Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

2017

Feedback Statement on CP108
Consultation on New Methodology to Calculate Funding Levies in respect of Credit Institutions, Investments Firms, Fund Service Providers and EEA Insurers

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1. *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 multiple sectors including credit institutions, insurance companies, investment firms and funds service providers was changed to one based on PRISM impact categories from 2013 onwards.

B. On 27 March 2017 the Central Bank published Consultation Paper CP108 New Methodology to Calculate Funding Levies: Credit Institutions, Investment Firms, Fund Service Providers and EEA Insurers in order to remove the threshold effect and increase the transparency of levies paid by these sectors, while maintaining the principle that larger firms pay higher levies than smaller firms.

C. Stakeholders were invited to provide observations and comments on the proposed amendments. The closing date for comments was 28 April 2017 and eight responses were received, in addition to 25 requests for individual PRISM Impact Scores ("PIS").

D. This document sets out the Central Bank feedback on responses received to CP108.

E. In 2017, a number of the proposed changes will be incorporated into Regulations to be issued under Section 32D of the Central Bank Act 1942 (as amended).

2. Feedback on Proposed Changes

The eight responses received to the Consultation Paper are summarised below relative to the sectors they relate to:

2.1. Credit Institutions

There were four responses received with respect to the changes being proposed to the funding levy for Credit Institutions:

1. These firms' responses can be summarised as follows:

   a. One entity noted its agreement with the move away from the very steep levy differentials between individual PRISM categories.

   b. One firm noted its preference for a broad retention of the current model, which relates pre-set levels of charge to organisational size and complexity as an alternative to the changes proposed in CP108.

c. One respondent also suggested that, rather than splitting the 10% minimum levy component equally among Significant Institutions ("SIs"), that it is distributed in alignment with the weighting for the variable levy.

Central Bank Response:
The Central Bank adopts a risk-based approach to the supervision of institutions. The proposed levy methodology is aligned with this approach and takes into account the size and complexity of an institution when considering the calculation of the supervisory levy. In this regard, and in keeping with our risk based approach to supervision, those entities with the potential to have the greatest impact on financial stability and consumers will be levied in a proportionate manner to the level of supervision required by the Central Bank. The minimum levy, which is apportioned based on the categorisation of an institution, ensures that each entity regulated in Ireland will pay a fair and proportionate contribution to the cost of its supervision.

2. Three respondents expressed concern in relation to the divergence from the ECB model of classifying Credit Institutions as Significant and Less Significant Institutions ("LSIs") to Category A and B and have requested clarity in this regard:

   a. One respondent stated that in its view this introduces an unwelcome element of uncertainty and complexity into the methodology.

   b. Two respondents noted that there is no maximum individual total for Credit Institutions in category A or B and no apparent mechanism to prevent the largest payer in Category B to be a larger individual payer than Category A entities which could arise dependent on the number and size of SI and LSI entities reclassified into each group.

   c. In addition, one respondent noted that as part of the Single Supervisory Mechanism ("SSM"), Credit Institutions designated as significant by the ECB are required to contribute to the funding of the budget of the SSM. For foreign banks in Ireland, this could lead to a duplication of regulatory costs for these institutions, as well as domestic significant banks, which are expected to pay towards the Central Bank levy as well as the SSM levy.

Central Bank Response:

The Central Bank Reform Act, 2010 confers on the Central Bank the power, with the approval of the Minister for Finance, to make Regulations prescribing an annual Industry Funding Levy to be paid by regulated financial service providers to the Central Bank. To ensure all institutions pay a levy that is commensurate with the complexity, risk profile of credit institutions and associated supervisory effort, the Central Bank adapted the ECB methodology replacing the SI/LSI distinction with a category A/category B distinction, which recognises our broader consumer protection, anti-money laundering and financial stability mandate. The categorisation of institutions will remain as outlined in the consultation paper. However, following the consultation process and to ensure a degree of clarity, institutions (for the purpose of the supervisory fee) will initially be informed as to which category they are assigned with any subsequent changes to an institutions' categorisation also communicated.

