Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Brexit Task Force:

June 2019 Update

Circulated to Commission Members on 13 June 2019

Contents

Executive Summary

- Since the last Brexit Task Force report, a further significant weakening of the sterling exchange rate has been recorded, reflecting perceptions that the probability of a 'no deal' Brexit has increased. Over the last month, since early May, sterling has depreciated by almost 5 per cent against the euro to €1.125 and by around 4 per cent against the dollar.
- In the UK, economic growth during 2019 has been supported by an increase in stock building due to the threat of a 'no deal' Brexit. Household consumption and business investment continue on their diverging trends, with the former increasing amid real income growth, and the latter falling for the fourth consecutive quarter. The Decision Maker Panel survey suggests that Brexit uncertainty has affected business investment.
- Despite uncertainty in relation to Brexit, as well as further depreciation of sterling against the euro, Irish trade with the UK has held up reasonably well during 2019. It is likely however that Irish export growth was supported by UK firms stockpiling, and import demand from the UK may be lower through the rest of the year.
- Indicators of Irish business sentiment have weakened significantly in recent months while the decline in consumer sentiment evident in the first quarter of 2019 has continued into the second quarter. There is tentative evidence of a limited effect of Brexit uncertainty on savings decisions of households.
- [Omitted due to confidentiality].
- The Central Bank's Brexit Steering Committee (BSC) continues its Brexit work to monitor and mitigate Brexit cliff edge risks and undertake any contingency planning required. This includes keeping under review, and remaining prepared for, the need for any further invocations in relation to Brexit.
- The BSC also commenced an interim lessons learned exercise in Q2 2019 to review the internal capabilities required to respond to Brexit developments and to identify any knowledge gaps or risks that had emerged in the run up to the two initial Brexit dates.
- [Omitted due to confidentiality].
- Banks and supervisors were in general prepared for the cliff edge effects of a 'no deal' Brexit at the end of March 2019. With the extension of Article 50 to end October, the opportunity is being taken, nonetheless, to see how […] Supervision can improve on supervisory […] response for the banking sector given the lessons learned to date.

- The extension of Article 50 has led to a delay in the transfer of material business to Irish entities […].
- For the Insurance sector, no new sectoral risks or issues have emerged since the delay to Brexit. The Insurance Directorate is continuing to engage with firms to ensure they are Brexit ready and with European and UK regulators to ensure identified risks are mitigated.
- Supervisors in AMS continue to engage with Medium High and Medium Low Impact firms to understand any business impact arising from the delayed Brexit timeline. Firms are expected to continue to assess and update their contingency arrangements and to ensure that preparations continue for a 'no deal' Brexit.
- SMSD is taking the opportunity provided by the Brexit extension to analyse outstanding issues and assess where lessons can be learned from previous preparations. This will allow the directorate to streamline and improve processes ahead of the new UK departure date and to ensure that it is once again 'no deal' Brexit ready.
- Every action, beyond a relatively minor change to the Companies Act by the Minister of Business Enterprise and Innovation, has been completed to facilitate Euroclear UK and Ireland (EUI) continuing to provide services in a 'no deal' Brexit outcome.
- Euroclear published a White Paper detailing the long-term solution on 8 May 2019. [Omitted due to confidentiality].
- Since the last update was provided, the operational risk environment resulting from Brexit has not changed significantly within the Central Bank. [Omitted due to confidentiality].
- [Omitted due to confidentiality].
- [Omitted due to confidentiality].
- Special Topic 1 uses BIS data to get insights into the role of banks based in the UK and British banks in terms of their cross-country banking linkages vis-à-vis the rest of the EU. While cross-border banking has retrenched since before the financial crisis, the difference between the EU28 and the EU27 exposures underlines the importance of the UK domiciled and British banking sector, with a large share of EU cross-border banking going through the UK. The Brexit process has already affected the EU27 banking landscape through relocations, with possible implications for financial stability.

Overview

Following the Brexit referendum, the Central Bank's Financial Stability Committee (FSC) requested that a Task Force on Brexit implications be established on a permanent basis to monitor and assess developments in this area.[1] The Brexit Task Force (BTF) provides updated information regarding political, economic and financial market developments, risks arising for firms supervised by the Central Bank and issues arising for the Central Bank itself, in particular with respect to authorisations. Furthermore, each report selects a number of issues or policy questions related to Brexit and provides an in-depth examination of these areas.

This twelfth BTF Report follows the twelfth meeting of the Task Force on 23 May 2019. The Report is structured as follows:

Section 1 provides a brief update of political developments; Section 2 provides an update in relation to the economic impact in Ireland arising from Brexit and an updated on the UK economic environment and monetary policy; Section 3 provides an overview of contingency planning and cliff edge risks; Section 4 provides an update in relation to contingency planning across sectors; Section 5 considers organisational risks for the Central Bank; Section 6 provides an overview of authorisations activity […], and Section 7 contains a Special Topic on UK cross-border banking and the EU.

[1] The following Divisions and Directorates are represented on the Brexit Task Force: AMSD, AMAI, BSAD, BSSD, CPD, FMD, FRG, FSD, GSD, IEA, IR, SMSD, INSA, MPD, ORD, Risk, SRD, PSSD, RES, and RCU. The report has also benefited from discussions with the Department of Finance (DoF). The Chair is the Director of Economics and Statistics, and the Secretariat is provided by MFD (Shane Byrne) and STSD (Andrew Hopkins).

1. Political Developments[2]

Article 50 Process State of Play

In response to Prime Minister May's letter requesting an extension to the Article 50 process, the European Council agreed at its meeting on 10 April to a further extension, up to 31 October 2019. The extension includes giving the UK flexibility to leave before that date, if both the EU and the UK ratify the Withdrawal Agreement before then. The European Council made clear that there can be no reopening of the Withdrawal Agreement.

The next European Council on 20-21 June will take stock of progress in the UK.

UK Developments

Following the European Council's decision at its meeting on 10 April to extend the Article 50 process until 31 October 2019, there are few signs that the UK is any closer to breaking the current impasse on Brexit. Six weeks of talks between the UK Government and opposition Labour Party ended without agreement and the Conservative Party leadership contest is likely to dominate UK politics for weeks to come, with 10 candidates declared.

European Parliament elections took place in the UK on 24 May. The newly-formed Brexit Party won 29 seats, followed by the Liberal Democrats (16), Labour (10), the Greens (7), the Conservatives (4), Scottish National Party (3) and Plaid Cymru (1). Overall the hard-Brexit/Remain vote largely matched the referendum result in 2016, and demonstrates that the UK remains highly polarised, putting pressure on both main parties to adopt harder positions.

