



# IRELAND

## REPORT ON OBSERVANCE OF STANDARDS AND CODES (ROSC)

May 2014

This Report on Observance of Standards and Codes (ROSC) on Ireland was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in April 2014.

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## REPORT ON OBSERVANCE OF STANDARDS AND CODES

April 2014

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This report is based on the work of the stand-alone Report on Observance of Standards and Codes (ROSCs) mission that visited Ireland in September-October, 2013.

- The assessment team was led by Antonio Pancorbo (IMF/MCM) and comprised Christopher Wilson (IMF/MCM) and José Tuya (external expert), who conducted the detailed assessment of the Basel Core Principles (BCP), and Tanis MacLaren and Mark McGinness (both external experts), who conducted the detailed assessment of the IOSCO Objectives and Principles for Securities Regulations. The mission produced two detailed assessment reports for the authorities in addition to the present ROSCs.
- ROSCs assess the extent to which countries observe certain internationally recognized standards and codes. They are intended to help countries identify key areas for improvement and prepare an action plan. They are not intended to represent an analysis of the state of financial institutions and financial sectors, or to identify sources of systemic risk.
- The mission met with Governor Honohan and Deputy Governor Roux. It also engaged extensively with senior officials and technical staff of the Central Bank of Ireland. External meetings were held with the Department of Finance, auditing firms, the Financial Intelligence Unit, private institutions and trade associations. The mission wishes to thank the authorities for their excellent collaboration and warm hospitality.
- This report was prepared by Antonio Pancorbo.

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## GLOSSARY

|          |  |
|----------|--|
| AML/CFT  | Anti-money Laundering/Combating the Financing of Terrorism |
| BCP      | Basel Core Principles for Effective Banking Supervision    |
| CBI      | Central Bank of Ireland                                    |
| CIS      | Collective Investment Scheme                               |
| CJA 2010 | Criminal Justice Act 2010                                  |
| CRA      | Credit Rating Agencies                                     |
| CRD      | Capital Requirement Directive                              |
| CRR      | Capital Requirement Regulation                             |
| ECB      | European Central Bank                                      |
| ESM      | Enterprise Securities Market                               |
| ESMA     | European Securities and Markets Authority                  |
| EU       | European Union   |
| FSAP     | Financial Sector Assessment Program                        |
| FSO      | Financial Services Ombudsman                               |
| GAAP     | Generally Accepted Accounting Principles                   |
| GDP      | Gross Domestic Product                                     |
| GEM      | Global Exchange Market                                     |
| IAASA    | Irish Auditing and Accounting Supervisory Authority        |
| IAASB    | International Auditing and Assurance Standards Board       |
| IAIS     | International Association of Insurance Supervisors         |
| IFRS     | International Financial Reporting Standards                |
| IMF      | International Monetary Fund                                |
| IOSCO    | International Organization of Securities Commissions       |
| ISE      | Irish Stock Exchange Ltd.                                  |
| KRI      | Key risk indicator   |
| MiFID    | Markets in Financial Instruments Directive                 |
| MTF      | Multilateral Trading Facility                              |
| MOU      | Memorandum of Understanding                                |
| NCA      | National Consumer Agency                                   |
| ODCE     | Office of the Director of Corporate Enforcement            |
| PRISM    | Probability Risk and Impact System                         |
| RM       | Regulated Market   |
| RPL Code | The Code of Practice on Lending to Related Parties         |
| ROSC     | Report on Observance of Standards and Codes                |
| SME      | Small and medium enterprise                                |

## EXECUTIVE SUMMARY

Since the crisis began, the Central Bank of Ireland (the Central Bank) has taken substantive steps to rebuild its reputation and functions in financial regulation and supervision. These include changes in the institutional setting, changes of senior staff, increases in the quantity and caliber of supervisory staff, design and implementation of a proactive and intensive approach to supervision, expansion of prudential requirements, and improvement of enforcement powers. This translates into an overall satisfactory level of compliance with the Basel Core Principles for Effective Banking Supervision (BCP) and a high level of implementation of the International Organization of Securities Commissions (IOSCO) Principles.

Nonetheless, the reform process is relatively young and effective implementation is still a work in progress that demands additional skills and resources. It is critical to maintain a clear direction and focus on implementation efforts, and that enforcement powers are used as a successful deterrent, including the new powers the Central Bank was given under the Central Bank (Supervision and Enforcement) Act 2013. The Central Bank has set up sound foundations, but gauging the full effectiveness of the reforms requires time for the new framework to season and for staff to gain experience through its use.

The Central Bank has made significant progress in implementing a proactive and intensive approach to supervision. The Probability Risk and Impact System (PRISM), the backbone of the new risk-based supervisory approach, is intellectually appealing and significant progress was evident to the mission and recognized by market participants. However, the calibration of the system deserves further attention. Currently, PRISM is specifically calibrated on the impact of the failure of an individual firm as regards financial stability. Accordingly, the supervisory approach to firms in lower impact categories is reactive. This may result in insufficient attention to institutions in these categories, which may not accurately reflect the actual risk to their customers and the market. In particular, risks may accumulate across a number of lower impact firms that are significant in aggregate without receiving proper supervisory attention. Reassurance on PRISM calibration and strict enforcement are also key elements to promote industry self-discipline in an environment of an international financial center with a very large number of institutions.

