



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Perspectives on the Evolution of Retail Banking in Ireland

Central Bank Response to the Retail Banking Review
Public Consultation

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Context

The Central Bank's mission is to serve the public interest by maintaining monetary and financial stability while ensuring that the financial system operates in the best interests of consumers and the wider economy.

We welcome the Government's Retail Banking Review, coming as it does at a time of significant change within the banking sector.

The Central Bank's five year strategy recognises the emerging context we are working in. Our strategy's four connected themes (future-focused, open & engaged, transforming, and safeguarding) represent a renewal and repositioning to ensure that our direction and ambitions are responsive and forward looking. Our future-focused approach is critical to enabling us to better understand, anticipate and adapt in the context of the far-reaching changes that are taking place.

While bank financial resilience has been enhanced, reflecting the lessons of the past, and the journey to addressing conduct and culture issues continues, retail banking faces a range of challenges. Profitability is constrained by subdued demand for credit, by high operating cost metrics and by reduced returns in a low interest rate environment.

Overseas parented retail banks have taken the strategic decision to exit the market. Ireland has gone from a position where the retail banking sector was disproportionate to the needs of the economy, to a position where consolidation has led to growing concerns regarding market concentration and competition.

The digitalisation of banking and payment services through technology-led change is transforming the sector and the consumer experience. As the number of retail banks has declined, a range of new market entrants and new business models, and a shift to mobile (app-based) and online delivery by incumbents, has been driving a fundamental transition within the wider banking ecosystem.

Getting the transition right will be key to ensuring that the banking system effectively serves the needs of all consumers and the economy into the future. Access to basic services raises significant social policy challenges that need to be considered collectively by policy makers and wider stakeholders as a matter of priority.

Innovation brings key benefits but also brings risks which must be managed and mitigated. This is critical to safeguarding the stability of the broader system and

protecting consumers and their savings, and it represents a central concern for the Central Bank.

The resilience of the banking system during the Covid-19 pandemic and its success in continuing to provide credit to consumers and the wider economy, has been an important positive milestone. However, the journey towards the full restoration of trust and confidence in the sector continues, and this provides a key context to the Retail Banking Review.

1. Transitioning Banking Ecosystem

Summary

- We are in a period of transformational change and transition in retail banking.
 - Technology and innovation can deliver benefits to consumers and the economy.
 - Risks to the banking system and to consumers must be managed and mitigated.
 - Achieving preferred outcomes must take account of this changing market context.
 - A level playing field is important but involves tackling difficult social policy issues.
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Shape of the Retail Banking Landscape

The domestic retail banks are at the centre of the Irish retail financial services landscape, with full service business models offering a broad range of deposit, credit and payment services to consumers and businesses. Within that landscape other traditional players include An Post and credit unions, who both have extensive branch footprints nationwide. While the retail banks remain the dominant providers of banking services, the banking ecosystem is in transition, driven by technology-led change and the emergence of new, innovative competitors.

While the focus of this paper is on domestic retail banking, it is important to recognise that some of the retail banks also have extensive client bases outside Ireland.

Domestic Retail Banking

At the end of 2021, the retail banks collectively held €270 billion in deposits for Irish households and businesses and provided loans totalling €152 billion¹. With a market share of c.80 per cent of the outstanding stock of mortgages², the retail banks collectively have over 820,000 mortgages in place with homeowners.

The balance sheets of the retail banks have evolved significantly in recent years - with the average loan-to-deposit ratio reducing from 102 per cent in 2016 to 78 per cent in 2020, significantly lower than the EU bank average of 107 per cent in December 2020. Ongoing sales of non-performing loan portfolios are contributing to this decline.

¹ <https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-balance-sheets/bank-balance-sheets-data>

² Goodbody Stockbrokers Analysis

The retail banks are central to the functioning of the Irish payments system, processing c.5 million transactions worth €3.7 billion every day for consumers and businesses.³

The combination of the subdued lending growth opportunities and reduced returns in a low interest rate environment, has negatively impacted Irish retail banks' profitability. This is compounded by traditionally high operating costs. Compared to EU peers, the retail banks have higher cost-to-income ratios (which averaged 76.3 per cent in 2021). They are also more reliant than their peers on loan interest income in terms of their overall profitability – an indication of relatively narrow business models focused domestically on mortgage lending.⁴

An Post

An Post's branch network is extensive with 944 active post offices, of which 45 are run directly by An Post and 899 run as franchises by postmasters. An Post makes an important economic and social contribution at community level, serving consumers and small businesses with a range of vital services including financial and banking services. Every week, An Post interacts with c.1.3 million customers and distributes social welfare including through cash payments⁵. It also operates lodgement and withdrawal of cash services on behalf of banks.

Credit Unions

There are over 200 credit unions in Ireland providing financial services to 3.5 million consumers and small businesses, through a range of savings, lending and payment products and services. At 31 March 2022, the sector had total assets of €20.0 billion and total loans outstanding of €5.3 billion.

Evolution of Retail Banking and Financial Services

Across Europe and in Ireland the range and nature of retail banking (and payment) services and the manner in which they are provided to consumers, is undergoing significant change. Key changes include:

- A rapid evolution in the way in which traditional banking services are being provided to consumers, including through mobile (app-based) and online delivery channels.
- Transformation in the electronic payments area, including the emergence of, and consumer demand for, instant payments.

³ BPFJ Payments Monitor.

⁴ In 2020, net interest income for the Irish retail banks represented c.80% of recurring operating income (versus c.54% for the EU banking sector), reflecting a high reliance on lending for income generation.

⁵ Source: <http://communityandpostoffice.ie/wp-content/uploads/2020/09/Irish-Post-Office-Network-Review-FINAL.pdf>

- New challenger banks emerging who are targeting the more attractive aspects of traditional financial service provision.
- The development of new business models and product categories, driven by the advent of open banking or new cloud-based and blockchain-based technologies.
- A range of structural changes taking place within retail banking arising from sector consolidation through M&A activity, Brexit impacts, branch closures, withdrawal of cash and other services in-branch, the sale of off-site ATMs and third party outsourcing (for instance cash distribution).
- The ever-increasing role of data and data-analytics in financial services provision.
- The pivot to a net zero carbon economy where banking has an important role to play in funding climate transition.

The speed and scale of change is significantly impacting on the market for banking services, presenting both opportunities and risks. While the traditional banking model continues to dominate, it faces challenges from changing consumer expectations and the emergence of new market entrants.

The ability of incumbents to rapidly develop solutions based on changing consumer needs depends upon the transformation of their legacy IT and wider infrastructure. In response to threats they are facing and to tackle high cost income metrics, the incumbents are investing heavily in their digital transformation – aimed at both enhancing their customer propositions and delivering cost efficiency. Simultaneously we have seen the closure of branches and ongoing exiting from more cost intensive activities such as cash services (see [Section 6: Access to Basic Services](#)).

