Opening statement by Ed Sibley, Director of Credit Institutions Supervision
Central Bank of Ireland
At the Oireachtas Committee on Finance, Public Expenditure and Reform, and Taoiseach

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Chairman, Committee members, we welcome the opportunity to appear before you today to discuss the potential impacts arising from Brexit in the context of financial services. I am joined by Gerry Cross, Director of Policy and Risk, and John Flynn, Head of Irish Economic Analysis.

In our opening remarks I will: (i) start by making a few key points, which summarise our overall perspectives and approach; (ii) consider the overall effects of Brexit on Irish financial services firms; (iii) outline our approach to dealing with the challenges of Brexit for existing financial services firms in Ireland; (iv) summarise our approach to engaging within the Europe supervisory framework; (v) provide a brief overview of our engagement with financial services firms considering relocating business from the UK; and (vi) detail the Central Bank's approach to resourcing challenges.

(i) Key factors and assumptions informing the Central Bank's approach

The Central Bank's mandate and mission of protecting consumers and safeguarding financial stability underpins our approach to dealing with Brexit. In this regard, I would highlight:

- the Central Bank has been working in earnest on Brexit-related risks for nearly two years, and, overall, still considers that Brexit will have negative effects for Ireland, notwithstanding that our overall economic forecasts are for relatively favourable growth in the near term;
- from an early stage we have sought to ensure that financial services firms are adequately prepared and resilient enough to cope with plausible stress scenarios related to Brexit;
- it is both desirable and realistic that decisions related to the relocation of activities from the UK to other parts of the European Union (EU) be driven by factors other than regulatory and supervisory differences;

- the Central Bank's approach across different financial services firms is consistent with there being commonality across sectors in many of the key regulatory and supervisory issues to be considered as part of any relocation of activities from the UK;
- the Central Bank is engaging effectively in influencing European regulatory and supervisory approaches to dealing with Brexit-related issues, as well as operating consistently with them;
- we expect Brexit to have significant impacts on the Irish financial services industry, with some negative but manageable impacts for both domestically focused firms and for those with a UK focus; and
- we expect a material increase in authorisation activity due to UK firms seeking to relocate some of their activities in the EU27, which needs to be considered from a financial stability perspective.

(ii) Macroeconomic impacts on financial services firms

Ireland has a substantial, complex and multi-faceted financial services sector. Brexit effects on the financial services sector will vary accordingly. For the domestically focused firms, clearly the Brexit-related impacts on the domestic economy will be critically important.

Disentangling the potential macroeconomic, financial stability, regulatory and legal effects of Brexit is no easy task and, in any case, is subject to the considerable uncertainty of the negotiations. While a wide range of factors will determine the precise impact on Ireland's economy, our analysis is that the overall economic effects for Ireland in the short and longer term will be negative. The effects will be much worse if there is no free trade agreement.

Furthermore, a 'hard' Brexit may also require sudden regulatory and financial adjustments since UK financial services firms would lose passporting rights associated with EU membership and vice versa. This risk is likely to be associated with a period of heightened uncertainty in the financial services sector. This emphasises the importance of a transitional period to mitigate potentially disruptive cliff effects and associated financial stability risks.

(iii) Central Bank's approach to Brexit for existing financial services firms

Prior to the Brexit referendum, the Central Bank carried out extensive and coordinated analysis of the regulatory, policy, economic and broader financial sector effects of a potential Brexit, including the risks arising for the firms supervised by the Central Bank and the risks arising for the Central Bank itself. That work prepared us for a number of potential Brexit scenarios.

The Central Bank initiated an internal Brexit task force approximately one year in advance of the UK referendum. The task force comprises representatives from fifteen divisions across the Central Bank, its work is ongoing and it provides comprehensive assessments of Brexit-related matters to the Central Bank's Financial Stability Committee and the Central Bank Commission.

From a regulatory and supervisory perspective, the focus has been to ensure that regulated firms were addressing and planning appropriately for the impacts, such as currency movements, liquidity provision and changes in economic outlook in the UK and Ireland. We continue to push regulated firms across all sectors to consider, plan and adapt to the potential implications for their business models and revenue streams. The first appendix to this statement provides a high-level summary of the impacts to date on existing Irish authorised financial services firms.

