

tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie

Funding the cost of financial regulation: Public Consultation Financial Services Division Department of Finance Government Buildings Upper Merrion Street Dublin 2

25th September 2015

Dear Sir/Madam

Please find enclosed our submission in respect of Consultation Paper 95 – Funding the cost of financial regulation.

Thank you for the opportunity to respond to this paper. We are at the Department's and the Central Bank's disposal for clarification or further detail on any of the points contained in the submission.

We look forward to further engagement on this issue in due course.

Yours faithfully,

Marc Coleman Director Financial Services Ireland



tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie

Introduction

We welcome the opportunity to comment on Ireland's industry funding model and appreciate references throughout the consultation paper to the importance of Ireland's macroeconomic position and of its attractiveness to international financial services, with express mention of 'IFS2020'.

Financial Services Ireland and its members are likewise committed to an ecosystem of regulatory excellence, an essential ingredient in developing our position as a leading centre for sustainable financial services. This supports Ireland's key objectives of creating sustainable employment and generating robust economic growth, both of which are required to drive Ireland's ongoing fiscal and social recovery.

The framework for assuring the independence, accountability and competency of our regulatory authority must be reinforced through the carefully considered design of its resourcing model.

We also note and appreciate that this consultation is limited to the gathering of views on any potential change to funding the cost of regulation in Ireland, rather than the formulation of any proposals. It is wise to examine the current position comprehensively and with care, and we look forward to engaging further with the Department on this issue in due course.

The consultation is an opportunity to exchange views on the broader regulatory issues and challenges facing industry, with value placed on simplicity, fairness, sustainability and proportionality. This should include regulatory staff turnover, which can have a direct, undesirable competitive impact and to which the resourcing model should be sensitive. We look forward to further engagement with both the Department and the Central Bank on addressing fundamental issues such as this for the betterment of our regulatory environment, and ultimately of our economy and society.

Finally, it is vital to keep in mind that the 'signal' is equally, if not more important than, the substance of the ultimate proposal. This is particularly so given the well-publicised peculiarities and impacts of Ireland's financial crisis and its understandable impact on our political climate. Of this, foreign direct investors and our competitors for their investment are well aware. In this context, the prospect of facing a regulator with inadequate or ineffective checks and balances in its funding model is not the signal that is in Ireland's interest to send.



tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie

i. Do you consider that there are any particular <u>competitiveness issues</u> to be taken into consideration in revising the funding approach?

Yes, we believe that international competitive considerations are the most important part of this discussion and we welcome the remarks made within the consultation to that effect. Ireland continues to recover in its international ranking as a global financial centre. Crucial to the ranking is *cost* competitiveness, and the leading international report, the Global Financial Centres Index (GFCI), incorporates regulatory costs. As noted by Minister Simon Harris TD, in September 2015 (when Ireland moved a further four places upwards to 48) "such external indicators are a useful background to drive forward the implementation of the Government's International Financial Services' Strategy, IFS2020." It is also appropriate at this juncture to bear in mind the government target of 10,000 net new jobs in IFS in Ireland within the next five years. This competitive consideration must form the backdrop to any discussion on the cost of being regulated in Ireland.

Funding trends: Ireland vs other jurisdictions

The fact that Ireland's funding model is different from other jurisdictions does not of itself mean that assimilating with international trends is in our best interests. The discussion on how we have arrived at this point must be reopened, acknowledging the success story of Ireland's emergence as a global financial services centre, the cornerstones of which should be understood fully in debating any changes. The discussion must also consider the 'messaging' that potential direct investors perceive when change is introduced, particularly in the context of other relevant developments both in Ireland and elsewhere.

We appreciate that the Department and the Central Bank have undertaken a crosscomparison with other jurisdictions as part of the consultation process. As acknowledged in the consultation, however, international comparisons at a *general* level, do not incorporate all relevant elements, and omit the multitude of additional factors that will influence international organisations in choosing a suitable jurisdiction.