Under the proposed supervisory levy calculation, the Central Bank is cognisant of the fact that institutions within category A will require more intense supervisory engagement and accordingly, these institutions will pay 80% of the total supervisory levy. The Central Bank will keep the model under review to ensure that the institutions pay a levy that is commensurate with supervisory effort, complexity and risk profile.

The Central Bank levy imposed on regulated institutions for the purpose of supervision is separate to any supervisory fee imposed by the ECB, given the Central Bank's mandate in relation to consumer protection and anti-money laundering in addition to the membership of Central Bank staff in the Joint Supervisory Teams ("JST") of the SSM. Central Bank staff that are members of the JST are included in the levy calculations of the Central Bank and not the SSM. Therefore, there is no duplication in this regard.

3. Two respondents noted that the proposed methodology is based on the relative proportion of the payer's inputs versus all other payers in its category. As such, recalculation of the charge will be impossible for individual entities to reproduce independently or validate.

Central Bank Response:

The proposed funding methodology ensures that an institution's size and complexity are factored into the calculation, meaning that a material change in these indicators will have an impact on the amount of supervisory levy paid by an institution. However, following the consultation process, the Central Bank has agreed to provide further information to industry, which would allow for a greater degree of predictability for institutions calculating an estimated supervisory levy.

4. One respondent queried the continued use of admittance to the Eligible Liabilities Guarantee (“ELG”) scheme as a key criterion in the determination of an institution’s levy contributions given that the scheme terminated four years ago. It was suggested that, as it is time defined, it inappropriately favours new entrants to the market.

Central Bank Response:
The objective of the Industry Funding levy is to raise approximately 65% of the budget attributed to the Central Bank’s financial regulation activities directly from the financial service providers it regulates. The Government gave the power to raise such a levy to the Central Bank Commission under the Central Bank Reform Act, 2010. In accordance with the legislation, the Commission will need to seek the approval of the Minister for Finance in relation to the 2017 levy proposals.

The Minister for Finance has previously agreed that Credit Institutions which were admitted to the ELG Scheme 2009 are required to fund 100% of supervisory costs. The supervisory levies payable by institutions included in the ELG scheme, under the proposed methodology, are deemed to be reflective of the supervisory engagement required. This requirement for institutions that were within the ELG scheme to pay 100% of its levy contribution will remain in place. However, the Central Bank is keeping the contribution rates of institutions to the Industry-Funding levy under review.

5. One respondent expressed concerns in relation to the competitiveness of credit institutions, which are already facing significant costs as a result of the Single Resolution Fund (“SRF”) and the Deposit Guarantee Scheme (“DGS”). The respondent is of the view that the existing regulatory burden is significantly higher in Ireland as compared to other jurisdictions.

   A respondent also highlighted the lack of exemptions and reductions based on individual status or circumstances with no consideration given to support from parent company, related parties or restrictions on the business model.

Central Bank Response:
The Industry Funding levy discussed in the consultation paper seeks to recoup a proportion of the Central Bank budget that is attributable to the financial regulation activities. The proposed levy methodology intends

to reflect the size and complexity of credit institutions, the Central Bank's role in their supervision within the SSM and also its consumer protection, anti-money laundering and financial stability mandates.

The levies that apply with respect to the SRF and the DGS are applied separately as they are for distinct purposes. They are required as part of the implementation of European Banking Recovery & Resolution and Deposit Insurance directives.

The specific exemptions discussed in the response to the consultation paper and outlined above would have limited impact in terms of the level of supervision undertaken in relation to an institution, as they are not material factors when considering supervisory engagement.

6. Another respondent suggested that enforcement fines, which are fully remitted to the Exchequer, should be used to partially fund the regulatory framework.