(iv) European engagement and drive for convergence

The lessons from the global financial crisis remain fresh in the minds of the European regulatory community and form the foundation for assessing the implications of the new organisational configurations that Brexit will trigger. For these financial stability reasons, the importance of a robust approach to prudential supervision is a widely held view. The post-Brexit evolution of the European financial system cannot involve any dilution in the capacity of supervisors to ensure effective regulation of international financial services firms, in relation both to firm-specific and systemic risk.

At a European level, in light of the obvious material Brexit impacts on the State, the Central Bank has been to the fore in the discussions on the regulatory and supervisory approach to Brexit across all three European Supervisory Authorities (ESAs) and the work of the ECB/

Single Supervisory Mechanism (SSM). The aim of this approach is to mitigate against the risk of regulatory and supervisory arbitrage and to ensure that regardless of where a firm relocates to, it can expect a consistent application of the applicable EU regulatory standards and intrusive ongoing supervision of its activities.

Specifically, the aim is to ensure that the Central Bank is operating in line with European regulatory and supervisory norms, and is being effective in influencing these norms. We are satisfied that this approach is both correct, and proving worthwhile, and it is clear both through our interaction at the European level, but also with individual firms, that the opportunities for regulatory arbitrage are being successfully targeted and addressed.

The role of the SSM in banking supervision ensures that a level playing field will apply in relation to banks. Although there is more national autonomy in relation to other types of financial services firms, national regulators operate within the broad framework of the European System of Financial Supervision and there is significant (if incomplete) convergence in supervisory approaches across member states. With a broadly similar regulatory framework across member states within the EU, the primary focus of firms in relation to Brexit planning should be on non-regulatory criteria such as business model fit, legal systems, the availability of a skilled workforce, the quality of relevant infrastructure, cost factors and so on.

The SSM and the ESAs are developing guidance that will set out the approach they expect to see adopted by national authorities when dealing with Brexit-related applications. The Bank has also been actively involved, via ESA working groups and membership of the relevant Boards of Supervisors, in contributing to ESA considerations of Brexit issues across these sectors.

(v) Engagement with financial services firms considering relocating business away from the UK

Since the Brexit referendum, the Central Bank has had significant engagement with firms who are exploring the possibility of relocating aspects of their operations to Ireland. This includes existing, currently authorised firms that are considering changes to existing operations and those that are considering seeking entirely new authorisations. This engagement represents a major increase against normal activity and has been observed across all sectors[1]. In addition to individual engagements, we have held a number of roundtables with industry to detail our approach and hear views, with accounts of these meetings published on our website.

In terms of our approach, we have dealt with all enquiries in an open, engaged and constructive manner. We are approaching new authorisations and material business model changes in a similar way, through a clear, well-structured, transparent, consistent and predictable authorisation process. The purpose of this predictability and consistency is twofold – firms will know what to expect from us and we can outline what will be expected of them in terms of deliverables and timelines.

Our approach is in line with sound practices agreed across Europe. Our responsibility is to ensure that firms authorised to operate from Ireland are soundly run in compliance with EU requirements. To this end, we seek to ensure that an entity will be substantively run from Ireland and that the set-up permits effective supervision, with local management accountable for decision-making. The Central Bank has consistently said it is not sustainable to entertain proposals that fall short of these basic requirements. Moreover, we are actively considering the financial stability risks associated with potential changes to the financial services sector in Ireland, factoring in recovery and resolution planning into the authorisation process.

We have outlined in Appendix II to this statement a high-level overview of our approach to engaging with firms seeking to relocate aspects of their UK-based business to Ireland.

It is clear that London will remain a majorly important location for financial services activities. The level of activity that moves from London because of Brexit is highly uncertain, and contingent on the outcome of the negotiations between the EU and the UK. In the face of this uncertainty, there are hundreds of meetings being held across Europe between

[1] For example, including banking, insurance, investment firms, investment funds, fund service providers and payment service providers.

firms and regulators as both firms and regulators seek to navigate a path through the uncertainty created by Brexit. Firms that are considering moving activities from the UK are typically visiting several jurisdictions to assess the fit of that jurisdiction for their businesses. They are then whittling these locations down to two or three possibilities and in all likelihood might have further visits. They will subsequently make their decisions and inform the regulator. In the case of Ireland, and similarly across the EU, they will then embark on the formal process. Even at this latter stage, a submission of a formal application may be several months away. Different firms are at different stages of this process.

