



IRELAND

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE ON BANKING SUPERVISION

July 2022

This paper on Ireland was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on June 28, 2022.

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June 28, 2022

TECHNICAL NOTE

BANKING SUPERVISION

Prepared By
**Monetary and Capital Markets
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program (FSAP) in Ireland. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

BCBS	Basel Committee for Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
Central Bank	Central Bank of Ireland
CET1	Common Equity Tier 1
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DDWG	Distressed Debt Working Group
DoF	Department of Finance
EBA	European Banking Authority
ECB	European Central Bank
ECL	Expected credit losses
ESRB	European Systemic Risk Board
EU	European Union
FCG	Forbearance Contact Group
FSAP	Financial System Assessment Program
FTE	Full-time equivalent
GFC	Global financial crisis
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IBBD	Investment Banking and Broker-Dealer supervision division
ILAAP	Internal Liquidity Adequacy Assessment Process
IMAS	ECB Information Management System
IMF	International Monetary Fund
IT	Information technology
JST	Joint Supervisory Team
LGD	Loss given default
LSI	Less Significant Institution
MBF	Market-based finance
MFIN	Minister of Finance of Ireland
NCA	National Competent Authority
NPL	Nonperforming loan
NPE	Nonperforming exposure
PAID	Prudential Analytics and Inspections directorate

P2R	Pillar 2 requirement
P2G	Pillar 2 guidance
PRISM	Probability Risk and Impact System
RWA	Risk-weighted assets
SEAR	Senior Executive Accountability Regime
SEP	Supervisory Engagement Plan
SI	Significant Institution
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism

EXECUTIVE SUMMARY¹

Supervision of less significant institutions (LSIs) is largely effective in Ireland. The Central Bank’s supervisory approach to LSIs is intrusive and well-developed supervisory tools are appropriately applied. To enhance the capacity of supervisory tools and approaches, the supervision leverages on its membership in the Single Supervisory Mechanism (SSM). Supervision has sufficient rigor, although some gaps in the enforcement framework yet to be covered by the legislative changes planned for 2022.² The supervisory responses to changing conditions are timely and agile. The expertise of supervisors is expanding with the development of the market, although keeping up its pace can be a challenge. The independence of banking supervision is strong in practice, and benefits from the safeguards of the SSM. Recent efforts to enhance cooperation between prudential and conduct supervision of banks (Central Bank’s “One Bank” approach) has raised the quality of supervision, although scope remains for further enhancements to unleash the full potential of integrated prudential and conduct supervisory functions framed by strong cooperation arrangements and operational processes.

The prudential regulation of banks has improved greatly since the 2016 FSAP. The EU framework has largely managed to embrace international regulatory reforms, following up on the causes of the Global Financial Crisis. Additionally, it has responded to legacy issues of some EU banking systems which materialized in heightened volumes of nonperforming loans. The Irish Government provided extraordinary financial support to individuals and businesses in the reaction to the pandemic crisis. The Irish and EU legislators also introduced regulatory flexibility, while maintaining steering principles of their conceptual approach and not slipping to regulatory forbearance. The Central Bank applies the entire SSM regulations to its LSIs, which provides a strong supervisory framework, consistent and proportionate to the framework applied for compared to SI’s.

The banking supervision has been tested by severe headwinds, with the final outcomes still in play. Supervision went through a period of major challenges for the economy and the financial system, namely from Brexit and the pandemic. Brexit has shaken up the institutional framework, imported new complexities to the financial system and posed substantial challenges to the economy. Before the economic impact of Brexit had fully settled, the COVID-19 pandemic crisis hit, representing a major threat to financial stability, with secondary impact still gradually materializing. On the back of these developments, climate risk is growing, bringing new challenges across supervisory dossiers.

The continued effectiveness of banking supervision in Ireland will depend on its success in solving several complicated problems. Essentially, banking supervision must find a recipe to accomplish in the following areas:

¹ This Technical Note was prepared by David Lukáš Rozumek, Monetary and Capital Markets Department, in the context of the 2022 Ireland Financial Sector Assessment Program.

² A new individual accountability framework will allow more efficient enforcement.

- **Mitigation/management of the impact of the COVID-19 pandemic** – banking supervision will need to follow up on latent credit risk with sufficiently intrusiveness to ensure that all relevant indicators measuring credit risks are accurately calibrated, while monitoring capital and liquidity positions with increased intensity.
- **Transformation of business and operational models in retail banking services** – the situation will require a consistent rigor in the application of the existing core approaches, mostly embedded in the supervisory review process, as well as supplementary tools inspired by an open-minded attitude, and in making conceptual changes in frameworks, assuring consistent and proportionate regulatory and supervisory approaches across financial institutions.
- **Continuous upgrades in supervision of international/investment banking** – banking supervision has to keep upgrading its capacity in response to the growing size and complexity of international banking businesses, factoring in the benefits of cooperation within the SSM and outside of the EA.
- **Constitution of climate-related financial risks supervision** – the increasing importance of climate-related risks will shape supervision into the future, requiring a robust approach to deal with the new risks and additional complexities.

Table 1 provides the main recommendations to enhance the supervision of the banking activities conducted in Ireland with a direct bearing on its financial stability. These recommendations are focused on LSI supervision.

Table 1. Ireland: Main Recommendations¹

#	Recommendation	Addressee	Priority	Timeframe
Organization of supervision				
1.	Amend the Central Bank Act or other appropriate legislation such that the Minister of Finance may dismiss Central Bank Commission members only on one or more specified grounds of serious misconduct (¶ 31).	DoF, Oireachtas	M	ST
2.	Enshrine in legislation a written procedure for the submission by the Central Bank and approval by MFIN of the supervisory levy. (¶ 33).	DoF, Oireachtas	M	ST
3.	Apply sufficient flexibility on remuneration to recruit and retain appropriate talent (¶ 34).	Central Bank	M	ST
4.	Continue adapting supervisory capacity and tightening supervisory cooperation to reflect increasingly complex business and operational models of international LSIs, seeking to maintain consistency in supervisory approaches and techniques across international SIs and LSIs, with due regard to the nature, scale, and complexity of specific banks (¶ 36).	Central Bank	M	MT
5.	Amend relevant legislation to provide for greater individual accountability and enhance powers of the Central Bank to take direct enforcement action against individuals. Finalize related internal framework to operationalize execution of the upgraded accountability regime (¶ 39).	DoF, Oireachtas, Central Bank	H	MT
6.	Expand collaboration across conduct, consumer protection, and prudential supervision, to unleash the full potential of supervisory functions integrated under the 'One Bank' approach, while adjusting the underlying cooperation arrangements and operational processes (¶ 49).	Central Bank	M	ST
Supervisory Approach, Tools				
7.	Intensify ongoing efforts to implement the report on "Behavior and Culture in Irish Retail Banks" in systematic supervision of individual banks, and by connecting findings with prudential supervision outcomes on an individual bank level (¶ 69).	Central Bank	M	ST

Table 1. Ireland: Main Recommendations (Concluded)

Credit Risk				
8.	Perform dedicated reviews of banks' approaches to the calculation of expected credit losses, reflecting on findings from the COVID-19 pandemic crisis as well as broader experience since the implementation of the IFRS 9 (¶ 76).	Central Bank	H	ST
9.	Maintain the use of tools developed for intensified supervision during the COVID-19 pandemic crisis, where practical and appropriate, including the monitoring tools to identify latent credit risk and to ensure accuracy of banks' credit reviews and credit risk indicators (¶ 78).	Central Bank	H	ST
10.	Maintain the supervisory focus on banks' processes ensuring consistency, comparability, and the independence of valuations of residential real estate properties (¶ 81).	Central Bank	M	MT
Climate Risk				
11.	Set up a formal cooperation mechanism with the Government to support coordination of climate action on a national level, respecting the independent mandate of the Central Bank (¶ 114).	Government, Central Bank, DoF	H	I
12.	Adopt a sequenced action plan to manage climate-related financial risks in priority areas. Put the emphasis on robust data and quality disclosure in the early stages (¶ 117).	Central Bank	H	I

¹ In terms of priorities, H, M, and L stand for high, medium and low. In terms of time frame, I, ST, and MT stand for immediate (within one year), short-term (within 1–3 years), and medium-term (within 3–5 years).

INTRODUCTION

1. The Irish banking system has experienced significant changes in recent years, reflecting the issues of business model sustainability in retail banking, and absorbing the impact of Brexit. While the profitability of retail banks is impacted by the low interest rate environment and concentrated income streams reliant on interest income, international banks from outside of the EU find Ireland an attractive location to establish their operations for the EU-27. The process of business models' transformation will require time, a focused approach by the supervisor, and it may be accompanied by further concentration of the market. With increased concentration in the retail banking market, the role of the state as a significant owner of banks will grow, unless it decides to withdraw.³ Competition from the EU single market leveraging on various advantages of operating from/across other member states, and new technology will be creating additional pressures on the transformation of Irish banks. International banks bring both opportunities and challenges. Finally, supervision of international banks brings new challenges, adding to the complexity of the supervisory approach and increasing pressures in availability of talents.

2. The EU regulatory framework has strengthened dramatically since the 2016 FSAP, including with the implementation of Basel III, although some additional steps remain. The regulatory framework also responded to the issues of nonperforming loans (NPLs), which represented a burden for some member states' banks, including for retail banks in Ireland. There are also new regulatory initiatives reflecting new climate and environmental risks.

3. Since the last FSAP, banking supervision has come a long way, on a path lined with challenges. The development of robust supervisory and regulatory expectations regarding the management of NPLs, including the application of provision coverage expectations on long dated NPLs, has contributed to a reduction of NPLs in retail banks, tackled major threats of Brexit, and faced the COVID-19 pandemic challenges with agility. The Central Bank has also successfully established a firm position in the Single Supervisory Mechanism (SSM). The core of the supervisory approach to respond to struggling business models of Irish banks was also put in place. The ultimate success of the Central Bank's achievements in the area will largely depend on developing supporting tools and methods, and progress in other areas of its mandate. The overall outcome of the COVID-19 pandemic crisis is still unfolding, and supervision will need to stay alert to mitigate the impact on the banking system. The overarching challenge ahead is climate related financial risks.

4. The progress achieved in regulation and supervision of banks can be also demonstrated on the action taken to reflect the 2016 FSAP recommendations. Although, a number of recommendations was primarily addressed to the SSM, the Central Bank has acted upon them and reflected them to the extent of its consistent with its mandate. Overall, the response by the Central Bank was found adequate and the findings raised by the 2016 FSAP as appropriately

³ In 2021, the state announced share trading plans, which will be running through 2022, aiming to sell a part of the state stakes in AIB Group Plc and Bank of Ireland ([gov.ie - Intention to sell shares in AIB Group Plc through a trading plan \(www.gov.ie\)](https://www.gov.ie/en/news/2021/03/gov-ia-intention-to-sell-shares-in-aib-group-plc-through-a-trading-plan/); [gov.ie - Minister extends successful Bank of Ireland share trading plan \(www.gov.ie\)](https://www.gov.ie/en/news/2021/03/gov-ia-minister-extends-successful-bank-of-ireland-share-trading-plan/)).

addressed. Concrete updates to the recommendations of the 2016 FSAP are presented in Appendix I.

SCOPE

5. This note primarily focuses on the Central Bank’s supervision of the Irish LSIs within a broader context of the EU regulatory environment. The Irish system of supervision is to large extent defined by the EU legislation and measures taken by the EU institutions, including the European Banking Authority (EBA) and the European Central Bank (ECB), as a part of the Single Supervisory Mechanism (SSM). The Central Bank incorporates the EU approaches to all banks with due regard to the nature, scale and complexity of the institutions. Hence, for a solid understanding of the Irish system of supervision, it is critical to understand the EU and SSM foundations in which it is established, and which set its basic contours and boundaries. This applies not only to the EU-27 framework, but also to the SSM framework, which the Central Bank also applies to less significant institutions (LSIs). This note is not intended either to represent an analysis of the state of the banking sector or crisis management framework.

6. The mission took a detailed look at supervision of LSIs, using selected Basel Core Principles (BCP) as a guiding structure for the discussion. Irish LSIs are a heterogenous group of institutions, which includes retail, investment, captive and payments banks. The review considered all these categories of business models, regardless of the number of entities which operate within this segment. The recommendations which are made regarding supervisory approaches, supervision of traditional financial risks or supervisory resources are meant to be applied for the supervision of LSIs and these recommendations do not consider the quality or resources of the SSM supervision.⁴ The recommendations which are made to the Central Bank’s institutional framework cannot apply such criterion as they are universal across activities. The mission selected the following core principles (CP) of the BCP to structure discussions with the Central Bank along fundamental pillars of LSI supervision:⁵ CP2 - Independence, accountability, resourcing and legal protection for supervisors, CP3 - Cooperation and collaboration, CP5 - Licensing criteria, CP8 - Supervisory approach, CP9 - Supervisory techniques and tools, CP13 - Home-host relationships, CP14 - Corporate governance, CP15 - Risk management process, CP17 - Credit risk, CP18 - Problem assets, provisions, and reserves, CP19 - Concentration risk and large exposure limits, CP20 - Transactions with related parties, CP22 - Market risk and CP26 - Internal control and audit. The Central Bank prepared a self-assessment anchored by these CPs and a questionnaire prepared by the mission. Additionally, the Central Bank and the ECB responded to questions in three areas of specific concern: Brexit, the COVID-19 pandemic crisis and climate risk. This note builds on these responses, as well as on almost 40 virtual meetings which took place within this FSAP, the documents shared in virtual data rooms

⁴ These topics are discussed in the Euro Area FSAPs.

⁵ This selection was made in order to assess the institutional setup and overall governance of supervision and regulation of risks, which are most relevant for the LSIs in Ireland. This selection also well supported the discussion about cross-cutting topics, of Brexit, Covid and climate risks.

by the Central Bank and ECB, additional responses by the Central Bank, and on research of publicly available information. The ECB also shared information regarding its oversight of LSIs.

7. A broader focus, on all banks (LSIs and SIs), was applied in three cross-cutting areas – Brexit, the COVID-19 pandemic crisis, and climate risk. The issues of particular concern at this time are the impact of Brexit and the global pandemic. Brexit has led to a changing of the institutional landscape, with heightened demands on supervision from new complex institutions moving to Ireland from the United Kingdom (U.K.) Brexit has also introduced cross-border issues on supervisory coordination and collaboration, for both home and host supervisors. The mission inquired about the impact on some supervisory colleges for foreign banks in Ireland, and an update on EU-U.K. agreements on cross border issues. The impact of the COVID-19 pandemic is also a concern, as major support measures are wound down. While considerable fiscal and supervisory relief has mitigated the impact of the pandemic, the FSAP has examined asset quality issues that have/may emerge, especially as financial support to households and businesses is unwound. Finally, the FSAP also explored supervisory approaches to climate risk, which provides a context to the resilience assessment, as agreed with the Central Bank and ECB. A targeted review of the functioning of the SSM was performed in some areas to understand strengths and potential weaknesses it brings to the Irish supervisory landscape.

8. The mission maintained close coordination and consistency with other FSAPs in the euro area working on banking supervision, particularly the work of the concurrent 2021 Germany FSAP.

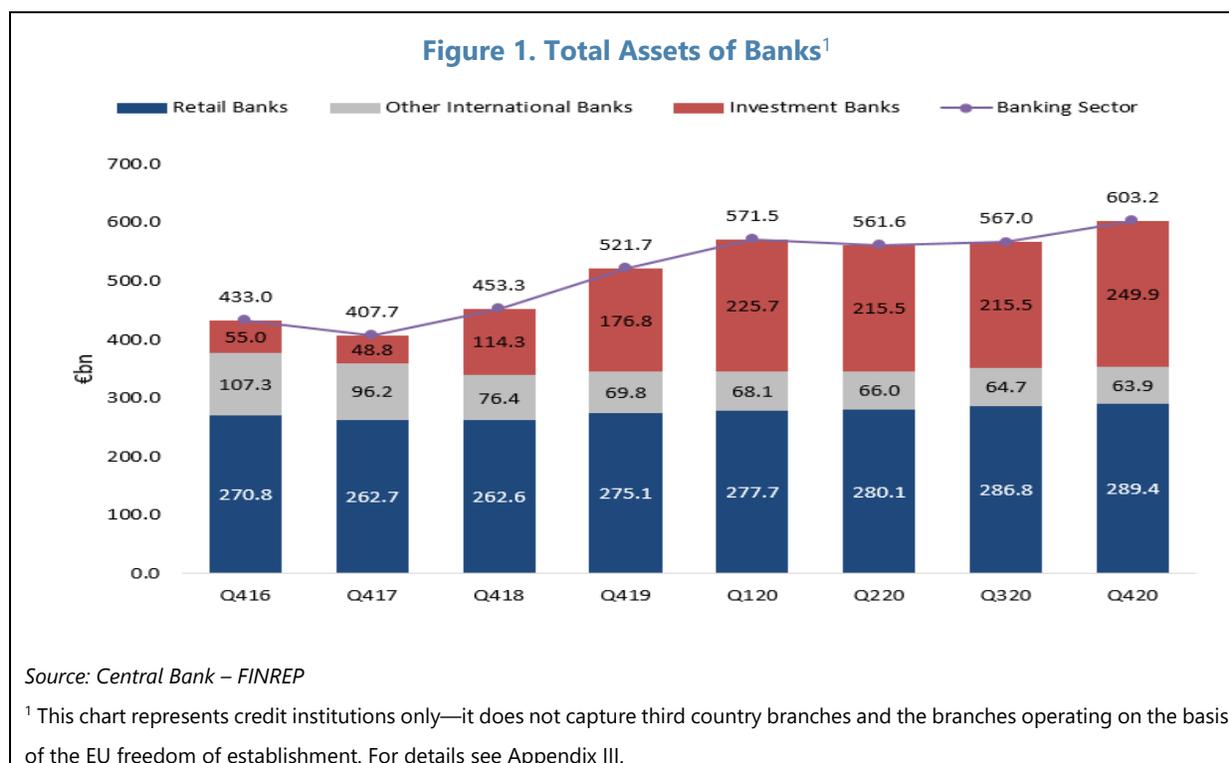
9. The rest of the note is divided into two sections: The first section discusses banking supervision in Ireland from a general perspective. The second section takes a closer look at its effectiveness through selected cross-cutting issues of Brexit, the COVID-19 pandemic, and climate risk.

