENTS AMENDED BY SUBSTITUTING "CENTRAL BANK OF IRELAND" FOR "CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND"

1. European Communities (Non-Life Insurance) Regulations 1976 (S.I. No. 115 of 1976), Regulation 2(1) (definition of "Bank")

2. European Communities (Insurance Agents and Brokers) Regulations 1978 (S.I. No. 178 of 1978), Regulation 2(1) (definition of "Bank")

3. European Communities (Co-Insurance) Regulations 1983 (S.I. No. 65 of 1983), Regulation 2 (definition of "Bank")

4. European Communities (Life Assurance) Regulations 1984 (S.I. No. 57 of 1984), Regulation 2(1) (definition of "Bank")

5. European Communities (Non-Life Insurance) (Amendment) (No. 2) Regulations 1991 (S.I. No. 142 of 1991), Regulation 2 (definition of "Bank")

6. European Communities (Non-Life Insurance) (Legal Expenses) Regulations 1991 (S.I. No. 197 of 1991), Regulation 2 (definition of "Bank")

7. European Communities (Credit Institutions: Accounts) Regulations 1992 (S.I. No. 294 of 1992), Regulation 2(1) (definition of "Bank")

8. European Communities (Licensing and Supervision of Credit Institutions) Regulations 1992 (S.I. No. 395 of 1992), Regulation 2(1) (definition of "Bank")

9. European Communities (Non-Life Insurance) Framework Regulations 1994 (S.I. No. 359 of 1994), Regulation 2(1) (definition of "Bank")

10. European Communities (Life Assurance) Framework Regulations 1994 (S.I. No. 360 of 1994), Regulation 2(1) (definition of "Bank")

11. European Communities (Deposit Guarantee Schemes) Regulations 1995 (S.I. No. 168 of 1995), Regulation 3(1) (definition of "Bank")

12. European Communities (Non-Life Insurance Accounts) Regulations 1995 (S.I. No. 202 of 1995), Regulation 2 (definition of "Bank")

13. European Communities (Insurance Undertakings: Accounts) Regulations 1996 (S.I. No. 23 of 1996), Regulation 2(1) (definition of "Bank")

14. European Communities (Electronic Money) Regulations 2002 (S.I. No. 221 of 2002), Regulation 2(1) (definition of "Bank")

15. European Communities (Cross Border Payments in Euro) Regulations 2002 (S.I. No. 335 of 2002), Regulation 2(1) (definition of "Bank")

16. European Communities (Distance Marketing of Consumer Financial Services) Regulations 2004 (S.I. No. 853 of 2004), Regulation 3(1) (definition of "the Bank")

17. European Communities (Financial Conglomerates) Regulations 2004 (S.I. No. 727 of 2004), Regulation 3(1) (definition of "the Bank")

18. Central Bank Act 1942 (Sections 33J and 33K) Regulations 2004 (S.I. No. 447 of 2004), Regulation 2 (definition of "Bank")

19. European Communities (Reorganisation and Winding-up of Credit Institutions) Regulations 2004 (S.I. No. 198 of 2004), Regulation 2(1) (definition of "Bank")

20. European Communities (Insurance Mediation) Regulations 2005 (S.I. No. 13 of 2005), regulation 3(1) (definition of "the Bank")

21. Prospectus (Directive 2003/71/EC) Regulations 2005 (S.I. No. 324 of 2005), Regulation 2(1) (definition of "Bank")

22. Central Bank Act 1942 (Section 33K) Regulations 2005 (S.I. No. 325 of 2005), Regulation 2 (definition of "Bank")

23. Criminal Justice (Terrorist Offences) Act 2005 (Section 42(6)) (Counter Terrorism) (Financial Sanctions) Regulations 2006 (S.I. No. 221 of 2006), Regulation 2(1) (definition of "Central Bank")

24. European Communities (Award of Public Authorities' Contracts) Regulations 2006 (S.I. No. 329 of 2006), Regulation 13(1)

25. European Communities (Reinsurance) Regulations 2006 (S.I. No. 380 of 2006), Regulation 3(1) (definition of "Bank")

26. Criminal Justice (Terrorist Offences) Act 2005 (Section 42(6)) (Usama Bin Laden, Al-Qaida and Taliban of Afghanistan) (Financial Sanctions) Regulations 2006 (S.I. No. 432 of 2006), Regulation 2(1) (definition of "Central Bank")

27. European Communities (Capital Adequacy of Investment Firms) Regulations 2006 (S.I. No. 660 of 2006), Regulation 2(1) (definition of "Bank")

28. European Communities (Capital Adequacy of Credit Institutions) Regulations 2006 (S.I. No. 661 of 2006), Regulation 2(1) (definition of "Bank")

29. European Communities (Award of Contracts by Utility Undertakings) Regulations 2007 (S.I. No. 50 of 2007), Regulation 20(1)(*e*)

30. European Communities (Markets in Financial Instruments) Regulations 2007 (S.I. No. 60 of 2007), Regulation 3(1) (definition of "Bank")

31. Credit Union Act 1997 (Exemption From Additional Services Requirements) Regulations 2007 (S.I. No. 107 of 2007), Regulation 2(1) (definition of "Central Bank")

32. Criminal Justice (Terrorist Offences) Act 2005 (Section 42(6)) (Usama Bin Laden, Al-Qaida and Taliban of Afghanistan) (Financial Sanctions) Regulations 2007 (S.I. No. 206 of 2007), Regulation 2(1) (definition of "Central Bank")

33. European Communities (Admissions to Listing and Miscellaneous Provisions) Regulations 2007 (S.I. No. 286 of 2007), Regulation 2(1) (definition of "Central Bank")

34. European Communities (Insurance and Reinsurance Groups Supplementary Supervision) Regulations 2007 (S.I. No. 366 of 2007), Regulation 3(1) (definition of "Bank")

35. National Oil Reserves Agency Act 2007 (Returns and Levy) Regulations 2007 (S.I. No. 567 of 2007), Schedule 1 (twice occurring)

36. European Communities (Information on the Payer Accompanying Transfers of Funds) Regulations 2007 (S.I. No. 799 of 2007), Regulation 2(1) (definition of "Bank")

37. Private Security (Licensing and Standards) (Cash in Transit) Regulations 2007 (S.I. No. 857 of 2007), Regulation 3 (definition of "Central Bank")

38. European Communities (Settlement Finality) Regulations 2008 (S.I. No. 88 of 2008), Regulation 2(1) (definition of “Bank”)

39. Central Bank and Financial Services Authority of Ireland Superannuation Scheme 2008 (S.I. No. 99 of 2008), Rule 3(1) (definition of “Bank”)

40. European Communities (Cross-Border Mergers) Regulations 2008 (S.I. No. 157 of 2008), Regulation 16(7)

41. European Communities (Payment Services) Regulations 2009 (S.I. No. 383 of 2009), Regulation 3(1) (definition of “Bank”)

42. European Communities (Credit Institutions) (Consolidated Supervision) Regulations 2009 (S.I. No. 475 of 2009), Regulation 3(1) (definition of “Bank”)

43. National Asset Management Agency (Determination of Long-term Economic Value of Property and Bank Assets) Regulations 2010 (S.I. No. 88 of 2010), Regulation 5(2)(*c*)

44. European Communities (Republic of Guinea) (Financial Sanctions) Regulations 2010 (S.I. No. 221 of 2010), Regulation 5

45. Financial Transfers (Republic of Guinea) (Prohibition) Order 2010 (S.I. No. 222 of 2010), Article 5

46. European Communities (Slobodan Milosevic and Associated Persons) (Financial Sanctions) Regulations 2010 (S.I. No. 224 of 2010), Regulation 5

47. Financial Transfers (Slobodan Milosevic and Associated Persons) (Prohibition) Order 2010 (S.I. No. 225 of 2010), Article 5

48. European Communities (Credit Rating Agencies) Regulations 2010 (S.I. No. 247 of 2010), Regulation 3(1) (definition of “Bank”).

THE IRISH TIMES

Banking on very shaky foundations

Fri, Sep 7, 2007

Economics: While there has been a lot of interest lately in the possible risk to banks from subprime loans, nobody seems terribly concerned by the large and rapidly-growing exposure of Irish banks to property speculators, writes Morgan Kelly.

Irish banks are now owed almost as much by builders and developers as they are by mortgage holders, and are now more exposed to commercial real estate than Japanese banks were when they crashed in 1989.

While mortgage lending has slowed since the middle of last year, lending to builders and developers continues to grow rapidly and now stands at almost €100 billion, an increase of €20 billion on last October.

To put this in perspective, €20 billion is twice the market value of Bank of Ireland shares; while €100 billion is the approximate value of all public deposits with retail banks. Effectively, the Irish banking system has taken all its shareholders' equity, with a substantial chunk of its depositors' cash on top, and handed it over to builders and property speculators.

In fact, if you leave out the quarter of mortgages that are for buy-to-let property, itself a small-time form of property speculation, lending to developers is now €20 billion more than lending to people to buy their own homes.

In 2000, lending to construction and real estate made up only 8 per cent of Irish bank lending, much like other European countries. Now it has risen to 28 per cent. By comparison, just before the Japanese bubble burst in late 1989, construction and property development had grown to a little over 25 per cent of bank lending.

Increased lending for construction and development is driven by banks' urgent need to meet earnings expectations and is unavoidably risky.

While most home owners will continue to pay mortgages, even with negative equity, international experience shows that developers will walk when markets turn down, leaving banks, and often governments, to pick up the pieces. Diversification for lenders is difficult, moreover: when one developer goes bust, they typically all go bust.

While lending to builders, at €25 billion, is a good deal smaller than the €75 billion lent to real estate speculators, many of the loans appear to be in difficulty already.

During the property boom of the last decade, a mutually profitable symbiosis emerged between banks and builders. Banks would provide lines of credit at a generous mark-up over wholesale interest rates for builders to buy and develop sites, and builders would pay off the loans once they sold the new property, which they were often able to do before a single brick had been laid.

The arrangement between banks and builders was fine so long as sales of new houses did not slow, leaving builders unable to repay loans. Since the start of this year, sales of new houses have not slowed, they have entirely collapsed.

A Dublin estate agent told me that whereas last year they sold more than 3,000 new units, this year they have sold fewer than 100. They are about to try to launch one of their new developments for the third time, the first two launches having netted exactly no buyers.

While the market for secondhand houses still limps along, people have stopped buying new houses because they are afraid that developers will eventually slash prices and leave them with negative equity. They are right.

My contact told me of one heavily marketed development where they have taken deposits on €750,000 apartments and are now anxious to get the buyers to sign contracts so they can cut the prices of the many remaining units to €600,000.

It is ironic that the Government's abolition of stamp duty for first-time buyers has allowed them to escape entirely from the new housing market.

What was intended as a dig-out for the building industry may turn out to be one of the last nails in its coffin.

Given that nobody wants new houses, it is natural to ask who is going to buy the 80,000 or so units that will be completed this year and the 60,000 on stream for next. The answer, though they may not know it yet, is the shareholders of Bank of Ireland, Anglo Irish and other builder-friendly banks.

While we can see banks starting to make a show of turning up the heat on smaller developers, they have lent too much to large builders to allow them to fail. It is one thing to chop a developer off at the ankles if he owes you €16 million; it is quite another to admit that a developer in south Dublin owes you €160 million, let alone to force him into bankruptcy.

Were any one of the several Dublin developers, who are reputedly unable to service any of their large borrowing, to be driven into bankruptcy, the ripple effect on Dublin house prices and the value of other loans would be unpleasant.

Along with the many loans to builders that are already in the non- performing category, the exposure to commercial real estate poses a grave threat to bank solvency, because of the large sums involved and the highly leveraged nature of the borrowing.

Commercial real estate borrowing during booms follows the same pattern everywhere. You put up 20 per cent of the price of an office block or warehouse and borrow the rest. As prices rise, you use the equity gained in the first property as collateral for an 80 per cent loan on a second property and so on, as long as prices keep rising.

