Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

2017

Feedback Statement to Consultation Paper 95 – Funding the Cost of Financial Regulation

Joint Consultation Paper

Department of Finance and the Central Bank of Ireland

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1. *Introduction*

On 3 July 2015, the Central Bank of Ireland ("the Central Bank") and the Department of Finance published a joint consultation paper ("CP95") entitled 'Funding the Cost of Financial Regulation'. The aim of CP95 was to gather views on a move from the current approach of partial industry funding of financial regulation towards full industry funding.

CP95 set out the current funding arrangements whereby industry currently funds approximately 50% of the costs incurred by the Central Bank for financial regulation with certain exceptions[1]. This translates into a corresponding reduction in the annual surplus remitted by the Central Bank to the Exchequer. The implications of a move to full industry funding were also explored.

The closing date for comments was 25 September 2015 and 25 responses were received. The Department of Finance and Central Bank's Joint Working Group ("the JWG") wishes to acknowledge the contribution of the regulated businesses and financial services industry representative bodies who responded. This feedback statement summarises the responses received and reflects the views presented. It is intended to be read in conjunction with CP95 and makes references to proposals and terms used in the original consultation document which can be found on the Central Bank's website.

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[1] Exceptions to the 50:50 funding arrangements are as follows:

- Credit Institutions: Credit Institutions which had participated in the Eligible Liabilities Guarantee Scheme 2009 are required to fund 100% of supervisory costs. Where appropriate, individual credit institutions are also required to fully fund costs incurred by the Central Bank in carrying out any external review of the institution.
- Credit Unions: The levy payable by a credit union is currently capped at 0.01% of their total assets as at 30 September in the previous year. As a result, credit unions currently contribute approximately 8% to the cost of their regulation.
- Securities Market Supervision Costs: The excess of
  - costs incurred by the Central Bank in performing its responsibilities under the Prospectus, Transparency, Market Abuse, Short Selling, Securities Financing Transaction Regulation Directives together with the European Markets Infrastructure Regulation over
  - Transparency fees and Prospectus Approval and related fees

  is currently funded by the Central Bank by way of subvention.

The responses by industry to CP95 and resultant proposals formed part of the JWG recommendations to the Minister for Finance and the Central Bank Commission (“the Commission”).

In response to queries raised during the CP95 consultation period with regard to the Credit Union sector, please note that no changes to Credit Union levies are scheduled at this time. In addition, it must be noted that in April 2016, the Central Bank consulted with the Retail Intermediary Sector to capture views on a revised methodology for calculating the industry funding levy (CP102 ‘New Methodology to Calculate Funding Levies for Retail Intermediaries’). Moreover, in March of this year, the Central Bank consulted to elicit views on revised methodologies for calculating the industry funding levy for credit institutions, investment firms, fund service providers and EEA insurers (CP108 ‘New Methodology to Calculate Funding Levies. Credit Institutions, Investment Firms, Fund Service Providers and EEA insurers).

2. *Feedback on proposed changes to Funding the Cost of Financial Regulation*

Recognising that the cost of financial regulation activity must be borne either by industry, the taxpayer (via a reduced dividend from the Central Bank to the Exchequer), or some combination thereof, CP95 sought the views of interested parties on all aspects of a move to fully funding the cost of financial regulation from industry. The consultation took the form of a number of statements and questions. These are repeated below with summaries of responses received.

1. *Any change from the current funding arrangement would have to have due regard for the competitiveness of the industry. Do you consider that there are any particular competitiveness issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues, their quantification, and suggestions on how they may be addressed.*

Submissions:
The majority of respondents provided observations in relation to funding levy increases. A number of respondents commented on the increased demand for regulatory resources within business in light of continued regulatory developments and the potential impact of additional levy increases on competitiveness. Respondents with an international focus commented on the relativity of Central Bank levies to other competitor jurisdictions and the risk that future increases could temper inward investment. CP95's analysis of the trend of increasing costs which drive the funding levy was noted and industry's ability to absorb year on year increases, in addition to a move to full funding, was expressed. A few respondents commented on the size of the Irish financial services sector noting that other jurisdictions had a larger industry base to fund the cost of financial regulation.
Many respondents raised questions in relation to the methodology underpinning the current funding levy arrangements, requesting clarity in advance of any increase in funding from industry.