BANKING SECTOR IN IRELAND

A. Market Structure

10. The Banking Sector has undergone substantial changes since the last FSAP in 2016. This was partly driven by the United Kingdom's departure from the European Union (Brexit). The Brexit aftermath resulted in a significant shift in the composition as well as an increase in the scale and complexity of the banking sector in Ireland, represented by a growth in the 'investment banks' segment. At the same time a consolidation in the 'retail banks' segment, following structural issues undermining their profitability, in addition to a contraction in the 'other international banks' segment. More recently in 2020, the banking sector has seen annual growth of 13 percent in balance sheet size. However, looking through the lens of asset size does not capture how the complexity and internationalization of the Irish banking sector has evolved. In this context, the banks within the

investment banks segment, in particular, have brought a greater concentration of cross border activities to the sector given the international profile of the institutions and their client base.



11. Retail banking has been facing strong headwinds further driving the process of market concentration and delaying a withdrawal of the Irish state, a significant shareholder, from relevant banks. Retail banks account for approximately 50 percent of the banking sector and comprise five retail banks focused largely on the domestic market⁶ with combined assets of EUR 290 billion in 2020. Three of these institutions are Irish-owned; ⁷ the Irish state gradually decreases its stake in two of them through share trading plans.⁸ The remaining two banks ⁹ have foreign parents and recently announced their intention to exit from the Irish retail banking sector; their businesses are expected to be largely taken over by domestic Irish-owned banks, which will increase the concentration in the retail segment of the market. Irish retail banks have been facing challenges of low profitability (as a consequence of high operating costs, less diversified income structure, low interest rate environment, and elevated credit-risk costs), limited business opportunities, combined with growing competition in the niches of the banking market, and

⁶ These five institutions are: Bank of Ireland (BoI), Allied Irish Bank (AIB), Ulster Bank Ireland (UBIDAC), KBC Ireland (KBCI) – all of which are SIs supervised by the Single Supervisory Mechanism (SSM), and one LSI, Permanent TSB (PTSB) – supervised by the Central Bank.

⁷ BoI, AIB and PTSB.

⁸ See [gov.ie](http://www.gov.ie) - Minister extends successful Bank of Ireland share trading plan (www.gov.ie); [gov.ie](http://www.gov.ie) - Intention to sell shares in AIB Group Plc through a trading plan (www.gov.ie).

⁹ KBCI and UBIDAC.

lingering legacy nonperforming loans.¹⁰ Despite all these challenges the segment grew by 5 percent in 2020.

12. Investment banks represent an increasingly important segment of the sector. They represent approximately 40 percent of the banking sector and include three investment banks.¹¹ This segment is primarily responsible for the shift in scale and complexity of the banking sector overall. Activity in this segment reflects the increased internationalization of the Irish banking sector, primarily in response to Brexit, into new and more complex markets and products. Investment banking and global markets activity are materially different to the offerings of the traditional retail banking sector in Ireland. The business lines of these banks are largely wholesale and include leveraged finance, investment grade/sub investment grade lending, derivative trading and hedging activities, which has increased the inherent levels of prudential and conduct risks as well as the breadth of applicable regulation. The banks have diversified business models across corporate and investment banking, are headquartered in Ireland with branch networks in EU countries. Investment banks had combined assets of EUR 250 billion in 2020, compared to EUR 32 billion in 2015.

13. Other international banks have undergone business model changes after Brexit, reversing the contraction from previous years. Nine other international banks, generally comprising subsidiaries of large international banks/groups, account for approximately 10 percent of the banking sector.¹² These banks typically rely on parental funding and are closely aligned to the parent entity in terms of strategy, customers and senior resourcing (generally key executives and board membership include personnel from the group). In terms of evolution in recent years, the contraction in the banking sector noted earlier has been largely driven by this segment. Since 2016, the assets in this segment have dropped by approximately 40 percent, to EUR 65 billion in 2020, driven by some bank exits and some bank migrations to international banks significant institution status.¹³ However, a number of LSIs continue to undergo business model changes to accommodate Brexit-related business. As Brexit related business lines are re-domiciled from the United Kingdom to these EU hubs, the balance sheets of some of these LSIs are expected to grow.

B. Risks and Challenges

14. The remaining impact of Brexit is still unfolding, and the threat of further deterioration in credit portfolios/latent credit risk following COVID-19 is still present. Brexit presented one of the most significant challenges for Ireland with risks posed to the economy, the

¹⁰ The banks have gradually sold these loans from their balance sheets, however they remain a residual burden for the system.

¹¹ Citibank Europe plc, Barclays Bank Ireland plc (BBI), and Bank of America Europe Designated Activity Company are supervised in conjunction with the SSM. In addition, a new bank, Macquarie Bank Europe, entered the market in 2019 following an authorization assessment undertaken in conjunction with the ECB.

¹² Of the nine banks in this segment, eight are directly supervised as LSIs by the Central Bank, under the oversight of the ECB. The remaining bank is a subsidiary of an SIs and are therefore supervised directly by the ECB.

¹³ This is due to a number of banks exiting the segment (EAA Covered Bond Bank, Bank of America National Association, Depfa Public Finance Bank, LGT Bank (Ireland)) and Unicredit Bank Ireland.

structures, through active engagement at the working level in SSM networks and at Supervisory Board, as well as in EBA Standing Committees, Sub-Groups, and at the Board of Supervisors. The mission has gained evidence that common SSM methodologies, processes, and procedures supporting the consistent supervision of all banks within the SSM are largely operational in the Central Bank. The Central Bank also identifies and implements good supervisory practices from across the SSM.

18. The role of the ECB in the oversight of LSI supervision has increased since the 2016 FSAP. The SSM sets supervisory high-level priorities that drive the supervisory activities for SIs, while supervisory priorities for LSIs are set by the NCAs and should mirror the risks and challenges faced by the LSI sector. The Central Bank is expected to reflect the SSM supervisory priorities in a proportionate way when setting up their supervisory agendas complemented by the specific national LSI supervision priorities. The Central Bank summarizes its assessments in a report which lists the key risks to which LSIs are exposed in their jurisdiction and the supervisory priorities identified in response, and which is shared with the ECB. The ECB also provides the methodology for supervision of LSI. As to supervisory practice, the ECB may provide views on individual supervisory cases identified by the Central Bank, through notifications of financial deterioration cases, and, for high-priority LSIs, via notifications of the Central Bank's material supervisory procedures and draft decisions. In this regard, the ECB collaborates closely with the Central Bank, conducting its oversight activities. In this way, the ECB has an objective of achieving consistent supervisory outcomes and the stability of the Eurozone banking sector. Additionally, the ECB has a dedicated country desk, which is engaged in continuous communication with the Central Bank. The ECB has access to all relevant data related to LSIs. The Central Bank utilizes the ECB's IMAS system to upload risk assessments and carry out the SREP for LSIs.

19. The importance of the Central Banks engagements with broader global regulators of credit institutions located in Ireland has significantly increased since the 2016 FSAP. In reflection of market developments after Brexit, the Central Bank—even more strongly than before—promotes close cooperation with other European and third country regulators in order to achieve supervisory outcomes on priority areas with regard to international banks (LSIs). The cooperation can be—in general—described as proactive, including through the Central Bank's engagements in periodic supervisory and crisis management colleges. Regarding international banks, the Central Bank has ongoing supervisory engagements with the relevant National Competent Authority (NCA) and supervisors.

20. Within the context of the SSM, the Central Bank establishes supervisory priorities informed by the Central Bank's mission and strategy, which, at the time of the mission, largely reflected pandemic-related concerns. In 2021, strategic priorities included: (i) maintaining supervisory focus on financial and operational resilience, to ensure banks continue to support households and business through the economic disruption caused by COVID-19; (ii) seeking to improve governance and risk management capabilities, including the risks from disruptive change such as climate change; (iii) seeking to ensure that detrimental consumer outcomes were identified, prevented or mitigated, including those arising from the pandemic; and (iv) resolving both

pandemic-related and longer-term distressed debt in the system, ensuring the fair treatment of borrowers in financial distress and preserving financial stability.

21. Looking ahead to 2022-26, the Central Bank’s strategy and supervisory priorities will be built upon four connected themes that aim to ensure that the Central Bank’s direction and ambitions over the next five years are responsive and forward looking. These themes include (i) being future focused through anticipating and responding proactively to changes in the economy and the financial system, with a particular emphasis on technological innovation, climate transition, geo-political change, and developments arising in the context of the COVID-19 pandemic.; (ii) Being open and engaged through building trust and understanding in the role of the Central Bank through stronger engagement with the public, stakeholders and peers; (iii) Transform the Central Bank to be a more agile, resilient, diverse and intelligence-led organization; and (iv) Safeguarding through continuing to evolve our key policy frameworks and approaches, strengthening the ability to maintain price stability and the resilience of the financial system, while ensuring the best interests of consumers are protected.

B. Regulatory and Legislative Framework

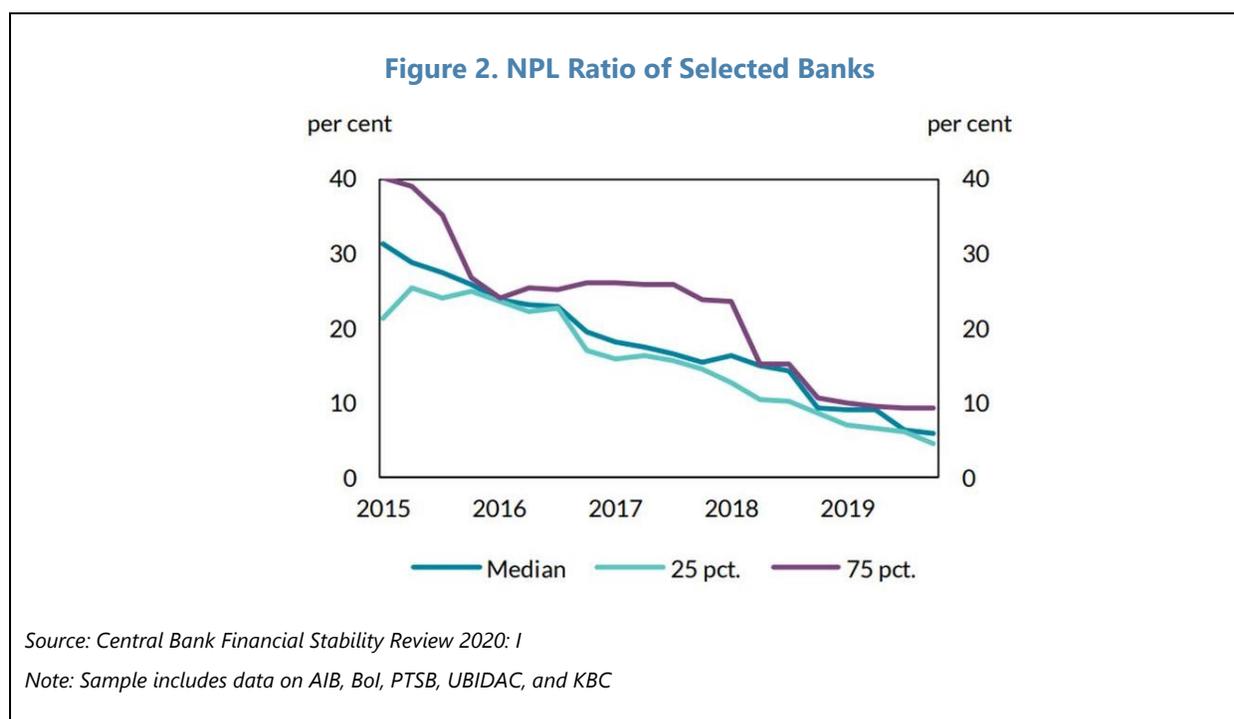
22. Since 2016, the EU has adopted several new laws to continue in gradual implementation of Basel III, to promote innovation and competition, to regulate the conditions for issuing covered bonds, to strengthen the recovery and resolution regime, or to reflect on the pandemic crisis conditions. More specifically the EU took the following major legislative initiatives:¹⁶

- Securitization (2017/2401; 2017/2402): amended capital requirements for securitization exposures.
- NPL Backstop (2019/630): introduced new minimum loss coverage provisioning requirements for exposures, originated after the Regulation and which subsequently turn non-performing.
- CRR II (2019/876): implements binding Net Stable Funding Ratio (NSFR) & Leverage Ratio, with changes linked to Basel fundamental review of the trading book (FRTB), Standardized Approach for Counterparty Credit Risk (SA CCR), total loss absorbing capacity (TLAC) and a revised Pillar 2.
- CRD V (2019/878): requirements in relation to IPU, financial holding companies, systemic risk buffer and Pillar 2 Requirements & Guidance.
- COVID-19 “quick fix” (2020/873): modified implementation timelines for certain aspects of CRR II, along with additional flexibilities (e.g., extended IFRS transitional arrangements).
- BRRD II (2019/879): further strengthens the recovery and resolution regime as regards the loss-absorbing and recapitalization capacity of credit institutions and investment firms.
- Covered Bonds (Directive 2019/2162): sets our requirements for national covered bond frameworks and the credit institutions operating within same.

¹⁶ For details on the EU Implementation of Basel reforms following the Global Financial Crisis see Appendix IV.

- PSDII (2015/2366): aims to payments more secure in Europe, boost innovation and open up payment markets to new nonbank entrants.

23. The EU regulatory initiatives to foster the framework for NPEs helped Irish banks to radically decrease the stock of nonperforming loans since the 2016. This is complemented by actions taken by the Central Bank since the Global Financial Crisis which aim to ensure fair and transparent treatment of financially distressed borrowers. The CIB has sought to ensure that lenders across the system, including those outside the banking system, are implementing long-term solutions for commercial and mortgage arrears cases that are sustainable for both firms and borrowers. Through these combined efforts, nonperforming loans were reduced from levels above 20 percent to 5 percent of total loans before the pandemic.



24. Since 2016, the EU released the EBA guidelines setting fundamental definitions. In late 2016, the EBA published Guidelines on the application of the definition of default¹⁷ prescribing additional criteria for the identification of non-performing and distressed credit, which includes aspects such as the days past due criterion for default identification or indications of unlikelihood to pay.

25. Later, the ECB introduced—in several steps—supervisory expectations for prudential provisioning under Pillar 2.¹⁸ The ECB approach to coverage expectations for NPEs consists of:

¹⁷ [EBA in Guidelines on the application of the definition of default](#) (September 2016).

¹⁸ Summarized in [Communication on supervisory coverage expectations for NPEs](#) (August 2018).

- Guidance to banks on NPLs published in March 2017, whereby the ECB expects banks to set internal coverage thresholds for NPLs, depending on their risk profile.¹⁹
- The Addendum to the ECB Guidance to banks on non-performing loans published in March 2018, which clarifies the ECB's supervisory expectations for prudential provisioning of new NPEs (i.e., exposures classified as non-performing according to the EBA's definition, from 1 April 2018 onwards).²⁰ Where banks fell short of these expectations after a phase-in period the SSM could impose a deduction to CET1 capital under Pillar 2.
- Supervisory expectations for provisioning of NPE stock (i.e., exposures classified as NPE on 31 March 2018), with the starting point of 2/7 years vintage buckets for unsecured/secured NPEs, subject to supervisory coverage recommendations and phase-in paths.²¹

26. The Central Bank was actively involved in setting these supervisory expectations, chairing the SSM task force. The Central Bank had an opportunity to steer this important work, with the Deputy Governor Central Banking chairing the SSMs task force on non-performing loans at the time. The ECB supervisory expectations for the provisioning of NPE stock, as communicated in a press release issued on July 11, 2018,²² was reflected in increased provisions, gradually growing since 2020. Although, the sales of NPL portfolios by Irish retail banks has been driven by a number of factors, banks that the mission met with cited provision requirements as an important factor (in some cases as a driving factor). The provisions currently largely reflect the expectations established by the ECB supervisory expectations for the provisioning of NPE stock

27. Finally, the EU set in its regulation the minimum loss coverage for non-performing exposures (NPEs), which has not fully impacted the books of Irish banks yet.²³ On the basis of a common definition of NPEs, the new rules introduced a Pillar 1 "prudential backstop"—a treatment that requires all banks to make a deduction from own funds where NPEs are not sufficiently covered by provisions or other adjustments in an automatic manner. This established statutory prudential treatment under Pillar 1 for NPEs arising from loans originated from April 26, 2019, onwards. New provisions also set that forbearance measures granted to a NPE do not discontinue the classification of the exposure as nonperforming unless certain strict discontinuation criteria are met. Pillar 1 NPE treatment fully applies: (i) after three years of NPE status for unsecured NPEs; (ii) after nine years of NPE status for secured NPEs secured by immovable collateral and residential loans guaranteed by an eligible protection provider;²⁴ and (iii) after seven years of NPE status for other secured NPEs. A quantitative impact of the CRR backstop phase-in on banks has not yet been completed. This Pillar 1

¹⁹ [Guidance to banks on non-performing loans](#) (March 2017).

