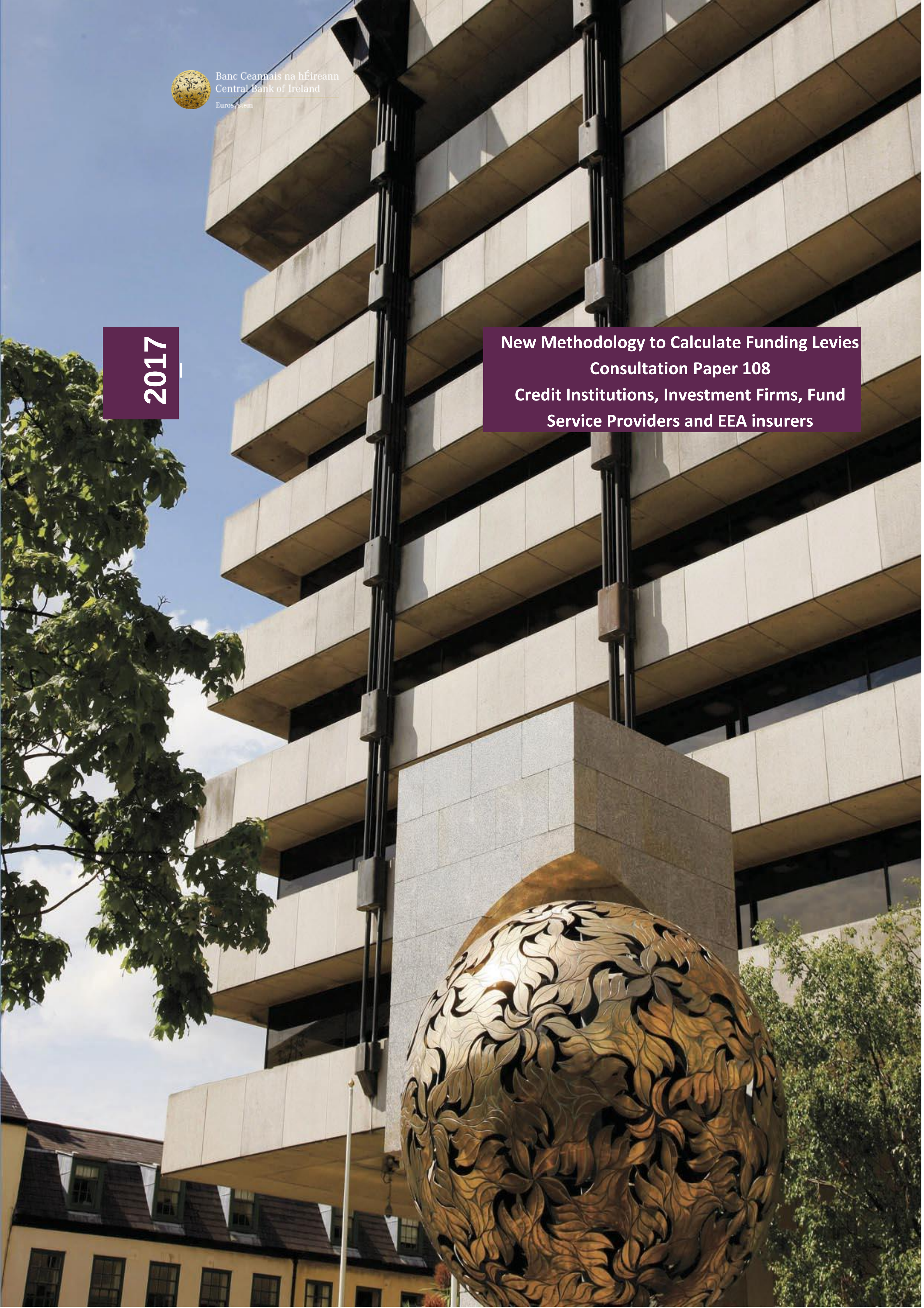


Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

2017

New Methodology to Calculate Funding Levies
Consultation Paper 108
Credit Institutions, Investment Firms, Fund Service Providers and EEA insurers

Contents

1. Objective

The aim of this consultation is to elicit views on revised methodologies for calculating the industry funding levy for credit institutions, investment firms and fund service providers. The paper also outlines and seeks views in relation to industry funding levy changes for EEA insurers, investment firms and fund service providers operating in the State. The revised methodologies do not increase the aggregate amounts levied from each sector but propose revised allocations of individual levies within each sector.

