Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Feedback Statement –
Consultation on New Levy Methodology to calculate Funding Levies payable by Payment Institutions & E-Money Institutions (CP137)

8 June 2021

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Foreword: Regulatory effort, costs and subvention

The number of Payment and E-Money institutions authorised and supervised by the Central Bank has increased significantly in recent times and there is currently a large authorisation pipeline. When levying costs for 2019 in 2020, the Central Bank applied significant additional subvention to the funding requirement to limit the costs for existing authorised firms by excluding them from the cost of activities related to firms at pre-authorisation stage.

Currently, the process of calculating 2020 levies is underway and the Central Bank may once again seek additional subvention to limit the costs of existing firms from the application of all regulatory costs for this sector in the levy calculation.

Looking to levies for year-end 2021, many firms are expanding in scale and complexity. The Central Bank anticipates that supervisory effort and costs will therefore increase. Industry should plan on the basis that the case for exceptional subvention beyond the 2020 or 2021 levy cycle will come to an end. Meanwhile, the Central Bank will consider options to apply specific year 1 authorisation costs to firms emerging from the pipeline so that subvention, ultimately a liability for the taxpayer, is minimised. In the course of regulatory engagement with industry representatives, the Central Bank will provide updates to help firms to plan for regulatory costs.

This foreword is set out to ensure that firms are aware that, irrespective of levy methodology, the regulatory bill applied in 2019 reflected substantial additional subvention in addition to planned subvention of thirty per cent (recovery rate of seventy percent). While special additional subvention may again be applied to 2020 levy calculations, consistent with the Central Bank's strategy to move towards full funding of regulatory costs by industry, such special subvention should not be anticipated into the future. Market conditions will again be assessed when year-end 2021 levy is being calculated with a view to eliminating additional special subvention unless there are compelling reasons to the contrary.

In summary, the Central Bank anticipates that due to the increased nature, scale and complexity of this sector the supervisory effort will continue to increase, subvention will be withdrawn and the aggregate bill for this industry will rise in the next number of levy cycles. The impact for each firm will be reflective of its relative size within the total population of firms subject to levy and the Central Bank encourages firms to take account of this outlook when setting projections for regulatory costs in their planning processes.

Introduction

A. The Central Bank of Ireland's ("the Central Bank") total funding requirement for financial regulation activity is determined on an annual basis by the resources required to discharge its legal responsibilities under domestic and EU law.

   Following a public consultation in 2012, the method for calculating industry funding levies for Payment and E-Money Institutions has been based on PRISM impact categories from 2013 onwards.

B. The Central Bank's funding strategy has evolved in the intervening years, arising from a public consultation in 2015 - Funding the Cost of Financial Regulation - issued jointly by the Department of Finance and the Central Bank. The strategy is to move towards full funding of regulated activities by industry in order to eliminate the level of taxpayer subvention. On 14 June 2019, the Central Bank issued a Press Release to communicate a number of changes in funding and to provide guidance to firms on the timelines to move towards 100 per cent funding. As part of the annual funding cycle, the Central Bank provides an industry guide. The Funding Strategy and Guide to the 2020 Industry Funding Regulations is the most recently published update.

C. A key element in the Central Bank's multi-year funding strategy seeks to implement levy methodologies that reflect a predictable, transparent and proportionate approach to pricing of levies. In recent years, levy methodologies for a number of industry categories have been reformed in order to eliminate, or at least reduce, the threshold effects associated with PRISM impact-derived pricing.

For 2020 levies, consistent with this strategy, on 16 February 2021, the Central bank published consultation paper CP137, on a New Methodology to Calculate Funding Levies payable by Payment Institutions and E-Money Institutions. In that paper, the Central Bank outlined that the case for a new levy methodology centred "on a need to take account of the changing landscape in the market, revisions to the Central Bank's PRISM impact models and a funding strategy which aims to achieve a predictable, transparent and proportionate approach to the calculation of levies".

Stakeholders were invited to provide feedback on two questions as follows:

1. Do you agree with the broad structure proposed?
2. With regard to the variable fee element, do you favour a methodology based on:
    a) Total Value of Transactions processed
    b) Total Value of Transactions processed & Average Value of User Funds Held at period end.

The closing date for comments was 16 April 2021 and twelve responses were received.

