



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

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FINANCIAL REGULATION PRIORITIES 2022

Last July I sent you my regular pre-budget letter for 2022 and outlined the economic outlook for the year ahead, the need to build resilience in the public finances and the policy challenges as I saw them. This letter sets out my views on the financial services landscape and regulatory priorities for the year ahead. As you know, the Central Bank works closely in supporting your Department in the development of regulatory policy for the financial sector.

Context: a changing landscape

The pandemic has shown us the benefits of building resilience in the financial sector. It has served the economy, consumers and investors effectively through a major economic crisis. Risks have now reduced as the pandemic recedes in Europe and the impact on the financial position of the banking sector has also started to dissipate. However, while financial markets have demonstrated resilience over this period, vulnerabilities remain as increasing levels of indebtedness, stretched asset values and risk-taking behaviour in a search-for-yield environment have become more prominent. Moreover, there remains a risk that regulated

entities make significant decisions without sufficient consideration of how the firm will ensure fair outcomes for their customers, consumers and investors in general.

The financial system more broadly is undergoing unprecedented and rapid change, involving greater digitalisation, innovative services and the need to manage climate change. We have to ensure the regulatory framework adapts to these transitions. In particular, market-based finance has grown rapidly in recent years and become a central part of the global order. The depth, speed and scale of technological innovation has been accelerated by the pandemic, with new entrants to the market spurring competition as well as having a structural impact on the economy and financial system. As the pandemic recedes, we will continue to focus on safeguarding the resilience of the financial sector to both current and future risks. And as the financial system changes, there will be a need for financial literacy and education to continue to support consumers more generally. (While the Competition and Consumer Protection Commission has the statutory responsibility in relation to financial education in Ireland, it remains highly relevant for the Central Bank's mandate which supports the overall welfare of the public (through the range of functions we perform including on consumer protection).)

Working with the Department of Finance

There are a number of areas where the Central Bank and Department of Finance have strong areas of common interest.

Banking Union and Capital Markets Union

Given the close economic and financial integration between Ireland and the rest of the EU (as well as the prevalence of EU legislation and regulatory requirements in respect of financial services), strategic, effective and committed engagement in the EU is a key priority and necessary to the achievement of the Central Bank's regulatory and financial stability mandates.

Ireland is a core jurisdiction in the EU's Single Market for financial services with a significant body of Irish-authorised firms providing financial services to individuals and businesses in other EU Member States. In light of the integrated nature of much of this market, consistent regulatory and supervisory standards for EU consumers is necessary for the proper functioning of financial markets in Europe.

The development of the Single Market in financial services is still evolving and taking shape, and faces a number of challenges. While having achieved a significant degree of progress, Banking Union remains incomplete and Capital Markets Union (CMU) is progressing incrementally. Although the progress that has been achieved is welcome, the incomplete nature of these projects carries risks for Ireland. Advancing both initiatives is important to ensure that the financial system is resilient and functions in the best interests of consumers and the wider economy in Ireland and the EU. The Central Bank and Department of Finance are well placed to provide leadership in addressing some of these challenges and helping to shape their future development.

Anti-money laundering/countering financing of terrorism

Over three decades, the EU has developed a solid ***Anti-money laundering/countering financing of terrorism*** (AML/CFT) regulatory framework, which has been augmented in recent times by the introduction of 4AMLD and 5AMLD and the increased mandate of the European Banking Authority. However the risks posed to the EU's financial system by fragmentation continues and I support further steps to harmonise and strengthen the EU AML/CFT framework with the aim of ensuring high-quality and consistent supervision across the Single Market. Preparing for the new EU AML/CFT infrastructure – which will mark a structural sea-change in the European approach to the underlying risks, will require close engagement with the Department.

The International Monetary Fund's Financial Sector Assessment Programme

The International Monetary Fund (IMF) ***Financial Sector Assessment Programme*** (FSAP) is a comprehensive and in-depth assessment of a country's financial sector. Ireland is one of 29 systemically-relevant financial centres for which an FSAP must be undertaken at a five-year interval. The IMF's current FSAP marks an important external assessment of the resilience of the financial sector, the quality of the regulatory and supervisory framework, and the capacity to manage and resolve financial crises. Work-streams include banking, insurance, securities and markets regulation and supervision, macro-prudential policy and financial safety net and crisis management. Jointly addressing the FSAP recommendations will be important to ensure the robustness of Ireland's regulatory framework continues.

Individual Accountability Framework

An important objective for the Central Bank and the Department this year will be to see progress on the introduction of the Individual Accountability Framework to enhance the governance of financial services firms. Following the passage of legislation, the Central Bank will issue a Consultation Paper setting out our proposed supporting regulation and guidance. This will ensure clarity of responsibilities and support good governance in financial firms.

Resolution

We will continue to strengthen our crisis management capabilities and progress the resolvability of financial services firms, engaging with your Department in relation to the remaining gaps in the legislative framework.

Cyber/Digital

We will continue to support your Department in finalising negotiations on the Markets in Crypto Assets Regulation Proposal (MICA) and the Digital Operational Resilience Act (DORA) and we will prepare for their implementation in Ireland.