2. Introduction

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.

Sections 32D and 32E of the Central Bank Act 1942, as amended, provide that the Central Bank Commission may make regulations relating to the imposition of levies and fees on the financial services sector in respect of the recoupment of the costs of financial regulation. Regulations made under Section 32D and 32E of the Central Bank Act 1942, or any amendment or revocation of these regulations, do not take effect until approved by the Minister for Finance. The industry currently funds 50% of the costs incurred by the Central Bank for financial regulation with certain exceptions.

This consultation does not concern itself with the case for full industry funding, an issue that has been the subject of consultation in 2015 (CP95 entitled "Funding the Cost of Financial Regulation") and is a decision of the government. Changes in this regard would affect the current and proposed methodologies' parameters.

3. The Case for a New Levy Methodology

The Central Bank currently levies credit institutions, investment firms and fund service providers based on their PRISM impact category.

In order to determine a firm's impact category, the weighted average of selected metrics, taken from its most up-to-date supervisory returns, is calibrated to compute an impact score. The impact score is recalculated automatically every time new data is submitted to the Central Bank via the online reporting system. Scores for each financial sector or subsector are calibrated and parameterized in order to align to impact categories (Ultra High, High, Medium High, Medium Low or Low) which reflect the potential scale of harm (prudential, reputational or consumer related) that could arise from the failure of the firm.

However, the use of impact categories to levy credit institutions, investment firms and fund service providers results in threshold effects whereby a movement between impact categories gives rise to a substantial increase or decrease in the levy.

The changes proposed in this Consultation Paper remove this threshold effect by introducing continuous levying. For investment firms and fund service providers this would be achieved by calculating levies as a linear function of individual firms' impact scores. For credit institutions, continuous levying would be achieved by using a modified ECB Methodology for levy calculations. Retail intermediaries' funding levies were changed to continuous levying in 2016.

The Central Bank intends to consult on continuous levying for Irish insurance undertakings in the second half of this year, once Solvency II data is compiled and analysis carried out in respect of alternative funding methodologies. Changes to Irish insurance funding levies would take effect in 2018. However, interim changes for EEA insurance undertakings are proposed in this consultation for effect this year.

More generally, in completing a review of the industry funding levy methodology across the sectors considered in this consultation we included European Economic Area ("EEA") firms that passport into Ireland through Freedom of Establishment (FOE) or Freedom of Service (FOS) to provide financial services. The freedom afforded to financial services entities to passport services or set up branches throughout the European Union, is a fundamental principle underlying EU directives. The European passporting framework provides that if a firm is authorised in the EU, it is entitled to sell its services throughout the EU/EEA. Where services are provided in this way, the Central Bank's role, as host regulator, is on conduct of business and anti-money laundering supervision, and relevant enforcement in these areas. Prudential supervision remains the sole responsibility of the Home Regulator.

EEA entities have been subject to enhanced supervisory oversight by the Central Bank, both individually, and as relevant to the supervision of the sector or line of business in which they operate. Consequentially, it is proposed that they will be subject to an industry funding levy that better reflect the Central Bank's engagement and the costs associated with this enhanced level of supervision.

The proposed changes seek to deliver on the views received by the Central Bank following CP95 in 2015. A number of respondents to CP95 expressed the need for a levying model that was transparent, predictable and which provided for equitable levying.

4. New Levy Methodology Proposals

4.1 Credit Institutions

Credit institutions are currently levied on the basis of PRISM impact rating; however, PRISM no longer drives supervisory engagement for these entities in light of the establishment of the Single Supervisory Mechanism (SSM). These entities have in the main transferred, or are in the process of transferring, from PRISM to the SSM's IMAS system.

Recognizing this change, the Central Bank proposes to adapt the ECB Methodology[1] for the calculation of the industry funding levies. In keeping with our risk-based approach to supervision, those entities with the ability to have the greatest impact on financial stability and the consumers will be levied in a proportionate manner to the level of supervision undertaken by the Central Bank.