The Central Bank is also encouraged to strengthen further its supervisory processes for first-hand independent verification of data provided by institutions, particularly that from credit institutions. Strong first-hand verification, especially in the areas of earnings and banking book asset quality, will enhance the ability of the new approach to identify effectively prudential concerns through an independent assessment of risks, while ensuring that these risks are mitigated in a timely manner. Independent verification will also support the “cultural change” promoted by the new framework where supervisors verify more than trust, overcoming previous years of hands-off supervision.

Limited supervisory resources and high staff turnover in some areas are additional concerns that may slow the pace and effectiveness of the reforms. Staff involved in supervision have broadly

doubled over the last five years but the starting point was very low. High-quality and experienced staff retention is becoming an increasing problem and turnover in some areas of supervision is high. The new ECB Single Supervisory Mechanism will have additional impact on resources which cannot be assessed at this stage. As the financial sector recovers, there will be increased pressure on resources. A strategy to retain staff is, therefore, needed to implement effectively current reform efforts. In a similar way, limited resources at the Irish Auditing and Accounting Supervisory Authority (IAASA) are already a constraint for the tasks presently assigned, and this is an issue that also needs to be addressed.

While there is no observed political interference with day-to-day operations, the authorities are encouraged to seek legislative changes to codify and foster the independence of the Central Bank. The current legal framework exposes the regulatory process to political considerations as it provides the Minister for Finance with several points of influence into the policy making process. The mission did not find evidence of the Minister exercising these powers, but the potential for such political influence limits the implementation of the BCP and IOSCO Principles on independence.

In addition to the cross-sectoral gaps mentioned above, the assessment of the BCP raises specific issues. While progress has been made in terms of issuing sound prudential requirements for loan loss provisions and classification, the Central Bank should continue to review banks' practices to determine whether provisioning fully reflects loss experience. In addition, the Central Bank should strengthen the monitoring of banks' compliance with the related party lending code. Finally, the Central Bank should continue the implementation of the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, and strengthen the supervision of banks' AML/CFT compliance.

The assessment of the implementation of the IOSCO Principles also raises specific issues. The Central Bank should make more use of on-site inspections and all of its available enforcement authority, including criminal prosecutions, where appropriate. The disclosure requirements that apply to issuers who offer securities to the public but elect not to have their securities admitted to trading on the Main Securities Market of the Irish Stock Exchange (ISE) need to be strengthened in line with the disclosure requirements that apply to regulated market issuers. Finally, the Central Bank lacks the power to appoint administrators to investments firms in the event of financial difficulties, limiting the Central Bank to liquidation of the firm in question, even if this is not the most appropriate option.

The remainder of this report discusses in greater detail the mission's assessment of the Central Bank's compliance with the BCP and its implementation of the IOSCO Principles. Tables 3 and 5 present the mission's recommended actions to improve compliance with the BCP and the IOSCO Principles respectively.

## BACKGROUND

1. **At the request of the Central Bank of Ireland, an IMF team visited Dublin during September 23-October 10, 2013.** The team conducted full assessments of Ireland's compliance with the Basel Committee *Core Principles for Effective Banking Supervision* (BCP) and implementation of the International Organization of Securities Commissions (IOSCO) *Objectives and Principles of Securities Regulation*. The authorities' request for the BCP assessment was a commitment under Ireland's EU-IMF supported program. The Central Bank extended its request to the assessment of the IOSCO Principles. The request did not extend to the International Association of Insurance Supervisors (IAIS) *Insurance Core Principles* or any other Report on the Observance of Standards and Codes (ROSC) module.<sup>1</sup>
2. **The mission expresses its gratitude to the Central Bank for its hospitality and collaboration, including for prompt responses to information requests.** The mission would also like to thank the other competent authorities, regulated entities, market participants, and other stakeholders who generously shared their time and insights. The authorities provided comprehensive self-assessments of Ireland's compliance with the BCP and implementation of the IOSCO Principles, and detailed responses to additional questionnaires. They also facilitated access to supervisory documents and files, staff, and systems.
3. **The rest of this section that provides background to the assessments covers four main headings.** First, there is an overview of the financial market structure in Ireland, paying special attention to the banking and securities industries. Second, the institutional setting is discussed as it affects the assessment of banking and securities supervision. A third heading briefly introduces the prevailing supervisory situation before the financial crisis. Finally, the main recent reform efforts are presented.