New Entrants

In addition to the traditional participants in Irish retail banking, we now see two other broad categories of firms competing in the banking arena.⁶

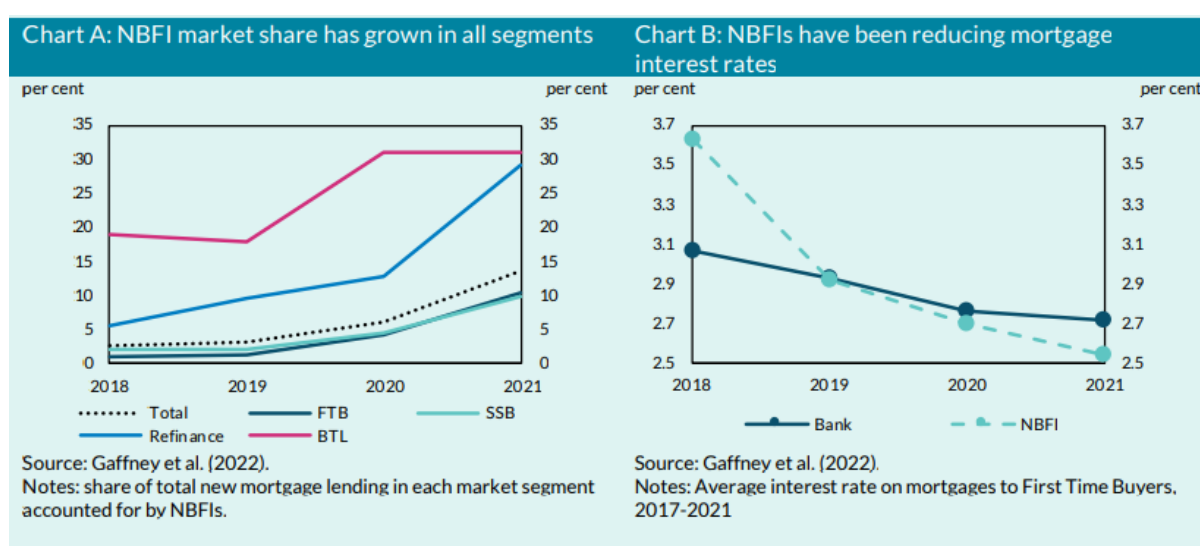
- Challenger banks: are digital-only offerings with relatively lower cost bases operating without the constraints of legacy infrastructure. Their business models seek to leverage the benefits of mobile and cloud technologies, with enhanced customer propositions offering ease of access and delivery of services, and an ability to adapt to changing consumer demand. This category includes new firms with lower cost models who compete with incumbents on price in key products (e.g. mortgages).
- Other new business models: new firms who leverage data arising from open banking to offer new services (i.e. personal financial management and data aggregation).

⁶ <https://www.centralbank.ie/news/article/speech-innovation-in-financial-services-ed-sibley-29-november-2019>

Non-Bank Lending - Mortgages

In line with developments in the global economy, non-bank financial intermediaries (NBFIs) have been playing an increasingly important role in the financing of domestic households and businesses in Ireland in recent years.

NBFIs have increased their share of total new mortgage lending from 3 per cent in 2018 to 13 per cent for 2021 (see Chart A below). NBFIs are responsible for almost one third of new lending in the refinancing and buy-to-let segments of the market. Non-banks have been reducing mortgage interest rates more rapidly than banks since 2018, and by 2021, they were offering a lower average rate to first time buyers (FTBs) than retail banks (see Chart B below) – albeit the changing interest rate cycle may reverse this trend with higher non-bank mortgage rates given their market-based funding.



Non-Bank Lending - SME

Non-banks account for a c.37 per cent share of total new SME lending. Non-bank lenders provided €6 billion in total new lending to Irish SMEs between 2019 and 2021. Of the €22 billion in SME loans outstanding in 2021, €4 billion was from non-bank lenders compared to €18 billion from banks. Real estate lending represents the largest proportion of non-bank SME lending (which averaged 43 per cent in 2021).

Credit unions had €135 million outstanding in SME loans as at 31 March 2022. It is challenging for individual credit unions to compete in scale in this area and as a sector they are currently only utilising 6 per cent of total available lending capacity for SMEs.

Payment Firms

Payment Institutions and E-Money Institutions (PIEMIs) have grown strongly in recent years. Payment institutions comprise merchant acquirers, payment account operators, money remitters and credit card issuers. E-money institutions comprise gift card issuers, e-wallet providers, prepaid card issuers and virtual card issuers.

Between Q4 2019 and Q2 2021, the number of authorised PIEMI firms increased by c. 45 per cent⁷, while the volume and value of transactions they undertook increased by c. 47 per cent and 53 per cent respectively. The PIEMI sector comprises c.40 firms which operate with end-to-end business models, and they have attracted significant customer bases largely based in other countries. In 2021, the total value of customer transactions across the sector was €370 billion. At year-end 2021, user funds totalled €6.0 billion.

As highlighted previously⁸, it is important that technology-driven firms recognise they need appropriate governance and risk management arrangements and demonstrate appropriate cultures, so that they can sustainably deliver for their customers and maintain trust in the financial system.

Transitioning Banking Ecosystem

We are seeing a banking ecosystem that is in transition. A transformational shift is taking place away from a market almost fully served by traditional participants (banks, credit unions and An Post), to one being served by a combination of full service banks and other traditional participants, partial service providers and new value chain disrupters.

While many of the new entrants are only partial service providers for now, in time it can be expected that at least some will expand their product and service range as they gain more customers – for instance moving from payment services to current account provision, or from mortgage provision to broader savings, loans and payment services.

The future retail banking landscape will likely see new entrants and new business models disrupting the entire value chain of traditional financial services, with disintermediation a key feature. New entrants to date have tended to be smaller but with scalable propositions. Going forward, it is anticipated that large scale technology firms (Bigtech) will also enter the retail financial services arena - where their size, resources and capabilities will enable them to target more profitable business lines.

While the transition of the ecosystem is challenging and disruptive, the new digital era presents real opportunities – for the economy and consumers, but also for the traditional providers to become more efficient in their operational processes and to enhance their cost income metrics. Opportunities also present in partnering with innovators and fintechs, to enable a more competitive proposition to meet consumers' demands for digital services, in order to grow revenues.

⁷ The Central Bank has seen the number of such authorised firms grow from low single digits to over 40 in four years, with a significant number of further applicants currently in the approvals process.

⁸ <https://www.centralbank.ie/news/article/speech-innovation-in-financial-services-ed-sibley-29-november-2019>

Ongoing retail financial services changes can provide clear benefits for firms, consumers and the economy. Ultimately new market entrants and new delivery channels can enhance market competition and provide greater availability and choice and value for money for consumers, and can therefore help enable effective functioning within the banking ecosystem.

However, the transition also poses risks to effective market functioning. While most consumers will benefit from ongoing changes, others face a risk of not having access to basic banking services. It will be important to ensure that important societal preferences are clearly identified - for instance ensuring continued access to cash services for all those who rely on it - and that the transition is managed in such a way that such preferences are not lost.

How the costs of such societal preferences should be allocated is an important question to be considered. For firms, representative bodies, Government, regulators and other relevant stakeholders - we all have roles and responsibilities in shaping the future banking ecosystem. A broader social policy discussion is needed, as a matter of priority, on ensuring all consumers' financial service needs are met into the future, especially those at risk of not having access to basic services (see [Section 6: Access to Basic Services](#)).

For our part, the Central Bank is committed to fulfilling our role in the orderly and proper functioning of the financial markets, one where good quality competition provides consumers with appropriate levels of availability and choice and value for money, provided by well-run, sustainable and resilient firms. Our objective is to create the regulatory context in which the potential benefits of innovation for consumers, businesses and society can be realised, while applicable regulatory standards are met by firms, and risks are effectively managed and mitigated, in order to protect consumers and their funds and the broader economy.

Effective Functioning Market

The Government's Retail Banking Review provides an important opportunity to consider the factors needed to support a successful banking ecosystem transition to deliver an effective functioning market.

With a decline in the number of traditional providers and an increasing number of new entrants, what is the right mix in terms of the number and type of banking services providers to underpin effective market functioning and competition? Identifying the right mix of market participants (traditional full service firms, partial service providers and new value chain disrupters) to achieve effective market functioning, is a complex issue which evolves over time and is dependent upon multiple factors.

Concentration concerns can arise at a consumer level in terms of access and choice to the range of products and services they need, as well as the number and mix of firms. Concentration considerations can also arise in terms of the levels of diversification in firms' business models and asset exposures.

