Banking & Payments Federation Ireland

BANKING AND PAYMENTS FEDERATION IRELAND SUBMISSION ON

"FUNDING THE COST OF FINANCIAL REGULATION"CP95

SEPTEMBER 2015

Introduction:

Banking and Payments Federation Ireland (BPFI) welcomes the opportunity to comment on joint Department of Finance and the Central Bank of Ireland (CBI) consultation paper on "Funding the Cost of Financial Regulation". The aim of this consultation paper as outlined is to seek views on a move from the current approach of partial industry funding of financial regulation towards full industry funding.

BPFI members recognise the need for an adequately resourced financial regulator staffed by competent and effective people. We also recognise that CBI's changed regulatory approach from principles-based to risk-based framework entailed changes in its cost structure. However, this has resulted in significant cost increases from the period from 2009 (€60.2) to 2014 (€133m). The scale of the development in costs is a significant issue for our members and we are concerned that full industry funding of financial regulation, **could result in inefficiencies and cost inflation** as costs will be simply passed onto regulated entities which have no capacity to influence the cost of regulation.

In order to win business today and in the future we have to **remain competitive in terms of the operational environment** for Banks here when compared to other jurisdictions. **We are strongly in favour of an impact assessment** being undertaken with regard to the proposals set out in this consultation. This could assist in ensuring that Ireland positions our regulatory levy in-line with other jurisdictions so that operations here are not at any regulatory cost disadvantage when competing to win business in the future.

We believe that **consistent** funding arrangements should apply across all industry sectors and financial institutions so that there is a **level playing field** in the industry. The current cost allocation for regulatory supervision results in credit institutions, insurance undertakings and investment firms bearing 72% of the overall cost. Levies should occur in a **cost effective**, efficient and consistent way with specific guidelines about design and implementation of cost recovery mechanisms. This also entails **robust budgetary controls** and prioritisation of tasks, as resources simply cannot cover everything and our members are concerned about the sheer scale of recent increases in regulatory fees.

We would suggest that regular key performance indicators should be produced around key cost drivers to ensure a rigorous cost discipline is maintained. If full industry funding were deemed appropriate, it should be introduced **gradually** in line with enhancements in the current level of transparency. In addition, there should be a **multi-year budget approach** so that credit institutions can incorporate associated costs for future years without significant changes in the costs from one year to the next with reduced volatility.

Competitiveness:

The consultation paper refers to competitiveness effects of any changes introduced from the current funding arrangements. It also recognises the importance of maintaining a competitive financial sector in Ireland as a key objective of the Department of Finance along with the Government's IFS 2020 Strategy which aims to create 10,000 net new jobs in the sector by 2020. BPFI members believe that the cost of regulation is becoming an important factor in Ireland over the past few years. For example 2015 levy increase proposals range from 21 per cent for a branch operation to around 58 per cent for medium low and medium high rated institutions. Any further increases in the cost of regulation may have an impact on the IFS 2020 strategy both for potential new operations as well as existing ones given the general reduction in the number of banks registered with a bank license in Ireland over the last five years.

In line with new regulatory requirements coming down the tracks as part of the changing regulatory landscape in the EU, banks in Ireland will face significant additional costs in 2015 and future years. This will include new funding requirements such as BRRD and DGS, in addition to the increased domestic and international direct supervision costs. For example, it is estimated by the Department of Finance that the total aggregate contribution figure for Irish licensed banks will increase from an estimated €75 million in 2015 to an estimated €225 million over the next eight years. This represents a significant risk to the financial services industry over the coming years.

The Central Bank's independent mandate which is summarised in its mission statement: 'Safeguard Stability, Protect Consumers' is essential, as its high level goal of operational efficiency and cost effectiveness. We note CBI's commitment to having clear, open and transparent engagement with stakeholders in fulfilling its financial regulation and supervisory objectives and in particular, when introducing new codes, regulations, standards or guidelines.[1] With this in mind, prior to implementing the outlined changes in the Consultation Paper we would request that the Central Bank perform an impact assessment of the proposed changes which would include a jurisdiction comparison of supervisory costs.

Our initial discussions with our FIBI (Federation of International Banks in Ireland) members suggest that, even before the proposed significant increases, the existing regulatory burden is not competitive with competing jurisdictions. In many cases our international member's biggest competitors are their sister banks in a different jurisdiction. For these operations, winning the battle on costs and regulatory overhead is vital to winning business here.

To highlight the current situation, if we take a real life example of a bank with operations here and Luxembourg categorised as "Non ELG Bank Medium High". Here, that operation's Central Bank levy in 2014 is €255k. This compares to their sister company operating on a bigger scale in terms of balance sheet,

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[1] http://www.centralbank.ie/regulation/poldocs/consultation-papers/Pages/default.aspx

profitability, activities and number of employees in Luxembourg being charged a levy of €120k in 2014. In this example, even before the proposed increase the Irish operation is burdened with a regulatory overhead which is 212.5% that of its competing sister company. Under the proposals outlined in this consultation this burden for the Irish operations will increase to 303% of that of its competing sister company in Luxembourg when it rises to €403k.

In order to win business today and in the future it is essential to protect what we have and build on it in terms of the contribution the Financial Services industry delivers to the exchequer and in employment numbers today. To ensure this, we have to remain competitive in terms of the operational environment for banks operating here when compared to other jurisdictions. An impact assessment with regard to the proposals set out in this consultation would allow us to strategically position the regulatory overhead in-line with other jurisdictions so that we are facilitating operations here to continue to win business today and into the future.