### A. Market Structure—Overview

4. **Ireland's financial sector is large, internationalized, and still recovering from a deep crisis.** The domestic banking system has been stabilized following the severe crisis of 2008-11, but remains weighed down by weak asset quality and profitability. The crisis had a direct public cost of €64 billion (some 40 percent of GDP) and large additional social costs through its contribution to an almost 10 percent fall in output, a 12 percent drop in employment, and the need for some 14 percent of GDP in fiscal measures in 2009-13. Substantial weaknesses in banking supervision practices were a key contributing factor to the crisis. The *International Financial Services Centre*, established in 1987, houses over 500 firms specializing in internationally traded financial services, including banking, asset financing, collective investment schemes (CIS), corporate treasury and investment management, and insurance. The insurance industry is diverse with substantial international activity particularly concentrated in reinsurance and variable annuity services. The

<sup>1</sup> It is worth noting that the 2006 FSAP Update recommended "a full reassessment of the IAIS Core Principles once sufficient time has passed so that transposition of the EU Reinsurance Directive can be effectively assessed."

securities sector is well developed and home to one of the largest number of CIS globally. These CIS are domiciled, authorized or administered in Ireland but largely sold elsewhere.

|  | 2011           |        | 2012           |        | 2013           |        |
|--|----------------|--------|----------------|--------|----------------|--------|
|  | Assets         | Number | Assets         | Number | Assets         | Number |
| <b>Banking sector</b>                                      | <b>1,025.9</b> | 78     | <b>872.7</b>   | 73     | <b>740.6</b>   | 68     |
| <i>of which</i> Domestic Banks 1/                          | 638.9          | 20     | 549.6          | 17     | 474.0          | 24     |
| <i>of which</i> Non-Domestic Banks 2/                      | 387.0          | 58     | 323.1          | 56     | 266.6          | 44     |
| <b>Insurance Corporations and Pensions Funds (ICPF) 3/</b> | <b>284.5</b>   |        | <b>294.5</b>   |        | <b>296.0</b>   |        |
| <i>of which</i> Life Assurance 4/                          | 148.9          |        | 161.8          |        | -              |        |
| <i>of which</i> Non-Life Insurance 4/                      | 34.5           |        | 32.6           |        | -              |        |
| <b>Total Investments Funds</b>                             | <b>1,056.3</b> |        | <b>1,229.6</b> |        | <b>1,346.6</b> |        |
| <i>of which</i> Money Market Funds                         | 287.6          |        | 297.3          |        | 276.3          |        |
| <b>Stock Exchange 5/</b>                                   | <b>85.7</b>    |        | <b>85.5</b>    |        | <b>129.0</b>   |        |
| <b>Total</b>   | <b>2,452.3</b> |        | <b>2,482.3</b> |        | <b>2,512.2</b> |        |
| <b>Nominal GDP 6/</b>                                      | <b>163.9</b>   |        | <b>166.6</b>   |        | <b>169.5</b>   |        |

**Sources: Central Bank of Ireland; Central Statistics Office; and Irish Stock Exchange.**

1/ Institutions whose ultimate parent entity is resident in Ireland or which have a significant (>20 per cent) level of business in Ireland. Credit unions are recorded as a single domestic bank; the number of credit unions are: 404 in 2011, 399 in 2012, and 390 in 2013.

2/ Institutions whose ultimate parent entity is non-resident in Ireland, including branches.

3/ Data for Q3 2013. Includes financial assets only.

4/ Includes both fixed and financial assets.

5/ Market capitalization ISEQ

6/ IMF staff estimate for 2013.

**5. The banking sector has been shrinking since the onset of the crisis, driven by deleveraging plans and a contraction of credit.** The system expanded aggressively in the years leading up to the crisis, fueling a gigantic real estate bubble. The stop and reverse of the speculative spree on the Irish property market triggered simultaneous failures of various institutions. Post-crisis, the stock of impaired mortgages and SME loans has continued to rise and bank profitability remains weak. Progress in working out durable solutions with borrowers in distress in order to tackle mortgage arrears has been slow. After nearly a decade of decline, net interest and operating margins of Irish banks remain narrow. Reliance on ECB funding remains elevated. In all, the



challenge going forward is for the domestic banks to rebuild their core business of lending to the real economy.

**6. The securities industry is expanding in volume, but the number of intermediaries and instruments is decreasing.** The growth in assets under management in CIS has been significant over the past three years, both in the retail and wholesale segments. At the same time, the number of authorized securities intermediaries is declining, reflecting the consolidation of firms and ceasing to do business given the difficult economic conditions. Increasing compliance costs were also cited by market participants as an additional factor. Market capitalization on the ISE has increased while the number of listed companies and instruments has declined over the past five years; as elsewhere in the EU, fewer companies have been tapping the markets.

## B. Institutional Setting

**7. An institutional setting for effective banking and securities supervision appears to be in place.** The Central Bank of Ireland is the primary regulator of the Irish financial system, including banking, insurance, and securities. The Central Bank is also directly engaged in the oversight of the retail and wholesale payments systems. It is also responsible for the resolution of financial institutions and consumer protection. The Central Bank enjoys broad powers for the discharge of its duties. Beyond the Central Bank, the legislation of companies includes adequate provisions for governance and accountability. The judiciary is considered independent and there are specialized commercial courts available, but the court process is slow owing to high volumes of matters.

**8. The accounting and auditing standards seem to be in line with internationally accepted practices.** Company law requires listed consolidated entities to prepare their group financial statements in accordance with IFRS as endorsed by the European Union. All other entities can adopt either local GAAP, which have converged to IFRS, or IFRS themselves. Company law requires auditors in Ireland to apply International Standards of Auditing (UK and Ireland) as issued by the Financial Reporting Council. Auditors are required to comply with ethical standards. IAASA is designated as the competent authority for accounting enforcement under the Transparency Directive and oversees the supervision of the audit profession. The self-regulatory organizations operating in Ireland are limited to three professional accounting associations and are subject to the oversight of both the Central Bank and IAASA.

