

Submission of the Davy Group in response to the Department of Finance and the Central Bank of Ireland Joint Public Consultation Paper Funding the Cost of Financial Regulation

25 September 2015

Section 1: Background

The Davy Group is Ireland's leading provider of wealth management, asset management, capital markets and financial advisory services. Headquartered in Dublin, with offices in London, Belfast, Cork and Galway it employs over 600 people. We offer a broad range of services to private clients, small businesses, corporations and institutional investors, and organise our activities around five interrelated business areas - Asset Management, Capital Markets, Corporate Finance, Private Clients and Research.

Eight entities within the Group are regulated by the Central Bank of Ireland as follows:

Name	Reference Number
J&E Davy	Central Bank Ref No: C775 FCA Registration No: 211884
Davy Corporate Finance	Central Bank Ref No: C29070
Davy Securities	Central Bank Ref No: C38060 FINRA CRD Number: 131901
Davy Investment Fund Services	Central Bank Ref No: C26414
Davy Asset Management Limited	Central Bank Ref No: C1547
iCubed	Central Bank Ref No: C132168
Advance Fund Management Limited	Central Bank Ref No: C20827
Davy Fund Managers	Central Bank Ref No: C25482

Although regulated entities in the Group are primarily MiFID investment firms¹, we hold authorisations as a product producer², a moneybroker³, an insurance intermediary⁴, a service provider to funds⁵ and as an authorised and registered Alternative Investment Fund Manager.⁶ As such our submission is necessarily focused on the impact of the Consultation Paper on firms in categories D2, D3 and E2a, although many of our comments have a broader application.

While our private clients are predominantly resident on the island of Ireland, we have an international client base across all of our business areas. As a leading Irish provider of financial services we have made a significant investment in people in recent years to ensure that we provide the best possible service to our clients and meet regulatory and other standards. We share the Department of Finance's interest in maintaining a competitive Irish financial services sector in an international context, but we are also mindful of the importance of maintaining healthy competition within the Irish market and a level playing field such that all participants pay their fair share of the cost of regulation.

We are supportive of the robust approach to supervision that has been adopted by the Central Bank in the aftermath of the financial crisis and of increasing dialogue between regulator and industry such that there is a clear understanding of the standards required of industry participants. Transparency and

¹ Authorised as an Investment Firm under Regulation 11 (1) or deemed authorised under Regulation 6 (2) of the European Communities (Markets in Financial Instruments) Regulations 2007

² pursuant to the Investment Intermediaries Act, 1995,

³ under Section 110 of the Central Bank Act 1989 (as amended).

⁴ under the European Communities (Insurance Mediation) Regulations, 2005 (as amended)

⁵ A service provider to a fund, which can be either an administrator, trustee or management company, is authorised under the Investment Intermediaries Act, 1995 (as amended) and/or approved under the relevant collective investment scheme legislation, as appropriate.

⁶ authorised by the Central Bank of Ireland under the European Union (Alternative Investment Fund Managers) Regulations 2013

mutual understanding must be cornerstones of effective regulation. It is equally important that the manner in which the regulatory activity of the Central Bank is funded by industry is fair, proportionate and transparent and that the Central Bank provides value for money in the discharge of its regulatory functions.

Section 2: Detailed Submission of the Davy Group

We are asked to consider whether the cost of regulation should be borne solely by the financial services industry such that the burden on taxpayers is removed. In so doing we are asked to consider, in particular, the impact on competitiveness.

We accept that the model whereby the cost of regulation is 100% funded by industry is in keeping with international norms in financial services and is consistent with the manner in which other Irish regulatory bodies are funded. Therefore, in principle, we have no objection to moving towards such a model. However, we have a number of concerns which we submit should be addressed before any change is made to the current funding model.

Firstly, there is no detailed consideration in the Consultation Paper of the actual costs included in the “*cost of financial regulation*.” Any request for views on a move from the current approach of partial industry funding to full industry funding logically requires consideration of what costs the industry is expected to bear going forward. We cannot support a move to a funding model whereby the financial services industry is exposed to, in effect, being asked to write a blank cheque to the regulator.