On 24 May, Prime Minister May announced that she will resign on 7 June, with the process to elect her successor to begin the week after her resignation. The end of her three-year tenure was hastened by a backlash within her party against her speech announcing a "new Brexit deal" on 21 May. The formal process to elect her successor will see a series of votes by Conservative MPs from 13 to 20 June to narrow down the field of candidates to two, who will be put to a vote of the party membership (some 160,000). The new party leader would be in place by the week of 22 July, before the

[2] Our thanks to the Department of Finance for providing the background information on the latest political developments.

Parliamentary summer recess. A number of leadership candidates have indicated that they will seek to leave the EU on 31 October 2019, with or without a deal.

Domestic Developments

On 17 March, the Withdrawal of the UK from the European Union (Consequential Provisions) Act 2019, was signed into law by President Higgins. The Act focuses on areas that needed to be addressed through primary legislation, under the broad themes of protecting the citizen, and supporting the economy, enterprise and jobs. It includes legislative measures in relation to Financial Services for the Settlement Finality Directive and the insurance run-off regime. The sections can be commenced as necessary. The Act is consistent with, and complementary to, the steps taken at EU level to prepare for the UK's withdrawal.

The Act forms part of the extensive preparations that are underway across Government and the EU. Preparations include a range of measures such as the recruitment of customs and SPS officials, preparations at our ports and airports, and a range of financial and advisory supports for businesses to help them to prepare for Brexit.

On 8 May, the Tánaiste and Minister for Foreign Affairs and Trade, Simon Coveney TD, and Chancellor of the Duchy of Lancaster, David Lidington MP, signed a Memorandum of Understanding (MoU) reaffirming both countries' commitment to the Common Travel Area and to maintaining the associated rights and privileges of Irish and British citizens under this longstanding reciprocal arrangement.

On 21 May, the Tánaiste and Minister for Foreign Affairs and Trade, Simon Coveney TD, briefed Cabinet on Brexit planning and preparation and the need for businesses who trade with the UK to continue their preparations. Government planning for all possible outcomes will continue.

2. Economic Background

2.1. Summary of Latest Irish Developments

Since the last BTF report, the Central Bank has revised down the forecast for growth in the Irish economy. This is primarily due to the less favourable and more uncertain international environment and domestic capacity constraints as the economy approaches full employment. GDP is expected to grow by 4.2 per cent in 2019 and 3.6 per cent in 2020. This forecast represents a downward revision of 0.2 per cent for 2019 compared to the time of the last BTF report. The forecast for 2020 is unchanged.

Macroeconomic Impact of a Disorderly 'No Deal' Brexit

The most pertinent risk to the Irish economy over the forecast horizon is that of a disorderly, 'no deal' Brexit. If the UK were to leave the EU with no transition period in place, the agreements that underpin Ireland's trade relationship with the UK would no longer apply. All areas of economic activity would be affected, with most of the impact on exporting as well as importing firms for whom the UK is a key part of their supply chain or consumer market.

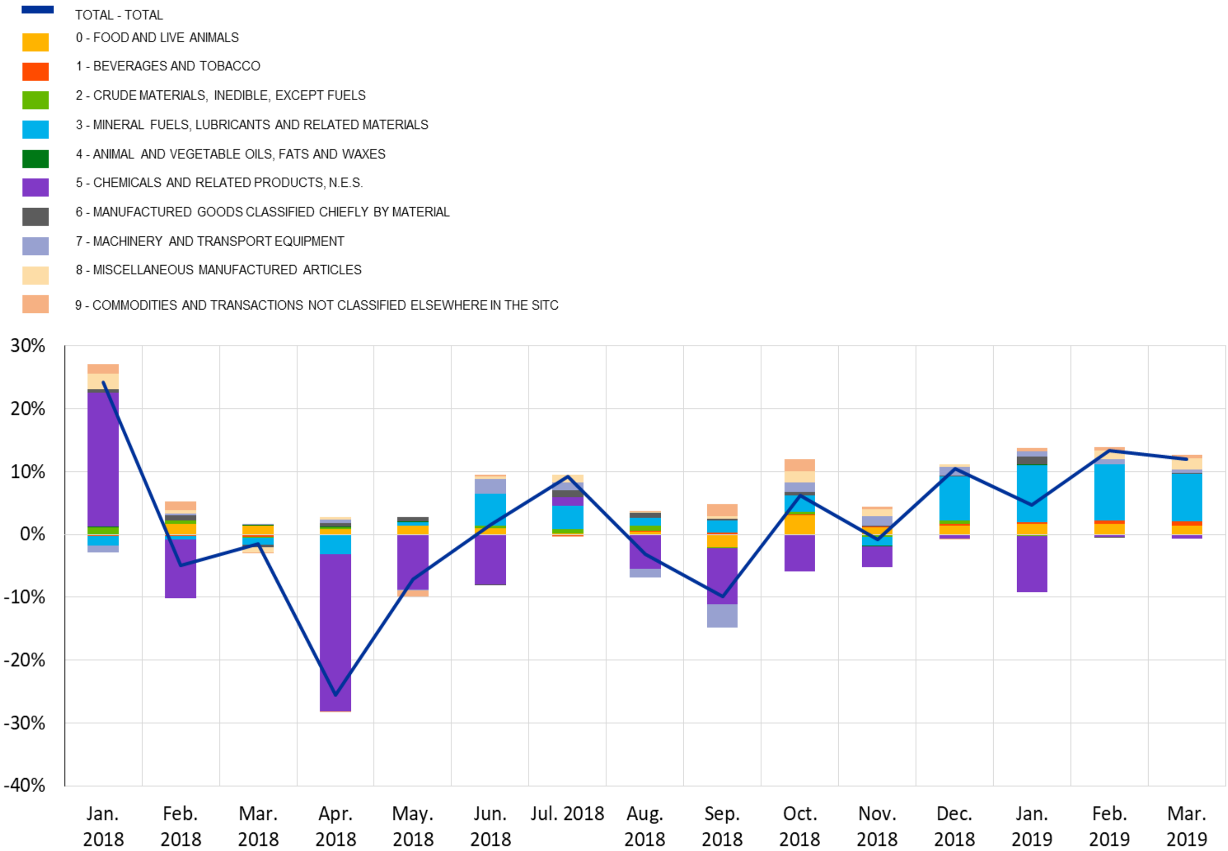
Previous Central Bank research[3] estimates that a 'no deal' Brexit would reduce output growth by 4 percentage points in the first year. Given that the possible date of the UK's exit from the EU is now October 31 of this year, most of the impact would be in 2020. [Omitted due to confidentiality].