**9. The regulatory responsibilities, powers and authority of the Central Bank are established by statute.** The Central Bank draws its powers from many laws that need consolidation to enhance the transparency of the legal framework. These include, among others, the Central Bank Act 1942, the Central Bank Reform Act 2010 and the Central Bank Supervision and Enforcement Act 2013. It also draws authority from secondary legislation such as regulations enacted to transpose EU Directives into domestic law. The Central Bank cannot itself initiate primary legislation. The Constitution of Ireland vests the sole and exclusive power of making laws in the National Parliament (the Oireachtas).

**10. The Central Bank has a dual objective for the supervision of credit institutions: to foster a stable financial system and to provide consumer protection.** As set out in the Central Bank Act 1942 (as amended), the Central Bank shall perform its functions and exercise its powers in a way that is consistent with the orderly and proper functioning of financial markets, the prudential supervision of providers of financial services, and the public interest and the interest of consumers. In the current organizational structure of the Central Bank there is a separate Directorate for Consumer Protection. Nevertheless, this dual objective between prudential supervision and consumer protection has to be closely monitored. An unbalanced approach, in addition to potentially weaken Central Bank's prudential concerns, would also pose additional strain on supervisory resources.

**11. The supervision of the banking sector by the Central Bank will be affected by the new EU Single Supervisory Mechanism (SSM).** The establishment of a single rule book underpinned by centralized direct supervision at the ECB will be of paramount importance in the new supervisory regime in Ireland and the EU in general. However, it is too early to assess its impact on the Irish banking supervisory regime. This will depend on the scale and timing of the establishment of the SSM. The Central Bank staff is confident that they will be well prepared to integrate into the new European structure.

**12. The Central Bank can grant Exceptional Liquidity Assistance (ELA) to a credit institution when this is deemed necessary for financial stability purposes.** ELA is one of the ways in which the Central Bank responded to the financial crisis. This is distinct and separate from regular funding operations carried out for monetary policy implementation purposes through the ECB. The Central Bank Act 1942 provides the statutory basis for the Central Bank to provide ELA. In February 2013, the Central Bank's ELA operations ceased.

**13. The Deposit Guarantee Scheme (DGS) protects deposits held with banks, building societies and credit unions authorized in Ireland.** All eligible deposits up to a limit of €100,000 per person per institution are guaranteed to be repaid by the DGS. DGS protection includes deposits held at branches of authorized Irish institutions operating in other EU member states. DGS excludes deposits belonging to large and medium sized companies, public authorities, insurers, pension funds, collective investment schemes, banks and certain other financial institutions. The DGS is administered by the Central Bank and is funded by the credit institutions covered by the scheme.

**14. There is one regulated market and no derivatives exchange in Ireland.** The ISE has been operating an exchange in Ireland since 1793. It is an Irish private company limited by guarantee, with six member/owner firms. The ISE has three trading venues: the Main Securities Market (MSM); the Enterprise Securities Market (ESM), an equity market designed for small to medium sized growth companies; and the Global Exchange Market (GEM), a specialist debt market for professional investors. The MSM is a regulated market and ESM and GEM are multi-lateral trading facilities (MTFs), as defined by Markets in Financial Instruments Directive 2004/39/EC (MiFID). There is an additional MTF in Ireland, an electronic crossing-system operated by Investment Technology Group Limited, called POSIT.

**15. In addition to the Central Bank, other authorities exist whose activities are relevant to securities markets.** Their responsibilities are set out in the laws. These other authorities are: (i) the Office of the Director of Corporate Enforcement that is responsible for enforcing compliance with the Companies Acts; (ii) the Takeover Panel, the statutory body responsible for monitoring and supervising takeovers and other relevant transactions; (iii) the Financial Services Ombudsman, which independently administers complaints from consumers of financial services that have not been resolved by the providers; (iv) Garda Síochána, the Irish Police Force, particularly the Garda Bureau of Fraud Investigation that investigates serious and complex cases of commercial fraud; (v) the National Consumer Agency, the competent public authority to enforce consumer law and promote consumer rights; and (vi) the Director of Public Prosecution. The Central Bank has established formal and informal cooperation arrangements with these agencies. Despite the number of bodies, there is a consistent regulatory approach among them.

**16. There are important areas where the institutional setting may need to be strengthened further to facilitate effective supervisory outcomes.** There are indications of dysfunctions in the processes for repossessing assets, debt restructuring, and the pricing of fees for banking services. These weaknesses, which have already been flagged in the context of previous “Use of Fund Resources” missions, may distort the banking business and complicate the ability to determine the sufficiency of provisions.