Central Bank Response:
The Central Bank operates an assertive risk based approach to supervision which is supported by a credible threat of enforcement. The Central Bank's enforcement strategy is aimed at promoting principled and ethical behaviour in regulated entities and those that work in such entities. The Central Bank will take appropriate action where regulated entities and/or individuals fall short of those expected standards of behaviour. The funds collected from monetary penalties imposed under the Central Bank's Administrative Sanctions regime are included in the Central Bank's surplus income which is payable directly to the Exchequer and are not deemed to be an appropriate mechanism for the funding of a regulatory framework.

2.2. Irish Investment Firms

Two responses were received in respect of this sector. Comments in relation to the proposed methodology included:

1. A suggestion that the flat levy for low impact firms should be higher, that medium high firms should pay a higher levy and that the client asset supplementary levy be re-assessed or discontinued.

2. That the levy should vary for the different sub-categories of firms e.g., D9 High Volume Algorithmic traders should have to pay more than D2 firms who receive and transmit.

3. Observation that the move away from threshold effects would give rise to a one-off rebalancing of levy structures.

4. Queries in terms of how individual firm PIS are calculated and whether the changes in the funding level model will result in a change in the supervisory engagement model.

Central Bank Response:
The Central Bank adopts a risk-based approach to the supervision of institutions. The proposed levy methodology is aligned with this approach and takes into account the size and complexity of an institution when considering the calculation of the supervisory fee. In this regard, and in keeping with our risk-based approach to supervision, those entities with the potential to have the greatest impact on consumers and stability will be levied in a proportionate manner.

The proposed minimum levy of €6,606 in 2016 was deemed appropriate, as this will naturally lead to increased levies for firms with higher PIS calculations.

With regard to the separate client asset supplementary levy it should be noted that the Central Bank proposes combining the Industry Funding levy and the Client Asset supplementary levy into one continuous levy in the future.

The Central Bank remains committed to continuing supervising regulated investment firms in line with PRISM Principles. This process is outlined, along with the metrics underlying the calculation of the PIS, in the “PRISM Explained” document available here.

In addition, the following observations in relation to the broader issue of Industry Funding levies were noted by respondents:

1. A request for levy changes to be introduced on a phased basis with levy notices issuing earlier. There was also an observation that other levies applicable to investment firms be considered for review.

2. Further transparency is required in relation to cross-subsidisation across sectors and the allocation of costs related to shared resources such as enforcement.

3. A credit on the levy should be given for firms who maintain capital buffers over and above their regulatory capital requirements.

Central Bank Response:
The Central Bank has noted the additional observations in relation to the annual funding levy process and the cost of financial regulation.

Each year, the Central Bank publishes a user-friendly guide to the industry funding regulations. It provides transparency to industry on how the industry funding levy is calculated for each industry sector. Acknowledging references to phased levy changes, industry should be aware of a phased increase in industry funding in 2017.

Finally, it is important that a distinction be drawn between the prudential regulations and the industry funding levy. It follows that deductions on the funding levy for maintenance of capital buffers will not be permitted.

2.3. Irish Fund Service Providers

One response was received in respect of the proposed levy methodologies outlined in the consultation paper in relation to Fund Service Providers. This response was supportive of the move whilst noting that PIS is sensitive to market movements and less correlated with the underlying cost of regulation. The response also commented on operational aspects of the levy.

Central Bank Response:
The Central Bank adopts a risk-based approach to the supervision of institutions. The proposed levy methodology is aligned with this approach and takes into account the size and complexity of an institution when considering the calculation of the supervisory fee; sensitivity to market movement is an important aspect of risk assessment. The Central Bank is committed to continuing the supervision of regulated fund service providers in line with PRISM Principles. This process is outlined, along with the metrics underlying the calculation of the PIS, in the "PRISM Explained" document available here.

While outside the scope of this consultation, we acknowledge the issues raised in relation to operational aspects of the Central Bank's annual levy process.

2.4. EEA Insurers

Two responses were received in respect of the proposal to introduce levies in relation to EEA Insurers:

1. One respondent noted their agreement that the current levies for EEA insurers were quite low. They were, however, concerned regarding the knock-on effect this could have across the EEA.

