CENTRAL BANK OF IRELAND **Circulated to Commission Members**

on 13 September 2018

FOR INFORMATION

BREXIT CLIFF EFFECTS AND CONTINGENCY PLANNING

Brexit Task Force

Contents

1. Cliff Effects[1]

As outlined in the March Brexit Task Force report, the Central Bank conducted a mapping exercise to identify the various risks arising across the sectors (insurance, banking, asset management, consumer, etc.) in the event of a hard Brexit, with a view to prioritising the risks which should be a key focus for financial services firms and for supervisors. These risks were then categorised based on those which are likely to cause the most significant disruption on day 1 post Brexit and those which are likely to have more medium to long term implications. Based on this analysis, the key risks that are considered as having the potential to cause the most significant disruption immediately post Brexit (so called 'cliff effects') are:

(i) lack of service continuity for insurance contracts;

(ii) loss of market access to:

  (a) central counterparties (CCPs) and

  (b) central securities depository (CSD);

(iii) loss of passporting - particularly in the case of fund management and

(iv) lack of equivalence- particularly in the context of data protection and transfer.

A number of specific internal working groups have been established to further consider these specific risks. [Omitted due to confidentiality].

At a specific Brexit related supervisory risk committee convened in July, an update was provided on each identified cliff effect, including an assessment of firms' contingency plans for each risk and an outline of the Central Bank's planned approach to seeking to mitigate these risks. [Omitted due to confidentiality].

[Omitted due to confidentiality].

2. Contingency planning

2.1. Banking

Banking supervision is in the closing stages of a thorough assessment of Brexit-related risks across Significant Institutions ('SIs') and Less Significant Institutions ('LSIs'). This assessment […] will

[1] The following Divisions and Directorates are represented on the Brexit Task Force: AMSD, AMAI, BSAD, CPSU, FMD, FRG, MFD, GSD, IEA, IR, LEG, SMSD, INSA, MPD, ORD, Risk, SRD, PSSD, RES, RCU. The Chair is the Director of Economics and Statistics, the Vice Chair is the Head of the Macro-Financial Division (MFD) and the Secretariat is provided by MFD (Shane Byrne and Sofia Velasco) and STSD (Andrew Hopkins).

inform areas of focus and engagement with banks and other stakeholders over the coming months. This assessment is complemented by on-going assessment and targeted analysis within the Single Supervisory Mechanism ('SSM').

To date, banks have provided information on their assessment of Brexit related risks and related contingency plans and timelines. This information has been assessed by supervisors. In the majority of cases, planning is considered adequate. In some cases, progress is slower than expected, as banks assume a legal binding transitional arrangement between the EU and the UK and/or the transitional period measures (regardless of an agreement) set out by the UK authorities. The SSM and Central Bank continue to engage on these and other issues to address any remaining deficiencies in planning and to ensure continued progress on Brexit related issues.

The SSM and Central Bank have engaged with the retail SIs to make sure that they have adequately considered Brexit downside risks in their internal capital adequacy assessment process ('ICAAP') through stress testing. This aims to ensure that banks will have sufficient capital in a plausible downside scenario.

A significant portion of the retail SI bank's UK business activity is conducted through subsidiaries in the UK, so there are limited structural changes needed as a result of Brexit. The main Brexit related risk to their UK business, therefore, stem from macro-economic risks rather than cliff-edge effects, however, it is worth noting that these subsidiaries are well capitalised at present. Where relevant, banks have considered the limited activities conducted on a passport basis[2] in the UK and are taking appropriate action where necessary (i.e. third-country branch applications with the UK authorities, with SSM/Central Bank approval). The most immediate risk stems from market disruption around a hard Brexit, including that relating to derivatives exposures with UK counterparties and central counterparties ('CCPs').

The LSI banks in Ireland are internationally-focused, and generally have a limited interaction with the domestic economy. [Omitted due to confidentiality]

---

[2] With the UK as part of the EU, other EU27 banks can operate in that market on a freedom of services/passport basis, usually through the creation of a branch, to provide financial services in the UK. When the UK exits the EU single market, and with no mechanism to enable passporting for a third country under the Capital Requirements Directive, banks may not be able to continue to provide certain financial services in the UK without establishing a third-country-branch or some other form of legal entity.

2.2. Insurance

2.2.1. Contingency planning outwards: Ireland to UK

Irish authorised insurance undertakings are implementing contingency plans to allow them to write and/or service existing insurance contracts, post Brexit. The options, which are available under the current legal framework to ensure service continuity that impact UK policyholders include:

i. Portfolio Transfer to an existing UK entity
ii. Portfolio Transfer to a newly established UK Subsidiary
iii. Establishing a Third Country Branch in UK (Outwards)
iv. Establishing a Third Country Branch in Crown Dependencies
v. Fronting arrangement with UK insurers
vi. Cease writing UK new business

Firms are using these options and supervisors have assessed the contingency plans and continue to engage with firms on progress and implementation of plans. Some plans lack sufficient detail and do not outline clear trigger dates or decision dates for implementation. In some cases, undertakings have started to implement their plan with draft applications submitted to the PRA for approval. For others implementation progress is slower as insurers are relying on the proposed transitional arrangement between the UK and Ireland or the UK Government temporary regime. The Central Bank engages with the PRA/FCA to address concerns and to ensure continued progress is being made for Brexit.