The Central Bank looks forward to working with your Department in these areas at international and national level where continued cooperation is essential. The Retail Banking Review will be important to ensure the banking system continues to serve consumers, the economy and wider community in the future.

Our Financial Regulation Priorities for 2022

Our financial regulation priorities for the coming year support our new Strategy and the need to respond to the dynamic and growing financial services system in Ireland. This growth presents both economic and consumer benefits, but also increases complexity in the financial system and creates risks.

Particular milestones in our work programme this year include:

- completing our framework review of the macroprudential mortgage measures;
- contributing to the European review of capital buffers for banks, including ensuring their usability in times of crisis, and concluding our own review of the Bank capital framework;

- starting a comprehensive review of the Consumer Protection Code by publishing a discussion paper and engaging widely with stakeholders on it. The paper will examine the role of consumer protection in supporting a well-functioning financial system and the balance of key aspects such as trust, innovation, and predictability;
- introducing our new Differential Pricing Regulation for non-life insurance with effect from July this year;
- introducing new measures to address risks in Irish property funds (while continuing to play a lead role globally in developing a macroprudential framework for investment funds);
- putting in place a structured framework for engagement which will include an Industry Stakeholder Forum, a Financial System Conference (to be held later in the year) and a Climate Risk and Sustainable Finance Forum (to bring together key industry and other stakeholders to share knowledge and understanding of the implications of climate change for the Irish financial system).

We have seen a material growth in the financial services sector in recent years including as a result of the UK's withdrawal from the EU, the Ireland for Finance Strategy and the emerging focus of technology firms in financial services. (The significant interest amongst Virtual Asset Service Providers (VASPs) in seeking registration with the Central Bank suggests that interest in authorisation as Crypto Asset Service Providers (CASPs) under MICA will be high.) We will continue to prioritise our **authorisation** work across multiple sectors, recognising the benefits of innovation, disruption and competition, but also the importance of protecting consumers of financial services and the importance of applying clear and consistent standards.

In the area of **payments** we will act across a number of initiatives to enhance the payments environment, including participating in the work on a digital euro, promoting low-cost instant payments domestically and across Europe and contributing to the review of the Payment Services Directive (PSD2) and the functioning of open banking.

On the **microprudential** side, we will maintain our focus on the financial and operational resilience of the financial sector. Key priorities here will include our work on stress testing and other financial resilience related work across multiple sectors. The supervision of business model and technology related change will also be a priority as firms implement new

technologies and respond to changing customer preferences. We will maintain a continued focus on operational resilience, covering cyber resilience, critical infrastructure and outsourcing.

In line with our mandate for **conduct and consumer protection**, we will continue to drive for fair outcomes and for consumer and investor interests to be at the centre of financial services. Our priorities include business interruption insurance, long-term mortgage arrears and oversight of the withdrawal of Ulster Bank and KBC from the Irish market. We will also continue to enhance the reports from the National Claims Information Database to support the wider policy agenda towards a better functioning non-life insurance sector.

We will also continue to step up our work on **climate change** to both ensure the financial system can support the transition to a carbon neutral economy and is suitably resilient to the risks. This will include continuing to ensure that financial firms are adapting business models and building resilience in the face of growing climate and transition risks. We will also focus on the development and marketing of ‘green’ financial services products and services such that they are meeting high standards of quality and disclosure. And we will learn from and apply international best practices through our participation in the Network for the Greening of the Financial System (NGFS) and work in the European Supervisory Authorities.

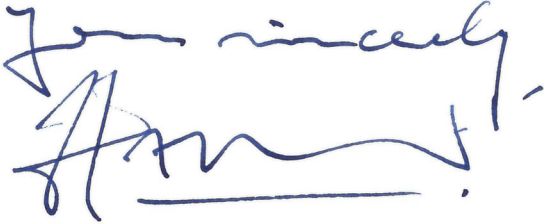
More broadly, we will continue to evolve our regulatory frameworks and supervisory approaches to ensure that the interests of citizens and the economy are well-served by innovation in the financial sector. This includes a review of our **Innovation Hub** which was set up four years ago to support engagement between the Bank and innovators and has provided a valued and successful service. In light of the changing landscape, it is timely to review its functioning and consider any enhancements that could be made.

Conclusion

Our broad mandate allows us to take a comprehensive view across many sectors and tackle challenges across the entire, inter-connected, financial system, including as an integral part of the EU and its institutions and frameworks. We need to take the changing landscape into account and the implications for regulation and supervision in our work with your Department. A core part of our new Strategy is to meet the challenges and opportunities of the rapidly changing environment by becoming a more agile, diverse and intelligence-led organisation,

building on the strong foundations established in recent years. Our work will remain anchored to our vision for the financial system, with the well-being of the people of Ireland being at the heart of everything we do.

I would be happy to discuss the contents of this letter with you.

A handwritten signature in blue ink, appearing to read 'Gabriel Makhlouf', with a horizontal line underneath the name.

Gabriel Makhlouf