Transcript of Central Bank 2016 Annual Report Press Conference

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Chair:
So good afternoon everybody and welcome to our new dockland campus the first press conference in our dockland campus for the annual report and annual performance statement. We are joined today by Deputy Governor for Central Banking Sharon Donnery, Acting Deputy Governor for Financial Regulation Bernard Sheridan, our Chief Operations Officer Gerry Quinn and Governor Philip Lane. So we'll open with some opening remarks from Governor Lane and then we'll go to questions.

Governor Philip Lane:
Good afternoon and welcome to our new building. The annual report, the statement of accounts and the annual performance statement are the centre piece of our framework for accountability. The annual report provides a comprehensive account of the fulfilment of our responsibilities and governance, the key activities and developments in 2016. While the statement of accounts gives a detailed overview of our financial operations and accounts.

In addition we also today published the annual performance statement on regulatory activities for 2016 which also includes plans for 2017.

Let me address some aspects of each in turn. In relation to the annual report the first chapter provides an overview of our strategic plan for 2016 to 2018. As well as outlining some of the desired outcomes in relation to our wide raging mandate. The strategic plan articulates how we aim to deliver on our mission to safe guard stability and protect consumers. As well as providing the benchmark against which the commission measures the performance of the bank.

Our activities span areas such as price stability, financial stability, consumer protection, supervision and enforcement, development of regulatory policies, payments, settlements and currency, the provision of economic advice, statistics, and the recovery and resolution of financial institutions.

The third chapter of the report gives more detail about our governance arrangements such as the structure of internal committees, the key responsibilities of each committee and attendance records by members of the commission at these various subcommittees. By elaborating on these factors we think it facilities and enhances transparency to the public in keeping with our commitment.

The annual report also gives an update on key activities and developments in 2016, let me touch on some of these. The first, ensuring that the best interest of consumers are protected is a core part of the banks mission. The tracker examination is one of our key priorities and is the largest most complex supervisory review undertaken as part of our consumer protection mandate. A lot of progress has been made in 2016 and I think it will be brought to fruition for many effected customers this year. And we recently published a comprehensive update including our principles for redress in cases where loses were made.

Our priority is to ensure that lenders carry out a full review and they ensure all affected consumers are appropriately redressed and compensated for the harm caused to them.

We are committed to taking the necessary supervisory action including enforcement action to ensure that lenders deliver fair outcomes for all affected consumers. We will publish a further update in the autumn and a final report will also be published upon conclusion of the examination.

Second, our macro prudential powers allow us to deploy a suite of measures to mitigate systemic risks. These include the mortgage measures which aim to enhance the resilience of both households and banks. In 2016 we completed the first review of these measures, which examined their performance against our stated objectives as well as assessing possible side effects. The review found the overall framework to be appropriate and effective in meeting these objectives. However some revisions were introduced last November to improve sustainability and effectiveness. And in line with our procedures of an annual review the next review will take place November this year.

Third, while the domestic economy continues to improve external risks remain significant. These risks include those relating to Brexit, but also the risks associated with any increase in global protectionism, or elevated levels of risk aversion in international financial markets. Prior to the UK referendum a Brexit task force was established here in the bank and it continues to assess and analyse the implications. Including the potential of a more diverse range of firms and businesses models requiring the banks authorisation and supervision.

We will ensure that any entities seeking to locate in this jurisdiction will be substantively run from Ireland. While we have considerable experience in dealing with authorisations of large financial firms we also have set up new teams to deal with the expected increase in the volume of applications and we are satisfied that we have calibrated our capacity to deal with both expressions of interest from firms, to substantive discussions regarding authorisations.

Fourth, in 2016 the IMF reviewed Ireland's financial system under its financial sector assessment program, the FSAP process. The FSAP found that the Irish financial system has strengthened significantly since the crisis and has undergone major structural changes. While recognising the considerable progress made and the quality of supervision and the capacity of the system and authority to manage and resolve crisis the IMF noted that vulnerabilities remain.

In addition the global scale of the international funds industry in Ireland was also noted, with recommendations that the bank continue the supervisory and innovations, collaborate with other agencies and data monitoring already established in this area.