To serve the needs of consumers and the wider economy on a basis where there is access and choice and value for money, we see an effective functioning banking ecosystem as having:

- A high quality regulatory framework which is aligned with the better functioning of the financial system that supports consumers and the economy. In regulating financial service providers including banking service providers in that context, the following outcomes are critical to us:
 - The stability of the financial system, so that it continues to serve the needs of businesses and households both in good times and in bad.
 - High levels of trust and confidence in the financial system such that:
 - inappropriate losses are not incurred by users of financial services.
 - customers are treated fairly and consumer and investor interests are protected.
 - the system is not abused for money laundering or terrorist financing purposes.
 - the system is governed and managed by individuals who behave in a manner consistent with our standards of fitness and probity.
 - The orderly and proper functioning of financial markets.
- A mix of sustainable, resilient and well run firms, offering appropriate levels of availability and choice and value for money to consumers by serving their needs through a range of products and services, where there is:
 - Innovation, coming from both traditional providers and new market entrants, in the design and development of new products and services to meet consumers' evolving needs.
 - Ease of switching for consumers both between providers and between products from the same provider, on a basis that delivers on their needs and offers value for money.
 - A level playing field between different firms, where the costs associated with society's preferences are appropriately and fairly distributed.
- A flow of firms entering and exiting the market on a well-managed basis to support its effective functioning with:

- On entry - new market entrants meeting applicable regulatory standards in line with EU standards and norms under a robust, risk-based authorisation process designed to protect consumers and wider system stability, and where early firm engagement enables an effective and efficient regulatory approval process.
- On exit – where firms who fail, do so in an orderly manner, without recourse to taxpayers or broader spill over impacts, enabled by appropriate resolution mechanisms, tools and safety nets in place to protect consumers and economy.
- Firms, acting in their customers’ best interests, display:
 - Appropriate customer-centric cultures, exhibited from the top to the bottom of their organisations, and are visible throughout the design and delivery of their products and services and in the treatment of customers (including in the handling of complaints).
 - High standards of customer service including in the handling of material change events and when consumers switch between both products and product providers, where the consumer is supported throughout the process.

Five Factors for Successful Transition

Reflecting a future focus on an effectively functioning market, our response to the Retail Banking Review consultation in this paper is structured around five important factors which we believe are key to delivering a successful ecosystem transition.

Those five factors are:

- **Regulatory Approach;**
- **Revising the Retail Conduct Framework;**
- **Competition;**
- **Innovation; and**
- **Access to Basic Services.**

2. Regulatory Approach

Summary

- Financial regulation aims to ensure that the financial system delivers on public interest outcomes.
 - Resilience of the banking system has been enhanced, albeit work continues on individual firm conduct and on culture supported by the Irish Banking Culture Board.
 - The boundaries of financial regulation are set by the EU and by the Oireachtas, with Central Bank input and advice. The framework needs to evolve in a rapidly changing environment.
 - Regulatory capital charges for mortgage lending are in line with EU requirements, and reflective of the Irish loss experience and context, including the infrequency of home repossession through the courts. There is potential room for incremental improvement in the calibration of EU rules on discount rates.
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The stability and resilience of the financial and the banking systems and the financial soundness of individual firms, ensure that the economy continues to be funded through good times and bad, and that citizens are not exposed to loss and damage which they could not have foreseen.

Our mandate, which is grounded in the Central Bank Act 1942, requires the proper and effective regulation of financial firms while ensuring the best interests of consumers of financial services are protected.⁹ We are required to perform our functions in a way that is consistent with the orderly and proper functioning of financial markets. The outcomes we are seeking to achieve in regulating financial service providers were outlined above in **Section 1: Transitioning Banking Ecosystem**, under Effective Market Functioning.

Regulatory Approach

Our regulatory priorities are informed by risk in an ever changing environment, and by our focus on promoting a resilient and trustworthy financial system which sustainably

⁹ <https://revisedacts.lawreform.ie/eli/1942/act/22/revised/en/pdf?annotations=true>

serves the needs of consumers and the economy, where market participants adhere to appropriate standards of conduct.

Regulated firms, including banks, must have sufficient resources, sustainable business models and effective risk management to mitigate risk. They must be overseen and managed by fit and proper persons. They must be run to appropriately high standards and they must act in their customers' best interests. They must be resolvable in an orderly manner, and without taxpayer recourse, if they fail.

The Central Bank's regulation and supervision of firms is carried out through rules and guidance, gatekeeping, supervision and the taking of regulatory actions including appropriate recourse to our powers of enforcement.

We seek to ensure firms enter and exit the market in an orderly way and, while operating in Ireland, do so in accordance with the objectives of the financial services frameworks, in line with EU norms and standards. Firms presenting the same or similar risks, they should be subject to similar regulation.

Our firm supervision is assertive, risk-based, analytical and outcome-focused, and it is grounded in a defined risk appetite. In line with our risk-based approach, we do not operate a 'no failures' regime. Regulation cannot eliminate all risk or prevent all failure, but an appropriate range of resolution tools and safety nets are required to deal with firm failure in an orderly manner, in order to protect consumers and their funds, and the broader system.

To be effective, regulation must have the following characteristics:

- Clear objectives aligned with the broader framework;
- Predictability;
- Proportionality; and
- Effective cost-benefit alignment.

In the first instance, these characteristics need to be present in the legislative framework itself at both EU and national level. It is clear, for example, that new regulation must be aligned with the better functioning of the financial system, and it must support consumers and the economy. Financial regulation is central to an effectively functioning market. It must be consistent with good quality competition providing consumers with appropriate levels of availability and choice, from sustainable and resilient, well-run financial firms.

Regulating for Transition

The economic and social consequences of the global financial crisis led to an important package of EU reforms, in particular applying to banks.¹⁰ For larger banks, the EU Banking Union led to the centralisation of supervision and resolution under the SSM/SRM¹¹, with the final aspect of Banking Union in relation to deposit insurance, still to be completed via EDIS.¹²

A great deal of regulatory and supervisory focus over the past decade has been on addressing the issues which led to the banking crisis. While we continue to incorporate lessons learned from the crisis into our work, it is also important to recognise the significant progress that has already been made to enhance bank resilience. Such resilience - both financial and operational - was evident during the recent pandemic, indeed operational continuity was maintained across all sectors.

We are now transitioning through a period of fundamental change in financial services largely driven by technology and innovation. As an open, engaged and future-focused regulator, we seek to anticipate and support financial services innovation in line with our mandate and risk appetite.

As noted in **Section 1: Transitioning Banking Ecosystem**, our objective is to create the regulatory context in which the potential benefits of innovation for consumers, businesses and society can be realised, while applicable regulatory standards are met by firms, and risks are effectively managed and mitigated. Firms presenting the same or similar risks should be subject to similar regulation. This includes appropriate resolution processes and safety nets, in order to protect consumers and the economy.

High Quality Regulation

The financial system and regulated firms play a central role in the functioning of the economy and the lives of citizens. The Central Bank has been delegated important functions by the EU and Oireachtas relating to the financial system and firms. We make decisions that affect everyone in society and therefore we are accountable to the public. In service of this accountability, the Central Bank is required to publish a strategic plan and an annual report and performance statement. We must also ensure

¹⁰ In response to the financial crisis of 2008 and the subsequent sovereign debt crisis revised liquidity and capital requirements were introduced under Directive 2013/36/EU (CRD IV) and Regulation (EU) No 575/2013 Capital Requirements Regulation (CRR).

¹¹ Single Supervisory Mechanism/Single Resolution Mechanism.

¹² https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/european-deposit-insurance-scheme_en

that peer reviews are undertaken on the performance of our regulatory functions. Our senior officials appear regularly before Oireachtas Committees.