In Dublin, the 5 per cent rental yield allowed banks to charge a 5 per cent interest on commercial real estate loans so investors could use rental income to cover interest payments while they sat back and enjoyed double-digit capital gains.

With lending rates based on five- year euro swaps now risen to over 6.5 per cent and rental yields fallen to 4 per cent, new investors cannot cover interest from rent and are entirely reliant on capital gains from rising prices. With commercial property prices slowing rapidly, and loans taken out a few years ago needing to be rolled over, there is a strong risk of a sudden exodus from the market and a collapse in prices.

The large exposure of Irish banks to property speculators does not mean large losses are inevitable. If a crash occurs, or even if already nervous overseas bond markets cut off liquidity to Irish banks (foreign banks have over €400 billion on deposit with Irish banks and hold another €200 billion of bonds), it will be very costly to fix, dwarfing the bailout of AIB in the 1980s.

A partial bail-out of Japanese banks cost their government 10 per cent of national income, while refloating Finnish banks cost its government nearly 15 per cent of national income. In Irish terms this would translate into a €15 to €20 billion bill for taxpayers.

You probably think that the fact that Irish banks have given speculators €100 billion to gamble with, safe in the knowledge that taxpayers will cover most losses, is a cause of concern to the Irish Central Bank, but you would be quite wrong.

At a recent Irish Economic Association discussion of house prices, the Central Bank official in charge of financial regulation (whose publications with the ultra-libertarian Cato Institute strongly oppose any form of bank regulation - a real case of an atheist being appointed an archbishop) stopped the proceedings to announce that the view of the Bank was that, as long as international markets were happy to buy debt issued by Irish banks, there could be no problem with their lending policies.

We can only hope that this insane logic is correct and that the refusal on ideological principle of bank regulators to regulate banks does not lead to the same debacle here that occurred with savings and loan institutions in Reagan-era America.

Morgan Kelly is a professor of economics at University College Dublin.

Banc Ceannais na hÉireann

Licensing and Supervision Requirements and Standards for Credit Institutions

Extract from

Central Bank of Ireland, Quarterly Bulletin, Winter 1995.

Licensing and Supervision Requirements and Standards For Credit Institutions

Preface

The Central Bank is statutorily charged with the licensing and supervision of banks and building societies, which are collectively termed credit institutions[1]. The Bank's powers in this respect are derived from the Central Bank Acts, 1971 and 1989, the Building Societies Act, 1989, the Trustee Savings Banks Act, 1989, the ACC Bank Act, 1992, the ICC Bank Act, 1992 and various provisions implementing EU Banking Directives[2].

The relevant legislation contains extensive provisions relating to, inter alia, the granting and revocation of licences; the obtaining of information from credit institutions; the undertaking of on-site inspections and the supervision generally of the activities of credit institutions. As many of the provisions are of a discretionary nature, the Bank has set down requirements and standards which it uses to guide it in the assessment of applications for licences and in the supervision of the business carried on by credit institutions.

The requirements and standards are non-statutory requirements which are applied by the Bank to credit institutions as a supplement to the statutory requirements contained in the legislation referred to in paragraph 1 above and the Appendix to this document. This document contains summary references to the main statutory provisions for the purposes of setting a context for the non-statutory requirements.

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1 The credit institutions supervised by the Bank comprise licensed banks, building societies, Trustee Savings Bank, ACC Bank, ICC Bank and ICC Investment Bank.

2 A list of the principal EU Banking Directives, together with details of the their transposition into Irish law, is contained in the Appendix.

It is emphasised that this document does not purport to interpret or comprehensively refer to the statutory provisions applicable to credit institutions. Interested parties should directly consult the various sources of statutory law applicable to credit institutions, seeking legal advice, where appropriate, for a definitive understanding of the scope and application of such law.

The requirements and standards were last published in the Bank's Quarterly Bulletin of Autumn 1987. They have now been revised to take account of the considerable changes that have taken place in both the domestic and international banking environments since that time, in particular the enactment of a significant body of legislation.

The requirements and standards apply to all credit institutions authorised by the Bank including branches in the State of credit institutions incorporated outside the European Economic Area (EEA)[3]. They have limited application to branches of credit institutions incorporated in other EEA Member States the supervision of which, under the EU Second Banking Co-ordination Directive and the EEA Agreement, is almost exclusively the responsibility of the supervisory authority in that Member State, i.e. home country supervision.

The requirements and standards apply to the totality of each institution's operations and, in addition, where relevant, the various ratios and limits will apply to the consolidated position of each institution.

Credit institutions are required to comply with the Bank's supervision requirements at all times. Compliance with the requirements and standards, however, does not relieve the boards and management of credit institutions of the fundamental responsibility to conduct the operations of their institutions in accordance with the relevant laws and in a prudent manner with full and primary regard for the safety of depositors' funds.

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[3] The European Economic Area (EEA) refers to the Member States of the EU and the Member States of EFTA (except Switzerland). Membership of the EEA currently comprises: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, The Netherlands, Norway, Portugal, Spain, Sweden and The United Kingdom.

1. AUTHORISATION AND OWNERSHIP OF CREDIT INSTITUTIONS

(Section 1: as amended on 22 April 1998)

1.1 The principal legislative provisions governing the authorisation and ownership of credit institutions are contained in the Central Bank Acts, 1971 to 1997, and in the Regulations implementing the EU Second Banking Co-ordination Directive (Statutory Instrument Number 395 of 1992). Specific legislative provisions governing the authorisation and ownership of building societies are contained in the Building Societies Act, 1989.

1.2 An applicant for a licence must satisfy the Bank that:

(i) it has an acceptable legal form;

(ii) the corporate structure of the group of which the applicant is part, or its relationship with other undertakings under common control, is clear and transparent and is not such as may result in the Bank being unable to exercise effectively its supervisory responsibilities;

(iii) it has clearly defined and adequately researched objectives and proposed operations which are consistent with the principles enshrined in banking legislation and in the Bank's licensing and supervision requirements and standards;

(iv) it is independent of dominant personal interests;

(v) there will be cohesion, continuity and consistency in the manner in which the business of the credit institution is directed by its owners;

(vi) the beneficial ownership of the credit institution is such as will ensure a capacity to provide such new capital for the credit institution as may be required in the future; and

(vii) there is a willingness and a capacity on the part of the credit institution to comply with the Bank's licensing and supervision requirements and standards on a continuous basis.

1.3 While not an absolute requirement, the Bank prefers that ownership be vested in one or more banks or other financial institutions of standing or, alternatively, that there be a wide spread of ownership. The Bank would not be receptive to a proposal from a general insurance entity to acquire a controlling shareholding in a credit institution.

1.4 In considering a proposal where ownership of a bank would vest in an industrial or commercial group, a range of additional considerations will apply, the more important of which may be summarised as follows:

(i) the Bank's assessment of the proposal will have regard to any additional risks arising from the ownership structure and, in particular, from relationships with non-bank elements of the group;

(ii) the Bank will attach high importance to the degree of independence accorded to the applicant and to the degree of decision making to be located within the State;

(iii) only groups of the highest integrity and financial soundness (as evidenced by their trading record and international credit rating) will be considered;

(iv) unless there are exceptional factors that warrant special attention, the Bank will require as a condition of granting a licence that there already exists, for some time, within the group, a separate financial entity, with its own management and financing structures and with skills and experience appropriate to banking;

(v) the minimum solvency ratio requirement for the bank (own funds as a percentage of risk assets) is likely to be set in excess of the minimum which applies to international banks;

(vi) in general, funding for the bank should not include small retail deposits; if there is to be any dependence on group funding sources, due regard will need to be had to the continuity of those sources;

(vii) in general, the bank would not be permitted to provide credit to or acquire assets from affiliated companies; and

(viii) the principles of consolidated supervision will be applied by the Bank to the applicant group in an appropriate manner.

1.5 An application for authorisation from a branch or subsidiary of an international bank, international banking group or international financial group will be considered only where the supervisory authority in the country of origin of that bank or group exercises effectively its supervisory responsibilities on a consolidated basis.

1.6 In the case of an application for authorisation from an international bank, international banking group or international financial group, the applicant shall obtain the prior consent of its home country supervisory authority. The Bank will consult the home country supervisor in advance of granting an authorisation to a credit institution from another country.

1.7 An application by an Irish credit institution to establish in another country will be considered only where the Bank is satisfied that it has the right to obtain from that entity whatever information it deems necessary to supervise effectively the credit institution on a consolidated basis.

1.8 Where a shareholding, registered in the name of a nominee, constitutes more than 5 per cent. of shares or of the voting rights attaching to shares in a credit institution, the ultimate beneficial ownership of shares so held should be made known by the credit institution to the Bank.

1.9 Prior approval of the Bank should be sought for the registration of any transfer of shares which would result in the transferee controlling more than 5 per cent. of the shares or of the voting rights attaching to shares in a credit institution.

1.10 A credit institution should provide the Bank once in each financial year, or at such other times as the Bank may direct, with a detailed statement of shareholders or beneficial owners of 10 per cent. or more of its share capital. Further requirements in relation to prior notification to the Bank of changes in shareholdings are set out in Regulation 14 of Statutory Instrument Number 395 of 1992 which implemented the EU Second Banking Co-ordination Directive.

1.11 The Bank will require from the parent or major shareholder of a banking subsidiary incorporated in the State an undertaking that the subsidiary will be in a position to meet its liabilities as they fall due for as long as the parent/shareholder continues to hold the majority of the equity of the subsidiary.

2. BOARD AND MANAGEMENT OF CREDIT INSTITUTIONS

2.1 The Bank must be satisfied with the structure of the board and senior management of a credit institution and that internal control systems and reporting arrangements are such as to provide for the effective, prudent and efficient administration of its assets and liabilities. In this respect, it is necessary for all credit institutions to have in place such committees of directors and management and other management structures as are necessary to ensure that the business of the credit institution is being managed, conducted and controlled in a prudent manner and in accordance with sound administrative and accounting principles.

2.2 The Bank must be satisfied that executive directors and senior executives are fit and proper persons and have appropriate competence and experience in banking and financial services to enable them to fulfil their duties and that non-executive directors are fit and proper persons and have suitable relevant experience.

2.3 All appointments to the board of a credit institution and its subsidiaries are subject to the prior approval of the Bank. In this respect, the following information shall be forwarded to the Bank: the proposed appointee's full name and address, a detailed curriculum vitae outlining the appointee's relevant experience and the date on which he/she will take office. All retirements from the board shall be notified to the Bank.

2.4 In the case of a credit institution, whose registered office is in the State, its head office or ultimate decision making organs shall also be located in the State. The day-to-day operations of a credit institution shall be conducted from within the State by at least two persons, who should be resident in the State.

3 INTERNAL CONTROLS

3.1 The European Communities (Licensing and Supervision of Credit Institutions) Regulations, 1992, (Statutory Instrument Number 395 of 1992) require that every credit institution shall manage its business in accordance with sound administrative and accounting principles and shall put in place and maintain internal control and reporting arrangements and procedures to ensure that the business is so managed.

The Bank must be satisfied that:

(a) directors and senior management exercise adequate control over the credit institution;

(b) comprehensive risk management systems commensurate with the scope, size and complexity of all the credit institutions activities, including derivatives and associated risks, are in place, incorporating continuous measuring, monitoring and controlling of risk, accurate and reliable management information systems, timely management reporting and thorough audit and control procedures; and

(c) where the size or nature of the operations of the credit institution warrant it, a properly staffed internal audit function exists which has direct access to the board of directors or an appropriate sub-committee of the board.

3.2 A credit institution must satisfy the Bank, in regard to possible conflicts of interest arising in the conduct of different types of activity under its control, that adequate arrangements have been made to protect the interests of its clients. All credit institutions will be required to comply with any prudential rules or codes of practice drawn up by the Bank in relation to their investment business in accordance with the EU Investment Services Directive (93/22/EEC).

3.3 A credit institution should be aware of and monitor, on an ongoing basis, the risk to its business arising from its participation in payments and settlements systems and to take reasonable steps to minimise that risk.