[Omitted due to confidentiality].

2.2.2. Temporary permissions to address contract continuity – UK

In order to mitigate Brexit risk in respect of financial services, the UK Government has published a draft of the statutory instrument that will, subject to parliamentary approval, provide a temporary permission regime for EEA firms operating in the UK for approximately a three-year period. This will allows firms to develop a longer-term strategy to access and operate in the UK market post Brexit.

2.2.3. Contingency planning Inwards: UK/Gibraltar to UK

Through the EIOPA Brexit Platform, bilateral engagement with the PRA/FCA and GFSC, the Central Bank has obtained the plans for the majority undertakings with a number of them applying for authorisation for either an Irish subsidiary or third country branch in Ireland. A number of these firms already have existing branch operations in Ireland with either converting the existing branch to a third country branch or to a full Irish subsidiary. The remainder are seeking to establish a subsidiary or branch operations in other EU jurisdictions.

The insurance market in Ireland may change post Brexit. Some of the new applications to Ireland have sizeable “with profits” portfolios. In addition, a number of the non-life undertakings seeking authorisation include specialist marine underwriters or specialist insurers.

2.2.4. Passporting from Gibraltar to Ireland

The Central Bank has obtained an overview of the proposed contingency plans of the Gibraltar firms that write Irish premium. [Omitted due to confidentiality]. […] insurers are seeking to either portfolio transfer to existing EU insurers or establish a subsidiary in Europe. There were no Gibraltar life undertakings that wrote into Ireland for year-end 2016.

3. Actions Taken by the Central Bank

3.1. EIOPA Brexit Cooperation Platform

The Central Bank actively participates in weekly EIOPA Brexit Co-operation Platform teleconference calls, which discusses specific undertaking contingency plans. All EU28 regulators attend this EIOPA platform. Through the platform, the Central Bank shares and provide updates on the Irish authorised undertaking progress and obtains details of the UK and Gibraltar undertakings contingency plans. EIOPA have issued three information requests on Brexit contingency plans (January, March and July). Through this information exchange, all EU 28 regulators are able to get an updated status and progress of contingency plan implementation.

3.2. Bilateral engagement with the UK and Gibraltar regulators

The Central Bank also engages and collaborates with the UK and Gibraltar regulators on a bilateral basis to discuss and challenge the robustness of plans. There have been several teleconference calls to discuss specific firms contingency plans progress.

The Central Bank held telcos with the PRA and FCA to discuss some undertakings plans in more detail. The Central Bank continues to share knowledge with the PRA and FCA on firms contingency plans so both parties are kept informed.

3.3. Direct engagement with firms

The Central Bank has issued letters to some firms in respect of their contingency plans approaches. Supervisors continue to challenge their respective firms on their proposed contingency plans, requesting more detail such as trigger points for implementing plans.

The Central Bank continues to communicate with the industry on the importance of having credible plans with key trigger points for implementation for Brexit through Brexit roundtables, industry events and industry newsletters.

4. Payments and Securities Settlements

Ireland is in a unique position among EU countries in that it has no indigenous securities settlement systems infrastructure. [Omitted due to confidentiality]. Ireland's reliance on the UK for this part of its market infrastructure means that once the UK fully exits the EU, the requirements of the CSDR mean that […] could not continue to service the Irish market without an equivalence decision from the European Commission or the European Securities and Markets Authority[3] (ESMA) recognition of […]. Furthermore, once the UK exits the EU, CREST will no longer be eligible to avail of T2 for euro settlement as T2 access is restricted to systems managed by entities established in the EEA.

It is […] current intention to continue to provide Irish Securities Settlement and Euro Settlement for as long as it is permitted to do so, however, this is subject to certain external dependencies.

[3] ESMA is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by enhancing the protection of investors and promoting stable and orderly financial markets.

[…] recently published a consultation paper, which considers two broad outcomes to Brexit negotiations i.e. a 'hard' Brexit and 'soft' Brexit.

[Omitted due to confidentiality].

4.1. Continuity of Irish Securities Settlement

In a soft Brexit scenario, […] expects to be able to continue Irish Securities Settlement during the proposed Transition Period (the Transition Period is currently intended to operate from March 2019 to 31 December 2020). This is on the assumption that the Withdrawal Agreement means that […] would be treated as an EU CSD for the purposes of the Central Securities Depositories Regulation[4] (CSDR) and would be permitted to passport services in respect of Irish corporate securities into Ireland from the UK.