Financial regulation needs to bring into balance a number of objectives relating to the effective functioning of the financial system in support of consumers and the broader economy. In developing regulation we need to balance key trade-offs and consider the costs and benefits of our proposed actions towards delivery of the public interest.

In public discussion around the functioning of the financial system and its impact on peoples' lives, concerns are often raised about perceptions of under and over regulation in Ireland.

It is important as a public authority with significant regulatory and supervisory powers, that we along with other policy makers and stakeholders, continue to be challenged as to whether we are getting things right. We have been - and aim to continue to be - clear in our articulation of the trade-offs we face and the judgements we make. This enables others to ask questions and hold us to account, which we welcome.

Are we regulating in a manner which ensures that risks are addressed while avoiding imposing costs on the market, and ultimately on consumers, that are not justified? This is an important question for all policy makers, and particularly so at the current time. While we believe we have been effective in the delivery of our mandate, we recognise the need to refine our approach on an ongoing basis to factor in new learnings and a changing environment.

The financial system has overall functioned effectively in serving the needs of the economy and consumers to help underpin Ireland's post crisis recovery. As firms have rebuilt their resilience and the journey towards restored trust and confidence continues, the general functioning of the financial system does not point to over or under regulation.

Nonetheless, in recent years we have seen instances where specific concerns have been raised publicly regarding the nature and extent of regulation. For example, the need to regulate newer activities, firms or sectors; the regulatory impacts on the cost of credit; and the inability of regulation to prevent poor firm behaviours which led to wider consumer detriment requiring significant regulatory interventions. The first two of these are considered below, with conduct issues considered in the next section.

Regulation of Emerging Activities

As new financial service providers or activities emerge, a public discussion often develops as to whether or not they should be regulated by the Central Bank. While the Central Bank does not have powers to ban new products or services, this question can

nevertheless add to public perception issues regarding the extent of over or under regulation in Ireland.

The scope and application of regulation in terms of whether or not specific sectors, firms or activities are brought within the regulatory perimeter, is not determined by the Central Bank. Only EU and domestic legislation can determine the scope and application of financial regulation.

Some sectors are embryonic in nature with business models that evolve quickly. The Central Bank seeks to ensure those sectors are regulated in a balanced way with the right guardrails in place to allow firms to grow in a safe and controlled way. While decisions are ultimately taken by legislators, we have a key responsibility to provide our advice and exercise our judgement, given our mandate and competence.

The Central Bank is closely involved in public policy discussions which raise important questions. Amongst the questions to be considered are: would premature regulatory intervention have a limiting effect on early-stage activities?; are the risks posed by still small, emerging areas of activity significant enough to justify the cost of providing and implementing a regulatory framework?; should a particular activity be best considered as falling within the scope of regulated financial services – where higher levels of trust and confidence need to apply – or within broader commercial activities? Do we know enough yet to provide good quality regulatory oversight? If the new activities are to be regulated, what will be the cost of regulation and who should pay for it?

A timely consideration of these public policy issues is important, so regulation continues to evolve as the financial system evolves to ensure the system serves consumers and the economy. Recently, a range of new activities have been brought within the regulatory perimeter. These include Hire Purchase, Personal Contract Plans (PCP), Buy-Now-Pay-Later activities and Crowdfunding, with EU legislation on crypto assets close to implementation. Legislative changes have also been brought forward on the provision of high-cost credit by licensed moneylenders, with a view to limiting how much consumers are charged for short term high cost credit. In all of these cases it was judged that the activities are mature enough, the risks significant enough, and that the time was right, to introduce regulation.

It is important that we and other stakeholders continue to assess activities and the application of the new regulatory frameworks, to ensure that the intended outcomes are being achieved and that the right balance continues to be struck. It is also important, in this time of rapid change, that we all keep wider market developments under scrutiny, and continually assess whether regulatory intervention may, on balance, become warranted.

Cost of Mortgage Credit

A recurring question is why home buyers in Ireland generally pay higher interest rates for their mortgages than elsewhere in the EU. People ask whether these higher interest rates are justified and whether regulation is to blame – and if so, should it be changed.

Mortgage interest rates reflect a range of factors. These include factors specific to the lending firm (for example its operating cost base, its business model, its pricing mechanisms, etc.); factors related to the wider environment (for example the extent to which competition functions effectively; and general loan recovery practices (which in an Irish context mean that home repossession via the courts is not common); and factors related to the EU regulatory framework (for example the formula that translates the likelihood and impact of a borrower defaulting, into an amount of capital that has to be held by that bank to cover the risk).¹³

Generally speaking we estimate that up to half a percentage point (30-50 basis points) of the mortgage interest rates charged by Irish banks are driven by capital requirements. Of this a much smaller proportion represents costs driven specifically by regulation, as banks hold capital against their lending, as part of their own risk management in the absence of financial regulation.¹⁴

We have given close attention to the question of whether the regulatory capital requirements that apply to mortgage lending may be overly stringent - in particular now when so much has been done to address the weaknesses and failings that led to the banking crisis.

The capital charge from mortgage lending (which in turn feeds into the level of interest charged) is reflective of two “risk components”: firstly, the likelihood that a borrower will stop paying back their mortgage loan (so-called probability of default or PD); and secondly, the amount that the bank is likely to lose if the borrower does stop paying (so-called Loss Given Default or LGD).

In relation to the PD component, the significant improvements that have been made since the crisis in tandem with improved economic conditions, have resulted in an overall reduced likelihood in borrowers defaulting. As these changes feed through into the data and new lending reflects this new data, we are seeing the PD component of the capital charge gradually reduce over time. This is positive for the cost of borrowing,

¹³ In reality the second and third of these three types of factor are closely related because the regulatory framework seeks to incorporate factors related to the wider environment.

¹⁴ In technical terms such costs represent the difference between so-called economic capital charges and regulatory capital charges.

while ensuring that banks continue to hold the right level of capital for the risks they take when lending. It correctly represents the risks to the lending bank in this regard.

The LGD component is more complicated and as we had an unusually large crisis in Ireland in terms of the scale of loan losses, its effects continue to negatively impact the LGD component. Firstly, the losses that must be guarded against are, under EU law, those which might occur in a crisis (or “downturn”), when for example property prices generally fall or unemployment rates rise. (As we have seen, not only from the financial crisis, but also from the Covid-19 pandemic and the Russian invasion of Ukraine, it is important that banks’ are prepared for systemic events not just individual borrower problems in normal times.)

Equally important in considering the losses that a bank might suffer, is how long it takes to recover any amount that the bank can get back. This reflects the so-called time-value of money and is a very important concept. For example, if a bank has loaned €100,000, the borrower then defaults and it takes the bank 5 years to get its money back, then the loss to the bank is the value today of the €100,000 (or some lower recovered amount) in five years’ time.

Again we have examined this aspect closely. There are three key observations:

Firstly, in Ireland, compared to our peers, the ability of lenders to recover the value of the collateral (the mortgaged house) is quite restricted. This results in long time periods generally between default and resolution of the loan. This means that you would expect LGDs in Ireland to be higher than elsewhere because the time-value losses are higher.

Secondly, there is the mechanics of the calculations of LGD built into the applicable EU regulations. In response to questions raised we have been considering whether there is the possibility of these mechanics double-counting time periods for example where interest is being paid by the borrower even though the loan itself is not being repaid. We have found that the mechanics of the calculation are sound. There is no double counting.

Finally, there is the rate at which the time-value is calculated – the so-called discount rate. This has been set at European level as EURIBOR + 5 per cent. What is the correct discount rate to be applied is a complex question. There are different ways in which the time value of money to a bank can be considered - e.g. cost of capital versus cost of borrowing. Moreover, the EU-level discount rate must take account not only of a wide variety of different national contexts, but also of different types of lending.