D. This document sets out the Central Bank feedback on responses received to CP137.

Feedback on proposed changes to calculate funding levies

Of the twelve responses received,

1. All reflected support for the broad structure proposed with some caveats;

2. With regard to the variable fee component,
    a) 11 responses signalled a preference for a methodology based on the Total Value of Transactions Processed;
    b) 1 firm signalled a preference for a methodology based on the Total Value of Transactions processed & Average Value of User Funds Held at period end

Summary of twelve responses

	1. Do you agree with the broad structure proposed?	2. With regard to the variable fee element, do you favour a methodology which based on:	
		a) Total Value of Txs processed	b) Total Value of Txs processed & Average Value of User Funds Held at period end
1	Strongly support	✓	
2	Broad agreement	✓	
3	Appears reasonable with caveats	✓ (but with PRISM scores)	
4	Agree	✓	
5	Supportive but views on fixed fees; Ambiguities to be clarified	✓	If 2(b), weighting should change to 80:20 rather than 50:50
6	Broadly reasonable	✓	
7	Broadly supportive of flat and variable fee; Recommend period end is defined.	✓	
8	Agree with broad structure		✓
9	In favour	✓ (but with PRISM scores)	
10	No objection Clarity on costs appreciated	✓	
11	Preferable to the current methodology	✓	
12	Support review but AML risk categorisation preserves cliffs	✓	

Caveats reflected in responses

1. One submission, while stating that the approach seems broadly reasonable, advanced the view that it may be premature to base the calculation on 2020 data as authorisations are ongoing and the real volume of transactions processed in Ireland is unknown. It suggested that it might be fairer to calculate levies for 2020 based on quarterly data for Q1 2021 or Q2 2021 data when the market is more settled.

   The same submission called on the Central Bank to provide a guarantee on costs and levies remaining static for a period of five years and for a gradual move to 100 per cent funding by industry.

   This submission, while supporting a variable fee component based on Total Value of Transactions process, suggested that consideration might also be given to the incorporation of PRISM Impact Scores within the levy calculation methodology. This point was also raised in one other submission.

Central Bank response

a) On the proposal that it might be fairer to base 2020 levies on quarterly data for Q1 2021 or Q2 2021, the Central Bank is currently working on 2020 levies. While it is planning to base levies on 2020 data, it appreciates that changes in the market place and the scale of authorisation activity is a concern for some market participants.

In 2019 levies, the Central Bank recognised this and the Deputy Governor exercised his discretion to approve subvention for this category on an exceptional basis to avoid levying disproportionate costs arising from an exceptional pipeline of authorisation activity on established firms. As the 2020 levy calculation process progresses, consideration will be given to whether there are grounds for subvention on a similar basis again.

b) In relation to the proposal that the Central Bank might provide a guarantee on costs and hold levies static for a period, this would directly contravene the published multi-annual funding strategy which aims to eliminate significant annual subvention which imposes a direct burden on the Exchequer and ultimately on the tax payer. The Central Bank is not proposing to depart from its stated strategy.

c) A number of submissions asked for more information on the €2 million regulatory cost used in the examples. This figure, as stated in CP137, was selected for the purposes of illustration – in the 2019 levy cycle, the bill for industry amounted to c€1.7 million but this reflected exceptional subvention. The real cost of regulating this sector in 2020 is considerably more. The Central Bank is open to, and would welcome, engagement with industry representatives on costs and drivers later in 2021 after final 2020 levies have been approved

d) Finally, on the suggestion to consider incorporating the PRISM Impact scores into the levy calculation methodology, the Central Bank did model this amongst a number of scenarios before shortlisting the two proposals which featured in CP137. The main reasons for not including a methodology based wholly or partially on PRISM Impact scores in CP137 is that our work led us to believe that (a) a tight banding of scores would result in levy increases for many firms and (b) we favoured use of industry metrics in pursuit of our 'transparency' strategy. Notwithstanding this conclusion, the Central Bank is open to engaging with industry representatives after the 2020 levy cycle concludes to refine the methodology for future levy cycles if appropriate.

2. Two submissions, while supportive of the broad structure, made observations in relation to the fixed fee elements reflected in CP137, centring specifically on the AML flat fee component of €380k.

<u>One submission expressed the view that:</u>

a) The proposed fee structure carries over features of the current methodology that the CP seeks to address;
b) It called for more clarity on how AML risk categorisations are applied; and
c) It suggested that the "Ultra High" fee weighting associated to AML risk is being used to ensure a significant element of funding will be paid by a small cohort of firms.