Joint Working Group Response – Question 1:
The JWG has noted the competitiveness issues raised by respondents. This is a particularly challenging issue to address, with the recent financial crisis providing significant clarity in relation to the criticality of a robust and challenging regulator. Furthermore, it is clear from international examples that an efficient financial services sector is greatly enhanced by the presence of same. As such, strong regulation encourages growth and entices new entrants to the market. However, the cost associated with the provision of regulatory oversight is a consideration for both new entrants and existing financial services providers and should not be prohibitive.
Increasing the level of industry funding recognises the need for a competitive market in a robust regulatory environment to ensure a stable Irish financial services industry which benefits from prudent development and innovation.

2. *Any change from the current funding arrangement would have to have due regard to consumers and taxpayers. Do you consider that there are any particular consumer or taxpayer issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues and suggestions on how they may be addressed.*

Submissions:
Several respondents outlined that each of the financial services sectors contribute substantially to the Exchequer in terms of PAYE, corporation tax and levies. This was supported by the view that the Exchequer's contribution in relation to funding levies represents an investment upon which significant taxes are recovered. Respondents considered that taxpayers, as stakeholders

and benefactors of a well regulated financial sector, should continue to make a funding contribution.
In relation to the consumer impact, several indicated that additional funding costs would inevitably be passed onto consumers.
It must be noted that not all respondents addressed this question specifically.

3. *Do you consider it appropriate for taxpayers to continue to fund a significant proportion of the cost of financial regulation activity? If you disagree, what would you propose instead?*

Submissions:
Respondents had different perspectives in relation to the appropriateness of the taxpayer funding the cost of financial regulation. In a number of responses, the taxpayer was cited as a stakeholder who benefited from the significant tax return from the financial services sector. Other respondents observed that the taxpayer is a beneficiary of the financial services sector and should retain an interest in the levy process by contributing towards the cost of regulation.
It must be noted that not all respondents addressed this question specifically.

4. *Do you consider it appropriate that industry be required to fully fund the cost of financial regulation activity? If you disagree, what would you propose instead?*

Submissions:
A number of respondents suggested that a joint funding model whereby costs are borne by both industry and the taxpayers should be maintained. Respondents observed that if the cost of regulation was fully funded by industry, (i) there would be no oversight, transparency or accountability in place; (ii) there would be no incentive for the Central Bank to control its costs and deliver value for money; and (iii) there would be no recognition that regulated entities and the taxpayers are both stakeholders and benefactors of a well regulated financial sector.
Some respondents had no opposition to industry funding 100% of the cost of financial regulation so long as there was greater clarity around the costs directly related to regulation and that no exceptional costs or costs not directly attributable to regulatory supervision formed part of the levy.
A few respondents recommended that the Central Bank look at other options of funding the cost of financial regulation instead of 100% funding by industry, such as utilising enforcement fines to offset the costs.

Joint Working Group Response – Questions 2, 3 & 4

Submissions highlighted that the Irish financial services sector has a diverse array of industry providers servicing both domestic and international clients. Reflecting on this dynamic, and acknowledging that taxpayers are key stakeholders, the JWG was keen to address the anomaly of the Irish taxpayer substantially subsidising the cost of regulating financial services, the consumers of which are located both here and abroad.

In relation to the annual funding process, the level of regulatory funding is already subject to oversight by the Minister for Finance under Section 32D and 32E of the Central Bank Act 1942, (as amended). The Commission may make regulations relating to the imposition of levies and fees on the financial services industry but these regulations only take effect once approval is received from the Minister for Finance. In addition, the current levy process provides only for the recovery of costs directly related to the supervision of the financial services sector.

The outcome of CP95 is that subvention of funding levies through reduced exchequer returns from the Central Bank will be reduced as the level of funding from industry increases.