3.4 Where a credit institution is involved in a fiduciary capacity in the management of clients' funds, it should ensure that the possible risks to the credit institution arising from such activities are adequately assessed and provided for.

3.5 A credit institution should maintain adequate fidelity guarantee insurance for all staff or make alternative arrangements acceptable to the Bank.

4 CONSOLIDATED SUPERVISION

4.1 The European Communities (Consolidated Supervision of Credit Institutions) Regulations, 1992 (Statutory Instrument Number 396 of 1992) require the Bank to supervise a credit institution and its associated enterprises on a consolidated basis in accordance with the requirements of the EU Directive on the Supervision of Credit Institutions on a Consolidated Basis (92/30/EEC).

4.2 In accordance with the principles of the Directive and subject to the detailed provisions of the Regulations, the Bank's policy on consolidated supervision is as follows:

(a) the various ratios and limits set out in the Requirements and Standards are applied on a consolidated basis to each credit institution under the Bank's supervision. In addition, the ratios and limits are applied, in accordance with the Regulations, to each subsidiary credit institution authorised by the Bank, in order to ensure the satisfactory allocation of risks within the group;

(b) in the case of a credit institution, whose parent is a financial holding company, the ratios and limits are applied to the group on a consolidated basis as well as to the credit institution itself. Moreover, the Bank will require from all undertakings within the group such information as is necessary to enable it to carry out its supervisory functions effectively; and

(c) consolidation at group level is not required in the case of a credit institution which belongs to a group the majority of whose activities are of a non-financial nature. However, in such cases the Bank will require from all undertakings within the group such information as is necessary to enable it to carry out its supervisory functions effectively.

5 CAPITAL ADEQUACY

5.1 The Bank's requirements relating to the capital adequacy of credit institutions are set out in the Notice published in the Bank's Quarterly Bulletin No. 3 of 1991, implementing in Ireland the EU Own Funds and Solvency Ratio Directives. This Notice was amended by a further Notice issued on 22 August 1995 to all credit institutions.

5.2 In essence, under the Notice, a credit institution is required to maintain a level of own funds relative to the size and nature of the credit institution's assets. The Bank requires each credit institution to maintain a minimum solvency ratio (own funds as a proportion of risk weighted assets) in relation to credit risk of 8 per cent. or such higher level as the Bank may determine on a case by case basis. These minimum ratio requirements are the subject of continuous review.

5.3 A bank incorporated in the State, shall have initial capital in the form of paid up shares of not less than IR£5,000,000 or such other sum, being not less than IR£5,000,000 as the Bank may from time to time prescribe or in the case of a building society, have initial capital in the form of deferred shares of not less than IR£1,000,000.

5.4 In addition to the own funds requirements arising from Solvency Ratio Directive, the EU Directive on the Capital Adequacy of Investments Firms and Credit Institutions (93/6/EEC) specifies the application of capital adequacy requirements to the investment business of credit institutions. The Bank's implementation of this Directive is set out in Notice BSD S 2/95 dated 30 November 1995.

This Notice requires credit institutions to provide own funds, calculated on the basis specified in the Notice, in respect of position risk, underwriting risk, settlement and counterparty risk and large exposures for their trading book business and in respect of foreign exchange risk for all their business activities.

6 LIQUIDITY

6.1 Credit institutions should establish appropriate and prudent policies for the management of their liquidity. They should ensure, to the satisfaction of the Bank, that adequate internal systems exist to monitor and control maturity mismatches between their assets and liabilities.

6.2 Credit institutions should maintain a minimum ratio of liquid assets to total borrowings of twenty five per cent. or such other ratios or limits as the Bank may apply from time to time. Liquid assets are assets which can be realised at short notice without incurring significant loss. They mainly comprise notes and coin, interbank deposits, lending to the Central Bank (excluding deposits maintained in the Deposit Protection Account) and government securities.

6.3 In accordance with the provisions of the Regulations (Statutory Instrument Number 395 of 1992) implementing the EU Second Banking Co-ordination Directive and the provisions of the EEA Agreement, the Bank, in co-operation with the supervisory authorities in another EEA Member State, will continue to be responsible for the supervision of the liquidity of branches in the State of credit institutions incorporated in that other Member State.

(The Bank is currently reviewing its prudential liquidity requirements and it is expected that an amended requirement, combining a stock and maturity mismatch approach, will be adopted in due course.)

7 FUNDING

7.1 Credit institutions should establish appropriate policies relating to the funding of their activities. They should have a widely spread funding base. They may not owe more than 15 per cent. of total deposits (including interbank) to any one depositor or what is deemed by the Bank to be an associated group of depositors. The ten largest deposits may not exceed 50 per cent. of total deposits.

7.2 Funding from a parent or other group companies, which are themselves credit institutions, may be permitted to exceed the above proportions where the Bank is satisfied that, in general, the credit institution complies with the Bank's requirements to have a widely spread funding base.

8 LENDING

8.1 Each credit institution shall have in place appropriate policies relating to the management and control of lending. These shall include policies relating to credit assessment, credit review, risk management, the monitoring and control of large exposures and prudent provisioning for loan losses.

8.2 The Bank's requirements relating to the monitoring and control of large exposures are set out in a Notice published in the Bank's Quarterly Bulletin No. 1 of 1994, implementing the EU Directive on the Monitoring and Control of Large Exposures. This Notice was amended by a further Notice published in the Bank's Quarterly Bulletin No. 3 of 1995. This Notice requires that every credit institution shall have sound administrative and accounting procedures and adequate internal control mechanisms for the purpose of identifying and recording all large exposures and subsequent changes to them and also for the purpose of monitoring those exposures in the light of its own exposure policies.

8.3 Under the Notice, a credit institution incorporated in the State should not employ assets (both on and off balance sheet) amounting to more than 25 per cent. of its own funds with any one client or what is considered by the Bank to be a connected group of clients. The aggregate of large exposures - defined as an exposure equal to or in excess of 10 per cent. of the own funds of the credit institution - should not exceed 800 per cent. of own funds. A credit institution should notify the Bank of all large exposures on a quarterly basis.

8.4 In its implementation Notice, the Bank has largely adhered to the limits set out in the Directive. However, in certain instances, the Bank is applying more stringent criteria as follows:

(a) a credit institution's exposure to any one of its directors, including any exposures to any business in which the director has a major interest, may not exceed 2 per cent. of own funds; the aggregate of all such exposures may not exceed 10 per cent. of own funds;

(b) a credit institution's exposure to any one of its significant shareholders, including exposures to businesses in which the significant shareholder has a major interest, as defined, may not exceed 10 per cent. of own funds, unless such shareholders or businesses are also credit institutions; the aggregate of all such exposures may not exceed 30 per cent. of own funds; and

(c) a credit institution's exposure to a client or group of connected clients, other than a credit institution or financial institution, in which the credit institution has what is considered by the Bank to be a major interest may not exceed 10 per cent. of own funds; the aggregate of all such exposures may not exceed 30 per cent. of own funds.

(*For the purposes of this section, a major interest is defined as a holding by a person, either on his own or in concert with another person, of 10 per cent. or more of the shares or voting rights in an undertaking.*)

8.5 The large exposures of branches in the State of credit institutions incorporated outside the EEA will be monitored and assessed in relation to the own funds and exposures of the credit institution as a whole, as well as in relation to the balance sheet of the branch itself.

8.6 A credit institution, incorporated in the State, shall not have the risk assets amounting to more than 200 per cent. of own funds concentrated in any one sector of business or economic activity which is subject to a common predominant risk factor; where a common risk could be considered to apply to two or more separate sectors (as, for example, the property development and building sectors) not more than 250 per cent. of own funds shall be employed with such sectors in aggregate.

8.7 A credit institution shall not grant an advance, loan or other facility against the security of its own shares or the shares of any subsidiary, fellow subsidiary, or parent company unless such shares are quoted on a Stock Exchange.

9 ANNUAL ACCOUNTS OF CREDIT INSTITUTIONS

9.1 Licensed banks are required to draw up and publish their annual accounts in accordance with the provisions of Statutory Instrument No. 294 of 1992 (European Communities (Credit Institutions: Accounts) Regulations, 1992) which gives legal effect to EU Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and to EU Directive 89/117/EEC on the obligations of branches established in a Member State of financial institutions having their head offices outside the Member State.

9.2 Credit institutions shall forward to the Bank a copy of their annual accounts within three months of their financial year end. Each credit institution shall display, at all times, a copy of its most recent audited balance sheet in every branch or office in the State.

(Regulations extending the provisions of the EU Annual Accounts Directive to building societies will be implemented during 1996.)

10 EXTERNAL AUDITORS

10.1 Statutory provisions in relation to the appointment of and duties of auditors are set out in Sections 46 and 47 of the Central Bank Act, 1989, in Sections 83-90 of the Building Societies Act, 1989, and in Sections 36-38 of the Trustees Savings Bank Act, 1989.

10.2 The legislation referred to in paragraph 10.1 stipulates that external auditors of credit institutions are required to furnish information to the Bank in certain specified circumstances, for example, where, in the course of the audit, the auditor finds that: there are matters likely to affect the solvency of the institution; there are material deficiencies in the financial systems of control; or there are material inaccuracies or omissions in returns to the Bank. The auditor must also inform the Bank if he, or she, proposes to issue a qualified report. The auditor must also notify the Bank if he, or she, proposes to resign as auditor. The Bank may also seek specific information from the auditors in relation to the affairs of the credit institution.

THEME: R1

Effectiveness of the regulatory, supervisory and governmental regime structure

LINE OF INQUIRY: R1b

Effectiveness and appropriateness of the supervision policy and powers

R1b: Effectiveness and appropriateness of the supervision policy and powers

Information Summary (Section 33 AK)

Note: All references are aggregated

Categories of Documents summarised:	Crisis Resolution Options Final Draft
Time period covered:	Q4 2008
Document Name:	USB47-0010.pdf
Bates No.:	CB07438

The introduction to CBFSAI final report on the "*Crisis Resolution Options*" looks at whether the authorities should consider seeking to resolve liquidity or a solvency crisis and the systemic implications of not intervening. Factors that need to be looked at are the nature of a crisis and the direct fiscal costs for this intervention.

This report was broken down into three areas:

1. The nature of the Current Problem "liquidity or Solvency".
2. Resolutions options: Funding difficulties and capital adequacy.
3. Assessment: the appropriate form of intervention.

Regarding resolution options, it was noted that an option could be a Blanket Guarantee of Liabilities. This was reported to be the simplest option and would include senior and unsubordinated debt, but this option "*neglects the public interest argument of the taxpayer subsidising banks and the possibility of increased moral hazard arising from this*."

Another point under the resolution options was the option of nationalisation, this option was a possibility, "*however the threat of contagion for remaining banks also appears quite high*"

R1 – Effectiveness of the Regulatory, Supervisory and Governmental Regime Structure

R1b – Effectiveness and appropriateness of Supervisory Policy and Processes Information Summary (Section 33AK)

Note: All references are aggregated.

Document category	Time period
• **Minutes of Domestic Standing Group**	• **April 2008**

These minutes made reference to the suggestion that the Department of Finance was looking to prepare legislation to give the authorities powers to deal with banks in a crisis including consideration of the amendment of the Financial Regulator's powers to prevent payment of dividends..

CB06074-002

R1 – Effectiveness of the Regulatory, Supervisory and Governmental Regime Structure

R1b – Effectiveness and appropriateness of the supervision policy and powers

Information Summary (Section 33AK)

Note: All references are aggregated.

Document category	Time period
• Central Bank Commission Minutes	2013

Central Bank Commission: 2013

CB04429-005

The work of the Financial Stability Division (FSD) was presented. FSD's mandate was to examine the overall stability of the financial system. The Division's main priorities included a macro-financial assessment, the Balance Sheet Assessment (BSA) work, delivery of the national macro-prudential framework amongst others. There are challenges including input into BSA and ECB stress tests, development of risk assessment tools, resolution mechanisms, macro-prudential framework and macro-prudential tools.

