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DAVY

Funding Levies Consultation 108 of 2017
Central Bank of Ireland
P.O. Box 9708
New Wapping Street
North Wall Quay
Dublin 1

24 April 2017

Re: New Methodology to Calculate Funding Levies, Consultation Paper 108

Dear Sir/ Madam,

We welcome the opportunity to provide our views on the above consultation paper, in particular the proposed new levy methodology for investment firms and the revisions to allocations of levies within the investment firm sector. In revising the levy methodology we would ask the Central Bank of Ireland (or 'the Bank') to:

1. **Provide full transparency regarding the current investment firm levy calculation methodology**

J&E Davy (or 'the firm') strongly favours a levy funding methodology which is balanced, fair and transparent. Currently levies are based on an investment firm's PRISM impact category and impact score. However, given that investment firms currently do not have visibility on how their PRISM impact score is computed or the exact variables which result in firms transferring to different impact score categories it is difficult to assess and to comment with any degree of certainty on the financial effect of the revised proposed methodology.

We would recommend that investment firms be provided with full transparency with regard to the computation of their individual PRISM impact score to enable them to comment fully on the proposed formula.

2. **Apply a meaningful levy to all European investment firms operating in the Irish market.**

The consultation paper acknowledges the Bank's proposal that EEA entities be subject to an industry funding levy. We welcome the fact that the Central Bank has acknowledged our longstanding view that all investment firms who passport into and/or operate in Ireland providing financial services in this jurisdiction are charged an appropriate levy. This proposal will address the anomaly that has existed for many years now whereby European

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investment firms have been able to operate freely in this jurisdiction with the regulatory cost carried by a small number of indigenous Irish investment firms. As a consequence of this proposal we would assume this will have led to an increase in the number of participating investment firms and consequently a decrease in all existing participants' levy contributions. For this reason, it is surprising that the worked example set out on page 6 of the consultation paper increases the expected levy for firms categorised as Medium High. It is our view that a meaningful funding levy should be applied to all European investment firms who passport into Ireland.

3. Revise PRISM with a greater emphasis on probability risk

The consultation paper notes that levies are based on a firm's PRISM impact category. We would argue that the overall probability risk assessment of a firm is at least as important as the firm's impact category.

The history of capital and/or client asset issues in the investment firm sector has been with smaller firms such as Bloxham, W&R Morrogh Stockbrokers, MMI Stockbrokers and Custom House Capital ('CHC'). Each of these firms exhibited very limited separation of duties, weak internal control and oversight arrangements, leading to much higher overall probability assessments of risk. There is no doubt that there were very real tangible negative financial outcomes for the clients of, for example, CHC where in some instances the financial losses have been devastating with the eventual recovery of €20,000 from the Investor Compensation Fund of little comfort relative to the individual client sums of money lost forever.

The above evidence of repeated deficiencies in smaller investment firms would indicate that the Bank's PRISM approach is flawed by focussing on impact rather than probability risk in that presently under PRISM those with the greatest impact receive a high level of supervision and conversely those with a low impact are supervised reactively. The under-regulation and/or supervision of certain investment firms appears to be maintaining a higher probability of failure to protect clients against risk and adverse impact arising from firm default. Hence the probability risk assessment should, in our view, be fully factored into the levy computation to allow for the required level of supervision of these firms.

4. There should be a higher flat fee for lower impact firms

According to the Bank's analysis, which by its nature is extremely subjective, Low impact firms will see no change to their levy under the proposed regime. The Central Bank has made a number of statements regarding small Low impact firms. The Bank's Strategic Plan for 2013-2015 refers to the fact that "*...where circumstances warrant it, we will take action against lower impact firms as an effective means of deterring poor behaviour by other lower impact firms and raising the standards of compliance across this impact category.*"

In March 2016, the Bank noted in its thematic review of Annual Returns of retail intermediary firms potential areas of non-compliance with key regulatory requirements for a large number of such firms. Following these statements it is disappointing to find no reference in the Strategic Plan for 2016-2018 on the need to develop the PRISM model for Low impact firms.

While we acknowledge that Medium High firms should pay a higher levy, it is not justifiable that the levy currently applicable is 39 times that of Low impact firms. Reflecting on the history of defaults and the reactive nature of supervision of Low impact firms set out in the previous point, we would strongly recommend that Low impact firms are charged a higher flat fee under the new levy methodology.

5. The levy for investment firms should vary within the different regulated entity types

The Bank should consider differentiating between D1 to D10 firms in terms of levy sum, for example, high volume algorithmic trading firms, referred to as D9 firms, should logically be charged significantly more than firms merely authorised to receive and transmit orders, that is, D2 firms. A higher levy is justified for D9 firms due to the heightened risks and the very significant domino impact the failure of these firms would cause in economic terms in relation to an individual stock and/or sector and/or even an entire market. Under the current regime both types of D firm are charged the same levy for both D groups including within each sub-set of the respective groups. As the Bank will be aware, Market risk is a topic which has been considered and extensively developed in the proposed revisions to MiFID II, ESMA papers and in the revised Market Abuse Regulations and this should be taken into account in the new levy methodology and consequent allocations.

6. The levy calculation should give recognition for capital held

Investment firms which carry higher sums of capital in excess of their minimum requirements should be given a credit as part of the levy calculation. Initial capital requirements generally start at €125k or as high as €730k dependent on firm authorisations compared with as little as €10k for firms approved under the Investment Intermediaries Act, 1995 (or 'the IIA'). Some MiFID firms are only authorised to receive and transmit orders, which is significantly less risky than IIA firms authorised to provide the investment business service of investment advice to consumers. The demise of both Bloxham and CHC reinforces the need to continuously review the amount of capital required and actually held by individual investment firms. Investment firms who maintain capital buffers in excess of their mandatory regulatory requirements should benefit from a reduction in their regulatory levies since a capital buffer, of its very nature, reduces both the probability risk of default and the impact in the event of default. The levy computation therefore should provide a credit to

investment firms who maintain a buffer with the application of the credit being awarded on the basis of the size of and/or the multiple of the buffer held.

7. The rationale for a supplementary levy for client money should be re-assessed

We question the relatively recent introduction of a separate client asset supplementary levy given that the consultation paper explicitly states that the PRISM impact score (PIS) already considers client money as a component within the calculation. The introduction of a separate levy for firms authorised to hold client assets has therefore resulted in a double charge for such firms. The Bank should therefore consider either removing the client asset component from the PIS score or alternatively discontinuing the separate levy.

8. The continued applicability of other levies including BRRD and ICCL

Separate to this consultation paper, however, relevant to the subject manner of levies it is our view that:

- Investment firms which do not have any eligible clients, as defined in the ICCL legislation and guidance, should not be required to pay into the Investment Compensation Scheme; and
- With regards to Bank Recovery and Resolution (BRRD) levy we would strongly favour the approach adopted in the UK which was to apply this levy only to banks and investment firms with capital requirement of at least stg£100m. The anomaly of continuing to apply this levy to Irish investment firms should be addressed.

Consistent with previous changes to the industry funding levies any proposed changes in levies should not be effective until the commencement of the following calendar year, that is, in this case 1 January 2018.

We trust that this submission provides some valuable input to this consultation process. Given the important cost implications of existing and/or revised levies we would welcome a meeting to discuss the content of our submission.

Yours sincerely,

Brian McKiernan
Chief Executive

Cc. Mr. Micheal Hodson, Director Asset Management Supervision, Central Bank of Ireland