### C. Prevailing Supervisory Situation Before the Financial Crisis

**17. The prudential supervisory framework in Ireland was seriously flawed in the run-up to the financial crisis.** Ireland’s large scale banking crisis reflected to a significant extent weaknesses in banking supervision. The analysis of this situation helps assess whether the reform efforts have acted upon prevailing mistaken ideas and supervisory practices. To this end, Irish authorities conducted two critical postmortem reports: the *Honohan Report* and the *Nyberg Report*,<sup>2</sup> which helped identify and discuss the most serious shortcomings. The most important issues that were taken into account while conducting the assessments of the BCP and IOSCO Principles are elaborated below.

**18. The pre-crisis supervisory approach, which focused on process over outcomes, did not generate the most relevant information.** It failed to provide an independent quantitative assessment of risks. The starkest example was the valuation practices of major banks that led to a build-up of credit risk in the system. Missing actual exposures and independent estimates of their valuations, supervisors allowed an unacceptable degree of reliance on bank’s internal valuation processes, which resulted in a much greater accumulation of risk. Even when confronted with evidence that banks had insufficient information, supervisors failed to react and generate an independent view of the potential exposure. In addition, supervisory tasks were under-resourced. This provided another reason for supervisors to over rely on the banks' own assessments of their

<sup>2</sup> See: [“The Irish Banking Crisis - Regulatory and Financial Stability Policy 2003-2008”](#) and [“Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland.”](#)

governance and risk-management procedures, and neglect independently verified quantitative assessment that would ensure that sufficient capital was in place to absorb the growing property-related risks.

**19. A greater degree of intrusiveness and assertiveness of supervisors was lacking when challenging bankers.** Although at that time financial supervisors did not characterize their principles-based approach as “light touch,” the postmortem reports found indications of an unduly deferential and accommodating approach to the banking industry. The view in the reports was that corrective regulatory intervention was delayed and timid in an environment that placed undue emphasis on fears of upsetting the competitive position of domestic banks and on encouraging the Irish financial services industry. Supervisors were reluctant to second-guess bankers in any assertive manner. At the same time, consumer issues were exhaustively and actively dealt with by supervisors.

#### D. Recent Reform Efforts

**20. The authorities have undergone significant changes in the legal framework to support banking and securities supervision.**

- In 2010, the Central Bank Reform Act 2010 was passed to combine the functions of central banking and financial regulation into the Central Bank. The new structure replaced the previous related entities.
- In 2011, the Central Bank Credit Institution Resolution Act was passed to provide a special resolution regime. It permits the Central Bank to request recovery plans from institutions. In addition it confers powers on the Central Bank to resolve credit institutions where recovery is deemed to be unlikely. Resolution action is taken by the Central Bank under powers vested in the Governor. The Act is relatively new legislation and has not yet been used to resolve an authorized credit institution. The recovery plan aspect of the legislation has yet to be fully implemented. The Central Bank implementation may be deferred pending a review of the proposed arrangements under an EU proposed Directive on Crisis Management and Bank Resolution.
- In 2012, the new Personal Insolvency Act was passed to establish three new non-judicial procedures for debt resolution and modernized the Bankruptcy Act of 1988.
- In 2013, slightly ahead of the mission taking place, the Central Bank (Supervision and Enforcement) Act was passed to enhance the enforcement authority of the Central Bank and to harmonize requirements across all the financial sectors supervised by the Central Bank. The Enforcement Act also provides the Central Bank with regulation-making powers on conduct of business and corporate governance and increases the amount of administrative sanction fines for an individual and a firm.

**21. The Central Bank has also worked actively to substantially change its supervisory approach over the past three years.** It has been developed in accordance with the new statutory powers given in the Central Bank Reform Act, 2010, and the Central Bank and Credit Institutions Resolution Act, 2011. To this end, in 2011 the Central Bank introduced a new framework for the supervision of regulated firms called *Probability Risk and Impact System* (PRISM) to provide a structured framework for a risk-based supervisory approach. This approach is meant to deliver an assertive risk-based supervision system for financial institutions, supported by credible enforcement actions. PRISM was initially applied to banks and insurers in 2011, and then extended to investment firms and credit unions in 2012.

**22. The Central Bank has increased resources with a more intrusive approach to supervision.** The Central Bank uses PRISM to allocate resources and to plan supervisory activities based on probability of failure and impact on overall financial stability. Built into PRISM is an ongoing monitoring capability that will pick up changes in risk profile through the use of financial ratios that, if triggered, will prompt supervisory attention/intervention. Resources, supervisory attention and intrusiveness are increased where the impact rating is higher and resources are prioritized for the High Impact firms. A High Impact firm receives ongoing monitoring through offsite supervision, frequent onsite reviews, and ongoing engagement with senior management. To support this supervisory approach, the Central Bank has also introduced significant structural changes in terms of staffing and the establishment of new directorates and divisions.

**23. The Central Bank aims at strengthening the banking system through rigorous, conservative and independent assessments of loan losses.** This involves recapitalization actions and targeted reduction of non-core assets. A successful implementation of the intensive and effective supervisory approach, as mentioned before, and progress in raising the right skills and staff, is expected to consolidate a sound loan classification and provisioning across the system.

**24. The Central Bank has also sought to improve standards for the bank boards and senior management.** Since the quality of bank management deteriorated significantly in the run-up to the crisis, the Central Bank has, as a priority, targeted improved standards for governance and fitness and probity across the financial services sectors in Ireland generally.