²⁰ [Addendum to the ECB Guidance to banks on non-performing loans: supervisory expectations for prudential provisioning of non-performing exposures](#) (March 2018).

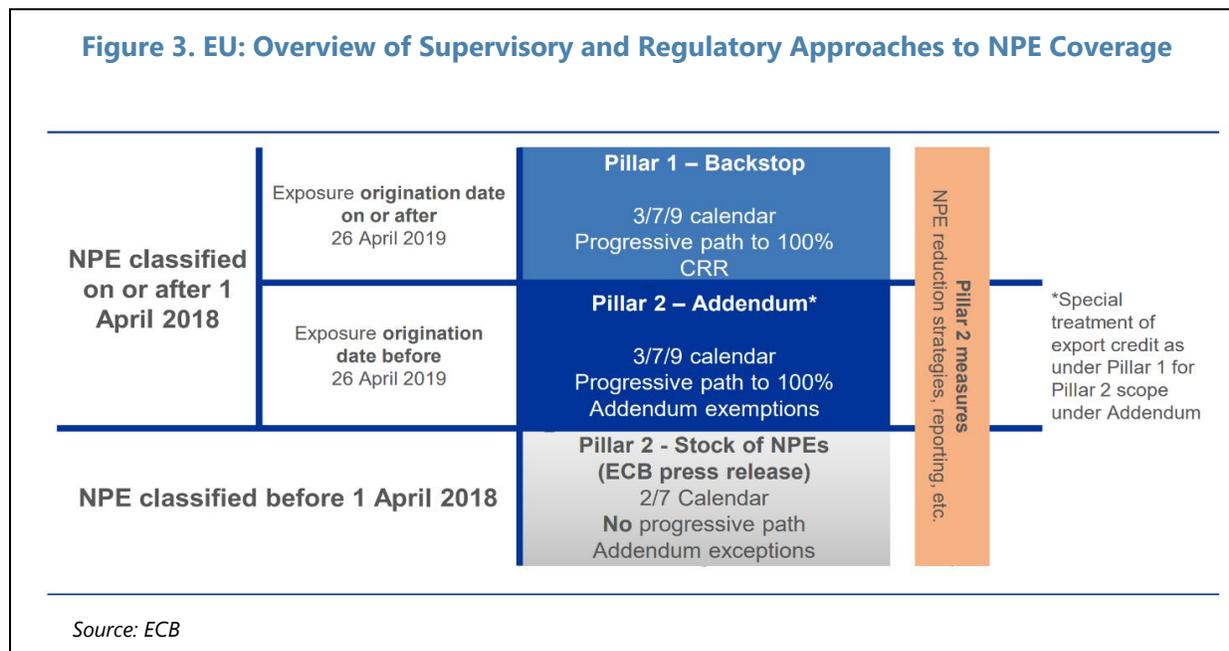
²¹ ECB press release – "[ECB announces further steps in supervisory approach to stock of NPLs](#)" (July 2018).

²² [The ECB press release – "ECB announces further steps in supervisory approach to stock of NPLs"](#) (July 2018)

²³ Regulation (EU) 2019/630.

²⁴ As defined in Regulation (EU) No 575/2013.

treatment starts at three years, so the impact will commence only from 2022 onwards. However, banks are already taking this requirement into consideration while managing their NPL portfolios.



28. In response to the COVID-19 pandemic, the EU adopted an amendment to capital regulation also known as the “quick fix”, which provided a temporary relief to banks. These regulations modified implementation timelines for certain aspects of CRR II, along with additional flexibilities such as extended IFRS transitional arrangements. For instance, the application of the Global Systemically Important Institutions leverage ratio buffer was deferred by one year (until January 2023), a temporary (until June 27, 2021) and conditional exclusion of certain exposures to central banks from the total exposure measure was introduced, while the application of a revised SME factor and infrastructure supporting factor were accelerated (effective on the date of entry into force of the CRR “quick fix”, instead of June 2021).

C. Supervisory Independence and Resources

29. While there was no observed political interference with day-to-day operations, the Irish authorities are encouraged to propose legal amendments to further strengthen the independence of the Central Bank. The legal framework has a gap that potentially exposes the regulatory process to political considerations as it provides the Minister for Finance with potential points of influence into the policy making process. The legislation provides for the approval of the Minister for Finance for setting the levy structure to fund supervision.²⁵ The Minister may also remove Commission members for specified reasons which are broad in nature and interpretation. There is no evidence that these powers have impinged on the day-to-day operational independence

²⁵ Central Bank Reform Act, 2010, Section 32D - Power to impose levies: “(3) Regulations made under this section do not take effect until approved by the Minister.”.

of the Central Bank. However, amending the legislation to limit the Minister's discretion in these regards would help ensure that the Central Bank is independent de jure as well as de facto.

30. The Central Bank is headed by a Commission, which is responsible for ensuring that the statutory functions of the Central Bank are properly discharged. The Commission consists of the Governor and two Deputy Governors of the Central Bank, the Secretary General of the Department of Finance and at least six, but no more than eight other members appointed by the Minister of Finance. There are currently six appointed members. The relevant legislation specifies the circumstances in which the Governor may be removed from office, but there is wide discretion for the Minister of Finance to dismiss other members of the Commission. There is no evidence that this power has impinged on the day-to-day operational independence of the Central Bank. However, amending the legislation to limit the Minister's discretion in this regard would further strengthen the Central Bank's independence de jure as well as de facto.²⁶

31. Recommendation 1: Amend the Central Bank Act or other appropriate legislation such that the Minister of Finance may dismiss Central Bank Commission members only on one or more specified grounds of serious misconduct.

32. Although Central Bank's resources have increased in line with the growth of the financial sector and are sufficient at present, the talent market conditions may affect the Central Bank's ability to retain members of staff in particular specialist areas. The Central Bank has a stable and continuous source of funding sufficient to meet its operational and regulatory needs. It recovers much of its regulatory costs through the industry funding levy, the calculation of which is carried out according to a robust and well-established process within the Central Bank. The legislation provides for the approval of the Minister for Finance for setting this levy. If it appears that the amount raised by the levy will be insufficient for the Central Bank to perform its regulatory functions, the Central Bank may direct other funds to meet the shortfall.²⁷ Since 2015, as part of a strategy to move towards full recovery of costs from industry, the Central Bank has steadily increased the proportion of costs attributable to industry. Since the Global Financial Crisis, the Central Bank has aligned with the public sector pay agreements and applied a global grading salary structure.

33. Recommendation 2: Enshrine in legislation a written procedure for the submission by the Central Bank and approval by MFIN of the supervisory levy. The legislation would: (i) Set out expectations on the timing for the process; (ii) Formalize the Bank's stakeholder engagement process; and (iii) Ensure transparency of decision-making, including on any divergence between the Central Bank's proposal and the regulations ultimately approved by the Minister of Finance.

²⁶ A similar recommendation was made in the 2014 and 2016 Ireland FSAPs.

²⁷ This is also subject to Ministerial approval, but the Minister must consult with the Governor and have regard to the Central Bank's functions and powers under Article 130 of the Treaty on the Function of the European Union and the ESCB Statute.

34. Recommendation 3: Apply sufficient flexibility on remuneration to recruit and retain appropriate talent.

35. Brexit has seen a material expansion in terms of the scale and complexity of risks in Ireland. From a broader supervision perspective this expansion may continue increasing pressures on the Central Bank's resources. The Central Bank's horizontal support function helps to manage demands on human resources. The Central Bank has also recruited subject matter experts with capital markets experience to supervise international banks. However, the talent acquisition and capacity building need to be elaborated in a way to support the performance of supervision long term and the Central Bank has to ensure that it keeps the relevant policies updated. Additionally, the capacity of supervision, in a broader sense, can benefit from techniques and approaches applied by the SSM for SIs.²⁸ The (proportionate) alignment of supervisory techniques and a broader harmonization of approaches will also contribute to the consistency of supervisory outcomes across banks.

36. Recommendation 4: Continue adapting supervisory capacity and tightening supervisory cooperation to reflect increasingly complex business and operational models of international LSIs, seeking to maintain consistency in supervisory approaches and techniques across international SIs and LSIs, with due regard to the nature, scale, and complexity of specific banks.

D. Supervisory Powers

37. The current legislative framework should be strengthened to ensure that the Central Bank can pursue individuals directly for their misconduct. In its 2018 report reviewing bank culture and behavior, the Central Bank identified several areas for strengthening the governance framework. Specifically, an enhanced Individual Accountability Framework was suggested to achieve behavioral, cultural and regulatory objectives. This framework is comprised of four key components:

- **The Senior Executive Accountability Regime (SEAR)** will require firms to set out, clearly and comprehensively, where responsibility and decision-making lie in order to achieve transparency as to who is accountable for what within firms.
- **The enforceable Conduct Standards** set out the behavior expected of firms and their staff, including obligations to conduct themselves with honesty and integrity, to act with due skill, care, and diligence, and in the best interest of consumers.
- **The Central Bank's Fitness & Probity Regime** will be enhanced and will place a greater onus on firms to proactively certify that certain staff are fit and proper and capable of performing their roles with integrity and competence.
- **The Central Bank's Administrative Sanctions Procedure** will be strengthened to ensure that individuals can be pursued directly for their misconduct rather than only where they have participated in a firm's wrongdoing. The reforms will also provide for greater process

²⁸ Including, a tight cross-border supervisory cooperation, procedures to assess certain type of operations, etc.

efficiency, clarity and administrative consistency to all involved, including those who may be the subject of enforcement action. A continued focus by the Central Bank on proportionality and fair procedures is a key theme of its IAF proposals.

38. The current legislative framework should be strengthened so as to drive positive behavior, bring about enhanced individual accountability and enable the Central Bank to take direct enforcement action against individuals, in appropriate cases. A legislative process has been launched to put in place the individual accountability framework, which will include enhancements to the existing administrative sanctions regime.²⁹ The legislative process is led by the Department of Finance, and the Central Bank has been heavily involved at all stages in the drafting of the provisions. The Central Bank is hopeful that the legislation will be enacted as soon as possible.

39. Recommendation 5: Amend relevant legislation to provide for greater individual accountability and enhance powers of the Central Bank to take direct enforcement action against individuals. Finalize related internal framework to operationalize execution of the upgraded accountability regime.

E. Organization of Supervision

40. The Central Bank has been continuously responding to the challenges posed by the legacy issues of the Global Financial Crisis (GFC), Brexit and other market developments, by restructuring the organization of supervision. After the GFC, supervision focus reflected the need to systematically address consumer protection and conduct issues in order to strengthen the preconditions for financial stability. In parallel, these initiatives have contributed to an increase in the effectiveness of prudential supervision. For instance, regulation of mortgage lending conduct stabilized the market and concrete follow up initiatives like the ‘Code of Conduct on Mortgage Arrears’ offered a solid basis for stronger prudential regulation. Prudential supervision started incorporating outcomes of analyses of trends and developments in consumer protection into their work, greatly benefiting from this cooperation in a number of supervisory outcomes. Later, the organization of supervision was largely impacted by the creation of the SSM and by Brexit. In both cases, the Central Bank took up the challenge and implemented structural changes, which fostered its governance and helped delivery in a more complex environment.

41. In 2017, the Central Bank Commission approved the restructuring of the regulation functions. The restructure was designed to ensure the Central Bank was suitably equipped to meet its expanded regulatory mandate. The financial regulation functions were resultingly organized under two pillars - Prudential Regulation and Financial Conduct. The Prudential Regulation pillar included the directorates for credit institutions; insurance; and asset management supervision³⁰ and is led by the Deputy Governor (Prudential Regulation). The Financial Conduct pillar includes the

²⁹ The “General Scheme” (i.e., a draft outline of the main elements) of the Bill was published in July 2021: <https://assets.gov.ie/180083/8175a004-8e41-4e76-b09d-d6ee8ab72506.pdf>.

³⁰ The asset management supervision directorate was subsequently restructured across the Credit Institutions Directorate and the Conduct Pillar (see Appendix II for the current structure).

directorates for consumer protection; securities and markets supervision; and enforcement and is led by the Director General (Financial Conduct), a role newly created as part of the restructure. The changes were predominantly driven by two factors. First, due to the expanded mandate of the Central Bank and the shift to a more intrusive method of supervision, the scale of financial regulation activity has sharply increased in recent years. Second, the level of European engagement has also been transformed, with the SSM in particular requiring extensive input. Allied to that, this restructuring places clear emphasis on the importance of financial conduct, which includes consumer protection, investor protection, the orderly operation of financial markets and enforcement.

42. The creation of the Prudential Pillar laid down preconditions for a smoother transition through the demanding period of Brexit. Building on improvements in banking supervision arising from the creation of the SSM, as well as the need to review the effectiveness of approaches relevant for the pre-Brexit conditions, the Central Bank established a new divisional and directorate structure. The Central Bank restructuring led to the creation of a new Investment Banking and Broker-Dealer supervision division (IBBD) and the new Prudential Analytics and Inspections directorate (PAID). Both organizational units are critical in supervising complex operations and international activities, which blossomed with Brexit. In PAID, which supports supervisory functions, the Central Bank concentrated its expertise on risks and data analytics, financial and nonfinancial risks. Overall, the approach reflects a holistic approach to execution of supervisory priorities between front-line supervisors and horizontal analytics and inspection experts, balancing specialist skills, as well as firm specific supervisory and sectoral knowledge. This new organizational structure seems conducive to the functioning of the Central Bank within the SSM as well as to responding to the current wave of increased supervisory responsibilities, stemming from Brexit.

43. The consumer protection related activities in the Consumer Protection Directorate centered into a new Financial Conduct Pillar.³¹ The changes respond to priorities and enhances integration across banking, investment firms and market-based finance supervision. Additionally, Consumer Policy moved to the Financial Regulation—Policy and Risk Directorate³², which should enable the formulation of investor and consumer protection policy from a holistic perspective. To ensure the high-level alignment of activities across organizational Pillars (Prudential Regulation Pillar and Conduct Pillar) reporting to different members of the Commission, the Central Bank established committees, including the Supervisory Risk Committee, which is co-chaired by the Deputy Governor-Prudential Regulation and the Director General—Financial Conduct. These committees typically take a bank-wide approach to decision making to allow the Central Bank to achieve its strategic objectives. At the technical level, cooperation relies on everyday communication between managers and experts.

³¹ See Appendix II for a full organizational chart.

³² The Financial Regulation – Policy and Risk Directorate supports both prudential and conduct pillars. The Director of Financial Regulation – Policy and Risk has a joint reporting line (see chart in appendix 1)

44. Following the implementation of structural reorganization of the Financial Regulation, the full potential of the progressive “One Bank” approach can be fully unleashed by promoting deeper integration of supervisory activities.

The Central Bank has demonstrated in practical examples, priority planning and multi-year strategy implementation, pooling of technical expertise, enhancing data analytics capabilities, and expanding horizontal views on risks and good practices. These advancements allow deeper dives into complex technical areas and a broader scope of thematic reviews. The policy has been applied systematically primarily within the functional Pillars (e.g., to support model validations), while the efforts across the Pillars are typically organized in ad hoc projects. However, the potential of the policy is greater if it is applied on long term cooperation steered by specific topics. In this sense, supervisors should seek more opportunities to connect data and information collected across the Central Bank’s mandates and leverage possible synergies, especially across prudential and conduct supervision. These activities should be increasingly focused on particular banks – on both sides, prudential and conduct supervision. A valuable source of inspiration for such activities can be taken from the report “Behavior and Culture in Irish Retail Banks”.

45. The “One Bank” approach served supervisors well in the demanding conditions of the COVID-19 pandemic crisis.

In this challenging period, the policy helped sharpen understanding of the financial system’s situation. It also expanded supervisors’ toolboxes and allowed better targeting of their actions. Additionally, a close cooperation between prudential and conduct supervision increased the efficiency of supervisory action—the consumer protection measures could be crafted in a way that supported overall financial stability, and the feedback of prudential supervision contributed to the efficiency of consumer protection actions (which helped stabilizing the market).

46. The Central Bank considers prudential and financial conduct regulation to be intertwined by common long-term goals of their objectives.