Next month our macro financial review will update our assessments of risks and remediation on probabilities across the financial sector. The bank is committed to providing regular public updates on our assessment of risks and vulnerabilities. These are also captured in the publication of our meeting accounts, of our macro-prudential measures committee and the meetings of the central bank commission.

Today the annual report also publishes our statement of accounts. We are reporting a financial profit of 2.3bn in 2016 after retained earnings the surplus income which will be paid over to the exchequer amounts to about 1.8bn. The banks' profits continue to reflect the legacies of the crisis both domestically and in the EU area.

These factors will diminish over time, so that the banks profit levels will normalise to more modest levels. The current high profit levels are primarily driven by the interest income and realised capital gains on the special portfolio that was acquired as a result of the liquidation of IBRC. So that component contributed 1.9bn to the 2016 profit numbers.

The Central Bank has stated it will dispose of the government bonds held in the special portfolio as soon as possible provided conditions of financial stability permit. It follows that these high profit levels will decline in future years as disposals of the special portfolio come to an end.

Furthermore a general assessment of financial risks has identified a potential interest rate mismatch related to the purchases as part of monetary policy implementation of low interest rates instruments in recent years. Considering this risk the bank has prudently chosen to set aside a provision of €165m in its 2016 annual accounts. The provision has been established to cater for the possibility of such mismatches arising.

Thank you we are not at your disposal for questions.

Chair:
Thank you and may I just ask if you have a question just to raise your hand and wait for the microphone to come to you because the session is being recorded. We'll start with two questions per media outlet and then with time then we'll come back around to everybody again. So may I invite questions please?

Colm Kelpie – Irish Independent:
Hello, can I just ask in the section on expenses on page 127 you make reference to the payment of €33,000 for redundancy payment to one contractor last year. Could you elaborate on that thank you?

Philip Lane:
Let me ask Gerry Quinn to take that question.

Gerry Quinn:
So in relation to the issue where we paid yes this was in relation to the expiry of a fixed term contract and it was a statutory requirement to pay that redundancy. This was an individual who was taken on for a specified purpose, contract had been extended beyond the two years and once you go beyond the two years you then get certain statutory entitlements. So it was simply a follow through of the statutory entitlement.

Philip Lane:
I'm not sure of the specific areas they were working in but I mean it just follows through in relation to following through on what we are required to do from a statutory point of view.

Vincent Boland – Financial Times

In relation to profitability how much more profit would you project that the bank can make out of the IBRC portfolio and when will the decline to more normal levels begin? I mean is there another year or more of exceptional profits to be made?

Philip Lane:
We really can't predict the future path of disposals. What you've seen is that the pace of disposals has been significantly above the minimum levels that were outlined at the time of the 2013 liquidation. At the same time it's also the case it's at a fairly measured pace. So the speed of disposals is going to depend on a range of factors which we've captured throughout in how we think about it, is that the disposals, it's important to make the disposal subject to conditions of financial stability. Which as you know can vary for all sorts of reasons. So it would be I think not a good idea to give a fixed forecast but you know what is true is that at some point they will come to an end and at that point we are going to look at a more normal situation.

Vincent Boland:
What is the normal level of profitability?

Philip Lane:
Let me say there's a second factor currently now also with the asset purchase program because of the fact that the European system is committed to buying assets as part of monetary policy the balance sheet is bigger for that reason also. So that factor also over some period of time will not be moving in the same direction. So I think there's two factors which means the current situation is not if you like normal. But you know the most basic calculation you could make there is we've said the profit level is 2.3bn which 1.9bn relates to the special portfolio, so the remaining which I wouldn't classify as normal but maybe closer to normal as 400m.

Dara Doyle - Bloomberg:
Governor could you explain to us again how central bank makes profit on the special portfolio, I used to understand it but I've forgotten it.

Philip Lane:
Sure, there are two components and it's important to say these are the central bank profits. Of c0urse from the point of view of the State in terms of a wider sense of what does it mean in terms of the overall calculations. It's that the interest income, these were fairly high interest rate bonds because they were struck if you like in early 2013 when the Irish Government if they went to the open market were paying a pretty high interest rate if they had tried to raise money at that point they would have been at a high interest rate.