ECB would likely impose more severe stress tests following the European 2010 exercise which presented scenarios which were too optimistic. It was asked that the Commission receive outlines of the work the Central Bank was doing to influence the parameters of the stress testing.

IMF Report on the Observance of Standards and Codes (ROSC) Review was discussed. ROSC was an assessment of a country's banking supervision regime against international standards measured against the 29 Basel Core Principles. It was anticipated that Ireland would be deemed materially non-compliant in four areas i.e. independence, accountability and resourcing; supervisory techniques and tools; transactions with related parties; and abuse of financial services.

R1 – Effectiveness of the Regulatory, Supervisory and Governmental Regime Structure

R1b – Effectiveness and appropriateness of the supervision policy and powers

Information Summary (Section 33AK)

Note: All references are aggregated.

Document category	Time period	Summary
• Irish Financial Services Regulatory Authority (IFSRA) Agendas	2003	• Agendas for IFSRA include a significant number of items relating to consumer matters but only one or two pertaining to prudential regulation.

THEME: R1

Effectiveness of the regulatory, supervisory and governmental regime structure

LINE OF INQUIRY: R1c

Appropriateness of the macro economic and prudential policy

Joint Committee of Inquiry into the Banking Crisis

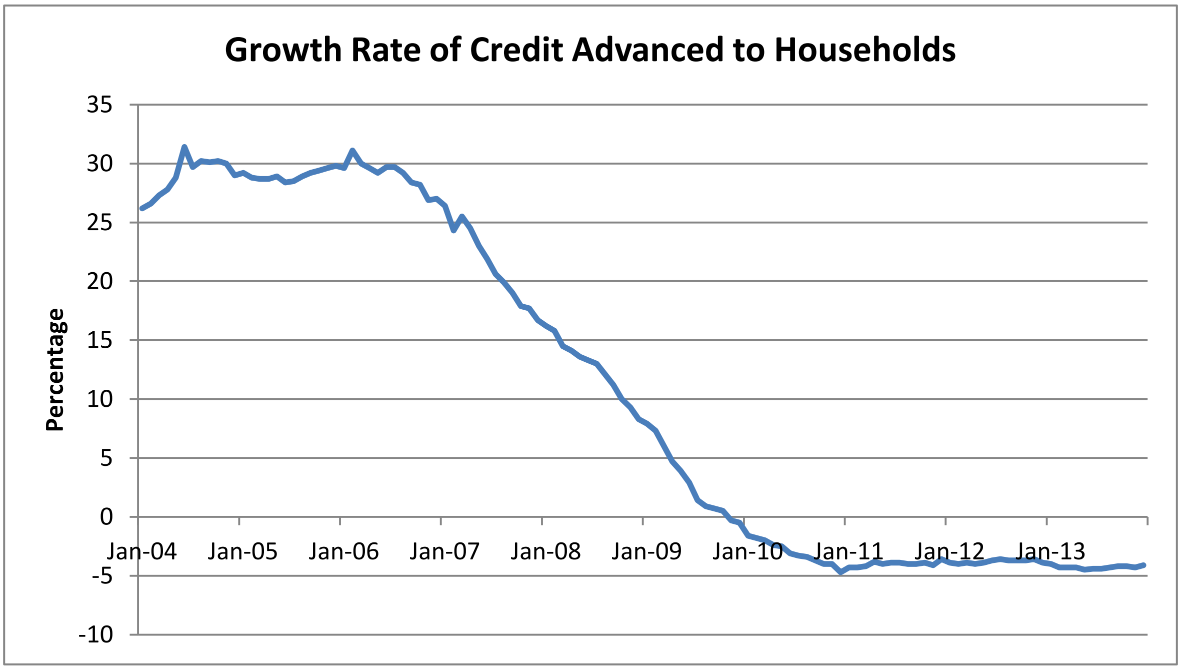
Data Repository: Selection of Graphs relevant to the Banking Crisis

prepared by

FTI Consulting Limited

Banking Data

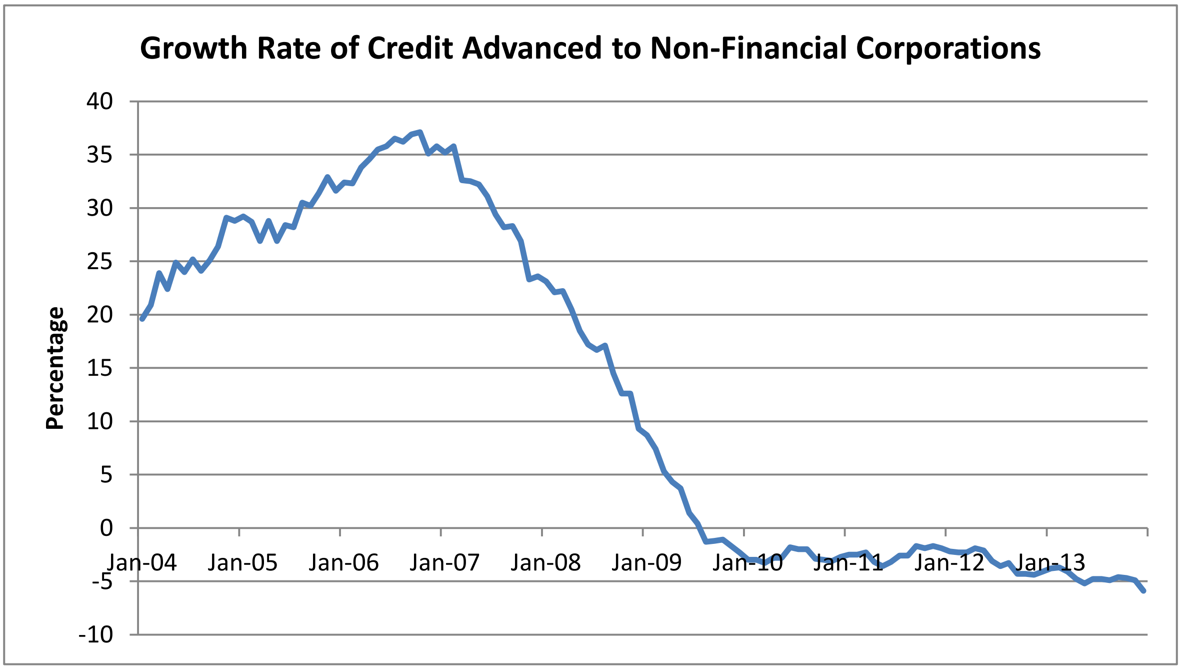
Figure 10: Growth Rate of Credit Advanced to Households by Covered Banks (2004 – 2013)



Source: Central Bank Data, Advisory Team analysis.

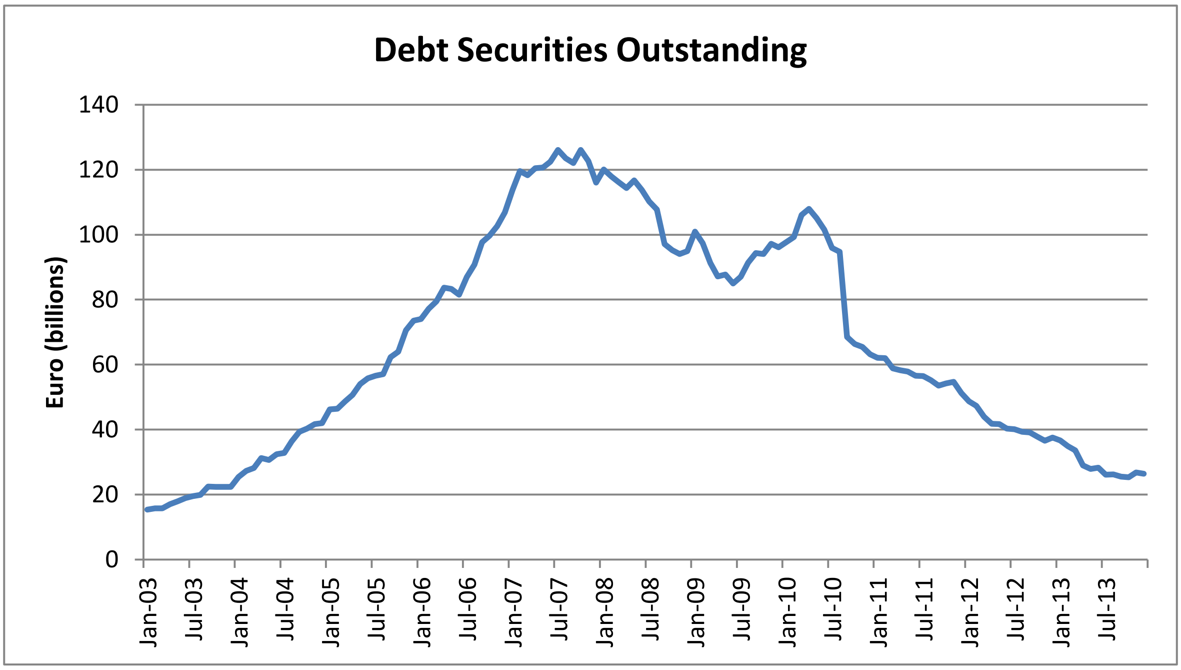
Note: Data not available prior to 2004.

Figure 11: Growth Rate of Credit Advanced to Non-Financial Corporations by Covered Banks (2004 – 2013)



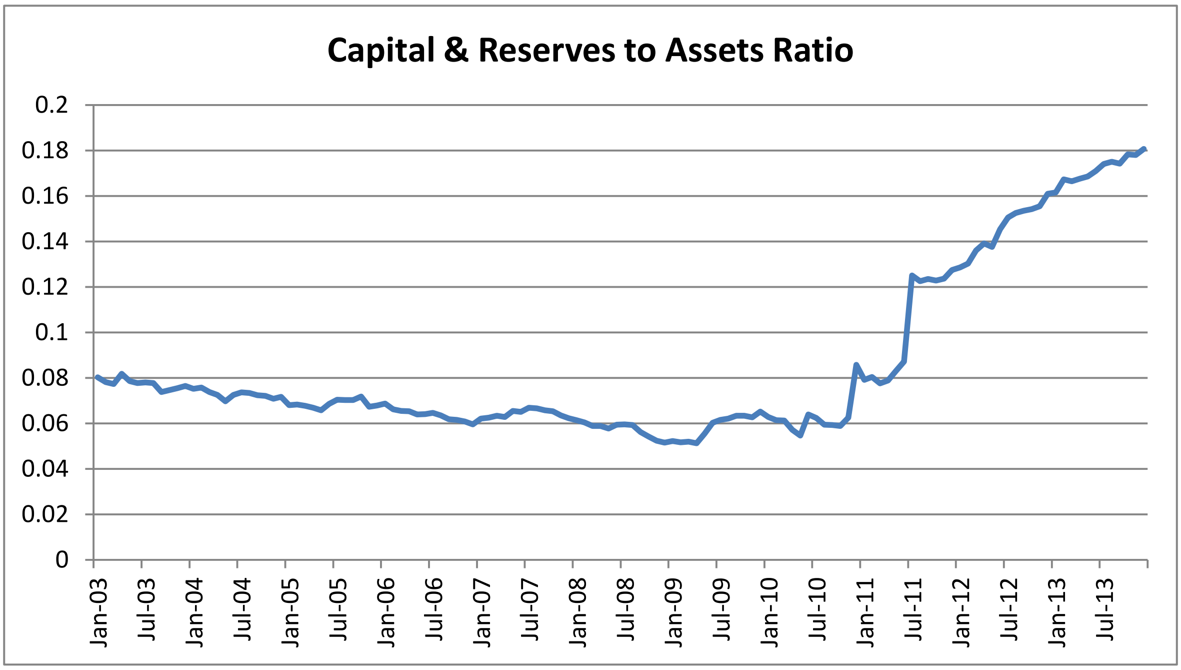
Source: Central Bank data, Advisory Team analysis.