In the absence of a Transition Period, […] objective is to be able to continue to provide Irish Securities Settlement after Brexit as a 'third country' CSD in accordance with the third country equivalence provisions of CSDR. […] currently intends to make an application for equivalence recognition in accordance with the timeframes set out in CSDR. Until […] application for equivalence recognition is determined, […] would intend to rely on the 'grandfathering' provisions of CSDR. Before […] can apply to ESMA for third country CSD equivalence, however, the European Commission would have to recognise the UK as a third country.

4.2. Continuity of Euro Settlement

[…] working assumption is that the UK will remain, or be treated as remaining, a member of the EEA during the Transition Period. In such circumstances, […] envisage that CREST will continue to be permitted to act as an ancillary system to T2 and therefore continue to offer Euro Settlement.

[…] working assumption is that the UK will not remain a member of the EEA in a hard Brexit scenario. Continued Euro Settlement would likely require a special arrangement or exemption to be agreed with the Governing Council. Continued access is therefore subject to a number of factors beyond […] control. The Bank is currently in discussions with the ECB regarding continuity of access to TARGET2 for […]. In the absence of a special arrangement or appropriate exception being made to the requirements of the TARGET2 Guideline, […] may be obliged to cease Euro Settlement (for all CREST securities) once the UK is deemed to have left the EEA.

[4] Regulation (EU) No 909/2014 of the European Parliament and of the Council.

5. Organisational Risk

ORD’s non-financial risk function is currently in the process of undertaking a Brexit Impact Assessment, to examine the status of Brexit operational risk exposures and to assess contingency planning within the Bank itself.

As part of this, ORD has completed an initial scan of the organisation and engaged, at a high level, with all divisions. The focus of this engagement has been the operational impact as a result of Brexit, the timelines in relation to impact and whether there was any additional complexity added to the ongoing work of the division as a result. In addition, ORD has probed divisions in relation to their contingency plans or risk mitigation measures.

This has allowed ORD to establish, on a preliminary basis where the high risk exposures lie in the organisation. Following this in-depth engagement, ORD has been determined the areas within the Bank that have high Brexit related operational risks, those areas which will be immediately impacted by Brexit in terms of workload, both in terms of volume and complexity. ORD has proposed to conduct further in-depth analysis of these high risk divisions in order further assess the risks posed by Brexit, to validate the current categorisation as high risk and to identify existing and required mitigating actions. As necessary, workshops will also be conducted in order to obtain more granular detail of the risks. Medium and low risk areas have also been identified, and ORD will continue to monitor and engage with these divisions

Where appropriate, Brexit related risks will be articulated and recorded on divisional risk registers which will allow for the monitoring of mitigation measures and will allow for an update in terms of the risk profile to senior management.

5.1. Asset Management

In November 2017, a Brexit specific letter was issued to all firms supervised by the Asset Management Supervision Directorate asking them to consider the risks associated with Brexit and outline their contingency planning.

Following analysis of the returns, it was determined that follow up correspondence would be issued. These letters, issued in June, outlined the key risks identified across their sector and requesting updated Brexit contingency planning (including stress and scenario analysis). Responses are due in September and the content will be analysed by supervisors with appropriate follow up actions taken on a firm and sectoral basis.

In addition, the Asset Management Supervision Division as requested by ESMA issued an ESMA Brexit survey to 28 Branches and […] Tied Agents, operating under Freedom of Establishment under MiFID, in July 2018. The Consumer Protection Directorate are collating the responses from the 22 survey responses received back to ESMA in September 2018.

5.2. Consumer Protection

In the context of Brexit contingency planning across all sectors, a key focus of the Consumer Protection Directorate is to work with the prudential directorates to evaluate the Brexit preparedness of sectors that represent the greatest risk to Irish consumers of financial services. The Q1-18 Brexit cliff-edge analysis identified, inter alia, the preparedness of UK and / or Gibraltar regulated entities passporting into Ireland as a key risk from an Irish consumer perspective. This 'passporting risk' is cross-sectoral and varies in risk level across the different sectors, e.g. in banking, investment firms and insurance etc. While CPD continues to liaise with all relevant prudential divisions in relation to passporting (both on a freedom of service and establishment [branch] basis), a key consumer risk continues to be insurance contract service continuity and this affects both insurers and the retail intermediaries that distribute insurers' products.

(See separate update from the Insurance directorate on status of insurer's contingency plans). [Omitted due to confidentiality.

[Omitted due to confidentiality].