So, in the same way as scores of meetings are being held in Dublin, they are also being held in Paris, Frankfurt, Amsterdam, and so on. The number of meetings held to date gives absolutely no indication as to the likely outcome. Nor does the number of applications or expressions of interest give any sense as to the size, scale or complexity of an operation. What I would say is that, based on the many meetings we have had to date, Ireland can expect to receive a meaningful share of the activities that will move from the UK. We are also conscious of other state bodies with other mandates and are working well with them to ensure that the Central Bank's approach is well understood.

(vi) Central Bank organisation and resources

The Bank is committed to ensuring that we are well positioned to predict, understand, assess and respond effectively to developments arising from Brexit. Of critical importance, we are seeking to ensure that we have the skills, experience and resources that will enable us to deal both with the authorisation of new and materially changed firms and their subsequent supervision and possible resolution. On the latter point, while the common European approach should ensure regulation is not the deciding factor for firms in their relocation decisions, it is important to bear in mind why we regulate in the first instance – to have a well-functioning financial sector, to safeguard stability and ultimately, protect consumers.

Since Ireland is already home to a large-scale international financial services centre, we have significant experience in dealing with the authorisation and supervision of financial services firms. We have approved the recruitment of additional staff and set up new teams in order to manage Brexit-related authorisation queries across banking, insurance, investment firms, investment funds and financial markets infrastructures. The need for further resources is being kept under constant consideration.

Conclusion

In conclusion, the Central Bank has taken a proactive, considered, adaptive and influential approach to dealing with the impacts of Brexit on financial services and beyond. We remain conscious of the likely negative impact of Brexit on the Irish economy. Our approach is anchored by our core mandate of protecting consumers and safeguarding financial stability. We are working effectively to both operate within and influence European norms so that relocation decisions will be based on factors other than potential regulatory or supervisory differences across Europe.

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Appendix I - High level summary of the impacts to date on existing Irish authorised financial services firms

Brexit impacts on domestically focused (retail) banks have been manageable to date. The banks have witnessed no material deposit outflows and no significant deterioration in credit quality. The banks do not currently foresee any material deviation from their current overall strategies but there have been some reductions in forecast loan book growth and subsequent profitability estimates out to 2019. However, second round impacts of a general downturn in the UK could have a potential knock-on effect on the Irish economy, with follow-through impacts on the credit quality, loan growth and profitability of all the Irish retail banks.

From an insurance perspective, the majority of Irish regulated insurance entities have little or no direct business with the UK. However, and notwithstanding this, many larger non-life firms do sell a portion of their business into the UK, particularly in Northern Ireland. For the companies not selling in the UK, the impact of Brexit will be limited to the impact on financial markets in general and any economic slowdown in the markets to which they sell. For those Irish insurance firms that sell into the UK, there is potential for their business model to be impacted. The extent of the impact will largely depend on the proportion of their sales that are to the UK and whether those sales are made via a branch i.e. freedom of establishment (FOE) or via freedom of services (FOS) arrangements available within the EU. As outlined in the opening statement, supervisors are engaging with firms on an ongoing basis to understand the impact that Brexit will have on their business models. Firms have been contacted to provide an updated assessment of firm strategy taking into account Brexit developments.

Supervisors continue to actively engage with supervised entities within the asset management industry[2]. Initial concerns post the Brexit vote centred on the market volatility. Some fund values initially suffered from the sell-off in equities and the fall in bond yields, but not to an extent which triggered substantial redemptions with investors broadly taking a “wait and see” approach.

[2] Specifically, fund service providers, stockbroking and wealth management firms, asset management firms and market infrastructure firms.