[1] https://www.bankingsupervision.europa.eu/ecb/legal/pdf/en_ecb_2014_41_f_sign.pdf

To determine a credit institution's annual supervisory fee, the ECB methodology provides for a minimum fee component and a variable fee component, apportioned as follows:

- The minimum fee component is equal to 10% of the total amount of the annual fees. Significant Institutions (SI) pay 80% of this minimum fee component, split equally among them. Less Significant Institutions (LSI) pay 20% of this minimum fee component, split equally among them.
- The variable fee component is equal to 90% of the total amount of the annual fees, divided up on the basis of the institution's size and importance (measured via Total Assets) and risk profile (measured via Total Risk Weighted Exposure Amount). Significant institutions pay 80% of this variable fee component, split among them proportionally under the above metric. Less significant institutions pay 20% of this variable fee component, split among them proportionally under the above metric.

The Central Bank proposes to adopt this methodology but replace the SI/LSI distinction with a category A/category B distinction, which recognises our consumer protection mandate, as follows:

- Category A entities – includes SI, retail subsidiaries of SI, and high-priority retail LSI. These entities will be levied in aggregate 80% of the annual funding charge.
- Category B firms – includes non-retail subsidiaries of SI, LSI except high-priority retail LSI, EEA branches and third country branches. These will be levied in aggregate 20% of the annual funding charge. Non-retail EEA branches will be subject to the minimum fee component of the methodology only.

In line with the current Central Bank funding methodology and as outlined in the 2016 Industry Funding Regulations (2016), credit institutions admitted to the Credit Institutions Eligible Liabilities Guarantee (ELG) Scheme 2009 pay 100% of their levy contribution; whereas non-ELG entities paid 50% of their levy contribution. For illustrative purposes, table 1 below provides a working example of how the funding levies would be calculated based on the proposed methodology outlined in this paper (fees in euros, assets in €'000):

Total Cost of Supervision	**50,000,000**
90% Variable Fee	45,000,000
***10 % Minimum Fee	5,000,000

	Category of Institution	Subject to 100% levy	Contribution Rate	Total Assets + Total RWEA	Calculation of Supervisory Fees: 10 % Minimum Fee	Weighting for Variable Fee	90% Variable Fee	Total Fee	Rebate due	Net Fee Payable
Category A entities- Subject to 80% of overall fee	Significant Institution	Yes	100%	150,000,000	666,667	29.53%	10,629,921	11,296,588	0%	11,296,588
	Significant Institution	Yes	100%	150,000,000	666,667	29.53%	10,629,921	11,296,588	0%	11,296,588
	Significant Institution	Yes	100%	50,000,000	666,667	9.84%	3,543,307	4,209,974	0%	4,209,974
	Significant Institution	No	50%	84,000,000	666,667	16.54%	5,952,756	6,619,423	50%	3,309,711
	Significant Institution	No	50%	54,000,000	666,667	10.63%	3,826,772	4,493,438	50%	2,246,719
	Subsidary of SI- Retail	No	50%	20,000,000	666,667	3.94%	1,417,323	2,083,990	50%	1,041,995
	Total Category A			**508,000,000**	**4,000,000**		**36,000,000**	**40,000,000**		**33,401,575**
Category B Entities- Subject to 20% of overall fee	Subsidary of SI- Non retail	No	50%	30,000,000	27,778	38.96%	3,506,494	3,534,271	50%	1,767,136
	Less Significant Institution	No	50%	18,000,000	27,778	23.38%	2,103,896	2,131,674	50%	1,065,837
	Less Significant Institution	No	50%	11,000,000	27,778	14.29%	1,285,714	1,313,492	50%	656,746
	Less Significant Institution	No	50%	5,000,000	27,778	6.49%	584,416	612,193	50%	306,097
	Third Country Branch	No	50%	13,000,000	27,778	16.88%	1,519,481	1,547,258	50%	773,629
	EEA Branch	No	50%	Not Applicable- No fee factors applied to EEA Branches	27,778	Not Applicable- Subject to minimum fee only		27,778	50%	13,889
	**EEA Branches	No	50%		833,333			833,333	50%	416,667
	Total Category B			**77,000,000**	**1,000,000**		**9,000,000**	**10,000,000**		**5,000,000**
	Total			**585,000,000**	**5,000,000**		**45,000,000**	**50,000,000**		**38,401,575**

**For illustrative purposes only, this example assumes 30 additional EEA Branches are paying the minimum fee (i.e. €27,778*30).

*** This example has been calculated as per the ECB Methodology. None of the Significant Institutions in this example have less than €10bn in Total Assets.