Ireland's current funding system has evolved over a considerable period of time, and has been the subject of previous consultations (December 2003). It has reached its current circumstance due to a multitude of country-specific issues: a reflection of our macroeconomic position; the proportion of high-value internationally-traded services based here; as a method of public oversight; and in response to Ireland's unique financial services market structure, serving both international and domestic organisations. Absent from the international comparison section of the consultation are the reasons why Ireland's funding model has evolved to this position, and it is crucial that these are included in any debate on changing the position.

Addressing competitive issues

The Central Bank has conducted comprehensive engagement with industry on policy issues in the past number of years, and the willingness shown to participate in industry events has

tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie



helped to establish appropriate and valuable lines of communication for all stakeholders. Nonetheless, there are additional engagement initiatives undertaken by peer regulators, particularly the UK, which if adopted by the Central Bank, could further improve the effectiveness of our regulatory system. These operate to the benefit of the regulator, industry and consumers and are included in this submission as proposals to address, in part, international competitive issues.

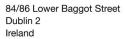
The UK Financial Conduct Authority (FCA) hosts a business incubator, described as a 'safe harbour' in which industry members can test-run products in an open and frank environment with the regulator. It is known as Project Innovate.

The FCA's financial services innovation support hub assists industry in generating new business. "Project Innovate will help businesses of all sizes to bring innovative ideas to market. It will ensure that when innovator businesses come into contact with the FCA, they are supported in their efforts to introduce new products and ideas, for the benefit of consumers."

Secondly, similar to the Central Bank of Ireland, the FCA is subject to oversight by the UK Treasury and thereafter, the UK Parliament. It is also governed by a number of committees. This has not interfered with its official industry engagement, through a 'Market Participants Panel' and a 'Practitioners Panel'. Both of these "consist of external and independent input" from industry members.

"Members of the FCA Market Participants Panel are senior level industry representatives of the major sectors of the UK's wholesale and securities markets ... Members are formally appointed by the FCA and the Chairman must have the formal approval of the Treasury." "Membership of the FCA Practitioner Panel is constructed to represent the various sectors within which regulated financial businesses operate, often based on nominations made by trade associations. Members are drawn from the most senior levels of the industry, and are formally appointed by the Financial Conduct Authority. The Chair must have the formal approval of the Treasury."

Goldman Sachs and HSBC currently hold the chairmanship of these two panels, respectively. These panels operate alongside a 'Financial Services Consumer Panel' and a 'Small Business Practitioner Panel', offering holistic input and support from key stakeholders.



tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie



As stated previously, while it is difficult to draw accurate *general* comparisons with other jurisdictions, it is nonetheless helpful to look at some points in isolation, such as the manner of calculating fees.

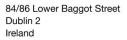
Method of calculating fees in comparator jurisdictions

The FCA fee consists of a minimum fee and a periodic fee. The minimum fee is payable by all authorised firms and is not linked to size of business. The variable fee will depend on the 'fee block' to which a firm belongs, and within this fee block, the levy is also linked to the volume of business written ('straight-line recovery'). There is a similar system in place in Malta and Luxembourg. In 2013, there were significant concerns (in the context of the Central Bank's Consultation Paper 61) that a spectrum of just five PRISM-ratings is too blunt on which to calculate the levy. We reiterate the point in our submission in 2013 that the Bank's decision to move to a risk-based levy system was practical and anticipated. Nonetheless, the above jurisdictions offer a graduated system, while firms operating in Ireland will simply pay one of five very varying amounts, e.g. a move from 'Medium High' into 'High' means a 500% increase in the regulatory levy for an insurance company. This exerts downward pressure on business development. In its Feedback Statement to CP61, the Central Bank acknowledged that in respect of 'Low' impact firms, "a single flat rate levy ... which fails to account of size, volume of business and/or ability to pay would lead to a regressive levy". The Central Bank has therefore already introduced a tiered approach where needed, based on the impact score in PRISM, and this would be welcome across all categories. In the 'Medium High' category alone, firms can have an impact score anywhere between 700 and 2,000, yet the fee remains the same. This is a fundamental issue with the current fee calculation, and any move upwards from 50% industry funding will exacerbate it.