Nonetheless, given the interaction between the historically high loss data in Ireland

and this EU discount rate, we believe that there would be merit in the matter being looked at further at the European level.¹⁵

In general therefore, the overall level of capital charges for mortgage lending in Ireland are appropriate, reflecting as they do the evolving positive “PD” data deriving from the significant improvements implemented since the crisis and the context of limited collateral realisation rates in Ireland. There may be small room for improvement in respect of the level of the EU discount rate, but this is likely to be relatively marginal and difficult to achieve in a European context.¹⁶

Framework Gaps

In terms of ensuring we have a high quality regulatory framework, it is important to identify and seek to address regulatory gaps. One area where there has been significant improvements in recent years has been in relation to the development of frameworks for dealing with failing firms including banks. This is highly important for the market to function well – as it is necessary that firms whose business model is failing are able to exit the market in an orderly manner.

There remain important gaps in the resolution framework area. In the case of deposit taking, the completion of EU Banking Union requires a centralised deposit insurance arrangement through EDIS¹⁷, which would enhance the depth of protection available to retail depositors. In the case of disruptor firms, an enhanced toolkit would protect consumers in the event of the failure of such firms – for example in the area of PIEMI firms.

¹⁵ It is also important to note that we take the above factors into account when considering setting of other capital requirements for banks under our macroprudential powers. This reflects the holistic approach we adopt towards regulatory capital for banks. Further details can be found at this link on our macro-prudential strategy: https://www.centralbank.ie/docs/default-source/financial-system/financial-stability/macprudential-policy/framework-for-macroprudential-capital.pdf?sfvrsn=526e961d_5

¹⁶ Further details on our assessment of capital charges for mortgages are outlined in our Financial Stability Review publications <https://www.centralbank.ie/publication/financial-stability-review>

¹⁷ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/european-deposit-insurance-scheme_en

3. Revising the Retail Conduct Framework

Summary

- High quality consumer protection is critical to maintaining trust and confidence.
 - Significant conduct failings by banks towards their customers have occurred.
 - It is timely to take stock of consumer protection developments and consider how to improve the regulatory framework:
 - How to ensure the best interests of consumers are protected within a framework that is proportionate and predictable?
 - What steps should be taken in respect of a number of key issues arising from the evolution of the banking and financial system?
 - We plan to publish a Central Bank Discussion Paper in advance of a wide-ranging engagement exercise to be launched later in Q3 2022, to be followed in 2023 and 2024 by a formal consultation on revisions to the Consumer Protection Code in service of updating the Irish Retail Conduct Framework.
-

Consumer protection is at the heart of the Central Bank’s mandate. From achieving price stability, through ensuring the effective functioning of the payments system, providing economic advice, and delivering high quality financial regulation, securing the interests of the citizen is central to what we do.

High quality consumer protection is essential to the proper and effective functioning of financial markets including the banking system. Without it there will not be the trust and confidence that is essential for financial services and the banking system to function.

Our current consumer protection framework and approach, grounded in EU requirements, includes as its centrepiece the Consumer Protection Code alongside other requirements and measures. It is a highly developed framework, one which has delivered significant outcomes in protecting the users of financial services.

We want to ensure that our consumer protection framework evolves and remains fit for purpose in a rapidly changing environment. For this reason we will be carrying out a significant engagement exercise on consumer-related issues from later in Q3 2022, before settling on proposed revisions to the Central Bank’s Consumer Protection Code during the course of 2023 and 2024.

Since the financial crisis, we have seen examples where banks' actions and behaviours have fallen short of required standards and public and supervisory expectations, resulting in customer detriment or potential detriment. This has included cases such as the treatment of borrowers in mortgage arrears and tracker mortgage customers. This indicates that, despite progress, firms have continued to fall short when it comes to embedding a truly customer-focused culture and ensuring that the interests of their customers are secured in the context of a sustainable business model.

As highlighted in the Central Bank's 'Behaviour and Culture of the Irish Retail Banks' report,¹⁸ this requires a collective understanding of what consumer focus means and the type of behaviour it requires, with a strong consumer focus needing to be reflected across structures, processes and systems.

We will be carrying out our wide ranging engagement on consumer protection issues in the context of our forthcoming review of the Consumer Protection Code.

Starting with a Discussion Paper, the aim will be to consider some central questions – such as what does it really mean for a firm to act in the best interests of consumers, in particular in some of the more complex situations? What should be expected of firms in these cases? What remains the responsibility of consumers? We will also consider how choice and availability of products and services can best be achieved under a high quality framework of consumer protection.

We will also be seeking to engage on a wide range of important topics such as how technological innovation and digitalisation can be made to work best for consumers; how consumer protection applies in the area of pricing; how regulated firms offering unregulated products should behave; and how customer vulnerabilities should be addressed.

In line with our Open & Engaged theme under our multi-year strategy¹⁹, we will be engaging widely. We hope to hear perspectives from a broad and diverse range of stakeholders. Our engagement will be focused on consumers, the financial services industry, as well as public representatives and other state authorities.

At its conclusion we plan to publish the summary discussion findings. This important exercise will help to inform our planned review of the Consumer Protection Code over 2023 and 2024, and to enhance broader understanding of the role and work of the Central Bank in terms of consumer protection.

¹⁸ <https://www.centralbank.ie/docs/default-source/publications/corporate-reports/behaviour-and-culture-of-the-irish-retail-banks.pdf?sfvrsn=2>

¹⁹ https://www.centralbank.ie/docs/default-source/publications/corporate-reports/strategic-plan/our-strategy/central-bank-of-ireland-our-strategy.pdf?sfvrsn=3a55921d_4

4. Competition

Summary

- **Effective competition is essential within a well-functioning banking system that serves the needs of consumers and the economy.**
 - **A wide range of regulatory interventions – transparency and disclosure, switching, open banking, etc. – are explicitly designed to support competition.**
 - **In exercising our regulatory powers we weigh the costs and benefits of new regulation. This includes assessing the impact on the functioning of the relevant sector.**
 - **We will continue to carry out consumer-based behavioural research, with data gathered through both surveys and fieldwork, to inform ongoing regulatory framework change.**
 - **In exercising our authorisation role, we seek to ensure that the flow of new entrants to the market is well managed. We also seek to ensure that new entrants meet the applicable regulatory standards, and that risks are managed and mitigated, so as to protect consumers and the wider economy.**
-

A healthy level of competition is a key characteristic of an effective, well-functioning market, where firms have to compete on price and product and service quality, to attract and retain customers.

There is a need for adequate levels of competition between firms in order for markets to function effectively and to provide consumers with appropriate levels of availability and choice. Well-regulated competition delivers value for money for consumers by reducing costs and prices and promoting better service levels, as firms seek to attract and retain customers.

We recognise the role of regulation in supporting an effective, well-functioning market, - for instance by ensuring there is transparency and information symmetry between consumers and firms, beneficial innovation and active switching between providers and products. We must also be cognisant of the barriers to competition which we consider below. In this section we specifically look at the role of regulation in the areas of competition, consumer switching and new firm authorisation.

Barriers to Market Competition

The practices and market features that can undermine effective competition, include:

Barriers to entry and growth: contestable markets exist where challenger firms can enter without significant impediments and place competitive pressure on established businesses. This process drives innovation as challengers develop competitive advantages through new products and delivery techniques. Where the flow of new entrants is materially restricted, then established firms will face less pressure to respond to consumer demands, which can diminish efficiency and innovation. However, it is accepted that unduly high contestability in financial services can also lead to negative consequences as seen from the financial crisis, and therefore firms’ practices and conduct must be subject to effective financial regulation. **Section 5: Innovation** below looks at key market developments, early regulatory engagement with new entrants and how best to foster innovation by firms.