## ASSESSMENT OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

**25. Ireland has significantly enhanced the legal framework to support banking supervision and implemented a risk-based supervisory approach, and compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) is satisfactory.** This reflects the continued strengthening of the supervisory process undertaken by the authorities, which has been achieved in a challenging environment. The financial crisis and subsequent state intervention have transformed the Irish banking system and while acute crisis conditions have abated there is continued elevated stress within the system and vulnerabilities persist. Added to this is the continued pressure on industry to meet forthcoming higher regulatory standards, most notably the new Capital Requirements Directive and Regulations (CRD IV/CRR). In addition to substantial regulatory and legislative changes, the supervisory authorities have also had to adjust to the challenges of transition brought by re-design of the regulatory architecture.

**26. However, some issues require continued attention.** The issues include: reviewing the provisioning requirements to determine whether they accurately reflect the current market conditions, continued implementation of the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (as amended) (CJA 2010), strengthening the monitoring of compliance with the related party lending code, and amending legislation to codify the operational independence of the Central Bank,

**27. While there is no observed political interference, the authorities are encouraged to seek legislative changes to codify and foster the independence of the Central Bank.** This could be achieved by stipulating in the Central Bank Act the exact conditions under which members of the Commission can be dismissed or removed by the Minister for Finance. Other legislative changes that would ensure independence include: (i) providing the Central Bank with the authority to revoke a bank license or deny a bank licensing application without having to seek approval by the Minister, (ii) not including the Secretary General of the Department of Finance on the Central Bank Commission, and (iii) eliminating the need for the Minister to approve the levy schedule.

**28. There is a need to expand the coverage of related party transactions covered by the Code of Practice on Lending to Related Parties (RPL Code) and strengthen the Central Bank monitoring of compliance with the code.** The RPL Code is comprehensive but only covers lending transactions and not, for example, asset purchases or deposits. Additionally, the Central Bank monitoring of compliance relies to a large extent on offsite review of reports filed by the banks. However, the reports do not provide information on the terms of the loans or dates of approval by the Board.

**29. Supervision of AML/CFT compliance in banks should be strengthened.** The CJA 2010 is comprehensive, and with the implementation of the Criminal Justice Act 2013 it was further strengthened. The Central Bank has enhanced its supervisory approach to AML/CFT compliance and

has conducted in-depth onsite inspections and offsite analysis through the collection of risk assessment questionnaires. The CJA 2010 is comprehensive but the Central Bank's position would be strengthened if statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, were issued. The extent of onsite reviews and the supervisory action following the reviews to enforce compliance should be reviewed to ensure that an appropriate base line, premised on sufficient onsite testing, is established and that strong corrective action requirements are implemented. Additionally, branches of member state banks should be subject to AML monitoring.

**30. Currently the Central Bank Banking Supervision Divisions are operating below approved staffing levels.** The Central Bank operates under Civil Service pay scales and hiring rules which make the salaries un-competitive with industry. Civil Service provides job security and other benefits that may offset the pay differential but increasingly bank supervision requires highly skilled staff as bank products and risk measurement techniques become more complex. The Central Bank is encouraged to review its turnover rates in skilled staff and determine reasons for turnover, consult other central banks to gauge how they attract skilled staff and determine how they achieved exemption from Civil Service pay limitations. It is also important to review advancement opportunities tailored to technical experts.

## A. Background Information and Methodology Used

**31. This assessment has been prepared according to the Revised Core Principles (BCP) Methodology issued by the Basel Committee of Banking Supervision.**<sup>3</sup> The current assessment was thus performed according to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2006. It is important to note that the two assessments will not be directly comparable, as the revised BCP have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority, and is therefore a more demanding measure of the effectiveness of a supervisory framework. This assessment reflects the regulatory and supervisory framework in place as of the date of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework.

**32. The assessment of compliance with each Core Principle is made on a qualitative basis to allow a judgment on whether it is fulfilled in practice.** Effective application of relevant laws and regulations is essential to provide indication that the criteria are met. The assessment was carried out on the basis of the legal framework governing the regulation and supervision of banks, principally the Central Banking Acts, the CJA 2010 and other relevant regulations and guidelines. A review of prudential returns, licensing documentation, and supervisory analysis records was also performed. The Team also examined on-site supervision reports and off-site analysis documentation. In addition, BCP assessors held extensive meetings with officials of the Central Bank, the Department of Finance, Financial Intelligence Unit, and additional meetings with auditing firms

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<sup>3</sup> The assessment was conducted by Christopher Wilson, IMF, and José Tuya, external technical expert.

and sector participants from domestic and international banks. The authorities provided a self-assessment of the Principles rich in quality and comprehensiveness, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff and systems.

**33. The standards were evaluated in the context of the Irish financial system’s structure and complexity.** The Principles must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the Principle, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the Principles must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

**34. The assessment does not include the Irish Credit Union Sector.** The Central Bank considered that it was not appropriate at the time of the mission to conduct an assessment due to the significant amount of legislative and regulatory developments which have been recently implemented as part of Ireland’s financial sector reform commitments under the EU-IMF financial support program for Ireland.