Finally, as recently as 2013, there were significant increases in the Central Bank levy, with some firms absorbing an increase of 90% on their fee in a single year. Any proposal to increase the industry contribution in 2016 onwards must be considered against this, and the associated international perception of continuously rising, uncertain costs of doing business in Ireland.

- *ii.* Do you consider that there are any particular <u>consumer issues</u> to be taken into consideration in revising the funding approach? (answered together with question iv.)
- iii. Do you consider it appropriate that <u>taxpavers</u> continue to fund a significant proportion of the cost of financial regulation? (answered together with question iv.)
- *iv.* Do you consider it appropriate that industry be required to <u>fully fund</u> the cost of financial regulation?

Ultimately, additional costs for industry become additional costs for the consumer, as businesses struggle to absorb increased overheads. If business is forced to pass excessive



tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie



lbec

cost to global consumers then it will find an alternative location from which to operate. Nonetheless, regulatory fees are just one of many increasing overheads for firms, including upcoming European regulatory levies, e.g. Single Supervisory Mechanism (SSM), Bank Recovery and Resolution Levy and potentially increased fees at the European Insurance and Occupational Pensions Authority (EIOPA). It would be helpful to have a costs road-map from the Central Bank, as currently, there is much uncertainty about the level of dual fees once affected firms begin paying the SSM fee.

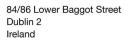
The case for sharing the cost of regulation

The regulation of financial services is a vital and valuable protection for consumers, and one for which it makes sense to retain a consumer contribution, similar to e.g. the aviation and food sectors, both industry and public-funded. The Central Bank of Ireland's regulatory activities are ultimately aimed at consumer protection, and generate a cost which should, therefore, be borne by society and the producer. While the consultation paper highlights other sectors of the Irish economy that pay 100% of regulatory costs, as a general comparator, this is just as problematic as comparing *jurisdictions*. The purpose, scale of cost and income between the Central Bank and bodies such as the Commission for Energy Regulation, are too disparate. In 2014, the Central Bank's costs were 139 million euro, with 74.8 million contributed by industry through the direct levy. An additional 6 million euro from monetary penalties was remitted to the exchequer and 2.4 million euro in 'other income' from industry.¹ These figures are approximately ten times those of the CER, for example.

The exchequer contribution provides an extremely important and otherwise irreplaceable oversight function, and incentivises high cost-control and transparency. A decrease in the public contribution will have a proportionate downward effect on the robustness of Oireachtas / committees oversight, with full elimination meaning the removal of all checks and balances from the system and relying on the probity of institution itself which, although not in question, would be a failure in design of a sound system.

Finally, on the taxpayer point, the consultation paper has highlighted that, "whereas the Irish taxpayer currently subsidises the cost of financial regulation, the consumers of these services are located both here and abroad." Equally, the 58 million euro (2014) exchequer contribution to financial regulation must be considered in the context of our unique financial services market, with 2 billion euro remitted to the Irish exchequer from the *international* sector alone. One quarter of the 35,000 jobs in international financial services is provided by Irish-owned firms, and half (by volume) of companies is Irish-owned. Once again, a further 10,000 jobs have been targeted by Government in 'IFS2020' within the next 5 years. Any debate on our industry funding model must come after the second strategic

¹ Central Bank of Ireland Annual Report 2014.



tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie



bec

priority of IFS2020, to "drive continuous improvement in the ... competitiveness of Ireland's IFS sector".

v. Do you consider it appropriate that a move to full funding should <u>commence in</u> <u>2016?</u>

(answered together with question vi.)

vi. Do you consider it appropriate that a move to full funding should take place in a <u>single step</u> in 2016?