Figure 14: Debt Securities Outstanding at Covered Banks (2004 – 2013)



Source: Central Bank data, Advisory Team analysis.

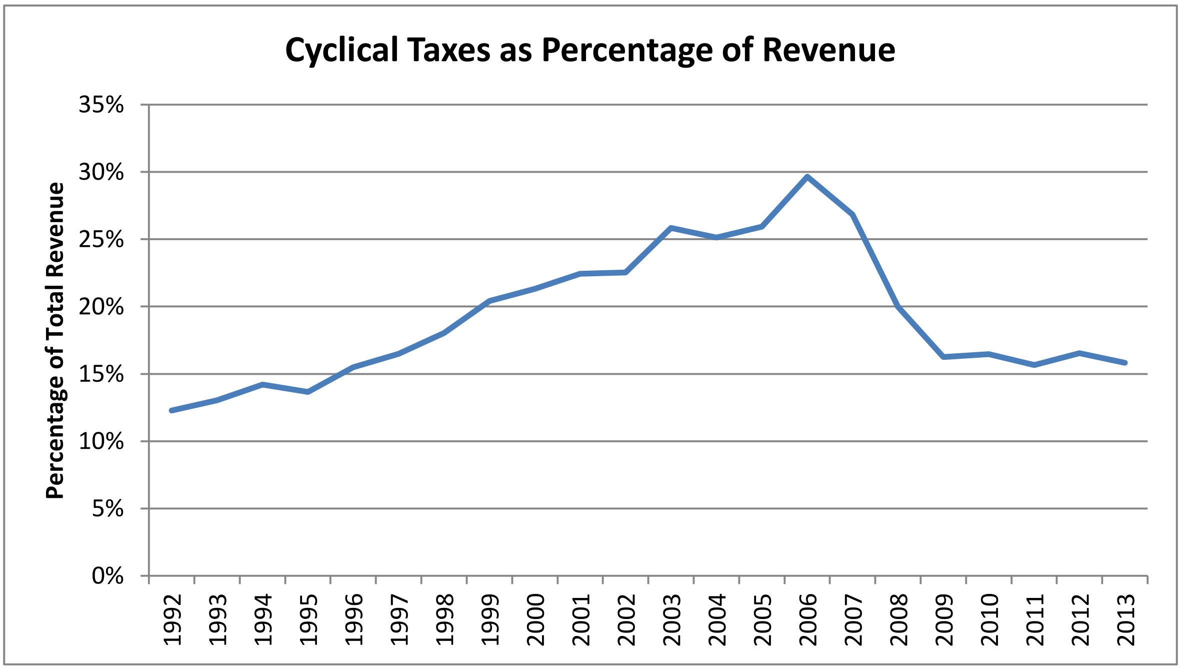
Figure 15: Ratio of Capital & Reserves to Assets at Covered Banks (2004 – 2013)



Source: Central Bank data, Advisory Team analysis.

Fiscal/Budgetary Policy

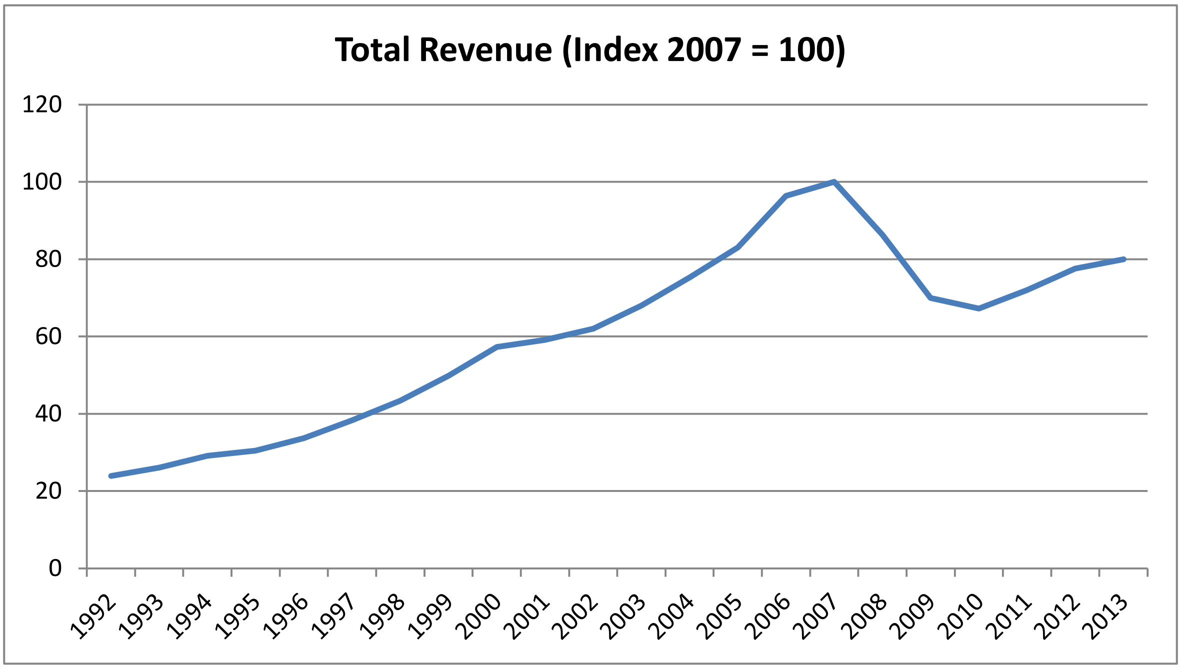
Figure 16: Cyclical Taxes as Percentage of Total Tax Revenue (1992 – 2013)



Source: Department of Finance data, Advisory Team analysis.

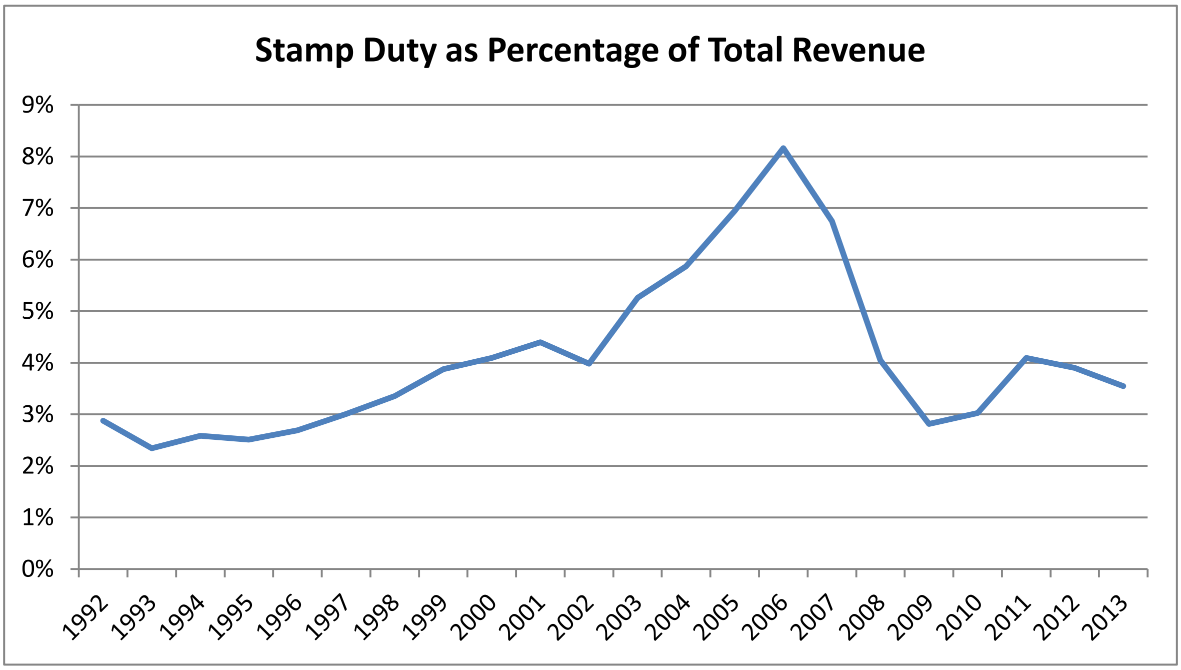
Note: Cyclical taxes are defined as Corporation Tax, Capital Gains Tax and Stamp Duty.

Figure 17: Nominal Total Tax Revenue (Index 2007 = 100) (1992 – 2013)



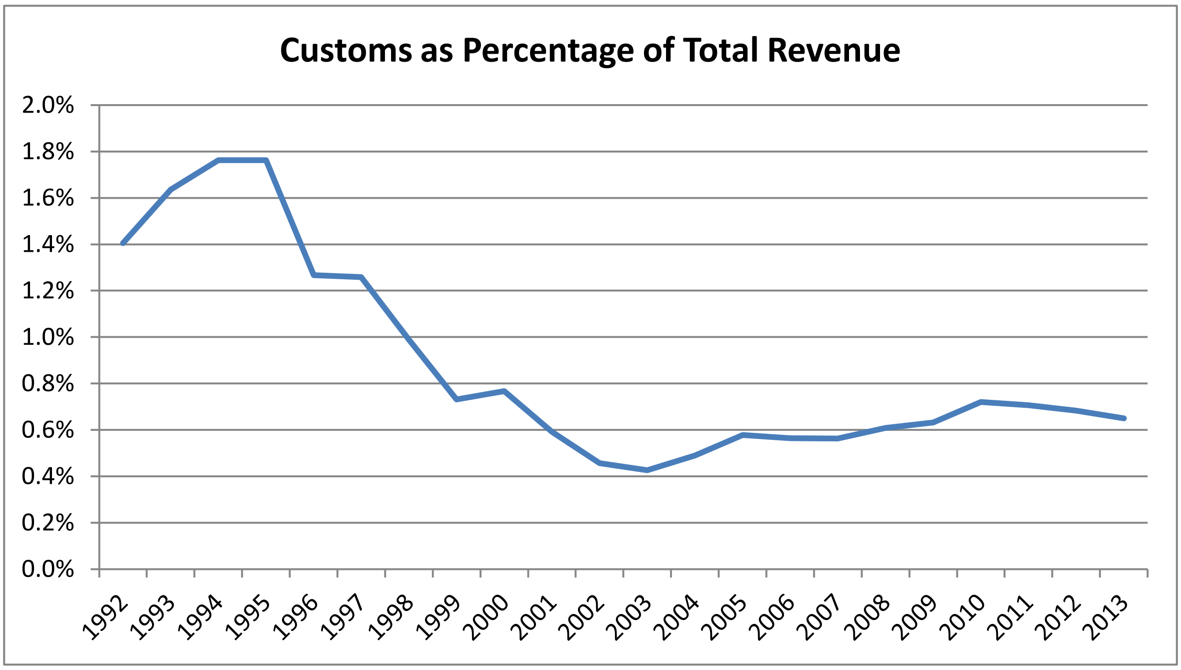
Source: Department of Finance data, Advisory Team analysis.