Barriers to switching: well-functioning markets depend on consumers being able to, and indeed willing to, switch service providers or products with relative ease. Where consumers cannot exercise choice efficiently, then they will be impeded from accessing products and services that best suit their needs. Additionally, if firms find it difficult to attract new customers from rivals e.g. by offering better value, then the impetus to innovate, or compete on price or through better quality services, diminishes. Where barriers to switching exist – for example termination costs or complicated administrative processes – consumers will be deterred from switching.

Lack of access to information & complexity: information that is difficult to ascertain or assimilate can undermine consumer understanding of product comparison, with the potential for direct harm to consumers and reduced competitive pressure on firms. Financial markets can be susceptible to the phenomenon of rent extraction, whereby innovation fails to deliver improvements in the actual efficiency of financial service provision, but rather it serves only to generate excess profits that are not tied to enhanced service provision or productivity gains. Rent extraction can evolve in a variety of ways, including through the structuring of highly complex financial instruments which investors may find are difficult to understand. The area of sub-prime securitisation in the financial crisis bore the hallmarks of rent-seeking behaviour.²⁰

Regulation and Competition

There are clear interactions between financial regulation and competitive market dynamics. In shaping the “rules of the game” regulatory frameworks can have important impacts on the structure of markets. They often constrain new firms’ entry into markets for good reason, through licensing regimes that ensure applicable regulatory standards are met, to protect the economy and consumers and their funds.

²⁰ “The Turner Review: a regulatory response to the global banking crisis” (2009, Pg. 51).

Regulation can also affect the manner in which firms compete with each other, as the requirements imposed by regulation can impact the ways in which firms behave and how they design and deliver their products and services.

In a transitioning banking ecosystem we recognise the need to create the regulatory context to support effective financial market functioning where the potential benefits of innovation for consumers, businesses and society can be realised, without introducing excessive risk into the system.

One of our regulatory objectives at the Central Bank is the orderly and proper functioning of financial markets. In delivering high quality regulation it is important that we consider the costs and the benefits of that regulation. Assessing impacts on the functioning of the market and on competition within the market is an important part of how we regulate.

In the context of rapidly changing financial and banking services sectors we plan to enhance our work on the economics of financial regulation in line with orderly and proper functioning of markets. This will equip us to further respond to the challenges of ensuring that our regulation – and the EU regulation to which we contribute – achieves overall optimal outcomes.

Consumer Switching

As noted above, well-functioning competitive markets depend on consumers being able to switch service providers and products with relative ease. The Central Bank actively supports switching by consumers. We undertake research on switching activity^{21 22} and we have issued consumer communications highlighting the benefits of switching.²³

We put in place a statutory Code of Conduct on the Switching of Payment Accounts with Payment Service Providers (Switching Code)²⁴ in 2010 to promote a clear and efficient switching process for consumers. We also introduced measures to help consumers make savings on their mortgage repayments, to provide additional protections for those eligible to switch, and to facilitate mortgage switching by enhancing the transparency of the mortgage framework.²⁵

²¹Shane Byrne, Kenneth Devine and Yvonne McCarthy (Vol. 2020, No. 12). *Room to improve: A review of switching activity in the Irish mortgage market*

²²Kenneth Devine, Sarah Frost & Rory McElligott (Vol 2015, No. 8). *Switch and Save in the Irish Mortgage Market?*

²³[Central bank press-release-mortgage-holders-could-save-significant-amounts-by-switching-but-switching-activity-remains-low-29-october-2020](#).

²⁴[Code of Conduct on the Switching of Payment Accounts with Payment Service Providers](#)

²⁵<https://www.centralbank.ie/news/article/mortgage-switching-20-June-2018>

However, in common with many other EU countries, switching levels in Ireland for key financial services have remained low.^{26,27} This may be due to the complexity, the cost and the time it takes to complete the switching process, as well as a degree of consumer inertia when it comes to switching between providers and products with the same provider. Notably, bank withdrawals and the prospect of rising interest rates have prompted a recent increase in mortgage switching, albeit this is from a very low base.²⁸

Payment Accounts Switching

There are a number of measures in place aimed at incentivising the entry of payment providers into the EU market and to ensure a level playing field, thereby strengthening competition. The right of access to payment accounts with basic features²⁹ and account switching, allows citizens to open and move accounts more easily.

The Payment Account Directive³⁰ lays down rules concerning the switching of payment accounts within a Member State, the facilitation of cross-border payment account-opening for consumers and the establishment of a ‘switching service’.³¹ The Switching Code sets down the steps involved and the actions required of existing and new payment service providers when customers wish to switch.

The Switching Code was designed to deal with, and support, a steady flow of switching between banks. It was not designed to deal with the current context of a mass migration of customer accounts due to bank withdrawals. Despite that it has provided a firm basis of obligations for the banks – individually and collectively – as they deal with the current mass migration challenge. Looking forward, there will be learnings which may inform switching process enhancements following completion of the migration process. This would inform a review of the Switching Code going forward.

²⁶ [Central Bank Consumer Protection Research - Mortgage Switching Research](#)

²⁷ [Central Bank Consumer Protection Bulletin - Current-Accounts](#)

²⁸ BPF mortgage approval data for May 2022 showed re-mortgage/switching grew by 111.5% to 1,237 in volume terms year on year and by 129.3% year-on-year to €329 million over the same period - <https://bpfi.ie/publications/bpfi-mortgage-approvals-may-2022/>

²⁹ 2014/92/EU4 (PAD) Provision 15(1) states that “Payment accounts with basic features shall be made available to consumers by all relevant credit institutions”. A “relevant credit institution” means an undertaking (a) the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account, and (b) that offers payment accounts to consumers in the State. The definition of a payment service provider, included in the PAR 2016 specifically excludes Credit Unions and An Post – consequently, the provision of payment accounts with basic features does not apply to either Credit Unions or An Post.

³⁰ Transposed into Irish law as Payment Accounts Regulations 2016.

³¹ The PAD facilitates the establishment of a ‘switching service’. Switching Services involves establishing a centralised service to carry out the switching process on behalf of the account providers and users. ‘Switching services’ exist in the UK e.g. Current Account Switching Service (CASS), which is a private enterprise that requires designation as an “alternative switching scheme” by the Payment Systems Regulator (PSR) in the UK. No such services exist in Ireland.

Mortgage Switching

Research shows that three in five borrowers in Ireland could save €1,000 or more within a year of switching and over 60 per cent of switched mortgages are over €10,000 cheaper over the remaining term of the loan.³² Despite the potential savings, most borrowers in Ireland never switch their mortgage. Research shows that the reasons for not switching are:

- Consumers do not realise how much money they could save;
- Consumers find it difficult to compare mortgages; and
- Consumers believe the process is too long and complicated.

In 2018, we sought views on proposals to enhance mortgage transparency and switching measures to strengthen protections for consumers in order to help them make savings on their mortgage repayments.³³ Following consultation, we amended the Consumer Protection Code to include requirements for mortgage lenders to tell borrowers about cheaper mortgage options 60 days before the expiry of their fixed rate offering, to tell borrowers they can switch to a cheaper mortgage based on the level of equity they have in their home, to explain the pros and cons of any mortgage incentives (i.e. cashback offers) and to provide borrowers with all the information they need to switch their mortgage.

The results of an EU Commission survey, undertaken as part of the review of the Mortgage Credit Directive, found that c.80 per cent of participants in Ireland said that it was ‘easy’ or ‘mostly easy’ to switch. In general, the most commonly cited difficulty is the administrative burden of the process. Our submission to the survey highlighted variations between lenders as to their documentation requirements. While these differences may not seem material, they can be off-putting for consumers and as such, they can limit switching. The standardisation of documentation requirements across the industry might be considered to eliminate possible barriers for consumers.