Our concerns in that regard have been exacerbated by the proposed 40%+ increase in funding levy in 2015 we have recently been advised is necessary to address a funding deficit in the Central Bank’s Defined Benefit Pension Scheme. We note from the Central Bank’s Careers page on its website that the Scheme is still open to new employees at a time when most of the industry it regulates has had to revisit pension arrangements for staff in response to the economic crisis.

In addition to the 2015 increase, Category D firms were subject to a 27% increase in the levy payable in 2014 when compared to 2013.⁷ While this can in part be attributed to the introduction of a supplementary levy for firms subject to the Client Asset Requirements, the lack of prior notice of both the introduction of the new levy and of its size undoubtedly caused difficulties for some firms.

The Central Bank correctly expects regulated firms to keep it informed such that there are no surprises, the same approach should apply to notification of significant changes in the rate of the annual levy. Category D firms are now expected to absorb an almost doubling in our Central Bank levy in a two year period, and this before the proposed move to full funding. This level of increase is untenable and unsustainable as is the approach whereby in both years regulated firms were unilaterally notified of the increase more than half way through the year.

It is not equitable that once off exceptional costs, or costs incurred to rectify legacy issues which bear no direct relationship to regulatory activity, should be passed on to the industry. We submit that costs such as funding the deficit in the Central Bank’s Pension Scheme should be borne by Central Bank itself by retaining the full amount of the pension shortfall from the Central Bank’s 2015 surplus income. Other such exceptional costs as may arise in future years should be treated in the same way.

The Consultation Paper includes a useful diagram, Chart 4.2, which shows the annual budget mix for financial regulation. It is notable that 39% or approximately €52m⁸ of the annual budget for 2015 is

⁷ Firms in other categories were subject to increases ranging from increases ranging from 1.5% to 32%.

⁸ Based on the €67m of the Central Bank’s 2015 surplus income that it is estimated will be redirected to make up the shortfall between the costs of regulation and the funding received from industry

attributed to Professional Support Services. This is against a backdrop of sustained recruitment by the Central Bank in recent years of highly qualified professionals devoted to regulatory and compliance matters. While we do not dispute the rigour of the Central Bank's budgeting process, the lack of transparency in this significant expense is of concern. To the extent that some of this budgeted cost is not directly attributable to regulation of the industry, then that portion should not be funded by the industry.

It is our submission that there should be no change to the current funding model until there is clarity as to the costs included in the “cost of financial regulation”. In particular exceptional costs and the costs of professional support services not directly related to regulatory activity should not be borne by the industry.

At present there are special arrangements in place whereby on the one hand Credit Institutions that had participated in the Eligible Liabilities Scheme 2009 are required to fund 100% of supervisory costs and on the other the levy payable by Credit Unions is capped such that they contribute approximately 8% to the cost of their regulation. Notwithstanding the legislative and public policy reasons for the differing approaches, we do not consider this to be a balanced approach. There are also anomalies in the current allocation of funding costs within funding categories. For example Category D Securities and Investment Firms with a PRISM categorisation of Medium High incurred a levy 5 times higher than Medium Low firms in the same sector in 2014⁹. This is on the basis that Medium High firms were subject to five times the level of supervision that Medium Low firms received and is consistent with projected resourcing requirements when PRISM was introduced in 2011¹⁰.

In the absence of any transparency on the actual allocation of Central Bank regulatory resources it is not possible to conclude whether this notional allocation is accurate. However it is difficult to see how it can be. The Consultation Paper points to significant upcoming regulatory developments as contributing to increasing regulatory costs. The implementation of MiFID II/MiFIR in January 2017 is one such development of relevance to investment firms. Regulatory upstream costs to be borne by the Central Bank cannot logically be said to be five times greater for Medium High firms than for Medium Low as many of the costs are common regardless of PRISM categorisation. Similarly, we understand that thematic reviews carried out by the Central Bank include a selection of firms from all PRISM categories.

In advance of any move towards full industry funding, there should be a root and branch review of the manner in which the costs of regulation are allocated across the financial services industry, starting by comparing the notional allocations based on PRISM projections in 2011 to actual expenditure in recent years on a category by category basis.