Figure 22: Stamp Duty as a Percentage of Total Revenue (1992 – 2013)



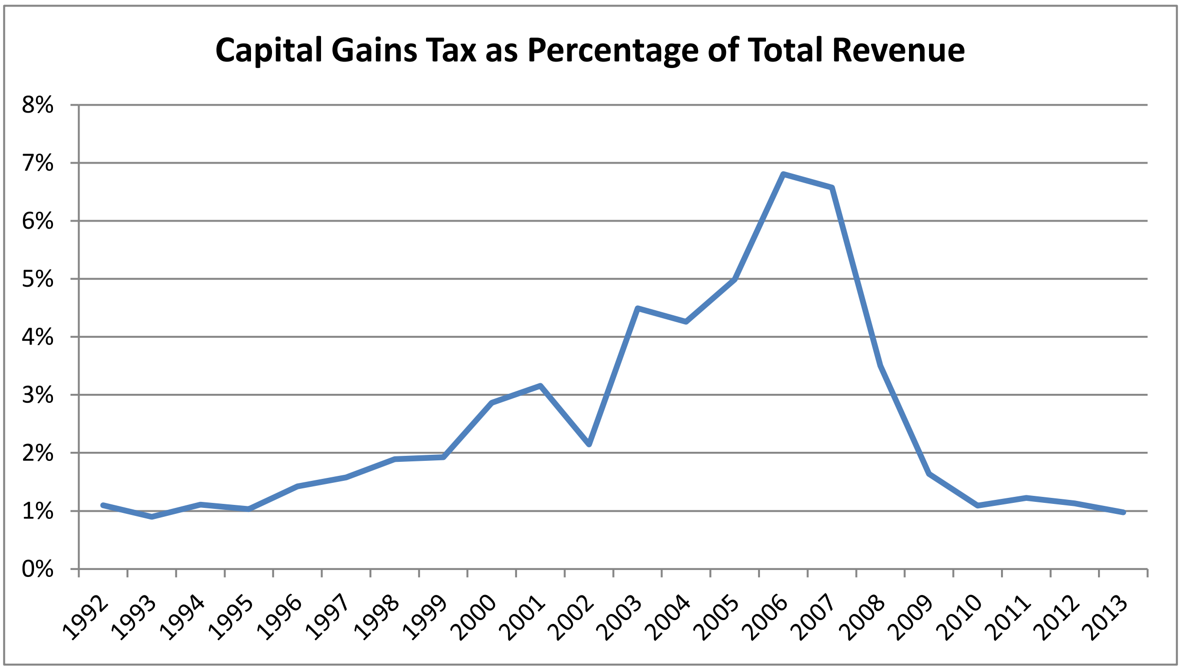
Source: Department of Finance data, Advisory Team analysis.

Figure 23: Customs Duty as a Percentage of Total Revenue (1992 – 2013)



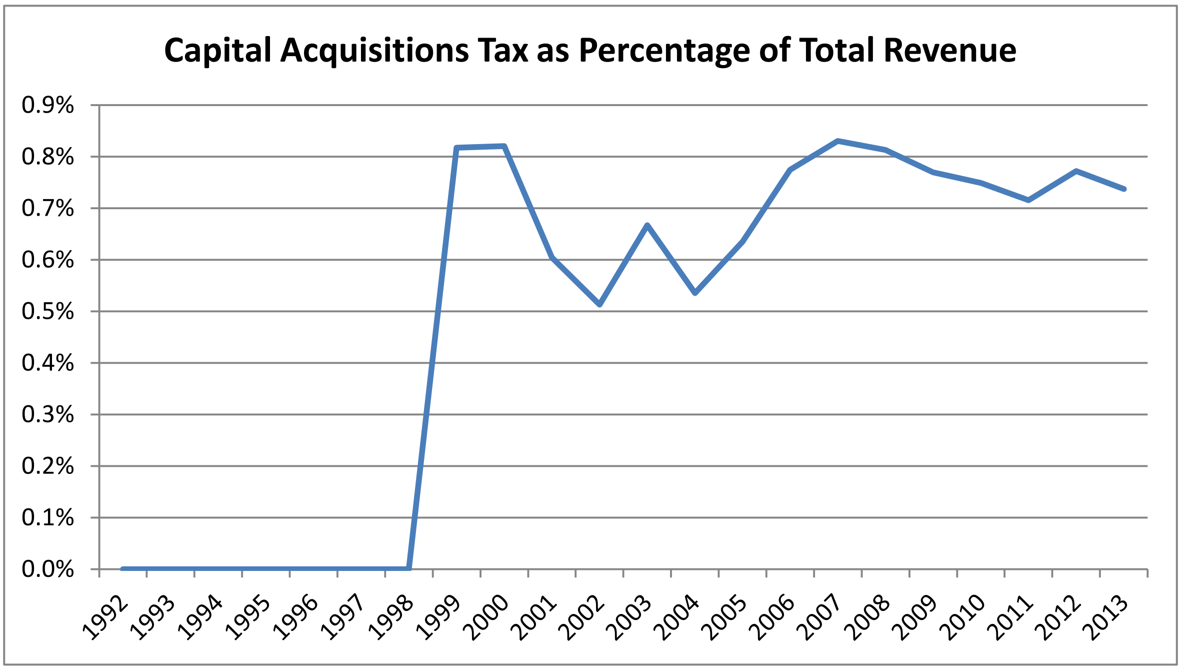
Source: Department of Finance data, Advisory Team analysis.

Figure 24: Capital Gains Tax as a Percentage of Total Revenue (1992 – 2013)



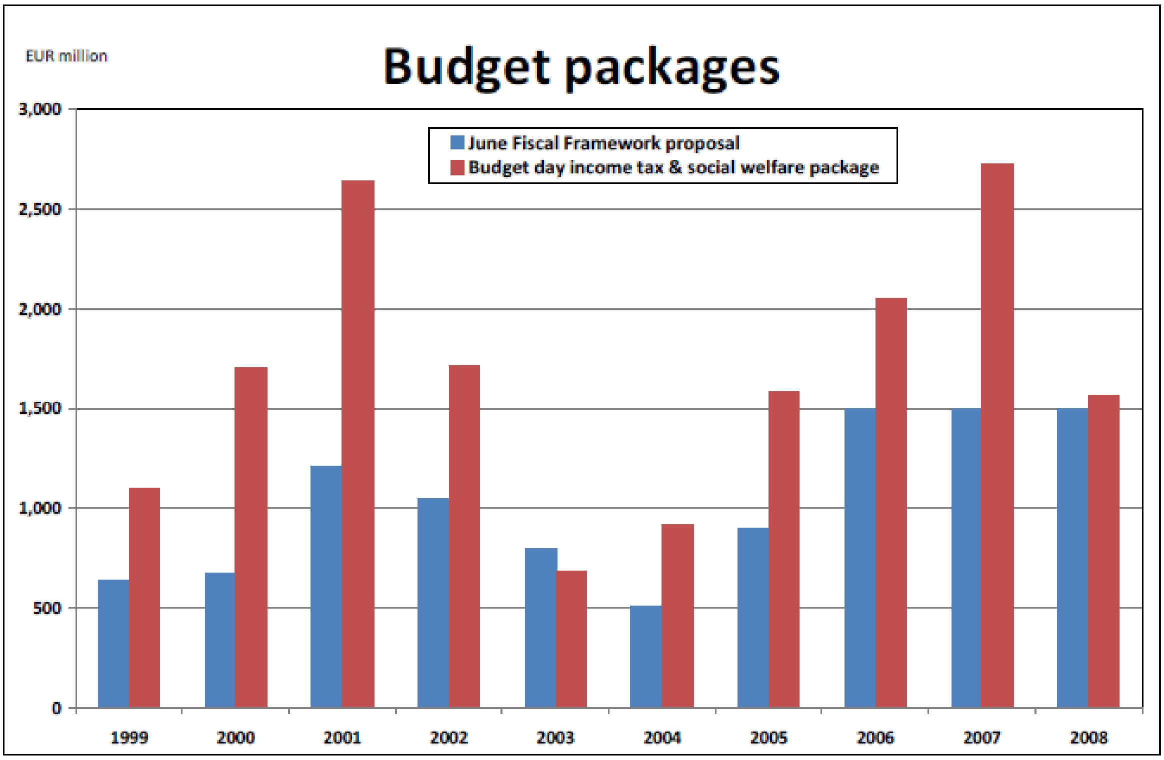
Source: Department of Finance data, Advisory Team analysis.

Figure 25: Capital Acquisitions Tax as a Percentage of Total Revenue (1992 – 2013)



Source: Department of Finance data, Advisory Team analysis..

Figure 26: Budget Packages



Source: Wright Report for Department of Finance.

adhering to time-bound deadlines for escalation, the FR allowed some important matters to drift. At the same time the appetite for legal challenge was limited which meant that in practice entities were given the benefit of the doubt; no penalties for breach of prudential regulations were ever imposed on a bank before 2008. If unsuccessful, test legal cases could have helped garner support for additional legislative powers.

- Overall financial stability policy (Chapter 6)

1.15 The major tool of overall financial stability policy was envisaged to be the Financial Stability Report (FSR). The language of successive FSRs was too reassuring throughout, even as late as November 2007, and did little to induce the banks – or the public and policy makers – to adjust their behaviour to avoid the threats that lay ahead. The FSR drafting overemphasised the central forecast whereas it is the downside scenarios and the condition of the weakest institutions that are the most relevant for a financial stability assessment. Admittedly, the views of outside bodies such as the IMF and OECD – especially in later years – were not sharply different and must have provided reassurance to any internal doubters. In particular, the relatively glowing 2006 update of the IMF's specialised Financial Sector Assessment Program (FSAP) mission – an exercise designed precisely to identify any weaknesses in prudential regulation and financial stability policy – would have been enough to set any doubts that may have existed at rest. The FSAP Report's misinterpretation – for whatever reasons – of the prevailing Irish situation **must be considered unfortunate**.

1.16 Although the FSRs included significant analytical material analysing the **underpinnings of the property boom**, the relatively sanguine conclusions tended to be reached on a selective reading of the evidence. This was particularly true in the case of the 2007 FSR when, despite internal evidence available to the contrary, the central conclusion regarding a ―soft landing" was not based on any quantitative calculations or analysis. This appears to have been a ―triumph of hope over reality". More generally, a rather defensive approach was adopted to external critics or contrarians. For years many observers had raised some concerns publicly or privately, albeit sometimes in coded form, about the sustainability of the property boom, which was indeed dramatic by international standards. For example, even though they appeared after most of the damage had already been done, the two 2007 articles by Morgan Kelly, while not backed up by in-depth quantitative research on the Irish situation, should nevertheless have raised more warning flags than they did and prompted a rethink of the reassuring message of the FSR published in November of that year.

1.17 Such quantification of risks as was attempted was carried out in the context of the stress test exercises reported annually in the FSRs. Although many caveats were noted, **too much confidence was placed in the reliability of the tests** which were overseen by desk-based analysts without sufficient engagement by hands-on regulators. Not being sufficiently close to practical banking, those relying on the stress tests may have had an unrealistic appreciation of what the bankers could and could not know. Thus, for the ―bottom up” tests, banks were asked to calculate possible loan losses in the event of a given (unfavourable) macroeconomic scenario. Apart from the fact that the scenario was insufficiently severe, the capacity of the banks to undertake the exercise differed greatly; indeed none of them had reliable models, tested and calibrated on Irish data, which could credibly predict loan losses under varying scenarios. Furthermore, the banks were naturally prone to over-optimism and even (later) denial – the stress tests conducted in the summer of 2008 still provide a reassuring picture. ―Top down” tests did not put the banks‘ positions under sufficient stress either. In any event, all took too much comfort from both sets of tests‘ relatively benign conclusions.

1.18 A **closer interaction between the staff involved in financial stability and regulatory staff** could have had the effect of alerting both sides to the limitations of the stress test methodology and reduced the sense of complacency. If regulators had realised how risky the macroeconomic picture was for the banks they might have concluded that forceful action was needed; conversely, if the analysts dealing with financial stability had had a fuller understanding of how dependent banks‘ solvency was on the property market holding up, they might have looked at the stress tests with a more sceptical eye. However, the inadequacy of the dialogue between economists and regulators was a long standing concern (and one which is mirrored in other parts of the world) that would have required a greater senior management effort to bridge the methodological divide present.