So part of it is on the bonds we hold, we receive interest income from the Government and essentially that's flowing back to the Government because the interest income is part of the profit. The second element is of course in a low interest rate world the market value of these bonds is high, much higher than at the time of acquisition. So when there's a disposal of these bonds when we sell off these bonds then there's a capital gain which then again is returned to the State. So those are the two elements of the accounting treatment. It's the central bank accounting view of it.

Dara Doyle:
The NTMA had to pay higher …

Philip Lane:
Exactly but it's also important to take into account the NTMA currently is able to fund at very low interest rates and if you like let's see 25 or 30 years from now about the calculations because I think from the wider public finances point of view a question in terms of the NTMA interest in buying these bonds you'd have to ask the NTMA but I think our view of the world is that the current low interest rate world won't necessarily last forever. And the ability of the NTMA to refinance if you like at low interest rates compared to the high interest rate environment of 2013 is part of the calculation here.

Dara Doyle:
1.9…

Philip Lane:
2.3bn yeah, yeah.

Padraic Halpin – Reuters:
Governor just quick ECB related questions. Just looking forward to the meeting in June should the ECB drop the references to downside risk or easing bias at that meeting? Just on a couple of data points there's strong GDP out today and there was inflation figures on Friday that were very strong as well. What are the implications for those in your thinking?

Philip Lane:
I don't think it would be good idea to, you know one week after the recent monetary policy meeting to start jumping ahead to the next monetary policy meeting. What is true of course is June will have a new forecast and as you say the kind of, the news that arrives day by day about certain numbers would be factored into the forecast. So I look forward to reading what the European system forecasts in terms of inflating GDP. When we get those updates of course that's relevant.

But I think if you listen to the press conference last week I think Mario Dragi conveyed the views of the General Council which is it remains the case that the current accommodated market strategy its important to maintain that while we have inflation well below target. We have to assess at what point would inflation be clearly on a sustainable path towards the target and until that day arrives the current strategy is in place.

Vincent Wall - Newstalk:
Just following up on Darragh's question Governor I was very disappointed that he couldn't remember the process, but seeing as he asked is it fair to say I mean obviously this is the central bank accounting process here but is it fair to say given the interest paid by Government goes back as profits and the NTMA buys the bonds for you in a holistic exchequer or State level there's no surplus being generated in response to the IBRC situation.

Philip Lane:
No, I don't think that's correct either. It's going to be a case of calculating at what point will interest rates go up again. Because right now it depends on at some point these bonds will mature so let's say we held onto these bonds until maturity at that point the NTMA would have to refinance this debt and what would be the interest rate at that point. We know interest rates are low now at least by historical norms and so if the Irish government can fund

itself at a fairly low rate at the moment that is the forward looking calculation. Is it better to refinance ahead.

The NTMA all the time is managing the national debt it might retire at a given maturity and replace it and that's up to the expertise of the NTMA to work out. What is optimal? I mean they have their job to do we have our job to do. And their calculations has to compare, the refinancing cost now versus taking the risk of waiting until the bonds mature before refinancing. So there is a genuine economic issue which the NTMA has to grapple with but I think the core of it is now versus later and given interest rates are low now that's a material issue in deciding whether they want to buy up these bonds.

Vincent Wall:
The second is a totally different one, is there a timeline at this stage in terms of the administrative sanction process against the former Irish Nationwide Executives and Board members.

Philip Lane:
The process is live, you know, but you know that this case is complex. There's a lot of documentation and the inquiry has to do its job. So you know we can't really as with any procedure it's really had to forecast in advance how long it's going to take. But there is a lot of effort going in to making that process work but you know I can't give you a timeline on it.

Peter O 'Dwyer – Times Ireland
Governor you mentioned in your remarks that you were satisfied with the capacity of the bank to deal with the level of applications and authorisations that are coming via Brexit. Can you just outline how many staff have been allocated to deal with those applications if you expect that staff will have to grow over time and how many vacancies there are across the bank generally at the moment outstanding?

Philip Lane:
Let me talk about how we are handling Brexit, I'll ask Gerry Quinn to talk about the overall vacancy issue. So if you like we've got maybe three levels of engagement with Brexit. First of all it's a big priority for large parts of the bank so the senior management of the bank across many dimensions are dealing with Brexit related issues on a day by day basis.