Trade

While exports to the UK declined by 1.8 per cent in 2018, the first quarter of 2019 has shown a return to export growth. In value terms, exports are up 9.8 per cent when compared with the first quarter of 2018. This growth was heavily concentrated in exports of energy products ("mineral fuels, lubricants and related materials" category) (see Chart 2.1.1). Furthermore, within this category, "electrical current" contributed 8.6 percentage points of the total 9.8 per cent export growth. Were this product removed from the analysis, annual growth in exports would have been close to zero in the first quarter.

[3] Conefrey, O'Reilly and Walsh. G. The Macroeconomic Implications of a Disorderly Brexit. Quarterly Bulletin 1, 2019. Central Bank of Ireland.

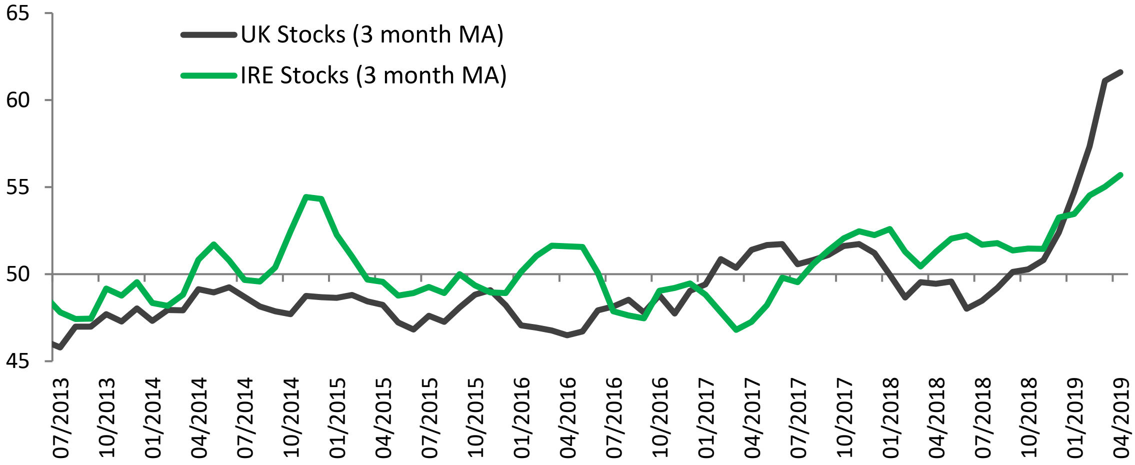
Chart 2.1.1: Contributions to UK export growth by Product Category



UK imports were particularly strong in the first quarter of 2019, with the narrative from UK commentators suggesting that this is primarily due to firms' stockpiling in preparation for the 29 March Brexit deadline. As shown in Chart 2.1.2, the UK stockpiling PMI is at its highest level since the series began. It is likely that Irish exports to the UK in the first quarter were supported by these developments and, if these stocks are unwound, export demand from the UK will be weaker throughout the rest of 2019. Irish firms have also increased the rate at which they are building up inventory, albeit not to the same extent as their UK counterparts. If uncertainty diminishes over the coming months and these stockpiles prove unnecessary, firms may seek to discount stock to expedite unwinding.[4]

[4] https://www.markiteconomics.com/Public/Home/PressRelease/8062928457f94913931debe1e7d75855

Chart 2.1.2: Stocks of purchases PMI

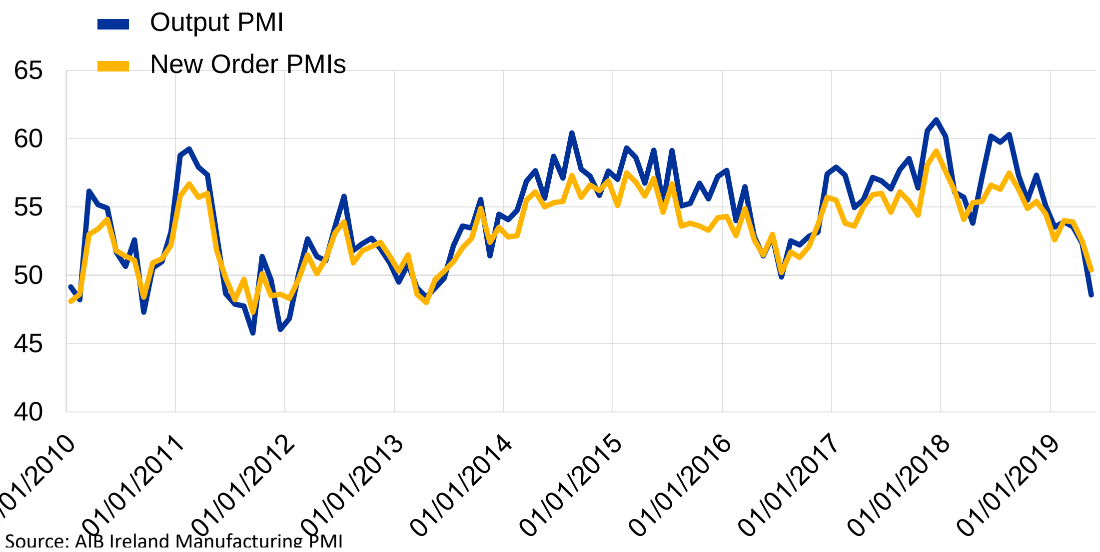


Source: IHS Markit - Stocks of Purchases PMI

Sentiment

Business sentiment, measured via the purchasing managers indices improved in the first quarter, more than likely related to the Brexit stockpiling discussed in the above section. However, the first quarter may be related to UK demand being brought forward in anticipation of a 'no deal' Brexit on 29 March. Consistent with this view, the latest readings (May 2019) for both output and new orders both weakened significantly. Significantly, the new orders index fell below 50, signalling contraction, for the first time since July 2016 after the referendum.