1.19 More generally, it may be that **the institutional separation of the Regulator from the rest of the organisation** (reviewed in Chapter 3) contributed to an insufficient appreciation of the micro-macro interlinkages involved in financial stability analysis. It could also have led to some perceived ambiguity as to which part of the house should take the lead in undertaking follow-up action. However, the division of labour was set out clearly in legislation – the Financial Regulator was responsible for micro-prudential supervision and the Governor for overall stability with the power to take micro-prudential steps if necessary. In practice, senior Financial Regulator staff were full members of the Financial Stability Committee that steered the stress test process and the FSR Report itself. Thus, whatever the other difficulties that may have arisen from the organisational structure, it cannot be held responsible for the failure of the CBFSAI to identify weaknesses sufficiently and take remedial measures as needed.[6,7]

- The failure to take sufficient macro-prudential corrective action (Chapter 7)

1.20 Effective financial stability policy in a potential bubble also required intrusive macro-prudential policy measures such as additional capital buffer requirements for risky property lending. Although some initiatives were taken, **deference and diffidence** on the part of the CBFSAI led to insufficient decisive action or even clear and pointed warnings. There was an unresolved anxiety that an aggressive stance would lead to (i) a loss of market share by Irish-controlled institutions and/or (ii) the triggering of a collapse in confidence, at first in the property market, and later for depositors. Thus, the belated and relatively modest tightening in 2006 of capital requirements for high loan-to-value (LTV) mortgages, designed mainly as a warning signal, was adopted only after prolonged and agonised debate.[8]

1.21 It is not clear how much merit the first concern ever had, inasmuch as almost all of the foreign-controlled banks operated through locally established subsidiaries which **would have been equally subject to restrictive regulatory measures**. In any event the legislation was straightforward – promotion of the Irish financial services sector was to be encouraged but subject explicitly to the CBFSAI's mandate to promote financial stability. Far too much weight was also given to the second consideration, especially in

[6] Issues of institutional rivalry may have contributed to inadequate communication between the two staffs on occasion. There clearly was some friction at board and senior management level between the FR and the Central Bank on matters relating to human resources and the quality and cost of services (particularly of IT resources) provided to the FR. In addition, while relations between the Governor and successive Chairs of the Authority were cordial, the Authority was always anxious to establish its operational independence from the Central Bank.

[7] An additional —structural" issue is whether the Authority gave too high a priority to consumer, rather than prudential issues. While there was a fairly widespread perception that this was indeed the case, there are no solid indications that in practice this impeded the Authority carrying out its prudential responsibilities.

[8] Alternative tough measures, such as banning (or disapproving of publicly) 100 per cent LTV mortgages, or setting and enforcing sectoral lending limits were not considered seriously as they were felt to be out of tune with the principles-based approach and with current international regulatory fashion.

the earlier period when decisive intervention could have made a major difference to the length and extent of the property boom. **Regulatory measures will inevitably have some disturbing effects on markets**; indeed this is their main purpose. The luxury of waiting until more clear-cut evidence becomes available must be set against the costs of inaction, especially when market participants are comforted and implicitly encouraged – or not sufficiently discouraged – to continue with risky borrowing and lending behaviour.

Section 3: Crisis Containment (Chapter 8)

1.22 The provision of the State Guarantee on 29 September 2008 greatly diminished the immediate liquidity pressures and represented the overarching context within which further containment actions were taken in subsequent months.[9] From late summer 2007, the CBFSAI had been in increasingly crisis mode as it sought to prepare for the consequences of a possible looming liquidity squeeze for some or all of the Irish-controlled banks. How well was this phase managed in terms of minimising the damage caused by the crisis which eventually crested with the unprecedented guarantee decision at end-September 2008? Partly with the benefit of hindsight, a number of elements are relevant to consider.

1.23 First, almost all of the efforts of the CBFSAI from August 2007 onwards were focussed on the important task of improving the contingent access of the banks to liquidity. However, as stressed earlier, if the authorities during this period had had better information about the underlying condition of the banks and a more alert appreciation of the scale of the macroeconomic imbalances present, a focus on building capital buffers could have **put the banks in a more robust position** entering the last weeks of September 2008.

1.24 While the final guarantee decision was taken under pressure of events, the meetings on the night of 29/30 September 2008 **were the culmination of an intensive series of interagency meetings** that had been taking place, and had greatly intensified since early

[9] These included the nationalisation of Anglo Irish Bank, the replacement of some directors and senior management of financial institutions and the injection of capital resources. Over the course of 2009 and into 2010, the focus shifted from containment to resolution with the enactment of legislation creating NAMA; the regulatory assessment of each bank‘s recapitalisation needs (PCAR); and further injections of capital funds, including into the two building societies in which the Government took controlling shares. This process provided a good indication of the overall net fiscal cost of the crisis. Much of this cost is attributable to Anglo Irish Bank, whose new management are in the process of completing a restructuring plan.

that month under the de facto leadership of the Department of Finance, also involving the NTMA and the CBFSAI (with the CBFSAI playing a less central role than might have been expected). Despite the relative absence of detailed written records, it is clear that the meetings during this period, which involved substantial legal work, made the authorities increasingly better prepared to act as the weeks unfolded.

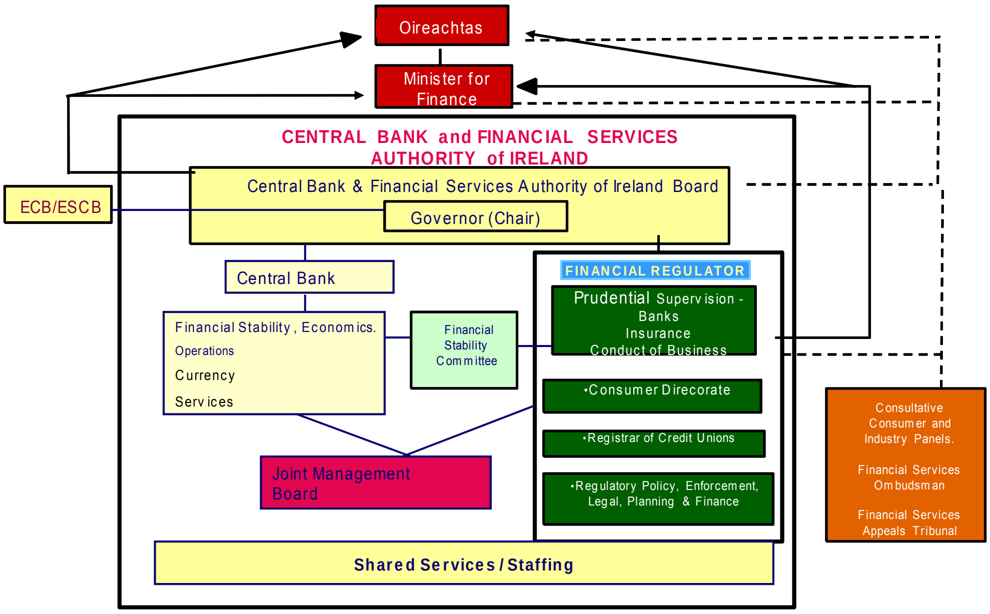
1.25 As regards **the substance of the guarantee itself,** it is hard to argue with the view that an extensive guarantee needed to be put in place, since all participants (rightly) felt that they faced the likely collapse of the Irish banking system within days in the absence of decisive immediate action. Given the hysterical state of global financial markets in those weeks, failure to avoid this outcome would have resulted in immediate and lasting damage to the economy and society. There would have been additional lost income and employment surely amounting, if it could be quantified, to tens of billions of euros. Nevertheless, the extent of the cover provided (including to outstanding long-term bonds) can – even without the benefit of hindsight – be criticised inasmuch as it complicated and narrowed the eventual resolution options for the failing institutions and increased the State‘s potential share of the losses.

1.26 While there was eventually a broad consensus, including among CBFSAI officials, that the guarantee scheme for all institutions was the best approach[10], the idea of **nationalising Anglo Irish Bank** (implying an associated change in management) as an accompanying measure was also on the table. As a contingency (and highly confidential) precautionary measure, legislation to nationalise a troubled bank and/or building society had been in preparation for some time.[11] It was felt by some that nationalising Anglo Irish Bank – which was facing by far the most serious liquidity crisis – would reduce the reputational damage that it was causing to the Irish banking system. This bank‘s business model was also thought by many to be irrecoverably broken; although few participants were even beginning to think it might have actual solvency issues. Among the arguments against an overnight nationalisation was the fear that it could present undue operational risks and that it might have a destabilising

[10] Other options mooted included extensive use of Emergency Lending Assistance (ELA) from the Central Bank and/or the creation and use of a domestic fund drawing in addition on resources from the NTMA. The possibility of temporary support from the two largest banks was also envisaged. None of these options could be expected to do more than buy a few days – say until the following weekend.

[11] This planning was first inspired by the experience of the UK Government in relation to the failure of Northern Rock one year earlier.

Box 3.1: Decision-Making Bodies of CBFSAI



The 2003 legislation produced quite a complex structure, as is conveyed by the above organisation chart from early 2009. However, the CBFSAI had just three main decision-making bodies:

- the Governor would be the decision-making body for European System of Central Banks (ESCB) related tasks – including financial stability issues;
- subject to the above provision, IFSRA, an autonomous but constituent part of the CBFSAI with its own Board (the Authority), Chairperson, Chief Executive and Consumer Director, would be responsible for licensing and prudential regulation of all financial service providers and for consumer protection across the sectors; and,
- the CBFSAI Board (chaired by the Governor) would be the decision-making body for remaining tasks, including the efficient and effective co-ordination of the constituent parts of the organisation as a whole and the exchange of information between them.

Section 3: Formal Structure

3.7 The division of responsibilities between the Governor, the CBFSAI and IFSRA was novel and contained the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis.[27] However, a number of provisions helped guard against any conflict.

[27] This observation was made by Honohan (2002) at the time in comments on the legislation when it was introduced (cf. http://tech.groups.yahoo.com/group/financial_stability/message/161)

- Allocation of supervision resources

5.7 BSD had to make choices as to how to assign responsibility for the 80 or so institutions within its remit, especially in view of the increasing need in the face of relatively static resources. BSD resources were concentrated on the domestic Irish institutions. For example, in 2005:

- a three person team was responsible for Bank of Ireland and Anglo Irish Bank;
- a two person team[76] was responsible for the AIB group and Irish Life and Permanent (IL&P);
- a three person team[77] was responsible for eight credit institutions and a branch, including INBS and EBS; and,
- a three person team was responsible for nine credit institutions and two branches, which included Ulster Bank.

To these resources need to be added those made available by a team of four persons that conducted prudential inspections across several institutions.[78]

5.8 In May 2005 the FR adopted a formal risk-based framework whereby ~~a~~ single cohesive approach across all sectors of activity is applied"[79]. The system evaluated risk using such factors as supervisory complexity, corporate governance, business and reputational risk and so on, based on regular statistical reports provided by credit institutions on their activities and financial condition.[80] The risk-based framework was used to draw up a schedule of on-site inspections. It concluded that a small number of rather large institutions should be inspected on-site once a year, with a one-every-two-years schedule for the next tier of institutions and the remainder to be inspected on a longer rotation depending on available resources.

5.9 It is generally felt now that the total number of supervisory staff allocated to the supervision of the 80-odd credit institutions was inadequate. To be sure, the regulatory approach being adopted was not an intrusive one, and as such need not call for a lot of resources.

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[76] It should have been three but there was a vacancy.
[77] It should have been four but there was a vacancy.
[78] Prior to 2005 these inspections were conducted by the team assigned to a particular credit institution, but from 2005 this function was performed by a separate team, but relying, of course, on the instructions of the team responsible for the day-to-day supervision of the credit institution.
[79] FR (2006g, p. 67).
[80] For details see *ibid*., p. 67. Successive reports of the C&AG (1999, 2007, 2009) have urged improvements in this methodology. Mazars (2009, p. 67) noted that the risk model was in place for the purposes of prudential supervision.

5.10 It should be noted that bank supervisors are required to carry out numerous detailed approval functions, for example, vetting proposed subordinate debt issues to ensure that they comply with the criteria to qualify them as capital instruments. This is an important prudential function, but it doesn‘t help identify ongoing risks in the operations of the banks.[81]

5.11 Indeed, a simple international comparison presented by the UK FSA in their 2006 Annual Report and reproduced by the C&AG in their 2007 report suggested that the resources devoted to regulation in Ireland may have been, if anything, above some larger EU countries albeit below some non-EU jurisdictions.[82,83] However, there are significant economies of scale involved in regulation, bearing in mind the considerable amount of policy development and regulatory design work that was under way, much of it related to introduction and application of the highly complex CRD procedure for determining the minimum required capital for a bank (this work is needed no matter how few banks there are). So a small economy will tend to have a disproportionately high regulatory cost, especially if the regulatory task includes (as it does in Ireland) a large financial services export business entailing the regulation of some 15,000 entities of all types.