5. *Do you consider it appropriate that a move to full funding should commence in 2016? If you disagree, what would you propose instead?*

Submissions:

The majority of respondents opposed a move in 2016 and outlined the issues that they felt needed to be addressed before a move to full funding can commence, such as:

• Greater clarity on the costs included in regulating entities;

• The possibility of utilising other funding methods such as levy contributions from firms passporting inwards and a charge for entities seeking authorisation approval from the Central Bank;

• Enhanced governance in relation to financial regulation costs and budgeting;

• Allowing for the IFS 2020 project to finish and current EU level legislation to be fully implemented; and

• Postponing any changes to the levy until certain time bound levies have ceased.

Several other respondents recommended that the current joint funding model should be retained and did not think that a move to full industry funding was appropriate.

6. *Do you consider it appropriate that a move to full funding should take place in a single step in 2016? If you disagree, what would you propose instead?*

Submissions:
Despite the observations raised about industry fully funding the cost of financial regulation, several respondents suggested that, if a move to full funding does progress, it should be introduced on a phased basis over a number of years (for example 3 to 5 years) and not introduced in a single step in 2016.
Respondents highlighted that a phased introduction of a move to full funding would allow regulated entities time to plan and budget for cost increases from one year to the next. Moreover, it was also highlighted that a phased introduction would limit regulated entities passing on additional costs to their consumers and minimise the negative impact on the IFS 2020 strategy.

Joint Working Group Response – Questions 5 & 6
The JWG noted the views expressed in the submissions from industry. Industry are aware that the funding arrangements remained unchanged in 2016 with industry continuing to contribute approx. 50% of the cost of regulation.

2017 will see an increase in the annual industry funding levy from 50% to 65% for the following sectors:
- Non-ELG Credit Institutions;
- Insurance Undertakings;
- Investment Firms and Fund Service Providers;
- Investment Funds;
- Moneylenders;
- Payment Institutions & E-Money Institutions;
- Approved Professional Bodies;
- Bureaux de Change; and
- Retail Credit, Home Reversion and Credit Servicing Firms.

There will be no change to the current partial funding arrangement for credit unions, retail intermediaries and debt management firms in 2017

7. *Do you consider it appropriate that any revision in the proportion of funding provided by industry should continue to apply uniformly across all industry funding categories? If you disagree, what would you propose instead?*

Submissions:
A small number of respondents addressed this question. Of those, a few considered that those sectors necessitating most regulation should shoulder the burden of the levy. Others expressed a preference for a level playing field with a risk based proportionate approach to funding.
A number of respondents commented on the lack of clarity regarding the current funding levy model. They considered it overly simplistic and called for a review of the allocation of cost between and within sectors. Alternative approaches such as greater consideration of domestic versus international service providers for levying purposes were proposed.
Finally, a number of respondents recommended that cost recovery mechanisms should be introduced.

8. *Do you consider that there are any particular industry funding categories which warrant a derogation or alternative funding approach? Please state clearly your reasons for such a view.*

Submissions:
Not all respondents answered this particular question. The following sectoral responses were noted:
• The Pension sector highlighted grounds for derogation as it is subject to dual levying and as pensions reduce future State liability;
• Credit Unions highlighted the "not for profit" ethos as the basis for derogation;
• Intermediaries outlined that the nature and scale of the sector warranted careful consideration in relation to levying as full funding could impact the viability of the intermediary sector and the associated employment implications;
• The Funds sector argued that levies for funds should remain competitive when compared to other competing jurisdictions; and
• The Irish Stock Exchange ("ISE") cited its market integrity role as a rationale for derogation from funding.

Joint Working Group Response – Questions 7 & 8
The JWG notes that the Intermediary sector has engaged with the Central Bank on levying methodologies and in light of this engagement, the Central Bank has introduced a new methodology (CP102 'New Methodology to Calculate Funding Levies for Retail Intermediaries'). With regards to the Credit Union sector, the Central Bank has previously provided clarification in the Feedback Statement on Consultation Process for CP61 in 2013. Most recently CP108 "New Methodology to Calculate Funding Levies" has seen engagement in relation to Credit Institutions, Investment firms, Fund Service Providers and EEA insurers.

The JWG has also noted industry's comments in relation to authorised entities paying for the costs associated with an entity applying for Central Bank authorisation. The Department of Finance and the Central Bank are currently examining this issue with consideration being given to recovery mechanisms in relation to authorisation costs.