Chart 2.1.3: Output and New Orders PMIs



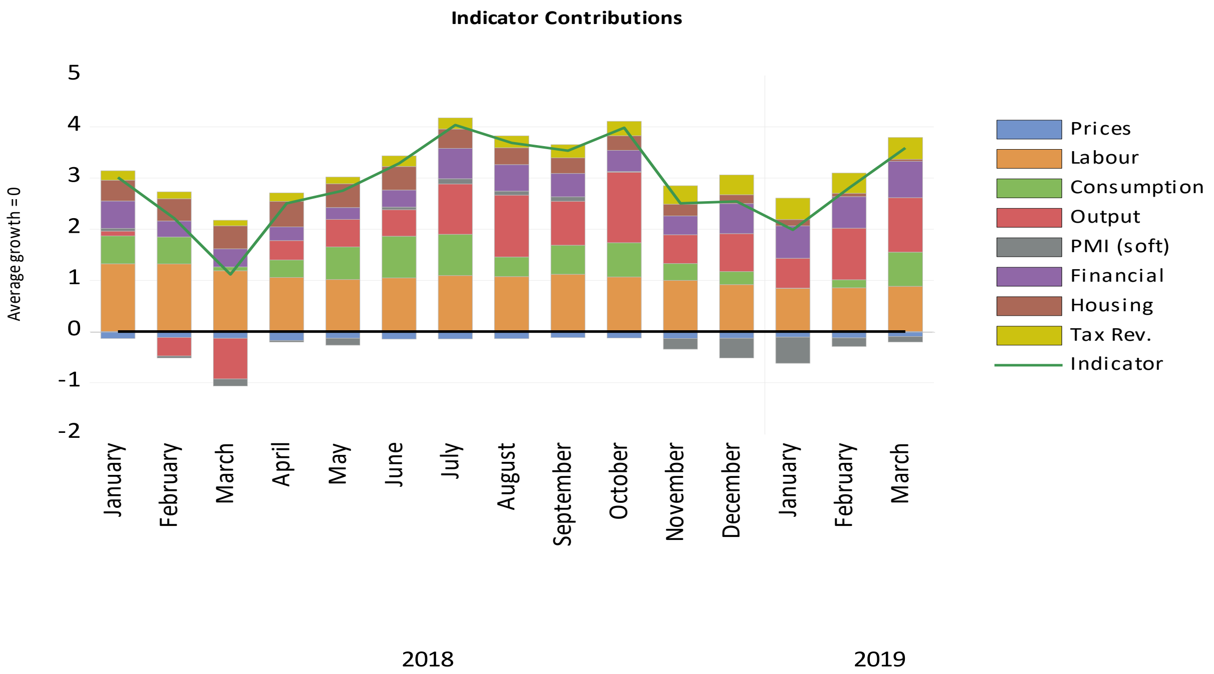
Source: AIB Ireland Manufacturing PMI

The latest KBC-ESRI Consumer Sentiment index shows that the decline seen in the first quarter of 2019 has continued into the second, down 5.4 index points to 87.7.[5] This represents a fall of 16.3 points since April last year. The majority of respondents have a negative outlook for the Irish economy's prospects over the next twelve months, with the General Economic Outlook index standing at 40.9.

In terms of households' views of their own finances, both the present sentiment and outlook have weakened since March. While the reduction in the present financial situation index was small (1.8 points), the future financial situation index fell by 9.8 points, possibly due to respondents considering some Brexit related difficulties in late 2019. As with the stockpiling activity mentioned above, these trends may well reverse should a deal be reached before October 31.

The Bank's Business Cycle Indicator[6] (Chart 2.1.4) shows that the negative drag on growth from uncertainty diminished somewhat. The sentiment and PMI components of the model showed slightly more positive contributions in February and March than had been the case at the end of 2018/beginning of 2019.

Chart 2.1.4: Business Cycle Indicator



[5] https://www.esri.ie/system/files/publications/CSI2019APR.pdf
[6] https://www.centralbank.ie/docs/default-source/publications/economic-letters/vol-2018-no-14-a-monthly-indicator-of-economic-activity-for-ireland-(conefrey-and-walsh).pdf?sfvrsn=8

The BOI/ESRI Savings and Investment index indicates that Brexit is having a limited effect on saving decisions – 88 per cent of people say Brexit is having no effect. This does represent a slight decline from last year, when 92 per cent of people reported no Brexit related saving. A stronger effect is present close to the border, where 6 per cent of respondents say they are saving more because of Brexit. The equivalent figure for Dublin is 3.7 per cent.

2.2. UK Macroeconomic Update & Monetary Policy

UK Macroeconomic Update

UK real GDP growth is expected to be at around 0.5 per cent in Q1 2019. The stronger-than-expected performance is attributed to an increase in stock building due to the threat of a 'no deal' Brexit.

Household consumption and business investment continue on their diverging trends, with the former increasing amid real income growth, and the latter falling for the fourth consecutive quarter. The Decision Maker Panel survey suggests that Brexit uncertainty has affected business investment.

Growth in net trade was 0.2 per cent in Q4 2018 and it is expected to have slowed down further in the first quarter of 2019. The current account deficit has continued widening in Q4 2018, reaching 4.4 per cent of GDP.

The labour market remains tight with the unemployment rate decreasing slightly to 2.9 per cent from an already low level. Net migration in Q3 2018 was slightly higher than forecasted by the Office for National Statistics (ONS), but net EU migration has continued on its decreasing trend.

Bank of England (BoE) Monetary Policy

The BoE Monetary Policy Committee voted unanimously to hold the Bank rate at 0.75 per cent at its May meeting and to maintain the current level of government bond purchases at £435bn and corporate bond purchases at £10bn.

BoE Governor Carney observed that while a 'no deal' Brexit remains possible, he cautioned that more rate hikes would be necessary if the BoE's economic forecasts prove accurate. He also stressed the negative impact that Brexit uncertainty is having on business investment and warned that it could result in its longest post war decline. UK money markets only see a 16 per cent chance of a UK rate cut and a negligible possibility of a rate hike in 2019.

The Organisation for Economic Co-operation and Development (OECD) supports a more dovish BoE stance in the short-term and warns against raising rates amid fears of Brexit-led downturn. The OECD forecasts below trend growth of 1.2 per cent in 2019 and 1 per cent for the following year.

2.3. Financial Market Developments

Sterling has priced in a greater political risk premium in the last month; it has depreciated by under 5 per cent against the euro to €1.125 and by approximately 4 per cent against the dollar to $1.27 since it hit a peak in early May.

Sterling/dollar volatility has picked up, particularly forward markets beyond 3 months, with the foreign exchange (FX) market pricing for a Brexit delay on account of the Conservative leadership contest and an Article 50 extension to the end of October.

Options data reveals that investors are taking out more protection against sterling weakness while speculators are building short positions reflecting an increasing chance of a 'no deal' Brexit.

The UK central government accelerated its FX reserve build in Q4 2018; they rose by a sizeable 19 per cent to $146bn as the government put in place contingent measures to defend sterling if required ahead of the original EU departure date on 29 March. They have unwound some of these FX purchases, back to $118bn, on the diminishing risk of a disorderly market exit following the Article 50 extension. The central government is likely to replenish these FX reserves if the UK deadline of 31 October 2019 approaches without a deal in place.

10-year UK gilts have strengthened markedly on a flight to quality bid amid greater economic and political uncertainty and rising US-China trade tensions. The 10-year yield has fallen sharply from an April high of 120bp towards to a 3-year low of 88bp. The slope of the UK yield curve, the differential between 2 and 10-year, has fallen to 26bp, its lowest level since 2008.