The work to ensure that financial firms are prudentially sound and well run is essential if these firms are to meet their obligations to consumers and investors. Specifically, the Central Bank’s financial supervision objectives can be summarized as follow:

- To maintain the stability of the financial system;
- To promote high levels of trust and confidence in the financial system via proper and effective regulation of financial service providers, such that:
 - Inappropriate losses are not incurred by users of financial services;
 - Customers are treated fairly, and consumer and investor interests are protected;
 - The system is not abused for money laundering or terrorist financing purposes;
 - The system is governed and managed by individuals who behave in a manner consistent with our standards of fitness and probity;
- To pursue the orderly and proper functioning of financial markets.

47. Projecting the long-term goals to concrete activities and maintaining deep coordination across functions, anchored in a strong governance, are keys to success of the “One Bank” approach.

This is a demanding task requiring continuing efforts on all levels of the

organizational hierarchy, with shared understanding of specific roles of particular management layers and members of the team. A strong governance structure establishing formalized processes across the organization is a requisite of a highly coordinated and efficient supervisory action. It also supports management of some risks, including the risk of short-termism or the risk of competing mandates. Day-to-day informal cooperation of experts and close dialogue of supervision management are important components of good governance, which need to be supported by systematic (formalized) measures, including regular consultations, quarterly meetings of the teams supervising a particular bank, and consistently encouraged by the senior management, providing strong examples of close coordination.

48. A holistic approach to coordination of supervisory actions for LSIs, anchored by the “One Bank” approach, also ensures that the Central Bank speaks one voice. This is crucially important for the effectiveness of supervisory communication, which influences banks in their decisions. It can also prevent duplication of supervisory requests towards banks. Additionally, it can support cross-fertilizing of supervisory activities between prudential and conduct supervision. The Central Bank provided some good examples from their practice, including ‘Dear CEO distressed debt letters’, the ‘Behavior and Culture’ report, or some public speeches, documenting strengths of this “one voice” approach. The Central Bank also confirmed that long term measures, for instance periodic meetings with LSIs’ senior managements led by prudential and conduct supervisors, side-by-side, or a system recording and sharing information about operational communication with LSIs associated with the exercise of one specific mandate exclusively, across functions, provide a crucial structure to this approach.

49. Recommendation 6: Expand collaboration across conduct, consumer protection, and prudential supervision, to unleash the full potential of supervisory functions integrated under the ‘One Bank’ approach, while adjusting the underlying cooperation arrangements and operational processes.

F. Supervisory Process

50. The Central Bank’s supervisory process takes the form of forward-looking assessments of the risk profile of banks, mostly concentrated in the Supervisory Review and Evaluation Process (SREP). Since the 2016 FSAP, the Central Bank has successfully adopted the SSM LSI SREP Methodology³³ The SREP is a main tool to steer the supervisory process and assess on an ongoing basis the nature, impact, and scope of risks for banks. It involves a comprehensive assessment of banks’ strategies, processes and risks, and takes a forward-looking view to determine how much capital and liquidity each bank needs to cover its risks. As the common SSM’s methodology establishes, when determining the future supervisory engagement for an LSI, supervisors consider the Central Bank strategy and financial regulation priorities in addition to the outcomes of the SREP assessment, the outcomes of any inspections or thematic reviews conducted on the LSI, and all

³³ LSI SREP Methodology complies with applicable EBA Guidelines, namely those EBA Guidelines on common procedures and methodologies for SREP, and supervisory stress testing, and on ICAAP and ILAAP information collected for SREP purposes. The structure of LSI SREP is captured in Appendix V.

recent supervisory work undertaken, including outcomes of thematic cross-bank working groups assessing emerging risks (i.e., Brexit and COVID-19), meetings with the banks' senior management, and reviews of regulatory returns.

51. In practice of the Central Bank, the SREP qualitative and quantitative assessments are very thorough and build on a number of inputs, including from internal processes and tools of LSIs to verify the robustness of their governance and risk management. Supervisors review the bank's risk appetite framework (RAF), risk reports that are submitted to the Board and Board Committees, other Board documentation, including minutes, to ascertain whether the Board and senior management obtain sufficient information to understand the risks facing the bank. Supervisors also use meetings with the Board and senior management to collect additional information. Supervisors consider the overall governance framework of a bank in their qualitative assessments. In quantitative assessments, supervisors employ data from capital and financial reporting regimes (COREP and FINREP), as well as granular data about individual positions of banks. Supervision uses a mix of in-house models and supervisory judgement to challenge a bank's economic capital quantifications (presented in the ICAAP).³⁴ Additionally, supervision challenges the bank's ICAAP stress testing framework,³⁵ though the use of an in-house top-down model based on the EBA Stress testing methodology and bottom-up stress testing models based on bank-specific data requests, which capture the key/material risks. Quantitative reviews of ILAAPs are conducted using the Central Bank's own stress testing tool (the Liquidity Sensitivity Tool).

52. The overall SREP assessment underpins a wide range of possible supervisory outcomes. These include capital requirements, liquidity requirements, and other qualitative or quantitative measures, generally in the form of risk mitigation programs (RMPs), where relevant. RMPs are actions imposed on LSIs to resolve/mitigate unacceptable risks and/or deficiencies in the bank. In certain instances where the risk/deficiency is of a serious nature, more impactful supervisory actions may be utilized. For example, the Central Bank has the statutory powers to instruct regulated financial services providers to appoint a third party or 'skilled person' to prepare a report in respect of any regulatory matter directed by Central Bank. The credible threat of enforcement continues to underpin the Central Banks approach to supervision.

53. The output of SREP is communicated to a bank's senior management in a supervisory dialogue and in a letter that outlines the areas of heightened risk. The purpose of the supervisory dialogue and SREP letter is to present the view of supervision regarding these risks and articulate supervisory expectations towards risk mitigation in RMPs. The supervisory outcomes sought from a SREP are to reduce these risks, and to ensure management buy-in in relation to the identification and reduction of risks. On a number of examples, the Central Bank demonstrated the robustness of its approach to communication of SREP results (including RMPs) to the mission. The

³⁴ Such as credit concentration risk, market risk, IRRBB, credit spread risk in the banking book, pension, operational risk, etc.

³⁵ E.g., governance process, scenario design, assumptions, outcomes.

communication is clear, comprehensive and well-structured. The mission also received a positive feedback from banks.

54. For risks not currently assessed under the SSM LSI SREP methodology, the Central Bank utilizes other core documents in performing risk assessments and establishes taskforces to monitor and assess impacts. For instance, the Central Bank uses the ECB Guide on Climate-Related and Environmental Risks as a guide of the expectations required of banks in mitigating and managing climate related financial risks. The Central Bank developed its own internal methodology for assessing these risks for LSIs in 2021 and a pilot assessment exercise was completed. Another example is the monitoring and assessment of the COVID-19 pandemic crisis impacts, where a dedicated task force was established. Supervision teams considered the output of the work completed by the task force in its assessment of the risks to each bank and the wider banking sector. The task force, with the support and input of the supervisors and risk experts, assessed the forward-looking resilience of the banking system (i.e., the impact of macro-economic factors on bank profitability and balance sheets, net income, and on credit risk through the repayment abilities of borrowers). It also assessed credit conditions and distressed debt levels within the banks. These assessments informed supervision teams' assessments of the risk scores of the banks as part of the SREP and their day-to-day engagements with the banks.

55. Additionally, the Central Bank has a number of analytical reports to inform supervision about the buildup of risks, trends and concentrations across the sector, which are part of the supervisory process. These include liquidity and credit packs (analytical reports), financial stability monitoring regime and the quarterly banking risk analysis pack. Liquidity and credit monthly packs are an evolution from earlier Brexit monitoring packs. The Central Bank's approach to supervision has continued to evolve since then and throughout the COVID-19 pandemic, and the mentioned horizontal reports are now part of supervisory process.

G. Supervisory Approach

56. The Central Bank takes a risk-based, intrusive, analytical, and outcomes-focused approach to the supervision of LSIs. In order to deliver this, banking supervision approach is focused on four overarching outcomes: (i) have sustainable business models; (ii) sufficient financial resources, including through times of plausible and severe stresses; (iii) are well governed, with appropriate cultures and effective risk management; and (iv) can recover if they get into difficulty and are resolvable without recourse to the taxpayer assistance, if they cannot. In addition, broader financial supervision objectives seek to ensure that inappropriate losses are not incurred by users of financial services and that customers are treated fairly and consumer and investor interests are protected.

57. The Central Bank maintains cooperation and information with the ECB. The ECB exercises oversight over the functioning of the system based on the procedures and responsibilities set out in the SSM Regulation (SSMR) and in the SSM Framework Regulation (SSMFR) and conferred upon the ECB and NCAs for significant and less significant institutions respectively. The SSM requires the Central Bank to report on a regular basis relevant information regarding LSIs, in accordance with

the SSM's Notification Framework for Less Significant Institutions. The Central Bank is required to provide certain material supervisory procedures or material draft decisions to the SSM on an ex-ante basis in order to seek the SSM's views Central Bank. These ex-ante procedures/decisions include removal of board members and appointment of special managers, early intervention measures and breaches of capital requirements, and developments/actions considered material by the Central Bank with a significant impact on the LSI. The Central Bank also provides annual information to the SSM on an ex-post basis including SREP decisions, any supervisory measures imposed on the LSIs, details of waivers granted to LSIs, and standard templates to be completed for each LSI that feed into the SSM's annual risk report on LSIs.

58. The SSM established a classification system to underpin a proportionate approach to the supervision of LSIs, which is followed by the Central Bank. The Supervisory Manual distinguishes the categories of LSIs based on the institution's intrinsic risk and its impact on the domestic financial system: high priority LSIs; medium priority LSIs; low priority LSIs. Effective as of 2022, the prioritization will be replaced by new categories of high-impact, high-risk and other LSIs. The Supervisory Manual provides that the intensity of the ECB's oversight is increased proportionately with each LSI's risk classification.

59. The Country Desk of the ECB has a significant role in coordinating communication with the Central Bank. The Country Desk coordinates an information flow which is framed by an automated notification system. The submission of a standardized notification by the NCA to the ECB is typically followed by interaction (e.g., calls, e-mails, exchange of documents). It is the role of the Country Desk to reach out to the Central Bank in order to clarify open questions or to obtain additional information if needed. The Country Desk also drafts the non-binding ECB views, which are submitted to the Central Bank, no longer than 10 working days after the notification. The ECB dedicates 1 FTE to oversight of the supervision of LSIs in Ireland.

Business Models

60. The Central Bank's focus on business model sustainability (and viability) of LSIs is articulated through comprehensive assessments which are outlined by the ECB Supervisory Review Methodology.³⁶ Business model assessments are run on a regular basis - depending on the LSI priority classification, and on an ad hoc basis - in response to significant changes in business models. In assessments, the Central Bank supervisors look at the robustness of a business model on a short-term time horizon (one year), in case of business model viability, as well as on a medium-term horizon (three–five years), for business model sustainability.

³⁶ [ECB Supervisory Review \(SREP\) Methodology](#).

Box 1. SSM SREP: Business Models Assessment

The assessment of LSIs' business models starts with information gathering and selection of material business areas,¹ to identify significant drivers of business model risk (Phase 1). A right selection of business areas and potential threats to future profitability is particularly important for the assessment of business model sustainability. A special attention is paid to the areas which generate losses or show a strong decline in profitability or to material business lines which are subject to strategic changes. The analysis includes a peer group comparison.

In the next steps, supervisors look at predefined indicators suggesting a score (Phase 2) that can be modified, using evidence-based supervisory judgement (Phase 3). The financial performance indicators are considered in a pre-defined matrix. After the translation of the indicators' values into a score, supervisory judgement is applied in a comprehensive analysis targeting a forward-looking view on a bank's viability and sustainability and identifying potential risks and vulnerabilities. Analyses build on quantitative (e.g., a balance sheet structure) and qualitative elements (e.g., track-record of an institution with strategic projects), which are not captured in the mentioned indicators. These analyses feed into the assessment of business model viability (the ability to generate acceptable returns over the following 12 month) as well as to the assessment of business model sustainability (the ability to generate acceptable returns over a period of three years). The analyses consider the strategic plan of a bank.

Supervisors take a holistic approach to the assessment of business models' viability. Supervision concentrates on the capacity of a bank to address potential threats and its ability to drive business performance. A quantitative analysis of several risk indicators at the consolidated level builds on the data from financial reports. In the assessment, supervisors take into account the consolidated level strategy as well as risk appetite and risk capacity. The assessment includes a peer level comparison.

¹ Relevant for high-priority LSIs.

61. The supervisory assessment of business models' sustainability run by the Central Bank is complex and thorough. The Central Bank supervisors analyze the bank's approach to achieve medium/long term profitability, in the context of key trends and developments in forward-looking business environment. As demonstrated on practical examples, the Central Bank supervisors seek to understand how the bank generates income or losses in the medium/long term and how it is planning to respond to future developments (external factors that could threaten future profitability). The assessment considers, for instance, the main quantitative and qualitative management objectives laid down in the strategy, projected financial performance, using similar metrics as the analysis of the current business model, or substantial changes to the current business model. Supervisors analyze the structure of revenues and costs, their concentrations, etc. In examples reviewed by the mission, supervisory judgement played a substantial role as analyses were of qualitative and quantitative nature build on a detailed reasoning, without mechanistically following predefined quantitative thresholds for the quantitative components.

62. The assessments' final scores for LSIs, determined by the Central Bank, use the full range of grades. Separate scores for business model viability and business model sustainability are set. The final score is a combination of these two, guided by expert judgement. The final score is interpreted in a short narrative, as demonstrated on the provided examples. These outcomes enter SREP, where they are reflected in the SREP decision, setting among others the Pillar 2 capital requirement. The mission had an opportunity to review cases evidencing a rigor approach of the Central Bank in shaping the final outcomes, including in assigning the scores.

63. This robust assessment forms a core of Central Bank's supervisory good practice. The process is well structured, the scope is comprehensive, and the practice achieves the right balance between flexibility and consistency. For all these reasons, as well as for comparability of results across banks, the described assessment methodology deserves to be at the core of business model supervision. Additionally, from practical examples shared with the mission, it is clear that the Central Bank is using this tool to its full potential—its reviews have sufficient depth, the assessment results are balanced and well-articulated, and the message to the bank is clear.

64. In recent years, actions implemented by the Central Bank and European authorities contributed to a reduction in the levels of NPLs in the banking system, representing a major hurdle to sustainability of banks' business models. Still, banks have to cope with the aftermath of the Global Financial Crisis, as some credit quality parameters are continuing to be influenced by historical data reflecting experience emanating from that time period. These legacy issues, as well as ongoing issues in foreclosing collateral, drive higher credit costs, which is a long-term burden for sustainable business models and financial stability.

65. Overall, a persistent need to improve Irish retail bank's business model sustainability³⁷ underscores the importance of further developing existing good practice and diversifying the supervisory toolbox. Possible enhancements can build on a strong current practice and complement it by operational tools, which would refocus on bank specific detail and follow-up on concrete measures taken by a bank, long-term. In every step taken, the message from supervision has to clearly point at the overarching goal of long-term sustainability and this message needs to reach senior managements of banks, in connection with their accountability for long-term progress over short-term targets. Additionally, supervision can inspire research projects going deeper to the roots of the problem and incorporate their outcomes in its activities. Furthermore, a comprehensive communication strategy of the Central Bank can steer/influence the direction of market developments. Finally, the Central Bank should ensure level playing field for banks vis-à-vis other providers of comparative products/services. In this regard, the Central Bank can leverage on its position of an institution integrating multiple functions in the financial system and banking

³⁷ The issue was also raised in last the 2016 FSAP: "For the future, priority work areas should continue to include the analysis of bank business models, and advance preparation regarding supervisory issues that may arise in the course of bank privatization and other structural changes."

supervisors can effectively pass their findings and suggestions to their colleagues working in supervision of other sectors or another functions of the Central Bank.³⁸

Box 2. The Central Bank Approach to Problem Loan Resolution

The Central Bank's approach has evolved significantly since the 2008 crisis, through the:

- introduction of Provisioning and collateral valuation guidelines in 2011 and 2012;
- imposition of bank-wide Mortgage Arrears Resolution Targets (MART) and bank-specific SME targets in 2013 through which the Central Bank imposed quarterly quantitative targets on the six main mortgage lenders at the time (accounting for approximately 90 per cent of the Irish mortgage market) on Republic of Ireland principal dwelling home/primary residence and buy-to-let mortgage portfolios. The targets were focused on resolving arrears greater than 90 days and comprised the following components:
 - Proposing sustainable solutions to borrowers;
 - Concluding those sustainable solutions;
 - Tracking of subsequent performance rates on the concluded solutions;

publishing the Code of Conduct on Mortgage Arrears (CCMA) in 2009 and subsequent updates to ensure fair and transparent treatment of financially distressed borrowers, and recognises mortgage arrears are unique when compared to other asset classes and each mortgage arrears case needs to be considered on its own merits;
- introduction of mortgage measures in 2015 limiting Loan to Value (LTV) and Loan to Income (LTI) of new lending;
- establishment of the Mortgage Arrears Strategy and Implementation Group (MASIG) in 2019 with the aim of ensuring that lenders put in place long-term solutions which are sustainable for both firms and borrowers;
- establishment of the Distressed Debt Working Group (DDWG) in 2020 to focus the Central Bank's efforts on both legacy and new distressed debt within lenders' existing / back-book credit portfolios (both retail and non-retail), and ensure we take a consistent, cross-Bank approach to the work. The DDWG considers and enhances existing work on distressed debt (e.g., MASIG and COVID-19 TF payment break workstreams). The deliverables of the DDWG include:
 - Driving the strategic direction of the Bank's work on the topic of distressed debt;
 - Design and implementing a work program of work to deliver the Central Bank's objectives;
 - Reviewing existing Central Bank structure, frameworks and approach to the supervision of lenders' management of distressed debt, with a view to recommending any changes;
 - Proactively engaging and communicating with key stakeholders;
 - Further developing and monitoring KPIs on distressed debt and using this analysis to inform our work.