So it's clearly a bank-wide priority and a lot of man-hours and management hours are going into that. Number two in some areas there were earlier indications about how many authorisation requests would come in, so we had an early point at the end of last year we made specific provision for extra hiring in those areas in relation to Brexit and we announced at the end of last year there's going to be about 28 extra jobs.

Then as we go along what's going to happen is as we, if we see a more concrete realisation at a given firm is going to seek authorisation then we will on a contingency basis, at fairly high frequency decide we need extra staff to take on this extra workload. Let me emphasise it's not the case that you know for an important authorisation we are waiting for new staff to arrive. But what's true is given the overall workload would be going up, given our more experienced staff will be leading the work on important authorisations there will be an element of back filling. For those people to be pulled into important Brexit related work other people need to be brought into the organisation. So you know I think it's this kind of approach is fairly calibrated and I think as we said in the statement we think its going to be okay.

Sorry Gerry on the vacancy issue?

Gerry Quinn:
In the overall situation we've just over 1,600 full time equivalent at the moment and we aiming for approximately 1,800 so at the moment we have in the region of 175 – 200 active vacancies.

Peter O 'Dwyer:
(Inaudible)

Gerry Quinn:
It's an ongoing process in terms of filling those, last year we had a net increase of about 83 fulltime equivalents in the organisation. That was added to about 150 in addition the previous year so we've grown by over 200 over the last two years and our agenda is to grow by that additional 200 over the coming months.

Colm Kelpie – Irish Independent:
Governor just following on from Peter's question you made a point in the report that the retention payment policy, there are no further payments due under that. Does that mean that policy is ended or would you like to see a policy like that continue because Cyril Rue makes the point in your internal interview that there is still an issue retaining and attracting staff so is that an issue in your view particularly in the context of Brexit.

Philip Lane:
It's not a current issue so the policy exists and the policy is pretty specific. So there's a range of criteria must be met before a retention policy would be triggered. But it's a natural part of dealing with that situation. So there's no current, you know since I've arrived there's no current new cases but as you point out with Brexit maybe there will be situations in the future I don't know. But I think it's a natural part of the toolkit to have a retention policy.

Colm Kelpie:
(Inaudible).

Philip Lane:
Well I think you see this across not just the public sector which of course we live under the public sector pay policies. The private sector also given the economy is doing so well, given that employment is growing quite strongly many firms and many institutions do have to deal with vacancies, do have to deal with retention issues. So you know it is a management challenge but I think especially in capital city I'm fairly sure its also the case for regulators in other financial centres its just part of life to deal with that problem.

Vincent Boland:
Governor how many institutions have approached the central bank for authorisation to operate in Dublin since the Brexit referendum and how many have you authorised?

Philip Lane:
We did discuss what can we say about this. I think it's not useful to say here's the number, because you can have very marginal inquiries like a phone call or something. You can have really substantive engagement, you can have a collection of small firms which are not really going to move the dial in terms of the Irish financial system. You could have other firms which are quite significant, which if a small number of those firms arrived would be quite important. It remains the case I think by and large, well you know you will see yourself as these firms report on their own thinking, it remains the case that many firms have yet to enter a decision making mode. They are still debating the pros and cons I think of different locations. So let's see what happens but you know we are discussing Brexit related issues with a wide range of entities across a broad range of sectors. But you know these firms as they make decisions by and large these firms will indicate what their plan is.

Dara Doyle:
Standard Chartered ?? today said they were choosing Frankfurt over Dublin are you disappointed with some of the decisions being made by firms particularly around the insurance sector it seems we've lost out on a couple of big ones, AIG for example being an obvious contender to come to Dublin. Obviously you can't discuss specifics but in general are you disappointed with those decisions.

Philip Lane:
I think throughout my aim has been to make sure that regulatory issues essentially do not play a role in these decisions. Firms have all sorts of factors to consider. I think throughout the European system I think a lot of what you see is essentially a determination by the entire European financial system that there is a level playing field more or less maintained.

So as firms make decisions my ambition is to see that these decisions are made on non-regulatory criteria. It is a single financial system, Ireland greatly benefits from having a single European financial system, and so our responsibility is to make sure that within that we are trusted. We are seen as a reliable and trusted regulator which is doing no more and no less than implementing the broad European regulatory framework.