**35. The BCPs are an independent benchmark and compliance determinations are not adjusted for local legislation.** While the EU has implemented a number of rules and supervisory practices that member states must follow, some of these practices may not meet the BCP requirements. The authorities highlighted some of these discrepancies, particularly as they relate to the supervision of EU banking branches that require less host involvement than required by the BCPs.

## B. Main Findings

### *Responsibility, Objectives, Powers, Independence, Accountability and Cooperation (Principles 1-3)*

**36. The Central Bank is the sole authority responsible for the supervision of the banking system.** The legislation describes the Central Bank objective as “the proper and effective regulation of financial services and markets.” In addition to safety and soundness of prudential supervision, the Central Bank is responsible for monitoring bank compliance with consumer protection regulation and AML/CFT legislation.

**37. The Central Bank is vested with discretionary powers to address areas of weaknesses or non-compliance, which powers are buttressed by a recently enhanced regulatory framework.** The legislative enhancements include the Central Bank Reform Act 2010 and the Central



Bank (Supervision and Enforcement) Act 2013 which strengthen the fit and proper monitoring regime, the Central Bank information gathering authority and broaden the range of matters subject to enforcement such as corporate governance, systems and control and minimum competency requirements. Another significant piece of legislation is the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (CJA 2010) that establishes requirements for banks and makes the Central Bank the competent authority for monitoring compliance.

**38. The Central Bank is currently operating below its approved staffing levels.** The prompt staffing of vacancies would enhance the Central Bank ability to conduct its activities.

**39. The Central Bank has authority to issue enforceable policies and codes to regulate the banking system; in addition, it can directly impose license conditions through existing legislation.** For example, the Central Bank has, inter alia, issued a code on related party lending, placed requirements on banks to address operational risk, established an approval/notification process for significant acquisitions, and increased requirements on banks to monitor country risk. In the area of AML/CFT the CJA 2010 is comprehensive but the Central Bank's position would be strengthened if statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, were issued.

**40. Although there is no observed interference, certain legal provisions of Central Bank legislation in relation to the role of the Minister for Finance raise concerns over Central Bank independence.** The Minister for Finance may remove a member of the Central Bank Commission "if in the Minister's opinion it is necessary or desirable to do so to enable the Commission to function effectively." The legislation does not include objective conditions that must be met before the Minister may evoke this option. Other areas of concern include the need to obtain Ministerial approval to increase industry levies to fund banking supervision. Further, although the Central Bank is the licensing authority, it must seek Ministerial approval to deny an application for a banking license or to revoke a license.

#### ***Ownership, Licensing, and Structure (Principles 4-7)***

**41. The Central Bank grants banking licenses to entities which may have unregulated corporate parents, domestically and cross-border.** As a result, a newly licensed bank operates under a ring-fence regime from the time it opens due to the lack of supervisory authority by the Central Bank over the parent. The Central Bank lacks authority to perform fit-and-proper reviews on management of the unregulated parent and to take enforcement action on parent. Until the enactment of the Central Bank (Supervision and Enforcement) Act 2013, almost at the time of the BCP assessment, the Central Bank also lacked authority to require submission by the parent of information needed for supervision. Options to address the lack of express authority over the parent may include imposing conditions at time of licensing, such as restrictions on the license and requiring the parent company and management to agree to provide Central Bank with information and to comply with fit-and-proper requirements.

### ***Methods of Ongoing Supervision (Principles 8-10)***

**42. The PRISM model is the centerpiece of the supervisory framework which is used to assign bank risk ratings and allocate supervisory resources and determines supervisory intensity and frequency.** Resources for activities such as onsite reviews and intrusive supervision techniques are mainly allocated to High Impact banks. The supervisory approach for banks that fall into the two lower impact categories (Medium-Low and Low) relies heavily on reactive processes. A primary concern is whether the calibration of PRISM is appropriate. Offsite supervision processes are largely automated, where there is a reliance on triggers of financial ratios rather than analysis of regulatory returns. In addition, the quality, frequency and depth of qualitative data to assess risk are limited (as is onsite activity). In the case of Low Impact banks, no minimum frequency of onsite reviews and engagement with banks are prescribed by PRISM. A reactive approach to supervision for this cohort of banks and a reliance on exception reporting does not allow for sufficient opportunity to accurately identify, assess and mitigate risk in a bank. A build up of risks across a number of lower impact banks in aggregate could create vulnerabilities in the banking system and, moreover, could create reputational risk for the Central Bank and a threat to the integrity of banking system. A more proactive approach would mitigate this risk.

**43. Focusing the supervisory process primarily on the impact of a failure on the overall market will distort the allocation of resources since the supervisory approach is supposed to be preventive/corrective to maintain safety and soundness and not on the impact of resolution.** Supervisory activities to identify risk are insufficient for banks with an impact rating below High, particularly the two lower impact ratings. More attention needs to be paid to independent verification of the banks' self-assessment of compliance with regulations and assessment of risk profile. Setting up the supervisory scope should focus on bank-specific risks, so even between high risk banks there should be a difference in activities being performed and greater flexibility in the suite of supervisory activities.