These questions pre-suppose the introduction of full industry funding, the wisdom of which is in question. Nonetheless, it is not appropriate that a move to full industry funding should take place either in 2016, or in any single step. It is also not appropriate to begin such a discussion in the absence of proposals to offset the potentially harmful competitive implications of a change, particularly, as mentioned above, where some firms have absorbed a near doubling of fees in 2013 alone. The potential cost saving of reducing the subsidy to the industry levy must be assessed against the overall value of the financial services ecosystem to the Irish exchequer, which figures have been set out above. We understand that, particularly during the 2003 consultation on funding the cost of financial regulation, there was much discourse about a potential increase in the industry contribution. In the subsequent eleven years, this is the first official consultation on this issue. It is therefore prudent to consider any rise on a much longer-term, and well-defined basis. It will be crucial to avoid either an immediate, steep increase, or an uncertain, undefined path over a longer period; either of which will generate a damaging international perception of cost.

vii. Do you consider it appropriate that any revision in the proportion of funding provided by industry should continue to apply <u>uniformly across all funding categories</u>?

(answered together with question viii.)

viii. Do you consider that there are any particular industry funding categories that warrant a derogation or alternative funding approach?

We have addressed this question above, in 'method of calculating fees' section under question i.

ix. Do you consider that there are any other considerations that should be taken into account in seeking to come to a decision on a move to full industry funding?

The following are deemed important considerations at this time:

- Oversight and Governance

Oversight of the regulatory function of the Central Bank is a key consideration in the discussion on industry funding. The current proportion of exchequer funding provides a very

tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie



bec

robust system of oversight, the removal or reduction of which must be considered in the round. Any change to the make-up of the Bank's income must address potential conflicts of interest. Albeit on a smaller scale, this key principle already appropriately underlies the Bank's remittance of all monetary penalties to the exchequer. Confidence, both local and international, of industry and consumers, will only be possible with robust independent controls.

• Value for money

A consultation process on regulatory funding models inevitable sheds light on the services to which they relate. Mooting an increase in the industry contribution therefore leads to thoughts on best practice, and what firms expect from a well-resourced, leading international regulator. The Central Bank has taken valuable steps to improve the ease of applying for authorisations in Ireland, and these are appreciated, but international firms will look further into the regulatory system beyond the entry point, to overall cost *vs service*. As mentioned previously, the discussions which follow this consultation must seek to address current challenges such as staff turnover, knowledge-retention and limited resources for engagement. We would value the opportunity on foot of this consultation to assist in addressing such issues.

- Cost uncertainties

Does the Central Bank currently have any views on the upcoming European-level fees, and what effect these will have as additional to its own fees? Many firms will be assessing the impact of the European Central Bank fee on their business lines, and any additional uncertainty about the Irish fee will pose a competitive threat.

Secondly, the industry levy should not be directed toward the cost of public service decisions, or political agreements beyond industry control. This must include commitments made under the "Public Service Stability Agreement 2013 – 2016" (Haddington Road) and any other legacy costs for the Central Bank, including its Defined Benefit pension scheme.

Finally, the levy notice needs to be published much earlier. As of August, many firms still do not know what they are due to pay in 2015. A cost-effective response to this could be to introduce a variable metric (ie PRISM impact score) on top of a base fee per PRISM category, and establish an online tool to allow firms to calculate their fee and pay it at a time of their choosing, within the relevant year. This is currently the arrangement in the FCA.

- IFS2020

Action 18, together with the general promotional efforts under this strategy, is crucial. Under Action 18, the Central Bank would have opportunity to include specific proposals to address competitive threats. Rising regulatory costs will have a direct effect on the decision whether to choose Ireland as a jurisdiction for new business. The Central Bank's extensive work to improve timelines for processing of authorisations is important, and complements the crucial work of agencies like IDA Ireland, Enterprise Ireland and the Department of Finance to attract *new* business to Ireland. We would draw attention to the need for similar initiatives for *existing* business, via well-governed industry panels such as those in the UK,



tel: +353 1 605 1500 email: info@fsi.ie web: www.fsi.ie

lbec

incubators for extending new business lines and more graduated regulatory fees to encourage expansion.

- EMIR

Reference has been made in the consultation paper to unknown supervisory costs of nonfinancial firms under the European Markets Infrastructure Regulation (EMIR) and intergroup exemption requests. However, only 'NFC+' companies will be subject to the clearing obligation, and the number of 'NFC+'s in Ireland is known/quantifiable. These costs will hopefully therefore, not add to uncertainty.