3. Contingency planning and cliff edge risks[7]

[Omitted due to confidentiality]. On 21 March, EU leaders agreed to the extension of Brexit until 22 May 2019, subject to the UK Parliament approving the Withdrawal Agreement by the end of March. In the absence of this agreement, EU leaders agreed to delay Brexit until 12 April. As such, the Central Bank continued to prioritise Brexit related preparations, risk mitigation and monitoring over this period in anticipation of a potential April withdrawal date. On 10 April, EU27 leaders agreed a further delay to Brexit until 31 October 2019, subject to the UK holding European Parliament elections at the end of May, otherwise the UK would have to have left the EU on 1 June.

[Omitted due to confidentiality]. The Brexit Steering Committee (BSC) continues its Brexit work to monitor and mitigate Brexit cliff edge risks and undertake any contingency planning required. [Omitted due to confidentiality]. The BSC also commenced an interim lessons learned exercise in Q2 to review the internal capabilities required to respond to Brexit developments and to identify any knowledge gaps or risks that emerged in the run up to the two initial Brexit dates. [Omitted due to confidentiality].

In terms of the status of the cliff edge risks outlined in the March report, there was very little change during Q2 as significant efforts had been made to ensure appropriate mitigations were in place for these risks by the initial Brexit deadline of 29 March. That said, it is recognised that the continued extension of the Brexit date erodes the agreed transition period and temporary equivalence periods put in place at EU level to mitigate the cliff edge risk pertaining to UK Central Counterparties (CCP) and the Central Securities Depository (CSD). To this end, continued impetus is required by industry to avoid any complacency and ensure appropriate measures are taken to mitigate these risks over the more compressed time period available (i.e. before the expiration of the relevant transitional equivalence decisions). Another risk associated with the further extension of Brexit date is the potential loss of impetus for firms to build out their operations in line with their conditions of authorisation, albeit cognisant that the pace of the build out may change in light of the extension.

[Omitted due to confidentiality].

[Omitted due to confidentiality].

[7] For a discussion of key cliff-edge risks identified as part of the Central Bank's Brexit preparations, please see the March 2019 Brexit Task Force Report.

4. Sectoral Update

4.1. Banking

Cliff edge risks at the banks were largely addressed prior to 29 March.[8] [Omitted due to confidentiality]. Heightened engagement with banks was initiated with a focus on operational preparations and any changes in liquidity flows or patterns. In addition, an exercise was undertaken with retail and investment banks to test their ability to provide crisis liquidity information within tight timelines. [Omitted due to confidentiality].

[Omitted due to confidentiality].

[Omitted due to confidentiality]. However, the extension of Article 50 has resulted in a delay to the transfer of a material amount of market related business […], driven both by client and firm preference to delay migrations. This has resulted in compressing the timeline available for the full execution of this transfer.

A bilateral banking MoU on supervisory cooperation has been signed between the Central Bank, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The MoU is based on the template MoU which was agreed by the European Banking Authority (EBA) and the UK authorities. [Omitted due to confidentiality]. On 12 April the EBA and the BoE agreed on the Framework Cooperation Agreement. This paves the way for national resolution authorities to enter into bi-lateral Cooperation Agreements with the BoE. The Central Bank has initiated contact with the BoE in this regard. [Omitted due to confidentiality].

Given the Article 50 extension, the opportunity is being taken to review the response to Brexit for the banking sector, examining where improvements could be made including the crisis response and information gaps. This work is well advanced, with some changes being implemented already and others in development. Banking sector working groups will also to be created including: one to ensure

[8] Considering mitigating actions taken at a public level – e.g. the European Commission temporary equivalence to March 2020 and related ESMA preparations for UK CCP recognition in the event of a 'no deal' Brexit.

that all cliff edge risks[9] have been identified; and another to prepare a framework for the assessment of second order impacts of a 'no deal' Brexit, building on the work already done in this area.

4.2. Insurance

With the delay to the Brexit withdrawal date, the Insurance Directorate has continued to ensure firms are Brexit ready. This has continued past March, through ongoing engagement with supervisors and their firms, European Insurance and Occupational Pensions Authority (EIOPA) and the UK and Gibraltar regulators.

At a European level, EIOPA conducted a fifth information request on Brexit contingency plans in May 2019. The Insurance Directorate has submitted the requested information on contingency planning and it is currently under review by EIOPA. The EIOPA Multilateral Memorandum of Association (MMoU), adopted in February, was signed at the end of March. [Omitted due to confidentiality].

Internally, the Insurance Directorate has continued to host BISC meetings with Legal, Consumer Protection and Policy representatives. No new sectoral risks or issues have emerged since the delay to Brexit.

[Omitted due to confidentiality].

Contingency planning outwards: Ireland to UK

The Temporary Permissions Regime[10] (TPR) has addressed the issue of UK contract continuity. Therefore the risk that Irish insurers may not be able to service existing insurance contracts and pay out claims to UK policyholders has been mitigated for a three year time frame. There are alternative methods to the TPR and these have been discussed in previous reports. For European Economic Area (EEA) firms that do not intend to write UK business post Brexit, and intend to run-off existing UK portfolios, the UK Government has passed the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 (FSCR).

[Omitted due to confidentiality].

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[9] Over and above those that have been identified by the European Banking Authority, European Commission and internal work on Brexit cliff-edge risks.

[10] EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 legislation.

Contingency planning inwards: UK/Gibraltar to Ireland

The Domestic Temporary Run-Off Regime was passed by the Oireachtas in March 2019. This has mitigated the contract continuity risks to policyholders and will allow UK and Gibraltar firms to run off existing portfolios for a limited three-year period. All aspects of this regime have been finalised in terms of the application process, processing of the notifications and on-going supervision of same.

4.3. Asset Management

Supervisory engagement: Analysis of firms' preparation for Brexit (including a 'no deal' Brexit)

Supervisors in Asset Management Supervision (AMS) continue to engage with Medium High and Medium Low Impact firms to understand any business impact arising from the delayed Brexit timeline. Firms are expected to continue to assess and update their contingency arrangements and to ensure that preparations continue for a 'no deal' Brexit. In addition, supervisors are engaging with the newly authorised firms to understand their plans for commencing activity and any alterations to business migration plans as a consequence of the delay to Brexit.

Supervisory engagement in relation to Brexit will continue in H2 with a particular focus on 'no deal' Brexit planning, the share trading obligation requirements, and any emerging risks as the political situation evolves.