Dara Doyle:
Eoin Murphy talks about the possibility of regulatory arbitrary so do you disagree with him that there are other cities undercutting Dublin with being more loose around their regulations and rules. Not around banking because you can't do it around banking but around other sectors in particular.

Philip Lane:
I think lets say, I think we'd have to wait for more decisions to get enough of a caseload to work out whether that is a substantive issue. Because of course it's tempting if you read about any individual firm its tempting to infer that that decision is you know driven by every possible factor. So I think there's a determination not just in banking but across the broader supervisory system to minimise the role of regulation in this process.

What is true is regulations in some areas can be complicated and there could be genuine differences of interpretation. But I think there's a lot of exchanges within the regulatory world to try and come to as far as possible a common view. A consensus view about this is what regulatory expectations should be in relation to Brexit. We saw in relation to banking the SSM quite recently put on their website you know basically a Q&A and I think we'll see more of that.

Niall Brady – Sunday Times:
Just on the Brexit issue again, Sylvia Cronin some time ago was able to talk about figures in broad terms and she mentioned I think about twenty insurance applications that were in the pipeline back then. Can you not give us some sort of an update even on those twenty applications?

Philip Lane:
At two levels, number one is probably insurance it turns out more firms were ready to make a decision earlier than in other sectors. And as you know we've a large insurance sector here. But it's very much the case that we don't you know have a continuous feed about here's the state of play. I mean the authorisation process is an interaction between the firm and the regulator, I think every six months we have a regulatory report.

Chair:
That comes out at the end of July so we have authorisations including fitness and probity applications as well. So that end of July report we can share with you.

Vincent Boland:
Governor is it likely that Dublin simply doesn't have the heft to be a serious competitor for post-Brexit business fleeing the city of London? And the lack of housing and the infrastructure problems and the smallness of the financial services industry in Dublin are serous handicaps to the attraction of new business into Dublin.

Philip Lane:
I think from early on when I've thought about Brexit I've pointed out that there's no replacement for the city of London. London if Brexit is Brexit London is London. And every location, there's not going to be I think any one location which is going to become an alternate to London for the EU 27 or the EU area. So I would think that there's a range of factors influencing how firms make decisions.

Common factors like you know housing, infrastructure, tax systems, legal systems and every firm has its own unique history, its own unique set of linkages to different cities. And you know I think all of those factors come into play. So it's not my impression that Dublin is you know not in the mix. I think what we are seeing is Dublin is being compared to various other locations in many cases. So let's say how firms make final decisions what the pattern is in the final configuration.

Padraic Halpin:
Two separate questions, on the Brexit firms just from conversations you are having do you have any indication of when those authorisations are going to come. Is it towards the end of this year or closer? And separately there's been a lot written recently about the poor statistics around housing supply in the country just wondering if you are concerned about that and where you see house prices, in double digits figures for the foreseeable future given the lack of supply we are seeing.

Philip Lane:
On the first now that Article 50 has been triggered you know I do think many firms are entering a phase of, at least narrowing down their options and I think in more cases I think actually making decisions. So my prediction is yes the rest of 2017 will see a lot of firms moving to decision making mode. On the second question about the housing sector let me emphasise is that you know this is reflected in our assessment last year is the Irish housing market has been so volatile because you had the gigantic boom, you had the massive crash. And then you had a kind of type of recovery in recent years.

But that type of recovery has seen very low transaction volumes, you know already the supply of new housing is quite limited. But the turnover of existing homes, the normal lifecycle of housing, trading up, trading down, all of that has been very low as well. So you know in that context when you see a movement in house prices over a short period of time its important not to extrapolate from that. Because if you like there could be all sorts of step adjustments with strong employment numbers, with the interest rate environment and so on. You can have re-valuations of where the level of house prices should be.