The Central Bank will shortly publish the findings of a field trial in the area of mortgage refinancing by Irish consumers which targeted specific behavioural obstacles which can inhibit engagement and take-up of beneficial refinancing opportunities among variable rate mortgage holders. Proposed changes in terms of how mortgage lenders present information on the potential savings from switching for consumers, are expected to follow.

³² <https://www.centralbank.ie/news/article/press-release-mortgage-holders-could-save-significant-amounts-by-switching-but-switching-activity-remains-low-29-october-2020>

³³ CP112 - Enhanced Mortgage Measures: Transparency and Switching - <https://www.centralbank.ie/publication/consultation-papers/consultation-paper-detail/cp112-enhanced-mortgage-measures-transparency-and-switching>

Firm Authorisation

Financial regulation controls access for new entrants to the financial services market through licensing and authorisation requirements which are designed to protect consumers and the wider economy. It is essential that consumers have assurance that regulated financial service providers and the individuals overseeing and managing firms, meet applicable regulatory standards – this is key to promoting high levels of trust and confidence in the financial system.

We seek to ensure firms enter and exit the market in an orderly manner and, while operating in Ireland, do so in accordance with the objectives of the financial services frameworks, in line with EU norms and standards. In the case of banks, the European Central Bank (ECB) is the competent authority for granting new licences. In addition to ensuring the authorisation of new firms and activities are in line with requirements and standards, under our Fitness & Probity regime we approve proposed key role holders to confirm those who oversee and manage firms are fit and proper persons.

Our authorisation approach is also informed by how feasible it will be for a firm of the type in question that gets into difficulty, to exit the market through an orderly failure. This underlines the importance of having the right toolkit and resolution powers to protect consumers and investors (such as for PIEMI firms as noted above).

We seek to strike a balance between the facilitation of new authorisation and the need to ensure that firms who take funds from consumers and investors, meet applicable regulatory standards. In doing so we apply a proportionate risk-based approach to authorisations, in line with our risk appetite.

We are committed to providing a clear, open and transparent authorisation process. We seek to ensure that we are clear about our expectations to prospective and applicant firms. The specific authorisation requirements across regulated sectors, reflect EU regulatory requirements and norms, and they are risk-based, anchored in our risk appetite.

There are five broad elements which the Central Bank's assessment requires of new firms, namely that they should:

- Have sufficient financial resources, including under a plausible but severe stress;
- Have sustainable business models;
- Be well governed, with appropriate cultures, effective risk management and control arrangements in place;
- Have the necessary systems and controls in place to manage money laundering and financial crime risks; and

- Be able to recover if they get into difficulty, and if they cannot, they should be resolvable in an orderly manner, without recourse to the taxpayer.

Reflecting the significant change underway across financial services, the nature and flow of authorisation applications changes continually.

Brexit led to a significant increase in authorisation activity levels in recent years. Over the years 2018 to 2021, a total of 88 new authorisations were granted to firms involved in the areas of banking, credit servicing, payments and investments³⁴. This included a significant expansion in the scale of banking activities located in Ireland – although the majority of this new business is EU-based, rather than domestically focused.

These higher activity levels also reflect the attractiveness of Ireland as a location for financial service providers and the emergence of new providers in areas such as electronic payments and fintech. Going forward, further activity is emerging from the extension of the regulatory perimeter to new areas under the evolving EU regulatory framework – for instance new virtual asset service providers (VASPs). The expectation is that crypto asset service providers (CASPs) will seek authorisation under the Market in Crypto Assets Regulation (or MICA), once it is fully enacted in the EU.

In order to ensure that the flow of new entrants into the market continues to be well managed, we continually adapt our processes to the changing context. This includes redeploying resources to busier areas of authorisation activity; publishing guidance on authorisation processes and expectations for new firms; increasing our emphasis on pre-authorisation meetings with firms so that they can get an enhanced ‘feel’ for the process and our expectations; and introducing practical improvements and efficiencies into our authorisation processes (including through the use of IT tools). We can provide further details on our authorisation process, our service standards and our operational performance in relation to Fitness and Probity approvals, if necessary.

Finally, an important feature of our approach to authorisation is our Innovation Hub which was established in 2018 to improve the interaction between the Central Bank and innovative entities. Firms with new or innovative business models benefit from early engagement with the Hub (see [Section 5: Innovation](#)).

³⁴ Banks, MiFID Firms, PIEMI Firms and Credit Servicing Firms.

5. Innovation

Summary

- **Innovation in banking and payment services provides important potential benefits for consumers and the economy – in Ireland and in the wider EU.**
 - **Ireland’s position as a location for both technology and financial services, underlines the importance of maintaining a high quality regulatory framework as regards innovation.**
 - **The Central Bank’s objective is to support the realisation of the benefits of innovation while ensuring that the risks are effectively managed and mitigated.**
 - **Our Innovation Hub has provided a valuable mechanism for engagement between innovators and regulators. We see earlier engagement by firms with the Innovation Hub as assisting the smooth and timely operation of the authorisation process.**
-

Well-functioning financial services markets depend on successful innovation. The ideas, developments and efficiencies that new entrants and incumbents can bring, along with the impact of their innovation and disruption on others, are key drivers of effective market functioning.

As reflected in our strategy, our future-focused approach is critical to enabling the Central Bank to better understand, anticipate and adapt in the context of the far-reaching changes taking place in financial and banking services. We seek to deploy our regulatory powers so that benefits of change and innovation are realised for the consumers and users of financial services, and for the economy, with risks appropriately mitigated.

We want to help foster an innovative, resilient and customer-focused banking services sector in Ireland, one which serves the evolving needs of households and businesses. We support innovations that enhance financial service provision for consumers, while also remaining vigilant to the consequential impacts and risks of such innovations on the stability of the financial system and on consumers.

Ireland has become a hub for technological innovation and is increasingly being chosen as a base jurisdiction for global technology-driven firms who plan to serve the wider EU market from an Irish base. It is important that there is a flow of new entrants coupled with orderly exit of firms from the market on a well-managed basis. While innovation offers key benefits to consumers, negative outcomes can also arise when new business

models do not succeed and fail in a manner that causes undue losses to consumers or harm to the wider economy. It is critical that such failure is managed in an orderly way to safeguard both the system and consumers and their funds, supported by appropriate toolkits and resolution frameworks.

Enhancing Engagement

Innovation Hub

The Central Bank's Innovation Hub was launched in 2018 to facilitate engagement and access by providing a direct point of contact for technology-led firms as well as more traditional providers looking to engage with regulators on innovation issues. The Innovation Hub also provides the Central Bank with early intelligence on such innovation, especially where it is being developed outside of the regulatory perimeter.

Feedback from firms that have engaged with the Innovation Hub indicates that they found the interaction to be valuable. The Central Bank has also gained important insights from these firms. While the Innovation Hub continues to grow in popularity – with a c.20 per cent increase in the number of enquiries each year – we want to ensure that it continues to be effective, both for innovative firms and for the Central Bank.

In late 2021 we initiated a review of the Innovation Hub to measure its effectiveness including how our approach and work in this area compares to innovation facilities provided by our EU peers. We found that when we set up our Innovation Hub in April 2018 that we were broadly aligned with the approaches of our peers. Since then however, many of our peers have expanded their engagement models with innovators, allowing for a deeper and more structured level of interaction and innovation support. In return peers have been able to garner more targeted intelligence from innovators.