ESMA Engagement

The European Securities and Markets Authority (ESMA) Supervisory Co-ordination Network (the 'SCN') continues to meet regularly to discuss cases of authorisation requests and issues of supervision/enforcement arising from investment firms, asset managers and trading venues seeking to relocate from the UK. The Director of Asset Management and Investment Banking, Michael Hodson, represents the Central Bank at the SCN. Key issues for ESMA include, inter alia, the risk of letter-box entities, substance in the EU, governance, significant outsourcing or delegation that lead to a substantial part of the activities being carried out outside the EU and the risk of significantly different treatment between entities across the EU.

National Competent Authorities (NCAs) are invited to present live cases to the Network on an anonymised basis for discussion and as applications develop NCAs will then provide further updates to keep the Network informed.

4.4. Securities and Markets

Given the extension to the 31 October 2019, SMSD is taking the opportunity through its internal BTF to analyse outstanding Brexit issues and assess where lessons can be learned from previous preparations. This will allow the directorate to streamline and improve processes ahead of the new UK departure date and to ensure that it is once again 'no deal' ready.

Since the last quarterly report, a number of significant cliff edge risks have been successfully mitigated, such as the continuation of portfolio management delegation to the UK for Irish authorised investment funds and the temporary resolution of the CSD issue with regard to continued Irish exchange traded fund (ETF) settlement. A number of outstanding issues still remain however, with work continuing to ensure no slippage is experienced throughout the summer months and readiness is maintained.

[Omitted due to confidentiality].

Given the continued political uncertainty surrounding the UK's departure, SMSD continues to monitor the liquidity of Irish investment funds. This work, which began in late 2018, requires Fund Administrators to inform the Central Bank immediately where net redemptions of funds breach certain thresholds or where funds have activated gating or suspension of dealing. Building on this work, a number of initiatives are now underway to streamline and automate the current manual procedures involved in how the data is received by the Central Bank. This will lead to increased efficiencies and allow liquidity information to be quickly analysed and disseminated to senior management.

As referred to earlier, the resolution of the CSD issue through the European Commission's granting of temporary equivalence in respect of UK authorised CSDs, together with ESMA's approval of Euroclear UK and Ireland Limited as a third country CSD ensures that Irish ETFs will have continued settlement access in the event of a 'no deal' Brexit and into 2021. After such time, a long term CSD solution will need to be in place. On the 8 May 2019, Euroclear published "*Delivering continuity of Irish securities settlement in the long term post Brexit*". This paper sets out a clear proposal with indicative timelines for Euroclear Bank to become the Issuer CSD for Irish corporate securities as and from March 2021.

SMSD will continue to monitor Euroclear's progress in this regard and liaise with our colleagues in AMS and PSSD who are working with all relevant stakeholders in this process.

Finally, SMSD continues to monitor market activity, with analysis circulated to SMSD management and relevant staff on a daily basis. Market developments are discussed each week at market surveillance meetings, which brings together members and management of the Market Integrity, Transparency, Wholesale Conduct and AMS Market Infrastructures teams. In addition to these current initiatives, SMSD is currently analysing the potential changes in the European trading landscape arising from the relocation of firms and trading venues, along with the operation of the MiFID trading obligation for shares post-Brexit.

4.5. Consumer Protection Supervision

In the course of the Central Bank preparation for a 'no deal' Brexit scenario, there has been significant engagement with UK and Gibraltar firms operating in Ireland on a freedom of services (FoS) and freedom of establishment (FoE) basis. Much of this engagement is focused on gauging the level of preparedness of these inward passporting firms. To date, the response rate of firms has varied across sectors. Consequently, the extension of the Brexit withdrawal date to 31 October 2019 has provided an additional window of time to address this, and the Central Bank continues to employ a risk-based approach to assess the Brexit preparedness of these firms across sectors, and is also working closely with the relevant ESAs in this regard.

4.6. Market Infrastructure

Euronext Dublin (Euronext) currently uses CREST – the securities settlement system operated by Euroclear UK and Ireland (EUI) to settle Irish corporate securities. Once the UK fully exits the EU, Euronext will no longer be able to use CREST without an equivalence decision from the European Commission and ESMA's recognition of CREST. Furthermore, once the UK exits the EU, CREST requires a solution in order to be eligible to avail of TARGET2 (T2) for euro settlement as T2 access is restricted to systems managed by entities established in the EEA unless connected directly to the T2-ECB module.

On 19 December 2018, the EU Commission published an implementing decision on the temporary and conditional equivalence of the regulatory framework for CSDs of the UK in accordance with Regulation (EU) No 909/2014. On 1 March 2019, ESMA announced that, in the event of a 'no deal' Brexit, the CSD established in the UK (EUI) will be recognised as a third country CSD to provide its services in the EU. On 18 February, the Governing Council decided that CREST can connect to T2-ECB for a maximum two years post March 2019 which ensures CREST access to the TARGET2 (T2) and the continuity of euro settlement.

Legislative changes were required to ensure that EUI can continue to provide services in a 'no deal' Brexit scenario. In this regard, Irish Settlement Finality legislation[11] was amended[12] to ensure that UK financial market infrastructures continue to get the protections in place today with respect to Irish participants.

The Irish Uncertificated Regulations (USRs)[13] will also need to be amended to allow for the recognition by the Minister of Business, Enterprise and Innovation (BEI) of an operator of a relevant system approved by a competent authority in a third country. The USRs amendment will be made by the Minister of BEI in a separate non-primary legislative process and can be completed at short notice once it becomes known that a 'no deal' Brexit will occur.

In summary, every action, beyond a relatively minor change to the Companies Act by the Minister of BEI, has been completed to facilitate EUI continuing to provide services in a 'no deal' Brexit outcome. The Minister of BEI responded to the Governor earlier this month confirming that a change will be implemented if required (i.e. in a 'no deal' Brexit outcome)

Long-term solution

Preparations for the migration of the Irish equities and some ETFs market to Euroclear Bank in March 2021 are ongoing. Euroclear published a White Paper, detailing the long-term solution, [Omitted due to confidentiality]. Market participants primary area of concern with regard to project planning, is the migration mechanism to facilitate the transfer of all issuers to the new CSD.

[11] The Settlement Finality Directive (98/26/EC)
[12] As part of the Withdrawal of the United Kingdom from the European Union (Consequential Provisions) Act 2019
[13] Companies Act, 1990 (Uncertified Securities) Regulations, 1996

They are seeking a legislative change to facilitate the move and are engaging with the relevant Government Departments (BEI & DoF) on their proposal. However, the Government departments have emphasised that there are no risk free options and issuers must explore alternative options (i.e. individual scheme of arrangements through the Irish Courts) as primary legislative change cannot be guaranteed in the timeframe.