In terms of investment firms, Irish authorised firms passport services to the UK, both on a FOS and on a FOE basis. Similarly, UK firms provide services to Ireland on a FOS and on a FOE basis under the passporting regime. A large number of investment firms operating in Ireland on a FOE basis are UK firms (91%). Similarly, of the Irish firms operating branches in the EEA, the majority of these are based in the UK (67%). Supervisors are actively engaging with these firms to understand the impact of Brexit on their business.

In relation to investment funds, Ireland is home to a substantial fund industry with extensive ties to the UK fund sector. For example, there are over 2,000 Irish-domiciled funds, both UCITS and Alternative Investment Funds (AIFs)[3] which are marketed into the UK and over 160 UK managers managing[4] Irish funds.

In the case of EU (including Irish) UCITS, they will not be able to avail of the UCITS passport in order to market into the UK. Therefore, the extent to which they will be permitted to market there will be at the discretion of the UK authorities. Post Brexit, all UK-authorised UCITS will become AIFs and will not be able to avail of the UCITS passport to market in the Union. Marketing funds to professional investors is a little different and is subject to AIFMD – the impact of Brexit in relation to the AIFMD regime will also depend on the outcome of the negotiations.

Both the UCITS and AIFM Directives permit fund managers to manage funds established in a host Member State. Post Brexit, UK managers will likely lose this right and EU managers will lose the right to manage UK funds. However, as the fund industry has well-developed arrangements in place, which allow fund managers to delegate investment management services to third country managers, the loss of the management passport may be less significant.

[3] Funds which are authorised as UCITS have a European passport and maybe marketed throughout the Union. Funds which are not UCITS are known as AIFs. Managers of AIFs (AIFMs) which are authorised in accordance with the Alternative Investment Fund Managers Directive (AIFMD) may market their AIFs (whether or not the AIFs are regulated by a supervisory authority) to professional investors throughout the Union

[4] A UK entity may have established an Irish fund management company / act as a delegate of an Irish fund management company by providing investment management services in respect of a fund.

Appendix II – High level approach to engaging with larger and more complex Brexit related authorisations

Generally, authorisation for larger and more complex entities begins with an exploratory pre-application process. The purpose of this phase is to provide us with an insight into the nature and scope of the firm's proposed business model. This stage also provides firms with a good insight into the Central Bank's requirements and approach and allows us to identify any potential areas of concern early in the process. At this early stage, we will focus on a number of different areas, including, for example, the firm's proposed strategy, the organisational structure, the firm's risk appetite and its approach to risk management and issues such as capital and liquidity arrangements, including the firm's approach to recovery and resolution. This exploratory phase will also comprise a number of dedicated face-to-face meetings to cover the main areas of the application.

Following the initial exploratory phase, the Bank will then seek to assess the draft application. Once this assessment is complete, the firm will be in a positon to submit a completed formal application. Following receipt of the formal application, this will be assessed in line with the legislative timelines as set out in the relevant and sector-specific legislation. As we are responsible for the authorisation of a wide and varying universe of firms across different sectors, this approach to authorisations as outlined is more streamlined for smaller, less complex institutions.

Our website contains detailed guidance outlining our authorisation process for each of the sectors that we regulate, and the different stages involved in this process. In line with our stated aim of transparency, the Central Bank publishes on a semi-annual basis our Regulatory Service Standards Performance Report. These reports, which are available on our website, provide real transparency around our authorisation process for firms, including measurement against standards to which we are committed in terms of application processing across each of the sectors we regulate.

Appendix III – List of references to relevant material and speeches

‘Some perspectives on Brexit’ *Sharon Donnery, Deputy Governor*, (22 February 2017 Irish Centre for European Law, Royal Irish Academy)

‘The European Banking Sector – Growing Together and Growing Apart’ *Sabine Lautenschläger, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB*, (2 March 2017 LSE German Symposium)

‘Caution Should be the Life of Banking’ *Sabine Lautenschläger, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB*, (22 March 2017 AFME Board of Directors)

‘European Financial Integration: Implications of Brexit’ *Governor Philip R. Lane,* (28 March 2017 Barclays European Financial Capital Summit)

‘Opening statement’ *Gabriel Fagan, Chief Economist Central Bank of Ireland,* (4 May 2017 Seanad Committee on Brexit)

Central Bank of Ireland Annual Performance Statement Financial Regulation 2016 - 2017