We have identified that there is value in enhancing our current engagement approach by providing additional facilities to support innovation aligned with our mandate. There is scope for the Central Bank to enhance our Innovation Hub and outreach programme further, and to broaden our contact point modality so that we can begin to:

- engage at a deeper level with innovators on regulation to support them;
- garner more intelligence on innovation for the Central Bank; and
- allow for deeper engagement in various initiatives at EU and international level.

As part of our continuing review of our Innovation Hub, the Central Bank plans to consult on proposed enhancements in 2023 with any changes to be implemented over the course of our current strategic cycle (2022 to 2026).

Financial Literacy

The ongoing advancement of digitalisation and innovation raises important issues around financial literacy. The widespread and deepening penetration of new types and offerings of financial services increases the importance of the issue. This topic will be addressed as a specific discussion theme as part of the planned engagement on consumer-related topics outlined above (see [Section 3: Revising the Retail Conduct Framework](#)).

European Forum for Innovation Facilitators

To complement our approach, at EU level the Central Bank as a member of EFIF (European Forum for Innovation Facilitators), will participate in the European Commission's Cross Border Testing Facility. The European Supervisory Authorities established EFIF to foster greater coordination and cooperation between innovation facilitators to support the scaling up of fintech across the EU single market. By participating as an observer in EFIF's cross border testing, the Central Bank will be able to access timely, relevant information and insights on the tested innovations and firms that could potentially expand into Ireland.

6. Access to Basic Services

Summary

- How consumers make payments is undergoing a major transformation.
 - Despite this cash remains a key component of the payments system.
 - In the Central Bank, we are committed to the ongoing availability of cash as a means of payment. This aligns with the European Central Bank’s commitment to cash remaining generally available and accepted.
 - For commercial reasons, retail banks have been reducing their branch networks and services, as well as their participation in the direct distribution of cash through the ATM network. An Post has a potential role to play at community level in underpinning continued access to in branch services and ATMs.
 - Access to basic services raises significant social policy challenges that need to be considered by policy makers and wider stakeholders as a matter of priority.
-

In **Section 3: Competition**, we considered competition issues from a market perspective in terms of the effective functioning of retail banking services. This section focuses more on consumers’ access to basic services.

As the banking ecosystem transitions, consumers are increasingly using a broader range of payment mechanisms - from cash to digital-based services. While historically cash was a dominant form of payment, cash utilisation is declining with the proliferation of card-based transactions, electronic funds transfers and digital-based transactions. This trend is set to continue, with new forms of block-chain-enabled payment mechanisms expected to emerge as well as other forms of instant payments. Central bank digital currencies will also likely have a transformative effect in this area.

Access to Basic Services

Consumers typically access cash through in-branch services and ATMs – they can also access cash through retail cash-back facilities. Retail banking structural changes are impacting consumer services (see **Section 1: Transitioning Banking Ecosystem**), raising broad social policy considerations across availability and access to, and acceptance of, cash.

Recent Trends

Cash utilisation levels have been declining in Ireland in recent years, in particular during the pandemic period. Central Bank statistics indicate that Irish ATM

withdrawals were €13.0 billion in 2021, compared to €19.7 billion in 2019, a decline of 34 per cent. The value of such withdrawals are now at about two-thirds pre-pandemic levels, albeit they remain relatively stable at c.€1 billion per month.

Whilst cash utilisation as a form of payment may recover, it is likely that it will not return to pre-pandemic levels. The ECB's 2020 Survey on the Impact of the Pandemic on Cash Trends revealed that 87 per cent of Eurosystem respondents intended to continue using less cash after the pandemic.

Nevertheless, cash remains an important means and choice of payment for consumers across the euro area including in Ireland. We believe that it is important that it remains as a central part of the payments system. From a financial inclusion perspective, cash plays a vital role in ensuring the financial services needs of some consumers are served, particularly those without access to a bank account, those digitally marginalised and those who are vulnerable. It also represents a critical contingency in the event of electronic payment system failures.

Structural Developments

There are a number of recent structural developments within Irish retail banking which pose challenges to access to cash for consumers, namely:

- Retail banks are selling their offsite ATMs to independent ATM deployers (IADs);
- Retail banks have outsourced their secure transit of cash to third parties – with such activity now largely handled by a small number of cash in transit (CIT) firms;
- Ulster Bank and KBC have announced plans to withdraw from the Irish market; and
- Retail banks have been closing bank branches and withdrawing cash and other in-branch services, as they seek to realign their customer offerings towards digital services aimed at reducing operating costs.

By end-2022, c. 25 per cent of Ireland's ATM network will be owned by retail banks (compared to 100 per cent in 2015). In-branch services are also reducing, with the total number of bank branches nationwide set to reduce by c.32 per cent compared to 2019.

The trend towards the withdrawal of cash and other in-branch services is being driven by commercial decision making. We expect banks to ensure that the impact of their decisions are considered carefully and with a consumer-focused approach. The impact for all consumers, including those who are vulnerable, must be assessed by banks, to ensure changes to branches and in-branch services are undertaken in an orderly manner. We expect that vulnerable customers will be provided with the necessary assistance to ensure that they can retain full access to basic banking services.

The Central Bank has also observed a significant shift by the retail banks towards outsourcing of cash based fulfilment (i.e. withdrawal and lodgement services). While the banks have outsourcing arrangements in place with An Post to facilitate ‘over the counter’ lodgement and withdrawal services, the outright disposal of ATMs means c.75 per cent of the ATM network is under the control of unregulated IADs.

Since the closure of their own cash centres between 2018 and 2020, the retail banks now are reliant on CIT security firms to move cash around their branch and ATM networks. The two biggest CIT operators now hold a c.95 per cent market share. The Central Bank expects regulated firms to ensure the effective oversight and control of such outsourced services and to have effective contingencies in place should any failure occur. Nevertheless, the continuity of day-to-day cash services to the public depends on business continuity of IADs and CIT firms.

At EU level, in addition to an emphasis on the supply of cash, there is a focus on the acceptance and facilitation of the use of cash in payments. The ECB’s Eurosystem Cash Strategy, adopted in September 2020, underlines the fundamental responsibility of the Eurosystem, together with the banking sector, to ensure the smooth supply of cash and to facilitate the use of cash in payments by people and businesses. The vision under the Eurosystem Cash Strategy is that ‘cash will continue to remain generally available and accepted as an attractive, reliable and competitive payment instrument and store of value of choice’. The European Commission also outlined its expectation of Member States to ‘ensure the acceptance and accessibility of cash as a public good’.

Social Policy Consideration

The Central Bank has engaged with international peers that have experienced similar fragmentation within their national cash cycles. Other countries have made legislative changes and implemented other interventions to ensure ongoing access to cash and in-branch services. Such examples are helpful. It is desirable that a social policy discussion takes place in the coming period about some of the critical issues that arise here, including how costs should be distributed in the context of a rapidly changing sector while ensuring fair competition and a level playing field.

Key questions to be considered in this context include:

- who should be responsible for access and availability of cash? Should it be the traditional retail banks? What about newly authorised banks with web-based business models? What about value-chain disrupters?
- the maintenance of branch networks are important commercial decisions for banks. But bank branches also form an important part of local communities. How should

the potential tensions in this regard be resolved? What role should be fulfilled by An Post in terms of access to cash services in branch and via ATMs?

- what “social contract” obligations should be considered to fall upon banks arising from their unique privilege in being allowed to engage in private money creation as a result of their “fractional reserve” relationship with central banks?
- what actions can be taken to ensure acceptance of cash across the economy during transition – as consumers can face cash-only or card-only payment situations day to day?
- as the secure transit of cash and ATM operation are critical functions in the provision of access to cash services, is there an argument that IADs and/or CIT firms should be regulated?

We think that to address some of these important and far-reaching questions, a wider social policy discussion – involving all stakeholders in the cash cycle - should be organised as a matter of priority.

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