As part of the review it may be instructive to perform a benchmarking exercise to compare the costs of regulation of the Irish Central Bank to its European peers. Given the significant overlap in the work undertaken by all financial services regulators this would be a worthwhile exercise.

It is important that any move towards full funding by industry has due regard to the ability of the industry to pay, but equally that a potential inability to pay is relevant to any assessment of the capacity of such firms to continue to operate in a manner that does not put their customers at risk.

It is our submission that any proposal to move towards full industry funding should incorporate a review of the allocation of funding costs across funding categories and also within categories such that funding costs are fairly allocated.

⁹ Medium High firms in categories D1-5 and D9 and D10 paid €197,728 compared to €39,307 for Medium Low firms

¹⁰ See Central Bank publication, PRISM Explained of November 2011

The current system whereby levies are formally notified two thirds of the way into the relevant year, in mid-September, and must be discharged within 35 days is unsatisfactory and should be changed as part of any move towards full industry funding.

We appreciate that the budgeting and approval process for annual levies is necessarily a lengthy one, however, many costs are predictable. The key drivers of the cost of regulation such as employment costs and costs associated with the pipeline of European and domestic regulatory changes can be reasonably estimated from year to year. Therefore the Central Bank should be in a position to pre-advise estimated levies at the end of the prior year or at worst early in the current funding year to facilitate firms to budget and manage cash flow associated with funding levies in a more realistic manner than is currently the case.

We are concerned that the Consultation Paper does not acknowledge that the Central Bank of Ireland should provide value for money in the discharge of its regulatory obligations.

The significant ongoing investment by the Central Bank in upskilling its staff in advance of significant regulatory developments, such as MiFID II/MiFIR, should be reflected in a requirement for the regulator to share the knowledge gained with industry participants to equip them to meet the challenges of implementation. There should be uniform engagement with industry in respect of all significant regulatory developments by way of consultation, through industry/regulator working groups and in industry training.

We submit that any proposal to move towards full industry funding should incorporate a requirement for the Central Bank to demonstrate value for money and to take an active role in upskilling the industry in advance of the implementation of significant regulatory developments.

It is critical that the Central Bank adopts sound commercial practices in its approach to managing costs such that the funding burden on the industry is managed. One approach to ensuring that this is the case would be to introduce a cap on the amount that each sector can be asked to contribute to fund the costs of regulation in any year. There may be reasons why the manner in which an appropriate cap is set will vary between funding categories, we favour a cap based on a maximum percentage of revenue. For financial services groups where a number of subsidiaries are subject to funding levies the cap should be set at group level rather than at the level of individual subsidiaries.

In our view Ireland should follow the UK and Australian practice of consulting with regulated firms periodically in relation to the funding levy, including in relation to the level at which any funding cap should be set. The most effective way to do so may be via consultation with representatives from all sectors of the financial services industry. We note that the former Financial Services Consultative Industry Panel has been discontinued, and while the Central Bank Reform Act 2010 makes specific provision for the establishment of certain advisory groups¹¹ we understand that as yet no proposal to replace the Industry Panel.

We submit that the percentage of revenue that any sector of the industry should be asked to contribute by way of industry levy should be capped. The cap should be set following appropriate consultation with the industry via the establishment of a panel of representatives for this and other consultative purposes

Other recommendations - Introduce a fee to apply for approval for authorisation by the Central Bank

¹¹ Section 18E(1)-(4)

We recommend the introduction of a fee to apply to be authorised by the Central Bank. In 2014 alone 1,133 authorisations were granted¹² across all sectors of the financial services industry, therefore the introduction of such a fee could make a material contribution to the Central Bank's costs of reviewing applications and approving new entrants. We do not consider it appropriate that these costs should be recouped through the funding levy. In the UK the application fee for authorisation varies based on the complexity of the application¹³ and this or some other appropriate model should be applied here. The imposition of an application fee may also facilitate the introduction of standard timelines for both applicant and regulator to process applications such that efficiencies are introduced which in turn would lead to cost savings.

Section 3: Responses to Consultation Questions

1. Any change in the current funding arrangement would have to have due regard for the competitiveness of the industry. Do you consider that there are any particular competitiveness issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues, their quantification and suggestions on how they may be addressed.