³⁸ For instance, the Central Bank can enforce capital requirements for certain types of nonbank mortgage lenders, establish a unified framework for consumer protection, adopt macroprudential measures, etc.

66. Recommendation 7: Maintain a long-term supervisory focus on the sustainability of business models of banks, using a wide variety of supervisory tools to incentivize prudent transformation of banks' business models to achieve long term growth and profitability.

Governance and Conduct

67. In 2018, the Central Bank published a report on 'Behavior and Culture' in retail banking which recommended the introduction of an enhanced Individual Accountability Framework for individuals, working in regulated entities which would go significantly beyond existing enforcement and fit and proper processes. A supervisory priority is to ensure banks have robust oversight over decision-making, with bank executives taking responsibility and accountability, including for strong governance prerequisites. In this sense, bank boards and executives are expected to be assessing whether the bank's decision-making is consistent with the culture of the organization.³⁹ In 2019-20, the Central Bank ran an exercise centered around individual banks' action plans designed to address the risks in 'behavior and culture' identified for each bank. Supervision used a broad range of information to assess the cultural drivers of misconduct, engaged banks' leadership to strengthen culture, which managements anchored in internal medium term action plans. Supervision follows-up on banks' efforts, including in SREPs.⁴⁰ The Central Bank underscores the topic of strong governance, risk management and culture, especially in supervision of international LSIs, which typically align their strategies within larger groups, and in some instances have frameworks that are not sufficiently localized, with adequate capacity to support local operations. Supervisors have taken measures to address such deficiencies, including risk mitigation programs and other supervisory tools (e.g., skilled person report). Where necessary, supervisors utilized their enforcement powers.

68. The gaps in the current legislative framework, in respect of individual accountability, limit options for the Central Bank to enhance further its supervisory approach. Despite the dedication of supervision to their mission and their readiness for intrusive and decisive action on governance and conduct, gaps in the legislation represent constraints to improvement. To fill these gaps, the 2018 report on 'Behavior and Culture' suggested the introduction of a new individual accountability framework⁴¹, anchored in legislation, which includes Conduct Standards,⁴² a Senior

³⁹ The culture should, for instance, consider diversity and inclusion in all its forms, to support a well-managed, financially resilient, strategically minded firm.

⁴⁰ The SREP Element 2 "Internal Governance and Risk Management" considers these issues across a number of areas including the assessment of the effectiveness of the board and management body of the banks and sufficient human resource capacity.

⁴¹ See paragraph 37 for details.

⁴² Conduct Standards embedded in the legislative framework can sit alongside prescriptive rules, and can be enforced where entities or individuals fall below them, as proposed by the Central Bank in the report on 'Behavior and Culture'. Supervision suggested to issue three sets of standards: (i) Common Conduct Standards for all staff in regulated financial services providers; (ii) Additional Conduct Standards for senior management; and (iii) Standards for Businesses.

Executive Accountability Regime as well as enhancements to the existing Fitness & Probity Regime⁴³ and enforcement process. Once new legislation is enacted, as expected in 2022, the Central Bank can put into life a new framework, which will require firms to set out clearly and comprehensively where responsibility and decision-making lie, to ensure its effective implementation. In conjunction with this process, the work in the area can intensify and the Central Bank should implement steps described in the section on ‘Organization of Supervision’.⁴⁴

69. Recommendation 8: Intensify efforts to implement the report on “Behavior and Culture in Irish Retail Banks” in systematic supervision of individual banks, and by connecting findings with prudential supervision outcomes on an individual bank level.

H. Supervision of Credit Risk

70. The Central Bank, through its supervisory activities and engagement is continuously assessing the inherent credit risk of LSIs. This ensures that LSIs have a robust and appropriate credit risk management framework in line with regulatory and supervisory expectations. The approach to credit risk is consistent with a broader risk and evidence-based proportionate supervisory approach. In general, retail banks are supervised more intrusively than non-retail banks, due to an inherently higher level of credit risk owing to the nature of assets held.⁴⁵

71. LSIs involved in non-retail banking activities exhibit a relatively lower credit risk profile. This outcome is based on generally higher proportion of exposures to lower risk obligors such as credit institutions, investment-grade corporations and central banks. Notwithstanding this, the Central Bank undertakes deep dive assessments (including loan file reviews) when LSIs expand their business activities and as part of the risk based supervisory assessment of credit risk.

72. During the COVID-19 pandemic, the Central Bank undertook enhanced monitoring of emerging credit risk and NPLs. Its intrusive approach included frequent calls with credit institutions to understand and assess initially the volumes of payment breaks requested by borrowers, and the lenders’ ability to process these in a timely manner. Monthly submissions were

⁴³ Currently, the Central Bank’s F&P Guidance states that banks should, on an annual basis, ask persons performing a controlled function role to confirm their awareness of, and compliance with, the fitness & probity standards. A positive duty on banks to certify each such person, would strengthen the regime and increase the focus on the responsibility of banks for the conduct of their staff and their corporate culture.

⁴⁴ Paragraphs 40-48.

⁴⁵ In particular, the focus is on assessments of: (i) governance and culture; (ii) skills and resources; (iii) concentration risk; (iv) credit approval process; (v) credit monitoring process; (vi) credit control and collections; (vii) impairment and provisions; and (ix) management information and modelling.

received including data on payment breaks, and forbearance requests,⁴⁶ through ‘Distressed Debt Monitoring Template’.⁴⁷

73. The methodological guidance on classification and provisioning was provided by the ECB,⁴⁸ in close coordination with the IFRS Foundation, during the pandemic.⁴⁹ The ECB highlighted that banks were expected to perform regular assessments of borrowers’ unlikelihood to pay, including exposures with general payment moratoria, using all relevant and available information; when the assessments were performed manually, banks were expected to follow a risk-based approach and not rely solely on days past due as a trigger for a significant increase in credit risk. In its guidance, the ECB stressed a prudential perspective and called for correctly estimate banks’ provisions using realistic parameters and assumptions which were appropriate for the current environment. In this regard, banks were recommended to continue anchoring their IFRS 9 baseline scenarios using the ECB’s forecasts in an unbiased manner. At the same time, they were advised not rely solely on through-the-cycle approaches or long-term averages but should instead consider incorporating reliable macroeconomic forecasts (if these are available) for specific years. Banks were also expected to ensure that overlays are directionally consistent with macroeconomic scenarios based on verifiable evidence.⁵⁰

74. The Central Bank has been reflecting on the ongoing challenges in ECL estimation in its supervisory approach. The supervision is already assessing and reviewing full year and half year ECLs charges (and IFRS 9 staging movements), with the special focus on the impact of COVID 19, and the use of management overlays. This leads to follow up with banks on weaknesses, which have resulted in SREP findings, and improvements in ECL quantification since the pandemic.

75. Once the situation stabilizes and more data is collected, the Central Bank should take a more systematic approach, engage with banks to draw lessons from the pandemic crises, as well as a broader experience with the ECL concept, since IFRS 9 has been implemented. This discussion can be timely also due to the fact that banks will need to upgrade the first generation of their models and frameworks. The Central Bank should prioritize its focus on the portfolios especially sensitive to these issues. With an appropriate time distance, the Central Bank will be also able to take on board the lessons from international experience.

⁴⁶ LSIs were pro-active and took a consumer-centric approach to all issues arising from COVID-19 to protect the interests of their borrowers.

⁴⁷ The Central Bank’s monitoring builds on credit metrics, trends and progress made by institutions in dealing with the COVID-19 pandemic from a credit risk perspective.

⁴⁸ [Identification and measurement of credit risk in the context of the coronavirus \(COVID-19\) pandemic](#) (December 2020); [ECB Banking Supervision provides further flexibility to banks in reaction to coronavirus](#) (March 2020); [ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus](#) (March 2020)

⁴⁹ [IFRS 9 and covid-19](#) (March 2020).

⁵⁰ Broader experience of EU banks with measuring expected credit losses is summarized in Appendix VI.

76. Recommendation 9: Perform dedicated reviews of banks' approaches to the calculation of expected credit losses, reflecting on findings from the COVID-19 pandemic crisis as well as broader experience since the implementation of the IFRS 9.

77. Nevertheless, at the present, focus should stay on latent credit risk, which is also underlined by the EBA in its Risk Dashboard.⁵¹ The EBA states that the impact of the phase out of COVID-related support measures on asset quality remains uncertain and banks need to keep on addressing any deterioration in asset quality proactively. This observation corresponds with the assessment by the Central Bank that it should continue using the monitoring tools to identify latent credit risk in the system, ensuring that banks' reviews are robust, and their outcomes are reflected in credit risk indicators. The focus should be on high-risk segments of banks' portfolios. For instance, the EBA comments in its report on poor prospects for non-prime commercial real estate (CRE); additionally, signs of overvaluation in residential real estate are also a source of concern for the EBA.

78. Recommendation 10: Maintain the use of tools developed for intensified supervision during the COVID-19 pandemic crisis, where practical and appropriate, including the monitoring tools to identify latent credit risk and to ensure the accuracy of banks' credit reviews and credit risk indicators.

79. Since the 2016 FSAP, which noted a lack of clarity in collateral valuation, steps have been taken by EBA⁵² and the ECB⁵³ to develop the framework. The frameworks of the ECB and the EBA are largely overlapping, ensuring regulation of all banks across the EU member states. The ECB focuses on immovable property, while the EBA Guidelines also include movables in the scope. The content consists of principles/requirements encompassing: (i) monitoring and controls; (ii) individual valuation vs indexation; (iii) appraisers; (iv) frequency of valuation; (v) valuation methodology, with the focus on expected future cash flow (and gone concern approach); (vi) back testing; (vii) IT databases of banks; (ix) valuation of foreclosed assets. These frameworks provide a solid basis for establishing a supervisory practice elaborating on these requirements. Both documents are relatively concise to address issue of appraising residential real estates.

80. The Central Bank considers the quite high volatility of residential properties⁵⁴ in the supervisory focus and supervisory actions. The Central Bank applies the EBA/ECB framework in an intensive supervisory approach to ensure its consistent application by banks. The supervisory dialogue provides a direction to banks on specific issues crucially important for risk management processes and techniques relying on residential properties valuations.⁵⁵ The Central Bank's approach

⁵¹ [EBA Risk Dashboard Q2 2021](#) (October 2022)

⁵² [Guidelines on management of non-performing and forborne exposures](#) (October 2018).

⁵³ [Guidance to banks on non-performing loans](#) (March 2017).

⁵⁴ See Appendix VII.

⁵⁵ For instance, the minimum content of appraisal reports, the review process by banks, the appraisal validation (elaborating on circumstances when a new appraisal is required), the alternative valuation content and development, etc.

is aligned with the standards by the Royal Institution of Chartered Surveyors, implemented by valuers in Ireland. The Central Bank is encouraged to continue articulating its expectations in the supervisory process, in a clear and transparent manner, to contribute to a level playing field across banks and to strengthen the risk managements of individual banks.

81. Recommendation 11: Maintain the supervisory focus on processes ensuring consistency, comparability, and the independence of valuations of residential real estate properties.

SELECTED ISSUES

82. Ireland has been facing challenges associated with Brexit and COVID-19, with an impact on supervision and the economy. The framework for supervisory cooperation with U.K. peers has changed considerably with Brexit. Within the EU, cooperation among member states is very close—as the supervisory institutions share the same rulebook and closely collaborate in the EU institutions, which they jointly govern. This state was radically changed by Brexit, when the United Kingdom became ‘a third country;’ accordingly, new cooperation protocols had to be set up and day-to-day communication needed to be adjusted to the new environment. For the Central Bank, this was a crucially important process, as some supervised banks have parents or subsidiaries in the United Kingdom and some international banks decided to move their headquarters for the EU operations to Dublin. Brexit had also an effect on the Irish economy, which was combined with the impact of the COVID-19 pandemic more recently. The COVID-19 pandemic has led to increased activity of banking supervision and policy makers.⁵⁶ However, the pandemic crisis is not over yet, and its economic effects will be unfolding over some time, creating new challenges for supervisors.

83. In addition, there are new challenges to come, with climate-related financial risks having increasingly material impact on financial systems. The Irish authorities took a pro-active approach to these challenges, benefiting from the initiatives by the EU and SSM. The government has established a system guiding its individual departments through the transition. It has also created a governance framework, with the ministers accountable to the Parliament for reaching the agreed goals and government led committees to steer these efforts.

A. Brexit

Role of the ECB (Irish SIs)

84. Over the past few years respective banks and the ECB have been preparing for the transition into the new regime. Now that Brexit has taken place, the ECB is planning to continue monitoring and following-up on how banks are settling themselves in within the SSM in order to

⁵⁶ Decisions taken for the Banking Sector have been communicated through the Central Bank webpage for Prudential Flexibility Measures for Credit Institutions (<https://www.centralbank.ie/regulation/covid19-flexibility-measures/credit-institutions>). Remaining supervisory measures applied while previous and expired measures for the Banking Sector are also published (<https://www.centralbank.ie/docs/default-source/regulation/covid-19/credit-institutions/credit-institutions---central-bank-expectations-in-light-of-covid-19---version-available-on-website-from-16-april-2020-to-5-november-2020.pdf>).

ensure that these banks comply with SSM supervisory requirements, expectations, policies and booking model practices, as other SIs. This process falls within the remit of ongoing prudential supervisory work. New Joint Supervisory Teams (JSTs) were set-up, as it was also the case for other Brexit incoming banks. The cooperation between the ECB and Central Bank is strong, the ECB and Central Bank have been able to ramp up the supervisory capacity to supervise these new SIs. In line with the common practice of the ECB, a comprehensive assessment including an asset quality review and a stress test were/are carried out for the new significant banks in Ireland.

85. Banks must allocate capital, liquidity, top management with effective responsibility to steer European business. They are also expected to allocate an appropriate quality and quantity of resources in charge of risk management to establishments within the Banking Union. This must be done in a way that is commensurate with the activities and risks undertaken with European customers and counterparts. JSTs continue to stress this message in their dialogues with banks and ECB plans to monitor closely how they implement their plans and build up their capabilities within the EU.

86. As reiterated in several public communications,⁵⁷ the ECB expects EU products and transactions with EU clients to be booked in the EU. Similarly, risk management capabilities related to EU products should be located in the EU. In this regard, the ECB has been continuously engaging with banks over the past few years, urging them to prepare for Brexit. Most banks have understood that empty shell banks are not acceptable and adjusted their business and operating models. However, a detailed discussion about individual activities continues. The ECB specifically focuses on booking models and trading activities, demanding the relocation of relevant (core) functions to the EU, to meet the supervisory requirements and limit macroprudential risks for the EU. In general, the mission shares concerns of the ECB and supports its steps to enforce the respective legal requirements.

87. The ECB Banking Supervision is and will continue conducting assessments on multiple aspects to understand and assess how banks are settling themselves. This includes in particular the mentioned implementation of the ECB's Supervisory Expectations on booking models, through a Desks Mapping Review (DMR). The purpose of the DMR is to assess in a consistent way the booking models of Brexit incoming banks, simultaneously, and using ECB's supervisory expectations on booking models as a benchmark. As such, the DMR will lead to a refinement of incoming SIs' Target Operating Models (TOMs).

88. The ECB Banking Supervision is also following up on the relocation of euro clearing activities from the U.K. to the EU. The ECB supports the work from the working group set up by the European Commission in this regard. In November 2021, the EU Commission⁵⁸ announced a

⁵⁷ ECB's Supervisory Expectations on Booking Models, Newsletter articles from February 2020 and November 2020.

⁵⁸ [Commissioner McGuinness announces proposed way forward for central clearing](#) (November 2021)

proposal to extend the equivalence for the U.K.-based CCPs. The ECB is expected to continue monitoring the situation and engage in targeted dialogues with its supervised banks on the matter.

Role of the Central Bank (Irish SIs and LSIs)

89. Brexit presented one of the most significant challenges for Ireland with risks posed to the economy, financial system, regulatory environment and the protection of consumers. In the period preceding Brexit, the Central Bank progressed work to ensure that the risks posed to the economy, financial system, regulatory environment and consumer protection arising from the United Kingdom's departure from the EU were understood and mitigated (insofar as possible). Through the establishment of the cross Bank, Brexit Steering Committee and throughout 2019 and 2020, the Central Bank ensured identifying all cliff edge risks and sought to mitigate as much as possible. The Central Bank also published research and forecasts⁵⁹ in relation to the potential impact of Brexit on the Irish economy and analysis in relation to Brexit risks. The Central Bank's approach to Brexit preparedness from a banking supervision perspective centered on three main priority areas: (1) ensuring existing banks were adequately prepared for a no-deal Brexit, (2) ensuring a consistent, transparent and robust authorization process for new and expanding firms, and (3) ensure that prudential supervisors were operationally prepared for a no-deal Brexit event. In terms of ensuring existing banks were adequately prepared for a no-deal Brexit—these included objectives around ensuring all cliff edge risks were identified, gaining comfort that banks had mitigants in place against identified cliff edge risks, and ensuring that banks were operationally ready for dealing with a no-deal Brexit event. Supervision worked closely with European and the U.K. authorities to seek to ensure that those firms providing services to Irish consumers were able to continue to do so in the event of a no deal Brexit.