5. Organisational Risk

[Omitted due to confidentiality]. On completion of the first and second phases of the assessment, which were heavily focused on engagement with first line divisions, ORD has now moved into the third phase of the three-stage methodology which is the ongoing monitoring and challenge of risks provided by first line divisions via their divisional risk registers.

Since the last update in March 2019, the operational risk environment resulting from Brexit has not changed significantly. The five high level themes initially identified remain relevant, as any risks that have been subsequently identified by divisions sit comfortably within one of these themes. As a recap, the five high level themes identified were as follows, (i.) volume of authorisations, (ii.) increased scope of supervisory requirements, (iii.) adequacy of resourcing and the consequent need to re-prioritise existing work demands, (iv.) continuity and enforceability of legal contracts, and finally, (v.) ensuring GDPR requirements are managed.

[Omitted due to confidentiality].

In relation to legal contracts, the cross-border transfer of personal data and business continuity, a three phase process has been completed (data clean, distribution and monitor). [Omitted due to confidentiality].

ORD will continue to review progress in this regard and challenge in line with the Central Bank's ORM Framework.

6. Authorisations Activity

6.1. Overview

[Omitted due to confidentiality].

6.2. Asset Management Supervision

[Omitted due to confidentiality].

6.3. Banking

[Omitted due to confidentiality].

6.4. Consumer Protection

[Omitted due to confidentiality].

6.5. Insurance

[Omitted due to confidentiality].

6.6. Securities and Markets Supervision

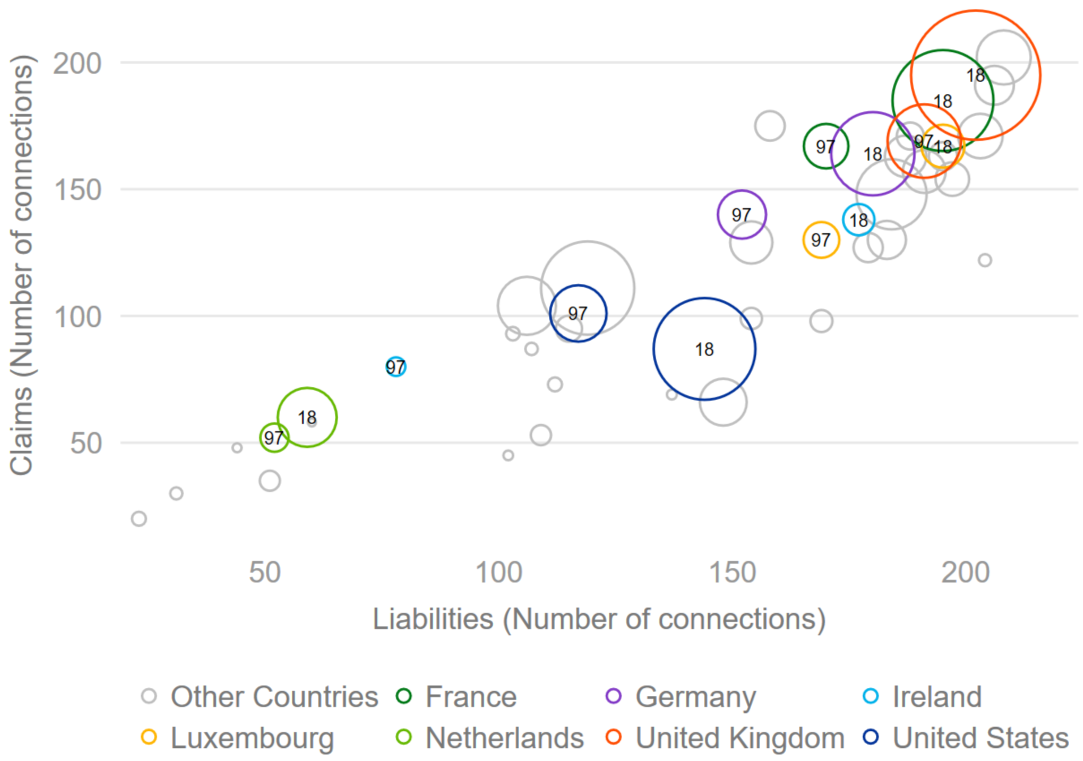
[Omitted due to confidentiality].

7. Special Topic 1: UK cross-border banking and the EU: insights from the BIS banking statistics[14]

In this Special Topic, we use Bank of International Settlements (BIS) data to get insights over the role of banks based in the UK and British banks in terms of their cross-country banking linkages vis-à-vis the rest of the EU.

Cross-border banking has retrenched since the crisis (Emter et al. 2018)[15], yet other dynamics were also at work. Some of these dynamics took place over the last decade, while some others pre-date the crisis. Chart 7.1.1 shows the increase in total value of cross-border assets and liabilities for each country over twenty years, represented as the size of the bubbles in the graph. The UK kept its primacy on this front over the period in the graph, but other countries have also increased their cross-border assets and claims over this longer time span.

Chart 7.1.1: Size and connectedness of banking centres (1997 and 2018)



Source: BIS Locational Banking Statistics, Calò and Herzberg (2019, forthcoming). The graph reports the number of connections for each reporting country for cross-country claims and liabilities in 1997 and 2018. The size of the markers reflects the sum of cross-country claims and liabilities vis-á-vis all counterparties for each reporting country. Grey markers identify other BIS reporting countries.

[14] Special Topic provided by Silvia Calo (International Relations)

[15] Emter, L., Schmitz, M. and Tirpák, M., 2018. Cross-border banking in the EU since the crisis: what is driving the great retrenchment?. *Review of World Economics*, pp.1-40.

When looking at cross-border banking connections – i.e. the number of countries with which a country reports cross-border assets (or liabilities) reported on the axes of Chart 7.1.1 – these have continued to expand, in particular for some small centres such as Ireland and Luxembourg. The UK on the other hand lost it primacy in connectedness when in 2013 Switzerland overtook it in terms of degree centrality for both assets and liabilities. In that same year, Belgium overtook the UK on the liabilities side.

Banks based in the UK are less EU-oriented than their European peers are. This was already true before the onset of the crisis, but a further decreasing trend has continued thereafter. Already well below ratios of other European banking sectors, cross-border claims vis-à-vis the EU dropped from a peak of under 50 per cent of total in 2008, to 40 per cent (Chart 7.1.2).