5.3. Securities and Markets

Senior management have outlined in speeches the need for firms to be aware of the impact of Brexit on their business models. In addition to this, earlier in the year a survey was undertaken to see how prepared the Funds Industry were for Brexit. Internal to SMSD, senior management schedule meetings to discuss Brexit and its impact on the work of the Directorate. Further, our close engagement with Banking and Asset Management Supervision means that SMSD are aware of firms due to be authorised and can plan accordingly.

6. Communications

A sub group working on related communications programme has been established and is gathering input from the relevant business areas

Glossary

AIFM	Alternative Investment Fund Manager
AMS	Asset Management Supervision Directorate
AUM	Assets Under Management
BoE	Bank of England
BoS	Board of Supervisors
BTF	Brexit Task Force
BSSD	Banking Supervision Supervision Division
BSAD	Banking Supervision Analytics Division
CA	Competent Authority
CBI	Central Bank of Ireland
CCP	Central Counterparty Clearing House

Central counterparty clearing, also referred to as a central counterparty (CCP), is a financial institution that takes on counterparty credit risk between parties to a transaction and provides clearing and settlement services for trades in foreign exchange, securities, options and derivative contracts.

COSMO	Core Structural Model of the Irish Economy
CPD	Consumer Protection Directorate
CRE	Commercial Real Estate
CPD	Consumer Protection Directorate
CPI	Consumer Price Index
CSD	Central Securities Depository
CSDR	Central Securities Depositories Regulation
CSO	Central Statistics Office
DoF	Department of Finance
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
EMI	Electronic Money Institutions

EMIR European Market Infrastructure Regulation

The European Market Infrastructure Regulation is a body of European legislation for the regulation of over-the-counter derivatives.

ESMA European Securities and Markets Authority

ESA European Supervisory Authority

ESRI Economic and Social Research Institute

EUCO European Council

EURATOM European Atomic Energy Community

EY Ernst & Young

FCA Financial Conduct Authority

FCA Framework Cooperation Agreement

FMD Financial Markets Division

FOMC Federal Open Market Committee

FSC Financial Stability Committee

FSD Financial Stability Division

FTA Free Trade Agreement

GDP Gross Domestic Product

GWP Gross Written Premiums

HPI House Price Index

ICAAP Internal Capital Adequacy Assessment Process

IEA Irish Economic Analysis

INSA Insurance - Actuarial, Analytics & Advisory Services

IR International Relations

IPD Investment Property Databank

IRC International Relations Committee

The International Relations Committee of the ECB. The IRC is responsible for forming policy views and advising the ECB Governing Council or General Council on external issues to the EU (including the IMF). It meets in 28 NCB format.

IRC BTF International Relations Committee – Brexit Task Force

KFD Key Facts Document

LSF Labour Force Survey

The Labour Force Survey is a large-scale, nationwide survey of households in Ireland. It is designed to produce quarterly labour force estimates that include the official measure of employment and unemployment. The LFS replaced the Quarterly National Household Survey (QNHS) in January 2017.

LSI Less significant institution

MiFID Markets in Financial Instruments Directive

The markets in financial instruments directive (MiFID) aims to increase the transparency across the European Union's financial markets and standardise the regulatory disclosures required for particular markets. MiFID implemented new measures, such as pre- and post-trade transparency requirements, and set out the conduct standards for financial firms. The directive has been in force across the European Union (EU) since 2008. MiFID has a defined scope that primarily focuses on over the counter (OTC) transactions.

MiFIR Markets in Financial Instruments Regulation

MoU Memorandum of Understanding

MMoU Multilateral Memorandum of Understanding

MoUPG Memorandum of Understanding Project Group

MPC Monetary Policy Committee

MPD Markets Policy Division

MS Member State

MSCI Morgan Stanley Capital International

MTF Multilateral Trading Facility

NSA National Supervisory Authority

NTB Non-Tariff Barrier

NTMA National Treasury Management Agency

ORD Organisational Risk Division

OTF Overnight Trading Facility

PRA Prudential Regulatory Authority

The Prudential Regulation Authority is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms in the UK.

PSD2 Directive 2015/2366/EU on payment services

PSSD Payment and Securities Settlement Division

RCU Registry of Credit Unions

RES Resolution Division

RI Retail Intermediary

RICS Royal Institute of Chartered Surveyors

RRE Residential Real Estate

RUK Rest of United Kingdom

SI Significant Institution

SMSD Securities Markets Supervision Division

SCN Supervision Co-ordination Network

SRD Supervisory Risk Division

SSM Single Supervisory Mechanism

TC-CCP Third-Country Central Counterparty Clearing House

TARGET Trans-European Automated Real-time Gross settlement Express Transfer system

TARGET2 is the real-time gross settlement (RTGS) system owned and operated by the Eurosystem

UCITS Undertakings for Collective Investment in Transferable Securities

UCITS are open-ended investment funds and may be established as unit trusts, common contractual funds, variable or fixed capital companies or Irish Collective Asset-management Vehicles (ICAV).

WTO World Trade Organization