The Pension sector and the ISE raised issues that have broader implications beyond the scope of the Central Bank's Annual Funding Levy and this consultation process. In the context of a developed financial services market place, the JWG notes that firms may fall to be subject to levies from a number of regulators.

9. *Are there any other considerations that you think should be taken into account in seeking to come to a decision on a move to full industry funding? If so, what are they?*

Submissions:

Several respondents outlined a number of other considerations that they felt needed to be taken into account in seeking a move to full industry funding including:

- Robust independent controls around key cost drivers to ensure industry and consumer confidence and to maintain cost discipline;
- Greater transparency around the calculation of the funding levies, the cost of financial regulation and how PRISM categories are determined;
- Regular forecasts of the future costs of financial regulation to enable industry to plan ahead;
- Introducing an annual levy consultation process with industry; and
- Postponing any levy increase until the economic recovery has taken hold.

Joint Working Group Response – Questions 9

The JWG acknowledges the broad range of issues that respondents have highlighted. As outlined earlier, Section 32D and 32E of the Central Bank Act 1942, as amended, provides that the Commission may make regulations relating to the imposition of levies and fees on the financial services industry but they only take effect once approval is received from the Minister for Finance. The legislation is therefore the principal driver of independence in this regard.

The JWG notes that in introducing the levy in 2004 and in revising the levy approach in 2013, the Central Bank has engaged with industry for input. Furthermore, consultation in relation to intermediary funding methodology issued in April 2016 (CP102) and a feedback statement was published last July to conclude that consultation process.

In addition, the Central Bank issued a consultation paper in March of this year (CP108) to gather views on revised methodologies for calculating the industry funding levy for credit institutions, investment firms, fund service providers and EEA insurers. A feedback statement on CP108 will be published later this year.

With regard to respondents' comments on independent controls around key cost drivers and maintaining cost discipline, the Central Bank has robust cost control and budgetary processes in place. For example:

• The annual budget is approved by the Commission.
• There is oversight of quarterly outturns against those budgeted.
• A sub-committee of the Commission, the Budget and Remuneration Committee ("BRC"), reviews all budgetary and expenditure matters on behalf of the Commission and in advance of Commission review / approval. The BRC incorporates independent oversight as it includes non-executive members of the Commission.

3. Conclusion

Section 32D and 32E of the Central Bank Act 1942, provides that the Central Bank Commission may make regulations relating to the imposition of levies and fees on the financial services industry 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 aim of this consultation was to examine the appropriateness of introducing a funding model that moves from the current partial funding model to a model that covers the full cost of regulation. The proposition was that a 100% funding model would be introduced from 2016.

The arguments in favour of a move to a full funding model were articulated in the consultation paper; including the scale of resources devoted to regulation, the escalating costs that are borne by the taxpayer, and the changing landscape of the industry where consumers are located both here and abroad.

Submissions to the Public Consultation presented a number of industry observations including: greater clarity and transparency around the levy process; Central Bank accountability in terms of cost controls and value for money; the methodology for attributing levies; and the impact on service providers and on consumers of a one-off move from the 50% model to a full funding model.

The immediate response to industry's submissions to the Public Consultation was the retention of the 50% funding model for the year 2016 to enable the Department and the Central Bank to further consider matters around transparency, cost control and methodologies. That process included meetings between the Department of Finance and industry representative groups.

Following that process, agreement has now been reached between the Department and the Central Bank to bring greater clarity and transparency to the levy model through the Bank's Annual Performance Statement. In relation to cost controls, the Central Bank continues to target resources at areas of highest priority. In terms of methodologies used to attribute levies, industry will be familiar with the Central Bank's recent public consultation, CP 108, entitled "New Methodology to calculate funding Levies".

Notwithstanding these developments, the Minister and the Central Bank responded to industry's over-arching request that any move to a full funding model should be introduced on a phased basis. Accordingly, the Minister has approved a phased increase, beginning with an increase from 50% to 65% in 2017. The Minister's approval would be required for any further increases beyond 65% in future years.

The Minister, the Department and the Central Bank would like to acknowledge and thank all of those that responded to the public consultation and look forward to further engagement with industry on this issue in the years ahead.

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