The proposed methodology reflects the size and risk of credit institutions, our role in their supervision within the SSM but also as regards our consumer protection, anti-money laundering and financial stability mandates. It also removes cliff effects present in the current levy methodology based on PRISM impact categories.

4.2 Irish Investment Firms

Currently, Irish investment firms are levied based on their PRISM impact category. These entities were levied as follows in 2016:

- Low impact firms €6,606.
- Medium Low impact firms €51,450.
- Medium High impact firms €258,809.

The PRISM impact score (PIS) for investment firms is computed from Assets under management, Client money, number of customers and turnover. Investment firms with a PIS of 200 or less are deemed low impact, those with a PIS between 200 and 700 are deemed medium low impact, and those with a PIS above 700 are deemed medium high impact.

Furthermore, when Irish investment firms hold client assets, they are subject to an additional levy for client asset requirements which was as follows in 2016:

- Low impact firms €1,579.
- Medium Low impact firms €12,300.
- Medium High impact firms €61,875.

In order to remove the threshold effect, the Central Bank proposes a new levy methodology for Irish investment firms, combining the two current levies into one simple and continuous levy smoothing out the cliff effects.

The proposal is that from the levy year 2017, Irish investment firms are charged a single levy comprised of a flat element (A_{IF}) plus a variable element, set as a multiple (M_{IF}) of the PRISM impact score (PIS) that exceeds a threshold (T_{IF}). The flat element, the multiple and the threshold will be determined annually and will depend on the cost of supervision, itself a function of the size and shape of the sector (at present it is the low impact, medium low impact and medium high impact levies themselves which are determined annually).

The levy L is calculated using the following formula:

$$L_{IF} = A_{IF} + \text{Max}\,(PIS\text{-}T_{IF};0)*M_{IF}$$

The parameters of the funding levy for Irish investment firms using the proposed methodology would have been set last year as follows in order to levy the same aggregate amount:

- Flat element (A_{IF}): €6,606
- Threshold (T_{IF}): 1,175
- Multiple (M_{IF}): 325

Three examples of how this methodology would have worked in 2016 are set out below:

Example 1: A low impact investment firm not holding client assets with an impact score less than 175.

In this case there is no change, the firm would have paid €6,606 in 2016 under the proposed methodology as it did under the current methodology.

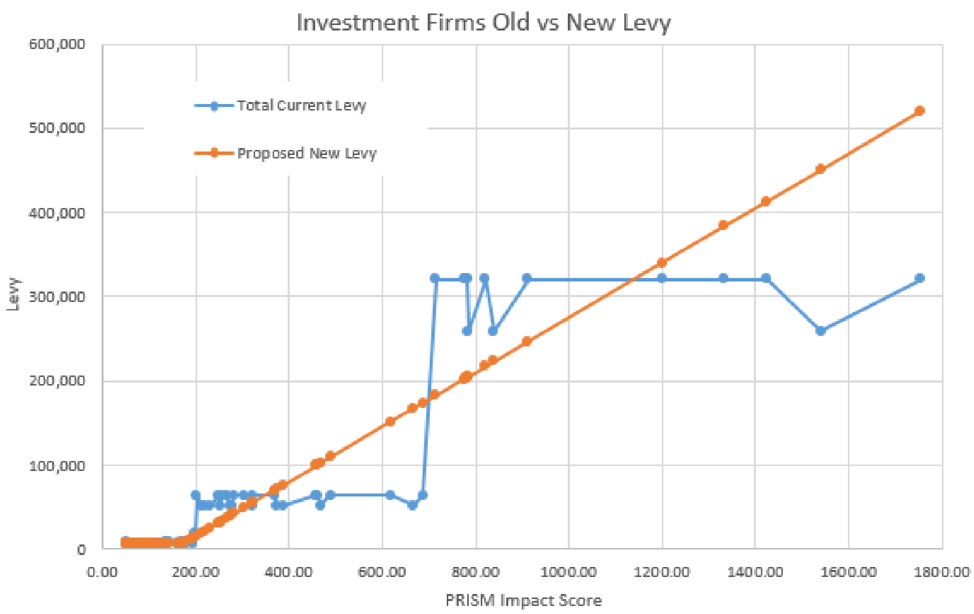
Example 2: A medium low impact investment firm holding client assets with an impact score of 300

In 2016 the levy for such a firm was €51,450 + €12,300 = €63,750, while based on the proposed methodology the levy would have been €47,231.