<u>A second submission</u>

d) Linked to a), b) and c) above, this submission proposed that consideration would be given to sharing the AML-related flat fee across firms assessed as "Ultra High" or "High" risk on the AML framework.

e) More generally, this submission sought clarification on a number of points as follows:
   - Definition of a transaction, treatment of transactions in / out and intra-group;
   - Clarity on period start and end for aggregation of transactions; and
   - Funding of inspections and administrative sanctions

Central Bank response

In relation to a), b), c) and d)

There is validity to the argument that the proposed structure, by incorporating a relatively significant flat fee for 'Ultra High' firms on the AML risk impact framework, does perpetuate an element of the outgoing methodology.

Information on AML risk categorisations is available here:
https://www.centralbank.ie/regulation/anti-money-laundering-and-countering-the-financing-of-terrorism/risk-based-approach-to-aml-supervision
The introduction of an AML-related flat fee for 'Ultra High' firms is reflective of costs and is, in our view, fair to the pool of firms overall. More broadly, many elements of the outgoing system have been eliminated – apart from flat fees, the variable element of levies will reflect industry metrics and will, therefore, be more transparent and more proportionate than before and firms should be better placed to predict regulatory costs and set aside accruals in their financial statements accordingly.

The Central Bank is committed to refining the levy methodology to take account of costs, cost drivers, populations and industry views and, in this regard, proposes to extend annual engagement with industry representative bodies to include this category too.

In relation to e)

Ambiguity around definitions, dates and treatment of transactions will be addressed in the next phase of detailed design of the levy methodology and the Central Bank will provide clarity to industry representatives in the months ahead. Given the almost unanimous support for the revised methodology to be based on the Value of Transactions Processed, for levy 2020, the variable element for a firm will reflect its share of the aggregate market across the four quarters of the year. In the example shown, Firm A's variable element will reflect 5.6% of the total levy amount to be recouped under this element.

	2020				
	Q1	*Q2*	*Q3*	*Q4*	**Total**
Firm A €bn	*€1*	*€2*	*€4*	*€5*	**€12.0**
Total Market €bn	*€40*	*€50*	*€60*	*€64*	**€214.0**
Share	*2.5%*	*4.0%*	*6.7%*	*7.8%*	**5.6%**

Costs associated with the Administrative Sanctions Process are included in the total cost of Financial Regulation and the cost of any new Inquiries will be included in the levy calculations and part-funded* by industry. Similarly, the cost of inspections is also included in the cost of Financial Regulation and part-funded* by industry. The cost of Financial Regulation attributed to Payment Institutions and E-Money Institutions is, in general, shared amongst industry participants on a pooled basis. However, where the Central Bank believes that it is unfair to the majority of compliant firms that costs associated with a regulatory breach in a specific firm are shared, it has avenues to seek to isolate such costs from the pool and to recover them directly from the non-compliant firm. For example, Inquiry costs associated with the Tracker Mortgage Examination are being recharged to the six firms that are subject to Inquiry rather than to all Credit Institutions.

While many industry categories now fully fund their regulatory costs, Payment Institutions & E-Money Institutions are on a trajectory towards full industry funding in accordance with the following plan, which was published in 2019. In this regard, industry is scheduled to fund seventy five per cent of 2020 costs when levies issue in arrears in September 2021. The trajectory of rates to move towards full funding is set out below:

Recovery Rates to 2024		Plan				
	Calendar Year →	2020	2021	2022	2023	2024
	Levied in →	2021	2022	2023	2024	2025
ELG Banks		100%	100%	100%	100%	100%
Other Banks Insurance Undertakings Investment Firms & Fund Service Providers		100%	100%	100%	100%	100%
Funds		90%	100%	`100%	100%	100%
Retail Intermediaries & Debt Management Co's Moneylenders Approved Professional Bodies Bureau de Change/Money Transmitters Retail Credit/Home Reversion/Credit Servicing Firms Payment & EMoney Institutions		75%	80%	90%	95%	100%
Credit Unions		35%	50%	TBC	TBC	TBC

Next Steps

The Central Bank appreciates the engagement with stakeholders in relation to CP137 and, taking into account the various submissions, will proceed to introduce the changes set out in CP137 for the 2020 levy year.

Taking account of industry views, for 2020 levy purposes, the variable fee methodology will reflect a 100 per cent weighting on the Value of Transactions processed and a 0 per cent weighting for User Funds held. This reflects the very significant levels of support shown for a methodology based on Value of Transactions processed. However, given the dynamic nature of the market and the evolution of different business models in the sector, the Central Bank may alter these weightings in annual levy cycles in order to achieve levy burden sharing in a manner which is proportionate to size and risk.

Industry's request for clarifications will be addressed though engagement with industry representatives in June / July 2021. Ministerial approval of 2020 levy rates is expected in August 2021 and firms can expect to receive invoices in September 2021.

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