Central Bank Response:
The Industry Funding levy seeks to recoup a proportion of the Central Bank budget that is attributable to its regulation of financial service providers. The proposed levy methodology intends to reflect the size and risk of firms, and the Central Bank's consumer protection, anti-money laundering and financial stability mandates.

2. One respondent noted that the proposed levies appear to be in direct correlation to recent issues in the general insurance industry and may impose a disproportionate cost on life insurers and questions whether life insurers are subject to the same levies as general insurers.

Central Bank Response:
The Central Bank adopts a risk-based approach to the supervision of institutions. The proposed levy methodology is aligned with this approach and takes into account the size and complexity of an institution when considering the calculation of the Industry Funding levy. In this regard, and in keeping with our risk-based approach to supervision, those entities with the potential to have the greatest impact on consumers and stability will be levied in a proportionate manner. The proposed categorisation of levies explicitly distinguishes between life and non-life business.

3. The increase in the levy, in another firm's opinion is disproportionate and suggest that instead of using 50% of medium high levy, the medium low levy would be more appropriate as a basis.

Central Bank Response:
See the Next Steps (section 3) for a two-step introduction of the category 1 levy to align it to 50 per cent of the medium-high levy.

2.5. EEA Investment Firms and Fund Service Providers

One response was received in respect of the proposal to levy EEA investment firms. The respondent welcomed the introduction of such a levy.

Central Bank Response:
The Central Bank has noted this response.

3. Next Steps

The Central Bank appreciates the engagement from stakeholders in relation to CP108 and, taking into account the various submissions, proposes the following:

3.1 Credit Institutions

The Central Bank will proceed with the adapted ECB Methodology for the calculation of the industry funding levies as outlined in the consultation paper. However, following the consultation process, the Central Bank has agreed:

- to provide further information to industry, which would allow for a greater degree of predictability for institutions when calculating an estimated supervisory levy;
- that institutions will initially be informed as to their categorisation with any subsequent changes communicated thereafter; and
- Institutions that were admitted to the ELG scheme will continue to pay 100% of their levy contribution. However, going forward, the Central Bank will keep the contribution rates of institutions under review, with any subsequent changes communicated to industry.

In keeping with the Central Bank risk-based approach to supervision, those entities with the potential to have the greatest impact on financial stability and the consumers will be levied in a manner proportionate to the level of supervision undertaken by the Central Bank. The levy factors (total assets and Risk Weighted Exposure Amounts ("RWEA")), which take into account the size and complexity of an institution, will be determined at the highest level of consolidation and inclusive of subsidiaries established in non-participating member states and third countries.

3.2 Irish Investment Firms and Fund Service Providers

The Central Bank intends postponing the implementation of the proposed levy methodology in respect of Irish Investment Firms and Fund Service Providers for the year 2017. Instead, the proposed levy methodology will be applied when MiFID II implementation is completed on 3 January 2018. This will ensure that the metrics underlying the PIS align to the updated business models as a result of this new regulation.

The Central Bank shall commence a project in respect of investment firms and fund service providers in order to implement the proposed levy methodology.

3.3 EEA Investment Firms and Fund Service Providers

In relation to EEA Investment Firms and Fund Service Providers, the Central Bank will proceed as outlined by introducing, in 2017, a levy set equal to the flat levy[1] component of Irish Investment Firms and Irish Fund Service Providers.

3.4 EEA Insurers

In respect of EEA Insurers, it is proposed to proceed with the change to levy branches based on three categories as highlighted in the consultation. The levy amount for Category 1 branches will be aligned to ½ of the medium-high levy, but this will be phased in over a two-year basis, (i.e. in 2017 branches will be levied at 25% of the medium high rate, this will increase to 50% of the medium high rate in 2018). The Central Bank will consider further its approach to levying of Freedom of Services (“FOS) insurers. In the interim, it will not proceed with changes to levying FOS insurers and the existing approach will continue for 2017.

[1] As outlined in CP108, the flat levy component will be determined annually. In 2016, this would have amounted to €6,606; the levy paid by low impact Irish investment firms and Irish fund service providers.

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