The financial services industry in Ireland overall employs in excess of 100,000 people, with employment having increased by 5% between Q4 2013 and Q4 2014¹⁴. In addition the industry accounts for almost 10% of GDP.¹⁵ As such the sector is a significant contributor to the Exchequer via payroll and other taxes.

The Consultation Paper focuses on the Government's strategy for attracting and retaining international financial services firms, but any consideration of competitiveness must also have due regard to existing Irish firms. The Government's Strategy for Ireland's International Financial Services Sector 2015-2020 refers to employment levels in the IFS of 35,000 in 2014. This compares to total employment in the industry of 100,000. Recent commentary on international firms has referred to the relatively low level of employment created by many providers who are attracted to Ireland for other reasons¹⁶. While we are naturally supportive of the healthy competition fostered by international entrants, home grown participants in the industry should not be lost sight of.

The current funding model does not differentiate between firms or funding categories based on number of employees or on the contribution to the Exchequer via payroll and other taxes. It is important that these contributions are not overlooked. We would not support any differentiation between the contribution to the costs of regulation by different funding categories in an effort to attract or retain international firms.

2. Any change from the current funding arrangement would have to have due regard to consumers and tax payers. Do you consider that there are any particular consumer or tax payer issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues and suggestions on how they may be addressed

¹² Central Bank Annual Report 2014, Chapter 1 page 26, Table 2, Authorisations/revocations

¹³ Straightforward applications cost £1,500; moderately complex cost £5,000 and complex applications carry an application fee of £25,000.

¹⁴ National Skills Bulletin, July 2015, A Report by the Skills and Labour Research Unit (SLMRU) in SOLAS for the Expert Group on Future Skills Needs

¹⁵ <http://www.irishtimes.com/business/economy/what-s-wrong-with-the-financial-services-industry-here-1.2360353>

¹⁶ By way of example see <http://www.irishtimes.com/business/economy/what-s-wrong-with-the-financial-services-industry-here-1.2360353>

We do not consider that there are any particular consumer or tax payer issues to be taken into consideration in revising the funding approach other than those referred to in response to question 1 above and in our Detailed Submission.

3. Do you consider it appropriate for taxpayers to continue to fund a significant proportion of the cost of financial regulation activity? If you disagree, what would you propose instead?

As set out in our Detailed Submission we have no difficulty with a move towards full funding of the cost of regulation by the industry, subject to industry bearing only the direct costs of regulation. Exceptional costs and those costs that cannot be directly attributed to the regulatory activities of the Central Bank should continue to be funded from the surplus generated by the Central Bank.

4. Do you consider it appropriate that industry be required to fully fund the cost of financial regulation activity? If you disagree, what would you propose instead?

Please see our Detailed Submission which sets out our views in this regard.

5. Do you consider it appropriate that a move to full funding should commence in 2016? If you disagree, what would you propose instead?

6. Do you consider it appropriate that a move to full funding should take place in a single step in 2016? If you disagree, what would you propose instead?

Please see our Detailed Submission which sets out our views in this regard.

7. Do you consider it appropriate that any revision in the proportion of funding provided by industry should continue to apply uniformly across all industry funding categories? If you disagree, what would you propose instead?

We do consider it appropriate that that any revision in the proportion of funding provided by industry should continue to apply uniformly across all industry funding categories. However, as set out in our Detailed Submission we consider that a review of the allocation of costs between and within funding categories should be undertaken before any move towards full industry funding to ensure that the burden is shared fairly.

J&E Davy, trading as Davy, is regulated by the Central Bank of Ireland. Davy is a member of the Irish Stock Exchange, the London Stock Exchange and Euronext. In the UK, Davy is authorised by the Central Bank of Ireland and authorised and subject to limited regulation by the Financial Conduct Authority. Details about the extent of our authorisation and regulation by the Financial Conduct Authority are available from us on request. Davy Asset Management Limited, trading as Davy Asset Management, is regulated by the Central Bank of Ireland. Advance Fund Management Limited is regulated by the Central Bank of Ireland. Davy Corporate Finance is regulated by the Central Bank of Ireland. Davy Investment Fund Services is regulated by the Central Bank of Ireland.