5.12 Overall in 2009, the ratio of employment in the FR to employment in the financial intermediation sector in Ireland was compared to several other EU countries and Australia with the conclusion that, ―[O]verall, the Financial Regulator would appear to be broadly in line with the comparator countries in terms of resources at its disposal."[84]

5.13 The way in which resources were deployed may have led to an under-resourcing of the micro-prudential banking function. The FR was somewhat different from other financial regulators given its role in promoting the Irish financial services sector. Mazars (2009, p. 48) observes that the FR in Ireland devotes considerable resources to:

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[81] Another task is vetting banks‘ internal risk models with a view to having them approved for the purpose of calculating CRD minimum capital requirements. Such approval would entitle regulated firms to operate with less of a capital buffer and as such was prized by such firms.

[82] Thus, in 2005, the resource costs devoted to regulation (per € million of assets valuation) was €14 in Ireland compared with: France, €13; Germany, €7, and the UK, €10. This compares with much higher numbers for: Hong Kong, €26, Singapore, €28, and the US, €177. (Based on C&AG, 2007, Table 6.4, p. 65).

[83] In a subsequent study, that considers all financial service providers rather than just banks and building societies, for similar sized countries, Ireland is about average for the ratio of financial regulator employees to financial service sector employees. On another indicator – cost per billion of assets regulated as compared to the international average Ireland was below the average. The study used 16 peer regulators, but no data is revealed about individual regulators. For details see Mazars (2009, p. 45).

[84] EIU (2009, p. 86). Other comparative indicators were also used in coming to this conclusion.

- ―Meet and greet" activities for new or prospective regulated entities[85,86];
- Advice to accountants, legal firms and other professional advisors;
- Participation in external committees/groups; and,
- Responding to requests for information from third parties.

Mazars also draws attention in this context to ―the specific mandate of the Financial Regulator under High Level Goal 4 ‗We will facilitate innovation and competitiveness' which is not as apparent elsewhere", which was introduced in the Strategic Plan for 2007-2009 (FR, 2006b, p. 26). Qualitatively, therefore, there was a drain – impossible to quantify – in the direction of ancillary activities which was more marked than in other comparable institutions reflecting the broader mandate of the CB and FR.[87]

5.14 The financial crisis has made it clear, though, both in Ireland and elsewhere, that effective bank supervision simply cannot be performed with the thin staffing that was applied to frontline operations of the FR.[88]

Section 3: Supervision and Regulatory Processes and Procedures

5.15 As set forth in various Annual Reports the FR's approach to micro-prudential supervision had flow and stock elements.[89] The flow aspect involves the authorisation of new entrants. Under this process ―[O]nly those financial service providers and persons who can demonstrate that they will be in a position to meet our regulatory standards will receive authorisation to provide financial services."[90] This included, for example, the Fit and Proper Requirements discussed in Chapter 4.

[85] Although there were few new authorisations for credit institutions, there were substantial increases in other categories of regulated financial institutions. For example, the number of collective investment funds approved in 2004 was 525; in 2007, 1,082. For further details, see the FR Annual Reports.
[86] It appears that the meet and greet approach predates the creation of the FR.
[87] To the extent that prudential regulators in other countries had a more robust enforcement policy such as that described in Chapter 4 and had Directors' Compliance Statements and Governance Codes in place, they would have made more effective use of whatever resources were available. In other words, resources have to be seen as part of a wider set of parameters that are likely to determine a prudential regulator's performance. It is not clear that more resources combined with the moral suasion approach of the FR would necessarily have led to much more effective prudential supervision.
[88] In the post-financial crisis world, combined with the failure of prudential regulation in Ireland, there is an emerging consensus for more intrusive prudential regulation and a greater readiness to impose regulatory sanctions. Such a regulatory regime requires more resources than the system in Ireland during the period reviewed by this Report.
[89] See also C&AG (1999, 2007, 2009) reports on the CB and FR.
[90] FR (2005c, p. 57).

5.16 The stock element consisted of an “active monitoring process” of authorised entities aimed at ensuring that they “do not create unacceptable risks to the financial system or to the safety of deposits.”[91] The fact that the number of credit institutions remained fairly constant combined with the small number of new entrants, meant that most resources were devoted to ongoing supervision, although this included development work on the CRD and other legislative changes. Management resources within the department were also quite regularly diverted from day-to-day supervisory tasks to deal with policy development work and work related to the Committee of European Bank Supervisors (CEBS).

5.17 Problems – both governance and financial – were identified via several mechanisms:

- Returns from banks and building societies. These could be weekly, monthly, quarterly or annual returns where these refer to audited accounts. The higher the perceived risk the higher the frequency of returns. In 2005, there were 598 monthly returns for banks and building societies, 495 quarterly, 49 annual and 198 weekly.[92]
- On-site inspections/reviews sought to “assess whether financial service providers are in compliance with our ongoing supervisory standards and requirements.”[93] These on-site inspections were of four types: general in nature with respect to a bank or building society; specific in nature relating to a particular area in a given credit institution; themed inspections covering a particular issue – e.g., mortgage credit – across a sample of the credit institution sector; and unscheduled inspections of a particular institution. The number of on-site inspections increased from 8 in 2005 to 25 in 2008.
- Review meetings conducted with banks and building societies. These meetings which increased from 39 in 2005 to 113 in 2008, were of “a more general nature and cover broad compliance issues and any matters outstanding from the most recent inspection.” (FR, 2007a, p. 71)

5.18 Information also came to BSD via the annual audit report and management letters. The latter, which by law must be sent to the FR, are issued by the external auditors “when they identify issues giving rise to concerns about the effectiveness of internal controls or other governance issues” (C&AG, 2007, p. 40). In some instances the FR would ask the institution to commission (and pay for) an external audit on a particular issue.

[91] *Ibid,* p. 57.
[92] FR (2006g, Table 3.5, p. 66).
[93] FR (2005c, p. 64).

Section 4: Supervision and Regulation in Practice

5.19 Two aspects of supervision and regulation in practice are considered. First, what were the governance and prudential issues and problems revealed by the on-site inspections and other supervisory interventions. Second, given the FR's suite of regulatory tools in terms of sanctions and discretionary prudential action, what were the options selected by the FR.

- What were the governance and prudential issues?

5.20 Based on a reading of the inspection reports and the follow-up correspondence for a sample of inspections over the period a number of conclusions can be drawn:

- consistent with the underlying regulatory philosophy, most of the focus of the inspections was on procedural aspects, namely, compliance with governance rules and procedures; and,
- the inspections did qualitatively identify a wide range of risks including those related to concentrations of lending on property, and the difficulty of evaluating the long-term recoverability of property-related loans;

Irrespective of the relevant aspects of provisioning of loans, the potentially very large loan-losses that would threaten insolvency in several institutions were not foreseen in the supervision documentation even as far as late 2008. Even the detection of serious deficiencies in loan appraisal and approval procedures of the major banks did not seem to trigger alarm.

5.21 Supervisors also saw that although banks may have had good written internal lending policies, in some cases exceptions were very frequent. At one bank in the mid 2000s fully 35 per cent of development property credits approved represented exceptions to policy. Two-thirds of these exceeded an 80 per cent LTV ceiling – some exceeding 100 per cent LTV; six of this bank's top 20 exposures had LTV in excess of 80 per cent at that date.

5.22 Box 5.1 draws on the record of inspection reports on three credit institutions in the period 2005-07 and which focused on the theme of credit or commercial lending. It illustrates some of the types of issues that were identified as of High, Medium and Low priority. Read in retrospect, it seems that the inspectors were looking for patterns of management practice and operational performance that might have presented a risk to the institution, but were not attempting to form an impression of whether the reported accounts including, for example, the provisioning of loans, was sufficient. Overall, supervision was focused on procedural aspects of how the bankers did their job, and did not seek to second-guess the business models[94] of the banks, by, for example, requesting additional provisioning or capital buffers against increasingly risky loans.

Box 5.1: Credit Inspections of Selected Credit Institutions, 2005 to 2007

Credit or commercial lending-focused inspections of three large banks in 2005-07 throw light on the kinds of issues identified in relevant inspections and give a flavour of the interaction between inspectors and the banks being inspected. All three of the banks subsequently encountered difficulties.

An inspection in May-June 2007 on Commercial Property Lending at Bank A found that exceptions to the credit policy accounted for 28 per cent of approved credits. Nevertheless the inspectors reported no High Priority findings (they did, however, report 15 Medium Priority findings). Responding to inspectors' questions about exposure to development property in light of the downturn in Irish property market, Bank A management remarked: ―The number of customers that this bank backs for unzoned land is very small and they are very high Net Worth Individuals, e.g., [Messrs X and Y] who have years of development experience. [Bank A] have full recourse to the borrowers." Unfortunately, concentration risk ―was not reviewed as part of this inspection" – though this would, in a sense, prove to be the Achilles Heel of the banking system's loan portfolio. Still, discussing the rapid growth of credit, the inspectors rightly noted that ―while such growth has not had an adverse effect on the overall credit quality of the loan book, as evidenced by the impaired element of the loan book as at March 2007 which stood at 0.49 per cent (June 2006 0.56 per cent), the robustness of the loan book may not become evident until such time as there is an economic downturn." This regulatory awareness that current impairment percentages were not a reliable indication of loan book quality does not always seem to have translated, though, into the necessary alertness to the need for precautionary action at the top of the organisation.

Not all inspections led to agreed conclusions. Bank B management rejected the three High Priority findings which were reported in the Commercial Property Lending inspection of April-May 2006. These related to: some exceptions to the credit policy just being noted on file and not sufficiently reported up the line to more senior decision makers; the formal credit policy not being sufficiently prescriptive; and limitations on the ability of the bank's management information system to report certain categories of summary information such as the total number of interest-only loans in effect. The management sought to refute each point at the concluding meeting of the inspection.

An inspection of credit risk management at Bank C took place in July 2005 (following concerns expressed in a previous inspection in November 2004). It made four High Priority findings relating to: (i) the lack of an overall defined credit policy; (ii) the large and imprecise risk appetite; (iii) reliance on implicit indirect guarantees for public sector entities or utilities; and (iv) insufficient Board oversight (no follow up on Board requests for presentations). There were also 13 Medium Priority findings, such as: the lack of a provisioning policy; no procedures for identifying and dealing with problem credits; the credit committee being pro-forma (approvals mainly happen between the weekly meetings and the chair had attended only 5 of 26 meetings); lack of independence of the credit risk unit review; and unclear credit appraisal/approval procedures. To a degree, this report would seem to show the principles-based approach at its best, identifying inadequate structures and procedures with some degree of forensic precision.

Source: FR files

[94] These models can be characterised as: relying to a considerable extent on wholesale funding; a heavy emphasis on the property related sectors; and a reliance on a small number of large clients.

R1 – Effectiveness of the Regulatory, Supervisory and Governmental Regime Structure

R1c – Appropriateness of the macro economic and prudential policy

Information Summary (Section 33AK)

Note: All references are aggregated.

Document category	Time period	Summary
• Irish Financial Services Regulatory Authority (IFSRA) Agendas	2003	• Agendas for IFSRA include a significant number of items relating to consumer matters but only one or two pertaining to prudential regulation.

R1 – Effectiveness of the Regulatory, Supervisory and Governmental Regime Structure

R1c – Appropriateness of the macro economic and prudential policy

Information Summary (Section 33AK)

Note: All references are aggregated

Document category	Time period
• Irish Financial Services Regulatory Authority (IFSRA) Agendas	Late September 2003

A number of commentators have suggested that consumer matters may have "crowded out" prudential matters at IFSRA in the period 2003 to 2008.

Agenda items from these meetings consist almost of consumer issues.

CB Batch 6 USB2A-0411.PDF Bates No. CB07007-001, CB07031

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