Example 3: A medium high impact investment firm holding client assets with an impact score of 1200.

In 2016 the levy for such a firm was €258,809 + €61,875 = €320,684, while based on the proposed methodology the levy would have been €339,731.

A graphical representation of the current versus proposed levy methodology is given below:



4.3 Irish Fund Service Providers

Currently, Irish fund service providers are levied based on their PRISM impact category. These entities were levied as follows in 2016:

- Low impact firms €6,606.
- Medium Low impact firms €51,450.
- Medium High impact firms €258,809.

The PRISM impact score (PIS) of fund service providers is computed from one single metric, Net Asset Value under administration/custody/management. Fund service providers with a PIS of 200 or less are deemed low impact, those with a PIS between 200 and 700 are deemed medium low impact, and those with a PIS above 700 are deemed medium high impact.

It is proposed that the funding levy for fund service providers continues to be based solely on PRISM impact score, but on a continuous fashion in order to remove the threshold effects.

The proposal is that from the levy year 2017, Irish fund service providers are charged a levy comprised of a flat element (A_{FSP}) plus a variable element, set as a multiple (M_{FSP}) of the PRISM impact score (PIS) that exceeds a threshold (T_{FSP}). The flat element, the multiple and the threshold will be determined annually and will depend on the cost of supervision, itself a function of the size and shape of the sector (at present it is the low impact, medium low impact and medium high impact levies themselves which are determined annually).

The proposed levy L_{FSP} is calculated using the following formula:

$$L_{FSP} = A_{FSP} + \text{Max}(PIS - T_{FSP};0) * M_{FSP}$$

The parameters of the funding levy for Irish fund service providers using the proposed methodology would have been set last year as follows in order to levy the same aggregate amount:

- Flat element (A_{FSP}): €6,606
- Threshold (T_{FSP}): 175
- Multiple (M_{FSP}): 250

Three examples of how this methodology would have worked in 2016 are set out below:

Example 1: A low impact fund service provider with an impact score less than 175.

In this case there is no change, the firm would have paid €6,606 in 2016 under the proposed methodology as it did under the current methodology.

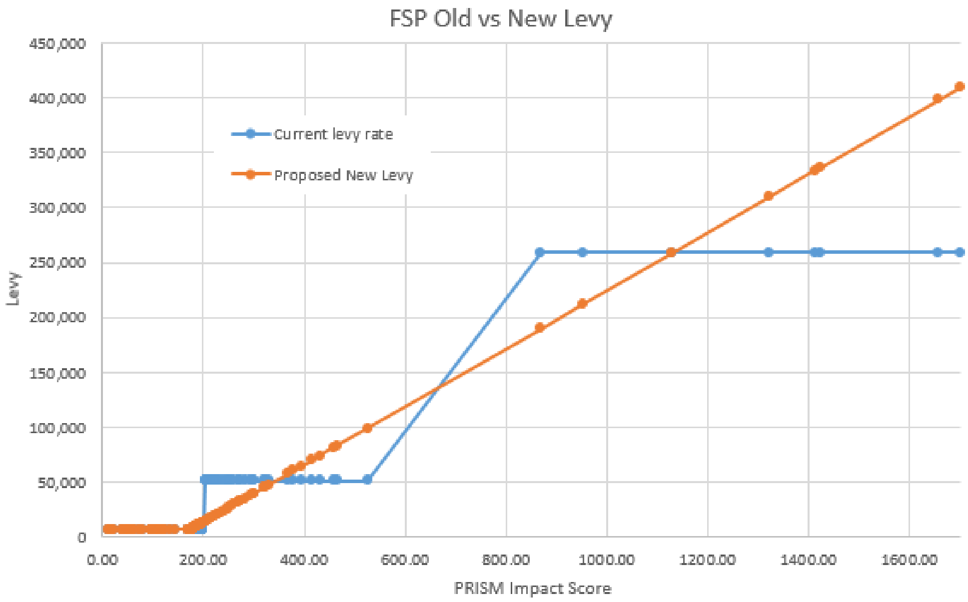
Example 2: A medium low impact fund service provider with an impact score of 300

In 2016, the levy for such a firm was €51,450, while based on the proposed methodology the levy would have been €37,856.

Example 3: A medium high impact fund service provider with an impact score of 1200

In 2016, the levy for such a firm was €258,809, while based on the proposed methodology the levy would have been €262,856.