90. A robust authorization process was a first important step in the supervision of an expanded supervisory portfolio. In terms of ensuring a consistent, transparent and robust authorization process, this was focused on the new and expanding banks. The Central Bank placed a significant emphasis on the importance of its gatekeeper role and worked collaboratively with the ECB to ensure that all authorization assessments were completed in a rigorous and consistent manner.⁶⁰ This was evidence by supervisory files, which were reviewed by the mission. In addition, the Central Bank significantly contributed to the updated SSM authorizations related operational procedures and Brexit policy stances. At European level, the Central Bank played a leading role in contributing to the development of SSM Brexit related operational procedures (particularly in relation to booking models). As part of this work, the Central Bank sought to promote a consistent approach across the different Member States in the context of Brexit-related decision making, contingency planning and communications.

91. The key objectives in authorization reviews were to understand and challenge the strategy, business model, proposed operations and risk profile of the expanded legal entity. In

⁵⁹ Quarterly Bulletins, Financial Stability Review, Economic Letters, Brexit Task Force reports.

⁶⁰ As part of the authorization process, the Central Bank reviewed transparency of ownership and fitness and probity of senior management ([Ireland's 2017 Mutual Evaluation Report](#)).

doing so, the assessment addressed both firms' proposed governance, risk management and internal control frameworks; funding and liquidity; capital; recovery and resolution plans. This was to ensure that, in particular, each legal entity had resources, internal governance arrangements and internal controls in place commensurate with their nature, scale and complexity and to meet the Central Bank's supervisory expectations on substantive presence in line with the SSM's Brexit policy fiche on booking models and empty shells.

92. The assessment was conducted in close co-operation with the SSM DG Governance and Operations Authorizations Division in the ECB. All stages went through local management governance, regular reports to a Steering Committee overseeing the progress of the expansion application, and a final governance process in which Central Bank's Directors reviewed the outcome of the assessment. In addition to the Central Bank governance process, the SSM Supervisory Board was also kept updated.

93. In the response to Brexit and COVID-19 challenges, the Central Bank expanded its supervisory techniques and tools to support supervision of capital and liquidity. Current liquidity and credit risk packs are an evolution from earlier Brexit monitoring packs. The supervisory approach to supervision has continued to evolve since then and throughout the COVID-19 pandemic with a focus on operational and financial resilience emanating from Brexit and COVID-19 experiences.

94. The Central Bank also put supervisory focus on credit risk and governance. With respect to the international banks, including those that are expanding their presence as a result of Brexit, there has been significant supervisory focus on the governance and control arrangements in place in the banks to ensure they are commensurate with the nature, scale and complexity of the business. This has contributed to an increase in resources, including human (both in terms of numbers and skills), operational and financial, in the international banks to support the business conducted. An on-site deep dive of credit risk in one non-retail LSI focused on the credit risk granting process, procedures and policies with a view to obtaining reasonable assurance as to whether the credit risk granting process is managed in line with supervisory expectations given the anticipated change in the credit risk profile arising from Brexit.

95. The Central Bank's resolution function reorganized and resourced its structure in order to adapt to the changes brought by Brexit and the Host banks in particular. Given the complex business models of these banks, planning for and dealing with the potential failure of these institutions or their parent is a supervisory focus (including cross-border shared service models, interconnectedness to the financial sector, and financial market infrastructure access). Internal resolution teams (IRTs) are arranged to manage the U.K. and U.S. banks respectively, facilitating enhanced stakeholder engagement with the respective ECB/NCA, SRB, and U.K./U.S. regulators. This structure also enables a concentration of expertise and learning within the function. A preliminary resolvability assessment is carried out as part of the Central Bank's authorization process for all new BRRD firms.

B. COVID-19 Pandemic Crisis

Role of the ECB (SIs)

96. As regards significant institutions, the ECB allowed banks to make use of their capital and liquidity buffers to mitigate the impact of the COVID-19 pandemic. As already communicated in summer 2020, banks will be allowed to operate below Pillar 2 Guidance and the combined buffer requirement until at least the end of 2022.⁶¹ Bank supervisors are monitoring developments in banks' asset quality closely. If the phasing out of public support measures leads to a surge in distressed loans is, the ECB is ready to extend the timeline. The ECB declares that the process of rebuilding bank buffers should not hamper efforts by the banking sector to respond quickly to the expected materialization of credit risk from the pandemic. In general, the ECB expects national competent authorities to apply the same treatment to less significant institutions as the one ECB is applying to significant institutions.

97. The ECB is finding current banks' capital projections sufficiently reliable to allow the assessment of dividend pay-outs, however the credit quality remains a concern.⁶² The supervision repealed the recommendation on dividend restrictions as of the end of the third quarter of 2021 and returned to reviewing dividends and share buybacks as part of our normal supervisory process, based on a careful forward-looking assessment of each bank's individual capital planning. At the same time, the ECB remains its focus on risk control frameworks to prevent a significant deterioration in asset quality. According to the ECB, the main areas of attention are the classification of loans, especially when there is a significant increase in credit risk (Stage 2 under the IFRS), the proper flagging of forbearance measures and the timely and adequate assessment of borrowers' unlikelihood to pay. The ECB stated that it reflects its findings in dialogue with the banks and in SREPs. Where appropriate, it requires remediation plans.

Role of the Central Bank (Irish SIs and LSIs)

98. The onset of the COVID-19 pandemic in early 2020—and the necessary measures to protect public health – led to an unprecedented disruption to economic activity, both globally and in Ireland. In 2020, the Central Bank shifted its priorities towards dealing with the immediate and longer-term impacts of the COVID-19 shock on the economy, the financial system, and consumers. Its focus has been on ensuring that the financial system is able to absorb, rather than amplify, the effects of the COVID-19 shock and that it continues to operate in the best interests of consumers during this period of significant disruption. In March 2020, the Central Bank invoked its crisis management arrangements and established a COVID-19 Crisis Response Task Force ("the Task Force"). The Task Force oversaw the Central Bank's response to COVID-19, across all areas of its mandate. Much of the Central Bank's focus over the last year has been on mitigating the effects of the pandemic. The Central Bank's responsibilities—in consumer protection, monetary policy, prudential regulation, macro prudential, resolution and payments—have strong interconnections

⁶¹ See - the list of measures in Appendices V and VI.

⁶² On the basis of the latest macroeconomic projections and the ECB's supervisory work on capital strength.

with each other. An integrated approach in exercising these mandates allowed the Central Bank to understand and mitigate the effects of the pandemic. The focus of the Task Force included, among others, financial resilience and recoverability, operational resilience and business continuity and credit impacts from distressed debt (payment breaks). The FSAP mission collected some positive feedback across banks on approaches of the Central Bank.

99. From a macro-financial impact perspective, focus was placed on enhancing Central Bank’s understanding of the impact and evolution of the shock on the economy as the path of the pandemic unfolded. This included the impact of health restrictions and government supports. The Central Bank’s work has also focused on real-time monitoring of developments in domestic credit markets to better understand how credit supply and demand is evolving. This work has informed the Central Bank’s macro-prudential policy responses to the COVID-19 shock, in particular with regard to capital buffers, in order to support banks in maintaining a sustainable supply of credit to the economy. The Central Bank regularly engaged with other European authorities, such as the ECB, European Supervisory Authorities (ESA’s) and ESRB on regulatory flexibility arrangements to ensure consistency.

100. A forward-looking assessment of the capital position of the retail-banking sector under different scenarios was conducted. The Central Bank produced forward-looking projections of the capital position of the domestic retail-banking sector under various potential scenarios. The analysis focused on the five domestic retail banks in aggregate, projecting the system-wide CET1 and total capital ratios under two macroeconomic scenarios over the 2020-2022 horizon and found that the loss-absorbing capacity of the system as a whole is sufficient to absorb shocks that are materially worse than baseline projections.

101. Ireland took a comprehensive and systematic approach to tackle the impacts of the COVID-19 pandemic, including establishing an appropriate coordination structure. At a national level, the Central Bank worked with the Department of Finance and National Treasury Management Agency (NTMA) on the response to COVID-19, under the auspices of the Financial Stability Group (FSG). The FSG’s crisis management arrangements were invoked in March 2020 to co-ordinate the interagency work on the impact of COVID-19 on the economy, markets and financial system.

102. Supervisors collaborated to achieve shared outcomes in areas including financial and operational resilience, distressed debt, recovery and resolution, and forbearance.⁶³ Notwithstanding the postponement of certain activities such as on-site inspections, in terms of outcomes, the pandemic has accelerated aspects of Central Bank’s work and understanding on the overall financial and operational resilience of the banking sectors.

103. The Central Bank covered all major categories of risks in its response to the COVID-19:

⁶³ For details of the supervisory actions see Appendix VIII.

- **Operational Risk and Resilience:** the Central Bank intensified its supervisory engagement with banks (including daily engagements) to ensure that any risks to business continuity that might have materialized were identified at an early stage and appropriate action taken.
- **Liquidity Risk:** the Central Bank's supervisory techniques and tools to monitor liquidity and capital evolved throughout the pandemic and now form a key part of its supervisory programs.⁶⁴
- **Credit Risk:** a number of supervisory programs focused on credit risk. Heightened assessment and monitoring of the evolution of credit portfolios to identify potential credit deterioration monthly (previously weekly/ bi-monthly) submission and assessment of individual bank credit management information. The supervision was seeking assurance about robust Board and executive management oversight, resolving long term arrears, and the timely and accurate recognition of any deterioration in the risk profile of borrowers. Supervisors were also challenging ECL forecasts and provisioning, ensuring the banks have comprehensive strategic and operating plans in place to manage payment break requests and undertaking credit quality assessments on a subset of banks most exposed to COVID-19 impacted sectors. Additionally, loan file reviews in retail banks took place to ascertain whether borrowers who availed of COVID-19 Payment Breaks were dealt with appropriately by retail banks upon expiry of their COVID-19 treatments. Also, a desk-based review of the credit files of a number of international LSIs was conducted to determine likely impacts of COVID-19 on the banks⁶⁵ and supervisors closely monitored their off-balance sheet exposures.
- **Market Risk:** a thematic review of market risk for six banks was performed by supervision. The analysis assessed the banks' current business model/strategy and related market activities, the banks' investment portfolios and their HQLA exposures including stress testing of the key risk drivers of portfolios and exposures (i.e., credit spread risk). A key objective of the assessment was to determine if the banks had sufficient capital to absorb potential market risk losses in a stress scenario. No significant issues were identified however the output of the review informed ongoing supervisory engagement with the banks.

104. Throughout the COVID-19 pandemic, the Central Bank has encouraged credit institutions under its direct supervision to refrain from paying dividends or performing share buybacks. These measures aimed at restraining from the remuneration of shareholders were in line with applicable ESRB, ECB, and EBA recommendations/statements. Where planning nonetheless to distribute, as has been generally possible subject to quantitative limits since February 18, 2021, when the Central Bank modified its policy stance, such credit institutions have been advised by the Central Bank to exercise extreme prudence and to discuss the planned distributions with their

⁶⁴ See paragraph 98.

⁶⁵ This review included assessments of the banks' portfolio quality, ECL assessments and SICR triggers, concentration risk, NPLs, and top exposures.

supervisors. Since March 2020, only two credit institutions have made dividend distributions (no share buy-backs), both atypical, relating to changes in group structures.

105. Decisions taken for the banking sector have been communicated through the Central Bank webpage for Prudential Regulatory Flexibility Measures for Credit Institutions. The Central Bank also issued two “Dear CEO” letters to banks communicating expectations with regard to Board oversight and challenge of senior management on COVID-19 Payment breaks and regarding ongoing assessments of the adequacy, completeness and timeliness of Board reporting of credit risk metrics relevant to the pandemic.

Box 3. Industry Measures Taken to Tackle COVID-19

In response to the pandemic, financial services firms in Ireland made payment breaks available to household and business customers. The Central Bank engaged with regulated firms to ensure they give appropriate support to borrowers whose incomes and affordability have been affected by COVID-19. **Payment breaks**, extended under the Irish non-legislative moratoria program, were offered in this context until September 30, 2020 and operated in a way that protects borrowers, in line with the relevant codes and regulatory requirements. In aggregate, both banks and Retail Credit Firms/Credit Servicing Firms granted payment breaks to over 172,000 accounts representing over EUR 23 billion of Irish lending over the course of 2020. However, as of end December 2020, the vast majority of these payment breaks had expired.

Flexibility and forbearance measures were applied in line with SSM and ESA measures, after consideration of requests from Industry Bodies or Individual Firm Requests as well as through proactive identification of potential measures from within the Central Bank.

106. The outlook remains uncertain for highly affected corporate, SME, and retail borrowers. The large uptake in payment breaks across retail and non-retail borrowers in 2020 pointed to a significant initial impact of the COVID-19 shock on borrowers. While the majority of loans on COVID-19 payment breaks have returned to full payments, there remains a cohort of lending, especially amongst highly affected companies, where additional support was required. More broadly, the full degree of financial distress is likely to become apparent as government supports unwind. In addition, while much has been done over the past number of years to reduce the levels of problem loans since the 2008 financial crisis, there are still over 29,000 mortgage borrowers with sizeable long-term arrears (greater than one year), whose distress pre-dates the COVID-19 pandemic.

107. Going forward, Central Bank plans to retain some of the supervisory initiatives introduced in response to the pandemic in its supervisory programs. For example, in 2020 supervisory priorities shifted from Central Bank’s annual supervisory strategies and plans to an organizational risk-based response that aimed to identify, monitor and mitigate the immediate and sudden impacts of the pandemic on the risk profiles of the banks and the wider sector. This was achieved under the auspices of the Central Bank COVID-19 Task Force. This organizational level

response enhanced the supervisory approach in certain areas and these learnings are being integrated into supervisory approach going forward.

C. Climate Risk

Role of the ECB (SIs)

108. In 2020, the ECB published its “Guide on Climate-related and Environmental Risks” for banks (SIs).⁶⁶ The guide outlines the ECB’s understanding of the safe and prudent management of climate-related and environmental risks under the current prudential framework. It describes how the ECB expects institutions to consider climate-related and environmental risks—as drivers of existing categories of risk—when formulating and implementing their business strategy and governance and risk management frameworks. It further explains how the ECB expects institutions to become more transparent by enhancing their climate-related and environmental disclosures.

109. The guide is not binding, but it rather aims to serve as a basis for supervisory dialogue. As part of this supervisory dialogue, the ECB plans to discuss with institutions the ECB’s expectations set out in this guide in terms of any possible divergences in institutions’ practices. The ECB is planning to continue to develop its supervisory approach to managing and disclosing climate-related and environmental risks over time, taking into account regulatory developments, as well as evolving practices in the industry and in the supervisory community.

110. The ECB has made a survey exploring a progress by SIs on the implementation of the guide.⁶⁷ Almost all banks have developed implementation plans in line with the ECB guide, and many have started to gradually improve their practices. The plans will lead to considerable progress, but they do not yet comprehensively ensure that most banks can properly manage climate related risks.

111. The adequacy of the banks’ plans varies considerably across the 13 supervisory expectations set out in the ECB guide. Over 60 percent of banks considered the expectations on the management body, organizational structure and stress testing to a reasonable degree. Allocating responsibility for climate related risks to the management body is widely addressed in the plans. Similarly, most plans also cover the organizational integration of these risks across the three lines of defense. Banks also anticipate making progress with stress testing their capital adequacy, which is likely in preparation for the ECB’s upcoming climate risk stress test in 2022.

112. Operational risk management, liquidity risk management, reporting and disclosures require the most work. Less than around two-fifths of banks have developed plans that are (broadly) adequate in those areas. Often the plans do not foresee any assessment of how many of their activities are exposed to liability and/or litigation risks driven by climate related factors. Similarly, plans do not often indicate whether disclosure policies include the key considerations that

⁶⁶ [Guide on climate-related and environmental risks](#) (November 2020)

⁶⁷ [ECB Supervision Newsletter](#) (August 2021).

underpin the materiality assessment of climate related risks, or whether banks' financed greenhouse gas emissions will be disclosed.

Central Bank (LSIs)

113. The Central Bank recognizes its own very important role in reflecting climate change impacts on the financial system within its mandate, however there is no formal structure in which the Central Bank engages directly with Government on this issue. The Central Bank understands an enormous size of its task, and it leverages on its cooperation within the EU and SSM to take comprehensive action encompassing all financial institutions, according to the gravity and nature of risks that the system will have to cope with. However, the Central Bank is not part of any formalized framework for cooperation with the Government on climate related issues. The Government's administration representatives communicated to the FSAP team that the communication is planned to be intermediated by the Department of Finance. The FSAP team understands that the independence of the Central Bank should be safeguarded, and the Central Bank should not take an active part in the government's decisions. However, considering the complexity of the problem, a great role of the banking system in the transition, and huge risks for banks, the Central Bank should be given a more direct line to communicate with the Government's structures.