Changing Regulatory Landscape:

The consultation paper refers to additional areas of supervision associated with the increase in EU mandated regulation in the coming years which will require allocation of additional staff and demands on the current funding arrangements. However, it does not highlight the fact that a significant portion of CBI's responsibility in relation to banking supervision has been transferred to the ECB as part of the Single Supervisory Mechanism (SSM).

In this context, we would have expected the creation of efficiencies within the CBI's supervisory teams to be used in other areas where activity is expected to increase. In addition, the consultation paper refers to EU legislative changes in the appendix on the regulatory landscape; however, it is difficult to understand how these are reflected in the cost structure as most of the work in these areas should be carried out by either the ECB SSM or the EBA. We would like to further emphasise that member banks have already incurred significant additional costs due to increased number of staff in the regulatory compliance functions. This is a direct result of the change in regulatory approach both domestically and internationally.

As part of SSM, credit institutions designated as significant by the ECB have to directly contribute to the funding of the budget of the SSM. For foreign banks operating in Ireland we believe that there will be a charge by headquarters associated with SSM fees. This will lead to duplication of regulatory costs for these institutions as well as domestic significant banks which are expected to pay towards the CBI levy as well as SSM levy.

Furthermore, it is likely that for any special projects arising in the context of financial regulation in Ireland or through the ECB SSM, costs will be recovered separately if there are external consultants involved in these projects (such as the Asset Quality Review) where there doesn't seem to be transparency in relation to the details of costs incurred.

Transparency/Accountability:

There is a significant lack of transparency around the calculation of funding levies applicable to individual firms and categorisation of firms under PRISM (see comments on PRISM below). This is not comparable with other European jurisdictions where the costs of regulation are clearly defined and activity based. These regulatory models generally use a base fee and variable charges for assets or income coupled with the number of branches or subsidiaries operated by a regulated credit institution. There is a similar lack of transparency as to how credit institutions , are allocated within PRISM categories, leading to uncertainty surrounding current and future regulatory costs.. This puts the Irish financial services industry at a clear disadvantage vis a via other jurisdictions.

There is limited detail available in terms of the overall cost of regulation. Key information that would ensure a clear and transparent assessment of the current cost base in terms of efficiency and as a benchmark vis-à-vis other jurisdictions should be available covering the following areas:

- Full Time Equivalent by Regulatory Sector
- Average Cost per Employee (incl. pension costs)
- Variable and Fixed Overheads Breakdown
- Professional Support Services (Analysis by Service)
- Premises and Housing Costs

This is necessary to ensure a clear and transparent assessment of the current cost base in terms of efficiency and as a benchmark vis-à-vis other jurisdictions.

Role for Comptroller & Auditor General

The consultation paper provides a comparison of funding arrangements for four other regulatory bodies in Ireland, two of which are related to the financial services area. The other two sectors mentioned are in the energy and communications sectors. However, these are characterised by significant infrastructural costs which firms operating in the market fund by way of payments of licence fees and levies. In addition, regulators in the energy and communications industries have to prepare financial statements in a form as may be approved by relevant Government ministers and submit accounts in respect of each operating year to the Comptroller and Auditor General for inspection. We recommend that, with full industry funding proposals, the regulatory operations of Central Bank of Ireland should be subject to similar arrangements with the Comptroller and Auditor General like other regulators with similar funding arrangements.

Role of Central Bank Commission

The Central Bank Commission was established in 2010 and is responsible for ensuring that the statutory functions of the Bank are properly discharged, with six external members appointed by the Minister for Finance. This Commission has different statutory powers however most of these are delegated to the Governor, Deputy Governor or an employee of the Central Bank. It is only where operational matters are brought before the Commission for decision that the Commission ensures that the Bank is acting in an appropriate manner consistent with its statutory functions and powers. We believe that this Commission should be given a stronger oversight role in terms of increased transparency and independent scrutiny of budget setting and performance reporting aligned with operating objectives.

International Experience:

The paper refers to international experience in relation to levies in other jurisdictions being on a 100 per cent industry-funded basis. However, it does not acknowledge that "value for money" has been an integral part of the considerations during the preparation of these regulatory funding mechanisms, such as in the UK. We would like to further emphasise that there is no clear correlation between high spending regulators and successful ones. For example The PRA in the UK asks firms to complete an annual feedback survey and carries out internal reviews of the relevant areas if survey results are less favourable.

A review of the charging structures in other European jurisdictions would suggest that activity –based models are very prevalent in contrast to the risk-based PRISM approach adopted by the CBI in categorising firms for the application of funding levies. It would appear to be more equitable that funding levies should be applied by reference to the (FTE) effort involved in regulating/supervising individual firms rather than by reference to their risk rating under PRISM which does not necessarily provide a direct correlation. .

Enforcement Fines:

Monetary fines are an important factor in encouraging regulated entities to maintain high standards and act as a significant deterrent. At the moment income from enforcement fines is fully remitted by the CBI to the Exchequer. We believe that if the full industry funding proposals were to be implemented, a system should be introduced, such as being operated in the UK PRA, whereby any penalties above the net cost of enforcement activity should be retained by CBI.

About BPFI

Banking and Payments Federation Ireland (BPFI) is the voice of banking and payments in Ireland. Representing over 70 domestic and international member institutions, we mobilise the sector's collective resources and insights to deliver value and benefit to members, enabling them to build competitive sustainable businesses which support customers, the economy and society. Delivering a range of services through our specialist team, BPFI also offers an Associate network through which we offer many of the benefits of membership to the leading professional service firms that provide related advisory and consultancy services.

Contacting us

BPFI look forward to progressing the agenda set out in this submission in co-operation with the relevant stakeholders and is happy to meet with interested parties to discuss the contents of this document as necessary. Should you wish to contact BPFI towards this end or for further information regarding the contents of this document, please contact:

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