A graphical representation of the current versus proposed levy methodology is given below (one outlier not shown):



This methodology is meant to cover also the supervision of investor Money Regulation: should it be adopted, there would not be a separate levy for the supervision attached to this new regulation.

4.4 EEA insurers

Currently, EEA insurers writing Irish risks are subject to a single low levy, irrespective of size and complexity. However, a few EEA insurers are major participants in the Irish insurance market and require greater supervisory oversight, from an individual business conduct, money-laundering and enforcement perspective and as relevant from a market surveillance and market oversight perspective.

Furthermore, the cumulative losses in motor insurance and the concurrent failures of Setanta (Malta) and Enterprise Insurance (Gibraltar) have brought the Central Bank to increase its supervisory oversight on all insurers writing motor insurance business, including EEA insurers.

Accordingly, it is proposed that in 2017 EEA insurers will be differentiated in three categories for levying purposes:

- Category 1. Large non-life and life insurers, to be levied at half the rate of medium high insurers.
- Category 2. Non-life insurers not belonging to category 1 having written motor insurance in Ireland in 2016, to be levied at half the rate of medium low insurers.
- Category 3. Insurers not belonging to category 1 or 2, to be levied as before.

If this methodology had been in place for the levies invoiced in 2016, the first category would have comprised non-life insurers having written more than €50m premiums in Ireland and life insurers having written more than €100m premiums in Ireland and the levy would have been set at €91,731. The levy for the second category (for non-life insurers having written motor insurance in 2015) would have been set at €18,236. The third category levy would have stayed at €6,002.

In the consultation to be issued in the second half of this year to introduce revised levying of Irish insurance companies, a further revision to the levy methodology for EEA insurers is likely to be proposed, as the PRISM categories may no longer form the basis of levying.

Furthermore, although the industry funding levy is due by EEA insurers whether they operate on a freedom of services or a freedom of establishment basis, only those operating on a freedom of establishment basis are currently invoiced. The Central Bank will henceforth invoice and collect levies for EEA insurers operating by way of freedom of services if they belong to category 1, category 2, or use the services of a Managing General Agent in the State.

4.5 EEA investment firms and fund service providers

It is proposed that EEA ***Investment firms*** be subject to the annual funding levy from 2017 onwards. At this time the Central Bank proposes that a fixed levy be imposed on these investment firms, equal to the flat levy component A_{IF} of Irish investment firms (see section 4.2 above). This would have amounted to €6,606 in 2016. The Central Bank may propose in the future a further revision to this methodology, should there be material changes in its supervisory obligations towards these firms or should the number or size of these firms change materially.

It is proposed that EEA ***fund service providers*** be subject to the annual funding levy from 2017 onwards. At this time the Central Bank proposes that a fixed levy be imposed on these firms, equal to the flat levy component A_{FSP} of Irish fund service providers (see section 4.3 above). This would have amounted to €6,606 in 2016. The Central Bank may propose in the future a further revision to this methodology, should there be material changes in its supervisory obligations towards these firms or should the number or size of these firms change materially.

5. Consultation Questions

The Central Bank would like your views on:

1. The proposed methodology for credit institutions.
2. The proposed methodology for Irish investment firms.
3. The proposed methodology for Irish fund service providers.
4. The proposed methodology for EEA insurance undertakings.
5. The proposed methodology for EEA investment firms and fund service providers.

If you do not agree with the proposed approaches, please state what you find objectionable, propose worked-out alternatives and argue in what respect they would be preferable.

6. Consultation Process

This public consultation process will run from 27 March 2017 to 28 April 2017. Any submissions received after this date may not be considered.

The Central Bank intends to make submissions available on its website after the deadline for receiving submissions has passed. Because of this, please do not include commercially sensitive material in your submission, unless you consider it essential. If you do include such material, please highlight it clearly so that reasonable steps may be taken to avoid publishing that material. This may involve publishing submissions with the sensitive material deleted and indicating the deletions.

Despite the approach outlined above, the Central Bank makes no guarantee not to publish any information that you deem confidential. So be aware that, unless you identify any commercially sensitive information, you are making a submission on the basis that you consent to it being published in full.

Please clearly mark your submission 'Funding Levies Consultation 108 of 2017'and send it to:

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E-mail: levyconsultation@centralbank.ie

Please include contact details if you are responding by post.

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