Chart 7.1.2: Share of cross-border claims vis-à-vis the EU by domicile

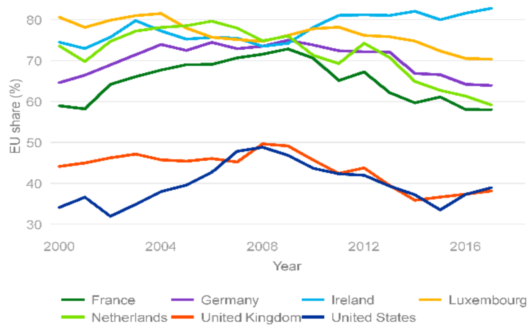


Chart 7.1.3: Share of international claims vis-à-vis the EU on a consolidated basis

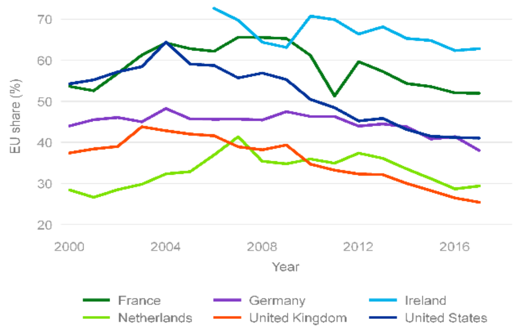


Chart 7.1.4: Share of cross-border claims vis-à-vis the EU27 by domicile

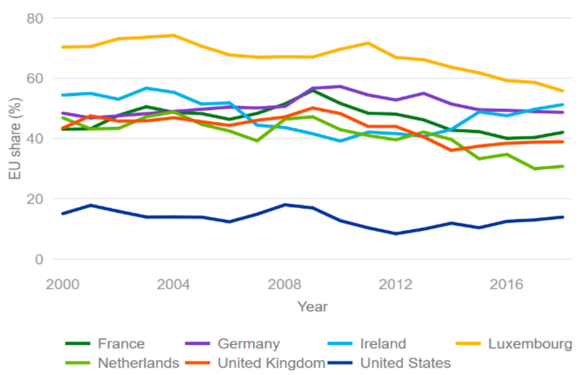
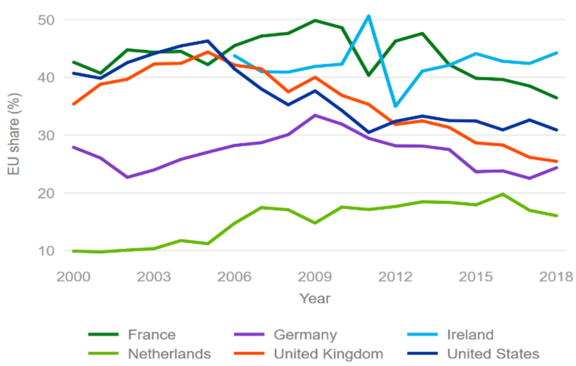


Chart 7.1.5: Share of international claims vis-à-vis the EU27 on a consolidated basis



Source: BIS Locational Banking Statistics and Consolidated Banking Statistics. Authors' calculations. Data refers to Q3 of each year. The BIS defines cross-border positions, as: 'position on a non-resident - for example, claim on or liability to a counterparty located in a country other than the country where the banking office that books the position is located'. International claims are 'Claim on a non-resident or denominated in a foreign currency. International claims comprise cross-border claims in any currency plus local claims of foreign affiliates denominated in non-local currencies.'

The share of claims vis-à-vis the EU of banks located in the UK is now similar to the exposure of banks located in the US. While US banks have increased their relative exposure to the EU from 2000 to the onset of the crisis in 2008, the EU share in the UK has been stable, to then decline in the following years. Because of this dynamic, banks based in the US now have a higher share of cross-border claims versus the EU than in 2000, while the same measure in 2018 is lower than it was in 2000 for banks based in the UK.

Figures for British banks – rather than banks located in the UK – confirm this picture. British banks are considerably less exposed to the EU than their EU peers, with the notable exception of Dutch banks. The decrease in the share of EU claims for British banks started around 2003, predating the crisis.

A large share of EU cross-border banking goes through the UK. When comparing the shares in Chart 7.1.2 and 7.1.3 to the shares for the EU27 in Chart 7.1.4 and 7.1.5 this is more evident, with UK claims falling in line with other EU countries in terms of magnitude, but still showing a different trend. Banks located in the UK are considerably more exposed to the EU27 than banks domiciled in the US, since a large part of claims of banks located in the US is towards UK counterparties. When it comes to nationality, German and Dutch banks have fewer claims to the EU27 than British ones.

The difference between the EU28 and the EU27 exposures underlines the importance of the UK domiciled and British banking sector. The Brexit process has already affected the EU27 banking landscape through relocations. The future also holds important implications in terms of financial stability. The EU will have to deal with an important counterparty now outside its *acquis*. Moreover, relocations to other EU member countries, most of whom are also euro area countries might have further financial stability effects if a new financial centre – or more than one – emerge in the EU27.

Glossary

AMAI	Asset Management: Authorisations and Inspections Division
AMS	Asset Management Supervision Directorate
BIS	Bank of International Settlements
BoE	Bank of England
BTF	Brexit Task Force
BSSD	Banking Supervision - Supervision Division
BSAD	Banking Supervision Analytics Division
CCP	Central Counterparty Clearing House

Central counterparty clearing, also referred to as a central counterparty (CCP), is a financial institution that takes on counterparty credit risk between parties to a transaction and provides clearing and settlement services for trades in foreign exchange, securities, options and derivative contracts.

CPD	Consumer Protection Directorate
CSD	Central Securities Depository
CSO	Central Statistics Office
DBEI	Department of Business Enterprise and Innovation
DoF	Department of Finance
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESRI	Economic and Social Research Institute
ETF	Exchange traded fund
EUI	Euroclear UK and Ireland
FCA	Financial Conduct Authority

FMD	Financial Markets Division
FoE	Freedom of Establishment
FoS	Freedom of Services
FSC	Financial Stability Committee
FSD	Financial Stability Division
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
IEA	Irish Economic Analysis
INSA	Insurance - Actuarial, Analytics & Advisory Services
IR	International Relations
MiFID	Markets in Financial Instruments Directive
MoU	Memorandum of Understanding
MMoU	Multilateral Memorandum of Understanding
MPD	Markets Policy Division
NCA	National Competent Authorities
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
ORD	Organisational Risk Division
PMI	Purchasing Managers' Index
PRA	Prudential Regulatory Authority
PSSD	Payment and Securities Settlement Division
SCN	Supervisory Co-ordination Network
SMSD	Securities Markets Supervision Division
SRD	Supervisory Risk Division
TARGET	Trans-European Automated Real-time Gross settlement Express Transfer system

TARGET2 is the real-time gross settlement (RTGS) system owned and operated by the Eurosystem

TPR Temporary Permissions Regime

USR Irish Uncertificated Regulations