114. Recommendation 12: Set up a formal cooperation mechanism with the Government to support coordination of climate action on a national level, respecting the independent mandate of the Central Bank.

115. The Central Bank has established a high-level multi-year strategic workplan and a governance structure supporting its delivery. The work plan is elaborated in several clusters: (i) climate change and macro-financial linkages, (ii) promoting the safety and soundness of regulated firms, (iii) sustainable finance, (iv) filling data gaps, and (v) external engagement. In the focus on regulated firms, the Central Bank is planning to increase engagement on climate risk assessment and management. The Central Bank's aim of outlining clear expectations of supervision, should be anchored by the ECB Guide on Climate-related and Environmental Risks. Finally, the Central Bank wants to regularly assess the industry progress and analyze firm-exposures.

116. The strategic workplan provides a good frame for the Central Bank's activities in the area. It aligns with the Central Bank Strategic Plan which includes a particular focus on the resilience of the financial system to climate related risks under the future focused theme. This workplan needs to be operationalized by an action plan for its individual components. The action plan would introduce clearly prioritized concrete actions, bound to specific timelines. It could define responsibilities for concrete milestones within the supervision. Additionally, the action plan should discuss the question of resources.

117. Recommendation 13: Adopt a sequenced action plan to develop approaches to manage climate-related financial risks in priority areas. Put the emphasis on robust data and quality disclosure in the early stages.

118. A first climate risk horizontal assessment was performed in 2021. The Central Bank issued a self-assessment to LSIs to ascertain the level of soundness, effectiveness and comprehensiveness of the management of climate-related and environmental risks by LSIs. A supervisory assessment of banks' responses was also completed. A focus of the questionnaire was on the how climate related and environmental risks, which are key emerging risk, were incorporated into the bank's materiality assessment of risks and overall risk management framework. Results indicate that the integration of climate-related and environmental risks into materiality risk assessments requires considerable development. Risk Management Frameworks, including risk reporting frameworks will need significant enhancements in order to meet the challenges associated with climate change.

119. The Central Bank is encouraged to continue in this supervisory dialogue. These useful high-level reviews should be gradually complemented by deep dives into specific areas. The Central Bank can also consider providing further guidance to LSIs as well as other opportunities to increase their capacity in the field.

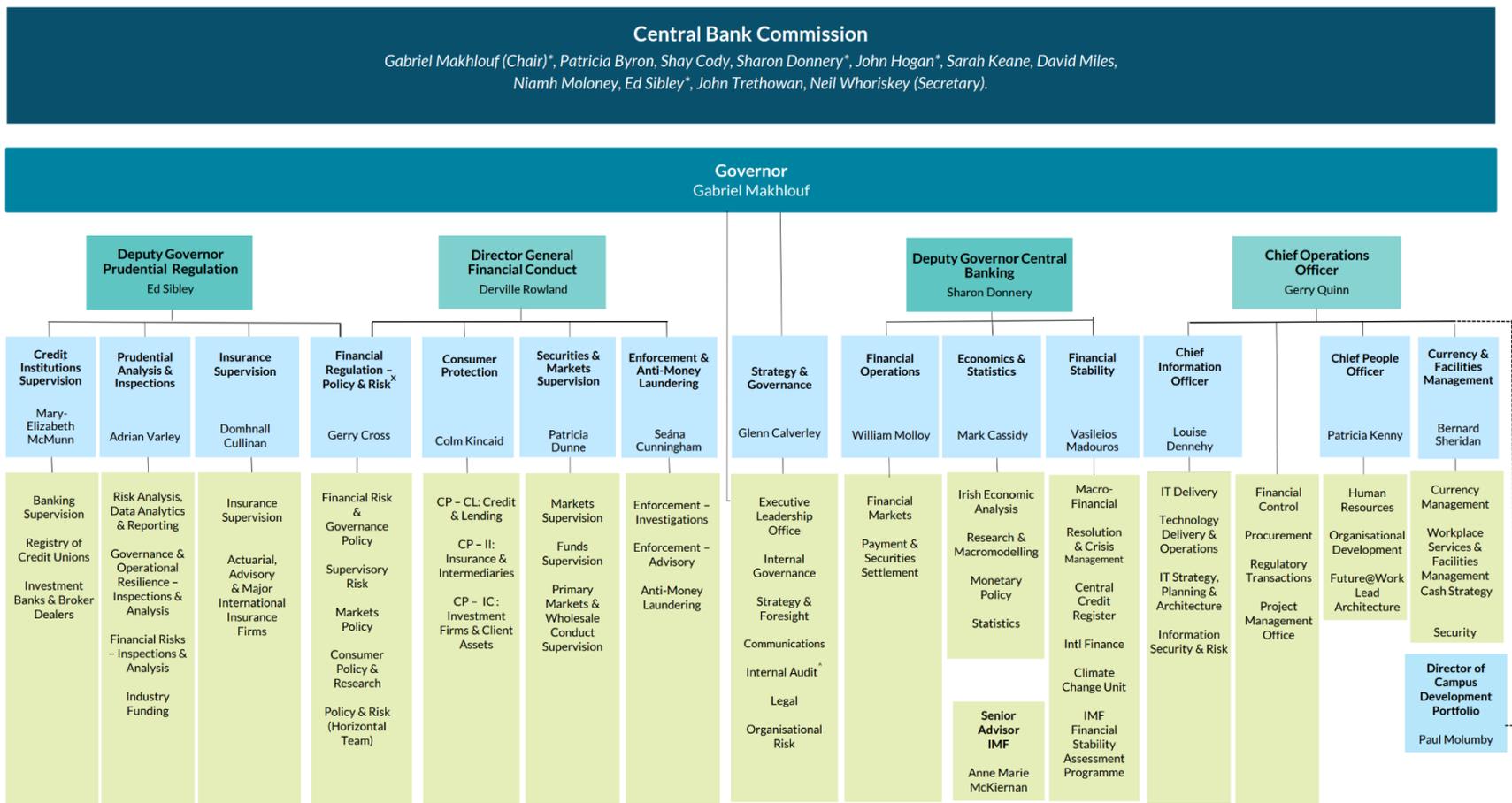
120. The Central Bank is working on the initial development of a climate risk database and dashboard. The dashboard will include a broad range of metrics on climate risk in the Irish financial system, and it is envisaged that the dashboard will also act as a central repository for all data relating to climate change and policy developments of relevance to Ireland. A supervisory expectation letter recently issued to all banks. All these activities can lay down solid foundations for future work, and the Central Bank should think about their application potential.

Appendix I. Actions Taken by the Authorities to Address 2016 Recommendations¹

2016 Recommendation	Actions Taken
1. Continue to streamline options under national discretion and ancillary national regulations and legislations within the SSM-wide thrust for regulatory harmonization.	Addressed to the extent of the Central Bank's mandate. As the competent prudential supervisory authority for Irish-authorized LSIs, the Central Bank has aligned its approaches for LSIs with those of the ECB under the SSM, as required and through the application of optional discretions in the ECB Guideline and ECB Recommendation, which resulted in streamlining the options.
2. Further enhance the efficiency and enforceability of SSM supervision of credit risk by considering the effectiveness of supervisory powers to require banks to adjust classification and provisioning for prudential purposes.	Addressed to the extent of the Central Bank's mandate. For LSIs, the Central Bank enforces the EBA Guideline on Definition of Default as well as the NPL calendar requirements imposed by CRR, which provide a regulatory support in requesting adjustments in classification and provisioning in particular cases.
3. Consider strengthening SSM supervisory guidance on credit risk by including time-bound requirements for uncollectible loans and a nonaccrual principle for the income recognition of NPLs.	Addressed to the extent of the Central Bank's mandate. Under the newly adopted provisioning calendar rules, longer term NPLs require minimum provisions (or CET1 deductions) depending on the vintage, which acts as a backstop to loans which may be deemed uncollectible. In accordance with IFRS 9, interest accrued (not collected) enters the income statement while the loan is performing and non-performing.
4. Enhance the current SSM prudential engagement with external auditors regarding credit risk and IFRS application by banks.	Addressed to the extent of the Central Bank's mandate. Supervisors have intensified engagements with external auditors; they meet annually for all LSIs to discuss the audit approach, the management letter produced by the auditors and major findings; in some instances, supervisors will meet with external auditors before and after the annual financial statement audit to discuss, inter alia, loan classification and provisioning in the IFRS context.

¹ In the context of the 2016 Ireland FSAP, prior to the 2018 Euro Area FSAP and understandings with the ECB on the coverage of national versus EA FSAPs, several of these recommendations are addressed primarily to the SSM on SIs.

<p>5. Enhance the current SSM prudential engagement with external auditors regarding credit risk and IFRS application by banks.</p>	<p>Addressed to the extent of the Central Bank’s mandate. Supervisors have intensified engagements with external auditors; they meet annually for all LSIs to discuss the audit approach, the management letter produced by the auditors and major findings; in some instances, supervisors will meet with external auditors before and after the annual financial statement audit to discuss, inter alia, loan classification and provisioning in the IFRS context.</p>
2016 Recommendation	Actions Taken
<p>6. Remain vigilant that harmonization of the SSM supervisory processes is balanced by application of the principle of proportionality.</p>	<p>Addressed to the extent of the Central Bank’s mandate. The supervisory approach to LSIs is determined based on the priority level of each LSI according to risk profile and systemic importance. Priority levels are determined each year using the newly adopted SSM’s LSI Prioritization Methodology. The priority levels of LSIs determine the extent of supervisory plans and supervisory exercises conducted each year.</p>
<p>7. Analyze further the stability implications of longer-term trends in the banking industry and implications for banking supervision in Ireland.</p>	<p>Addressed. The Central Bank reflects stability implications in Financial Stability reviews where, for instance, assessed the financial stability implications of bank withdrawals from the Irish market or conducted a forward-looking analysis of the system-wide capital position of the banking system under different scenarios. Furthermore, the Central Bank elaborates topics of technology and climate, including in its supervisory practice. The Central Bank has succeeded in assessing challenges posed by the COVID-19 pandemic crisis and Brexit.</p>
<p>8. Review Central Bank personnel policies to attract and retain experienced staff.</p>	<p>Addressed. The Central Bank has formulated and implemented a framework within its mandate – a People Strategy, which includes an approved approach to resourcing, learning and development, leadership development and talent management. The Central Bank has achieved in a significant growth in staffing.</p>
<p>9. Further enhance the efficiency of the preparatory work undertaken within the Central Bank which supports decision-making within the SSM.</p>	<p>Addressed. The Central Bank has developed structures to support decision making within the SSM, including a dedicated team in banking supervision that supports the SSM Supervisory Board (SB) member, active participation of Central Bank staff in SSM networks and working groups, targeted engagements with the SSM on key topic areas including Target Review of Internal Models, NPLs, Brexit, and P2R risk-by-risk.</p>



* Ex-officio.

[^] Internal Audit Division reports directly to the Governor and only reports to the Director of Strategy & Governance for matters of an administrative or budgetary nature.

^x The Policy & Risk Directorate supports the work of both pillars but is part of the Financial Conduct pillar for administrative purposes.

Note: Based on information available as at 21 January 2022.

Appendix III. Structure of the Irish Banking System

Significant Institutions (Supervised by SSM)	
<i>Retail</i>	<i>Non-retail / International</i>
Bank of Ireland	Bank of America Europe DAC
AIB Bank plc	Barclays Bank Ireland plc
Ulster Bank Ireland DAC	Citibank Europe plc
KBC Bank Ireland plc (subsidiary)	
Intesa Sanpaolo Bank Ireland plc (subsidiary)	

Less Significant Institutions (Supervised by Central Bank)		
<i>Retail</i>	<i>International</i>	
PTSB	Wells Fargo Bank International UC	Dell Bank International DAC
	Scotiabank Ireland DAC	Elavon Financial Services DAC
	Hewlett Packard International Bank DAC	Bank of Montreal Europe plc
	Macquarie Bank Europe DAC	Depfa Bank plc

EEA Branches (within SSM participating countries)	
Aareal Bank AG (Germany)	HSBC Continental Europe (France)
Bank Julius Baer Europe S.A. (Luxembourg)	ING Bank NV (Netherlands)
BNP Paribas Securities Services Dublin Branch (France)	J.P. Morgan Bank Luxembourg S.A., Dublin branch (Luxembourg)
BNP Paribas SA (France)	KBC Bank NV Dublin Branch (Belgium)
Caceis Bank (France)	Mitsubishi UFJ Investor Services and Banking (Luxembourg) S.A. (Luxembourg)
Citco Bank Nederland NV Dublin Branch (Netherlands)	Natwest Markets NV (Netherlands)
Coöperatieve Rabobank U.A (Netherlands)	RBC Investor Services Bank S.A. (Luxembourg)
Crédit Suisse (Luxembourg) SA (Luxembourg)	RCI Banque (France)
Deutsche Bank AG (Germany)	SMBC Bank EU AG (Germany)
Dexia Crédit Local (France)	Société Générale SA (France)
European Depositary Bank S.A. (Luxembourg)	Sparkasse Bank Malta plc (Malta)
FCA Bank S.p.A. (Italy)	The Bank of New York Mellon SA/NV (Belgium)
Goldman Sachs Bank Europe SE (Germany)	

Other Branches: EEA branches (Non-SSM)/Third Country (Supervised by Central Bank)	
Danske Bank A/S (Denmark)	Credit Suisse (Switzerland)
LGT Bank AG (Liechtenstein)	

Appendix IV. EU Implementation of Basel III

1. The EU reflected the Basel updates to the regulation of securitizations¹ in its legislation in 2017, effective since 2019.² These updates addressed the shortcomings that became apparent during the financial crisis, namely mechanistic reliance on external ratings, excessively low risk-weights for highly rated securitization tranches and, conversely, excessively high risk-weights for low-rated tranches, and insufficient risk-sensitivity.

2. Another legislative package representing a significant step on regulatory reforms following the Global Financial Crisis was adopted in 2019.³ This package implemented several concepts introduced by Basel III, including a leverage ratio requirement for all institutions as well as a leverage ratio buffer for all global systemically important institutions, and a net stable funding requirement. A new market-risk framework following a revised fundamental review of the trading book (FRTB) was adopted for reporting purposes only. Contrastingly, a new discount on capital requirements for investments in infrastructure and a more generous discount on capital requirements for exposures to SMEs introduced components which were not aligned with Basel III. Another major area of noncompliance with the Basel III framework was exemptions from credit valuation adjustment (CVA).⁴ In addition to capital rules, the legislation also established indicators important for the crisis preparedness framework: a new total loss absorbing capacity (TLAC) requirement for global systemically important institutions, and an enhanced Minimum Requirement for own funds and Eligible Liabilities (MREL) subordination rules for global systemically important institutions (G-SIIs) and other large banks referred to as top-tier banks.

3. However, the latest proposal by the EU Commission⁵ suggests a longer path to the finalization of the reforms. If the proposal is adopted as proposed, implementation of Basel III would commence from January 2025, two years after the implementation date proposed by Basel. The implementation of the output floor comes with a five-year phase-in period, with the framework fully in place by 2030—by comparison, the revised target implementation date decided by the BCBS

¹ On December 11, 2014, the BCBS published its revisions to the securitization framework (the Revised Basel Framework) setting out various changes to the regulatory capital standards for securitizations to address specifically those shortcomings. Then, on July 11, 2016, the BCBS published an updated standard for the regulatory capital treatment of securitization exposures, which includes the regulatory capital treatment for simple, transparent, and comparable securitizations.

² Regulation (EU) 2017/2401 and Regulation (EU) 2017/2402.

³ Regulation (EU) 2019/876 and Directive (EU) 2019/878.

⁴ Applies for: transactions with non-financial counterparties below the EMIR clearing threshold; transactions between clearing members and clients in the context of indirect clearing, when the clearing member is acting as an intermediary between the client and qualifying central counterparties; transactions with intragroup counterparties; transactions with pension fund counterparties; and transactions with sovereign counterparties.