But I think the important feature from our point of view is our mortgage measure framework has a lot of self-fulfilling breaks in the system. So the loan to income ratio it's difficult for house prices to climb persistently if incomes do not rise in the same way. because the three and a half times income ceiling on a mortgage means that as house prices go up the cohort of households that can meet that condition shrinks. It does reinforce the affordability issue, you know because house prices might rise relative to average incomes but it means those who are buying if they are meeting our criteria which is a fairly tight criteria compared to the UK that three and a half time income is, and then our percentage deposit requirements you know one category is first time buyers which is 10%.

A lot of the market, you know last year about half the transactions are first time buyers half are second time buyers you know trading up, trading down. For those the 20% deposit requirement remains unchanged and the buy to let is 30% deposit requirement. As house prices go up the amount of cash you need to fulfil those requirements goes up also. So there are self-correcting features compared to what, you know this framework was absent during the boom period in mid-2000s. So I don't think we can have the same dynamic as we had before. Because of the fact that those brakes are in the system.

Eoin Burke Kennedy – Irish Times:
The same sort of issue but the central bank provision to its mortgage lending rules has even criticised recently for fuelling further inflation I'd like your view on that. And then is it your impression that we may actually lose Brexit related business because of the infrastructure bottle necks which currently exist.

Philip Lane:
On the first you know I think it's important to emphasise a few things. One is in a very positive economic environment the fact that house prices are going up is maybe not too surprising. Especially given the fact that there's still the adjustment from the boom/bust cycle we had. So where house prices should settle down you know in terms of the economy I think remains a genuine debate. Of course the constraint in supply issue is also very relevant. But let me zero in on the revisions to our rules last November.

By and large the rules were unchanged the one revision was that for first time buyers looking for a house value above 220k there was this new requirement that instead of having to put down 10% on the first 220k and 20% on the balance now its 10% for the full value of the house that is a fairly small segment of the overall housing dynamics. And its also the case under the original framework when we looked at it and we published this last November when we released the review a large fraction of households were putting down more than the minimum deposit so they were not, they were unaffected by this change. Equally a significant fraction were receiving exceptions, we had this exemption framework so a certain fraction of the loans could be exempted from the rules.

So they've the fraction of households which are being actually affected by this revision. It's not zero, it's definitely a part of what's happening in some slices of the Dublin housing market. But it's only a fairly small slice because it didn't affect the second time buyers, and the material impact on the size of the, the ability of households to borrow money in certain cohorts its there and been for many others its not there. I remember the loan to income ratio is still there it's three and a half times.

So given all the different conditions required to satisfy our rules, it may well be playing a role but it cannot be the main source of what's going on. Because the cohort of borrowers affected by that relaxation is fairly restrictive compared to the whole housing market? Sorry your second question was Brexit infrastructure, I think many firms if you like what they think about now is two or three years from now will I have office accommodation. Two or three years from now will my workers be able to find school and housing.

So there is, you know I think the window is tight but it's not an issue about the current infrastructure it's about, it's a mix of the current infrastructure plus projections about how quickly will some of these problems be fixed. Because of course Brexit is not going to happen for two years at least, the scale of firms will naturally be limited until Brexit actually happens. So there is some time to work on those issues. But you know of course the primary interest in fixing these infrastructure problems is domestic. The domestic population want these problems fixed. Secondarily of course those looking to relocate would also welcome anything that improves the bottle necks.

Chair:
Thank you very much, may I invite any final questions?

Niall Brady:
Just returning to the Brexit issue again, you mentioned that regulation shouldn't be part of the decision as to where firms relocate to. I think yet we've seen AIG and Lloyds of London both would have referred to regulations as a factor in their decision making. And certainly within the insurance sector there seems to be a perception that maybe other jurisdiction are more lenient in terms of the proportion of business that can be reinsured and how that's treated for capital purposes and that Dublin has a much harder line on those issues.

Philip Lane:
Let me make the point, one is I'm not going to comment on the motivations behind individual, the decisions by individual firms. So I've nothing to say on that. But as you mentioned earlier on we did disclose, Sylvia Cronin did describe the fact we have had a significant number of applications in the insurance sector. So I would not view it as a case that the insurance sector is here, we are viewed as quite a strong regulator. We've a lot of

insurance activity here so I think the evidence is there that firms are interested in looking for authorisations here.

Chair:

Thank you, if there are no further questions thank you very much. We look forward to engaging with some further questions when we see you next month for the macro financial review. Thank you very much.