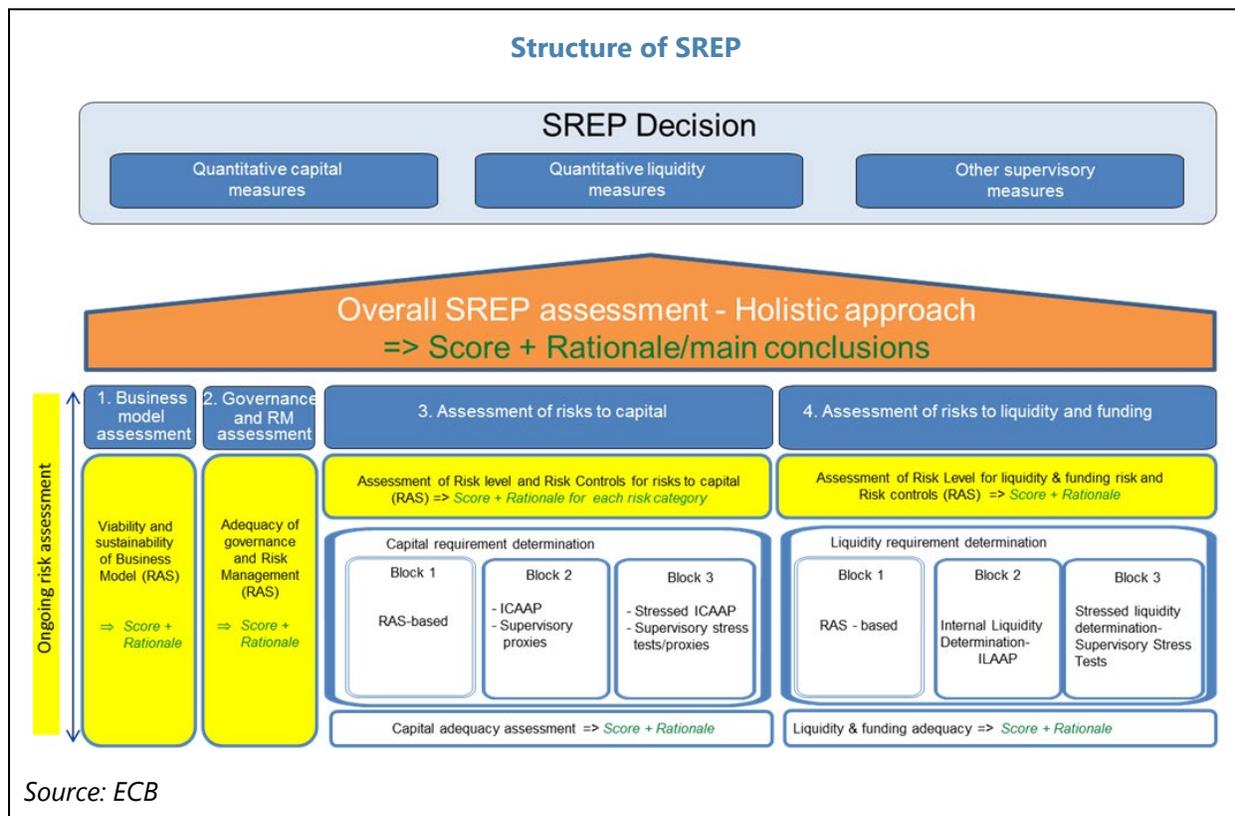
⁵ At present these proposals remain under negotiation at Council and European Parliament and no outcome has been reached.

was January 2023, with phasing fully implemented by January 1, 2027.⁶ In addition, there are some targeted transitional arrangements to further delay the impact of the output floor, in relation to unrated companies and low risk mortgages (to December 2032) and derivatives (December 2029). The proposal also introduces preferential capital treatments for several exposures classes under the standardized approach to credit risk, such as project financing, “strategic equity exposures” for securities financing transactions and “Emission Trading System” allowances. These provisions would lower the capital requirements for EU banks in relation to Basel III, adding to the existing deviations, if adopted in the final legislation.

⁶ The output floor (OF) requires banks to ensure their risk-weighted assets (RWAs) or Total Risk Exposure Amount (TREA) calculated using their own internal models are not lower than 72.5 percent of the RWAs that their activities would generate based on the standardized approaches. In other words, it sets a lower limit (“floor”) on the capital requirements (“output”) that banks calculate when using their internal models. By construction, the OF impacts banks that benefit from lower risk weights using internal models compared with standardized risk weights. The objective of the OF is to reduce excessive variability of RWAs calculated using internal models and to mitigate model risk.

Appendix V. Overview of the SSM Supervisory Review Process

1. The SREP methodology relies on quantitative and qualitative assessments, overlaid with supervisors' expert judgement, to derive SREP decisions that are tailored to a bank's specific risk profile.



2. The methodology is built on four elements, which can be tailored for the specific situation of each institution:

- *Business model assessment* – including an assessment of business model viability and sustainability.
- *Internal governance and risk management assessment* – assesses group structure, internal governance framework, risk management framework, internal control environment and risk infrastructure.
- *Capital assessment* - includes a risk-by-risk assessment of risks to capital i.e., credit risk, market risk, operational risk and Interest Rate Risk in Banking Book (IRRBB). This assessment also includes an Internal Capital Adequacy Assessment Process (ICAAP) outcome, encompassing ICAAP governance, capital planning, scenario design and stress testing, internal controls, independent reviews and ICAAP documentation, data and infrastructure, risk capture, management and aggregation.

- *Liquidity assessment* – includes a risk-by-risk assessment of risks to liquidity and funding, i.e., short-term liquidity, long-term funding sustainability and Internal Liquidity Adequacy Assessment Process (ILAAP) reliability assessment, encompassing ILAAP governance, funding strategy and liquidity planning, scenario design, stress testing and contingency funding plan, internal controls, independent reviews and ILAAP documentation, data and infrastructure, risk capture, management and aggregation.

3. Consideration is also given to developments in the sector and the wider economic environment that may impact the longer-term risk profiles of the banks. This is achieved through quarterly risk analysis packs (analytical reports of supervision), financial stability reviews, quarterly bulletins, internal ‘policy bites’ information sessions, SSM priorities, and SSM horizontal assessments. Frequency of engagement with each LSI is based on the risk profile of the bank, business model changes, and the nature, scale, and complexity of the institution.

Appendix VI. Expected Credit Losses—Broader EU Experience

1. Most banks across Europe have experienced impairment movements during the pandemic and challenges in measuring expected credit losses (ECL). A number of reports by consulting and auditing firms, and most recently also by the EBA, discuss challenges of ECL measurement in the COVID-19, experienced by European banks.

2. ¹The mission confirmed in meetings that these findings are also relevant for Irish banks. Banks across Europe typically followed the ECB guidance and used long-term macro-economic ECB forecasts to avoid procyclicality and mitigate cliff effects in ECL measurement. Many of them have struggled to capture first and second-order relationships between the macro-economy and credit losses. Models were operating outside the boundaries of the data used to calibrate them, for example, in the cited reports a number of banks referred to models providing unrealistically high default rates. The absence of consistent behavioral information and lagging information (as a consequence of moratoria) related to the credit quality of a borrower has created a “latent credit risk”, delaying timely ECL measurement and stage allocation. Some banks front-loaded credit rating changes via rating overrides while others spread the ECL impact at a portfolio or segment level via management overlays and post-model adjustments. The total of the post-model adjustments and management overlays, both in absolute terms and in terms of their proportion to the total of Stage 1 and Stage 2 ECL allowance, was significant.

3. The Financial Stability Institute (FSI) of the BCBS and the EBA have also summarized first lessons learned about ECL provisioning under the COVID-19,² while deeper observations can be drawn only in coming months. The COVID-19 pandemic has provided a unique learning opportunity for IFRS 9 practitioners with banks applying both short, and medium term, solutions as part of their holistic responses. These include modeling risks as well as challenges in the process of management overlays. For instance, the increased use of management overlays could highlight some gaps in governance and controls required to ensure ECL estimation is measured consistently across portfolios and over time.

4. As comes to modeling risks, the lessons learned can be drawn in relation to core models (which can lead to their adjustments) as well as to monitoring frameworks to ensure robustness of the final impairment result. According to the EBA Report on IFRS 9 Implementation by EU Institutions—38 percent of the banks, in the sample of its survey, have stated that a recalibration of the models was performed, in some cases following the results of the validation processes / back-testing; 10 percent of the banks in the sample have redesigned or redeveloped

¹ [EBA Report on IFRS 9 Implementation by EU Institutions](#) (November 2021); [Deloitte - Entering a “new normal” for IFRS 9 ECL measurement - Managing the Covid-19 impacts](#) (March 2021); [EY – IFRS 9: an analysis of Q2 impacts and expectations ahead](#) (September 2020); [EY - Disclosure of COVID-19 impact on expected credit losses of banks](#) (July 2021); [KPMG - European banks and COVID-19 – What do 2020 annual accounts say?](#) (April 2021).

² [FSI Briefs - Expected loss provisioning under a global pandemic, Raihan Zamil](#) (April 2020).

their models due to the severity of the deficiencies identified; and 8 percent of the banks in the sample mentioned that the significant changes/recalibrations were linked to COVID-19 impacts. These changes were introduced, inter alia, to: (i) incorporate accurate macroeconomic scenarios; (ii) recalibrate credit cycle models; (iii) incorporate sector information. The recent experience also shows that historical benchmarks might need to be revisited, as most banks estimate and calibrate parameters using historical default and loss data series, with model fitting influenced by the outcomes observed during earlier downturn periods (e.g., GFC).

5. It might be still too early to determine if banks' models over- or underestimated provisions in the COVID-19 pandemic crisis. This is largely because of the remaining "latent credit risk" in the portfolios, partly driven by the ongoing government support. Any write-backs so far are largely a product of improving economic conditions compared to the assumptions used at the outset of the crisis (i.e., the economic impact, helped by the scale of the support provided, has been more muted than anticipated).

Appendix VII. Overview of House Prices – EU Cross-Country Comparison

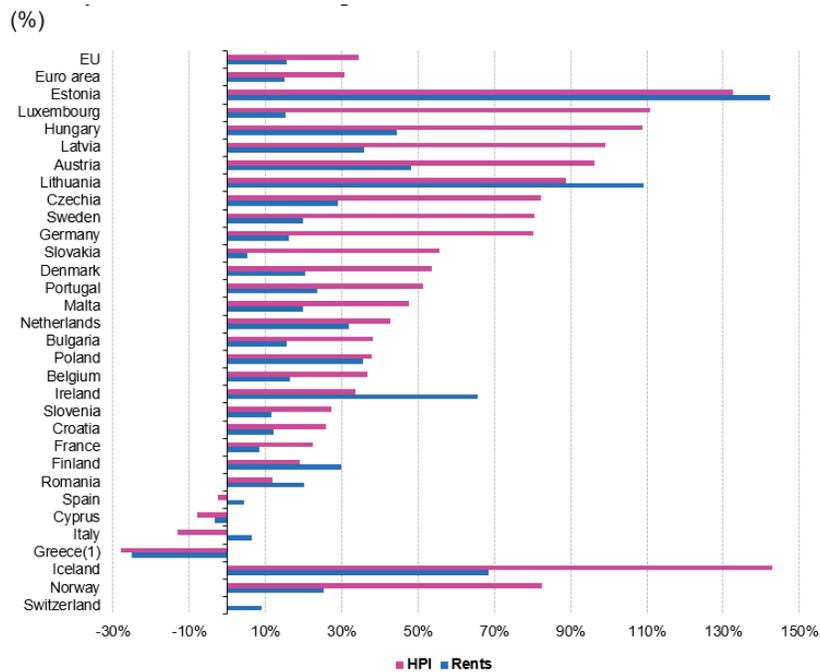
Annual Deflated House Prices – EU Member States – Rates of Change, 2010-2020

	DEFLATED HPI (1 year % change)										
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Belgium	1.2	1.1	0.2	0.1	-1.3	0.8	1.1	1.7	0.8	2.7	3.5
Bulgaria	-12.3	-8.6	-5.3	0.4	1.5	1.2	6.6	5.3	4.5	3.9	4.1
Czechia	-2.2	-1.6	-3.5	-0.7	1.6	4.0	6.8	9.1	5.9	6.2	5.5
Denmark	0.3	-4.0	-4.9	3.1	3.1	6.6	5.1	3.5	3.7	1.6	4.6
Germany	-0.6	1.6	2.1	1.7	2.2	4.1	6.7	4.6	5.1	4.4	7.1
Estonia	1.8	3.1	3.1	7.3	12.9	7.3	3.7	1.1	2.2	4.4	6.9
Ireland	-12.2	-17.8	-14.4	0.0	15.7	10.7	7.2	9.8	8.1	0.3	-0.2
Greece	-4.3	-8.2	-12.5	-9.3	-5.2	-3.8	-1.5	-1.4	1.8	7.0	5.8
Spain	-3.7	-9.8	-16.5	-10.0	0.2	3.7	4.5	4.6	5.2	4.1	2.2
France	3.5	3.8	-1.9	-2.5	-1.6	-1.6	0.8	2.3	1.2	2.5	4.4
Croatia	-7.6	-2.0	-4.6	-5.7	-1.3	-2.6	2.0	2.9	4.6	8.1	7.4
Italy	-0.8	-1.5	-5.0	-7.5	-4.9	-4.0	0.2	-2.1	-1.5	-0.6	2.2
Cyprus	-8.2	-4.4	-5.5	-3.9	-1.1	1.0	2.2	1.3	0.1	2.6	0.7
Latvia	-8.7	4.1	-0.2	6.8	4.6	-2.8	7.2	5.6	6.4	5.8	2.6
Lithuania	-8.8	2.2	-3.2	0.4	6.4	4.7	4.4	5.2	4.5	4.6	6.4
Luxembourg	4.2	0.6	2.1	3.3	3.9	5.3	5.7	3.7	4.8	8.0	13.3
Hungary	-5.6	-6.6	-8.9	-4.2	2.8	12.5	12.3	8.6	10.7	12.0	1.7
Malta	-1.1	-3.9	0.4	-1.6	2.0	4.1	4.4	4.3	5.0	4.2	2.2
Netherlands	-3.3	-4.0	-7.9	-7.9	-0.1	3.4	4.4	6.1	7.1	4.6	6.0
Austria	4.3	3.0	4.8	3.0	1.4	3.4	7.0	3.4	2.6	3.9	6.5
Poland	-6.0	-4.7	-6.6	-4.8	1.1	2.6	2.3	1.8	4.8	6.1	7.0
Portugal	-1.0	-6.5	-8.7	-2.6	4.0	2.2	6.1	7.6	8.6	8.6	7.4
Romania	-13.0	-15.5	-8.9	-2.8	-3.3	1.6	5.2	3.3	1.7	-1.6	2.3
Slovenia	-1.3	0.9	-8.5	-7.2	-6.2	1.4	3.6	6.6	6.6	5.3	5.2
Slovakia	-5.0	-5.2	-5.9	-0.4	1.5	5.5	7.0	4.4	4.9	6.2	7.2
Finland	4.8	-0.1	-0.4	-1.3	-1.6	-0.5	0.6	0.5	-0.2	0.0	1.3
Sweden	6.6	1.2	0.7	4.5	8.3	12.0	7.3	4.8	-3.3	0.4	3.0

Source: Eurostat (online data code: tipsho_10)

eurostat 

House Prices and Rents – Changes Between 2010 and 2021



(1) House Prices: Instead of 2021Q2 data, 2020 annual estimate by Bank of Greece
 Source: Eurostat (online data codes: prc_hpi_a, prc_hpi_q, tipsho20, prc_hicp_aind, prc_hicp_midx) [eurostat](https://www.eurostat.ec.europa.eu/)

Appendix VIII. Supervisory Action to Tackle COVID-19

- 1. A COVID-19 Crisis Response Task Force (Task Force)** was established, to ensure a “One Bank” approach was taken in responding to COVID-19-related risks to the financial system and the broader economy. The Task Force oversaw the Central Bank’s response to COVID-19 across all areas of its mandate, ensuring that crisis response actions were taken in a timely and coordinated manner. The Task Force had ten supporting workstreams, covering a range of channels through which the COVID-19 shock interacted with the Central Bank’s mandate. The selected workstreams outlined below involved work that was particularly relevant to the banking system and banking supervision.
- 2. Macro-financial impact of COVID-19:** The aim of this workstream was to enhance the Central Bank’s understanding of the impact and evolution of the shock on the economy as the path of the pandemic unfolded, including the impact of health restrictions and government supports. This included monitoring, including at a high frequency, macro-financial developments; assessing the impact of government supports on the resilience of nonfinancial corporates and households; as well as assessing developments in credit conditions, including the relative role of changes in the demand for, and supply of, credit to the economy. This analysis was used to inform, amongst others, assessments of the financial resilience of the banking system.
- 3. Financial Resilience:** Building on the insights of the above work around the macro-financial impact of COVID-19, this workstream advanced and deepened the Central Bank’s assessment of the financial resilience of regulated firms, including banks, to the COVID-19 shock. Given the uncertainty over the macro-financial outlook, this workstream both monitored short-term impacts of the shock on the financial position of firms and also conducted forward-looking assessments of the impact of COVID-19 under different scenarios. The workstream also engaged with firms on their own forward-looking assessment of the financial impact of COVID-19.
- 4. Bank Liquidity:** This workstream was set up to monitor the liquidity position of banks and to enhance their readiness to respond to potential liquidity stresses.
- 5. Operational Resilience:** This workstream coordinated engagement with firms on their COVID-19 contingency arrangements to ensure operational continuity of financial services, as their operational arrangements evolved through the different stages of the pandemic. This entailed engaging with key firms to ensure they had a greater understanding of the end-to-end processes and inputs for their important business services and could identify key risks (e.g., additional cyber risks related to remote working) and points of failure and focus resources to address these.
- 6. Recovery and Resolution:** This workstream was set up to enhance the Bank’s and firms’ own preparedness for financial distress and possible firm failure in the context of the specific COVID-19 shock facing the financial system. This entailed engaging with firms to further enhance their own preparedness to respond to potential future adverse shocks.