**44. The Central Bank employs a mix of off- and on-site supervisory activities.** Built into PRISM is an ongoing monitoring capability that picks up changes in risk profile through the use of financial ratios and key risk indicators (KRIs) that, if triggered, will prompt supervisory attention/intervention. KRIs are categorized into five risk areas: capital, liquidity, credit, business model/strategy and market risk. There are, however, no KRIs for interest rate risk in the banking book and only a single indicator for market risk. The KRIs form a key feature of exception reporting framework designed for lower impact rated banks where analysis of regulatory returns is automated. The KRIs should be expanded to ensure all material risks are monitored to detect changes in risk profile.

### ***Corrective and Sanctioning Powers of Supervisors (Principle 11)***

**45. The Central Bank is equipped with sufficient discretionary enforcement powers to address areas of weaknesses in banks or their non-compliance with applicable laws, regulations or supervisory instructions.** The Central Bank (Supervision and Enforcement) Act 2013 enhanced the range of sanctions available. The level of fines was doubled for both firms and

individuals, with an alternative calculation of maximum fine for firms based upon 10 percent of annual turnover. These deterrents are expected to increase compliance.

**46. A well designed enforcement process is in place and it is linked to PRISM to ensure supervisory action is initiated promptly when a situation is identified.** A Risk Mitigation Program is utilized when the Central Bank identifies an issue that the bank must remediate. The Risk Mitigation Program sets out the basis of the issue, the prescribed action, the required outcome and sets the timeline to achieve correction.

**47. The Central Bank follows an Administrative Sanctions Procedure when bringing possible enforcement action.** The Central Bank may issue a supervisory warning and the Administrative Sanctions Procedure permits the Central Bank to enter into settlements with firms and persons concerned in the management of the firm and following an Inquiry to impose a range of sanctions, from a caution or reprimand to fines and the disqualification of individuals from being concerned in the management of a regulated financial service provider.

#### ***Consolidated and Cross-Border Banking Supervision (Principles 12- 13)***

**48. The Central Bank applies prudential standards on a group wide basis where it is responsible for consolidated supervision.** The Central Bank undertakes supervisory activities to understand the overall structure of the banking group for which it is ultimately responsible and supervises and monitors material activities, including non-banking activities conducted by entities in the wider group, both domestic and cross-border. The Central Bank collects and analyses financial and other information which it considers adequate to ensure effective consolidated supervision of banking groups. The Central Bank takes action when risks arising from the banking group and other entities in the wider group are identified as potentially jeopardizing the safety and soundness of the bank and banking group. Home-Host relationships are working well particularly supervisory colleges.

#### ***Corporate Governance (Principle 14)***

**49. The Central Bank has issued a Corporate Governance Code which goes beyond the minimum requirements of the CRD and sets out the corporate governance obligations which must be adhered to by all financial institutions.** The Code provides detailed guidance across a number of elements of corporate governance such as the role of the Board, role of senior management and requirement for an annual compliance statement. The Central Bank also has extensive powers as regards the fitness and probity of the directors and holders of certain senior management positions.

#### ***Prudential Requirements, Regulatory Framework, Accounting and Disclosure (Principles 15-29)***

**50. Supervisors evaluate the adequacy of risk management strategies, policies, processes and limits established by a bank through periodic risk assessments and engagement with**

**bank senior personnel.** For onsite risk reviews, the Central Bank has dedicated Credit, Treasury, Risk Analytics (Quantitative Models Unit and Portfolio Analytics, and Stress testing Unit) and Business Model Analytics teams which analyze credit institution's risk management processes. These teams are also used in assessing offsite reporting by banks. Under the Central Bank's risk-based approach to supervision, the level of monitoring and frequency of analysis performed by the specialist teams varies according to the size, scale and complexity of the institution according to its PRISM impact rating. Where onsite activities are not performed, unless an event occurs, considerable reliance is placed on self assessments to make ongoing assessments of risk management. The range of qualitative and quantitative information to assess the status of risk management such as business continuity was not sufficient to reliably monitor the robustness of arrangements on an ongoing basis.

**51. To assess asset soundness and credit risk management, resources are heavily weighted toward the High Impact banks which are the banks of greatest systemic importance and the largest exposure to credit risk.** Routine supervisory activities for High Impact banks provide the supervisor with a variety of inputs to assess credit risk management processes against changes in market and macroeconomic conditions. Analysis of regulatory data and enhanced reporting requirements enable the supervisor to detect changes in risk profile on an ongoing basis. Equally, for High Impact banks, the routine supervisory activities are adequate to make an assessment of the Board's involvement in developing and regularly approving the credit risk management strategy and significant policies and processes. It was evidenced that supervisors are going beyond routine tasks and minimum activities prescribed by PRISM.

**52. Where an onsite review of loan files is performed, the supervisor (with the assistance of credit risk specialists) has the opportunity to assess whether senior management has implemented the credit risk strategy approved by the Board and whether underwriting practices are consistent with policy and prudent for market conditions and the economic environment.** The frequency and depth of onsite credit risk reviews for lower risk institutions and the allocation of credit risk specialists to assist in the assessment process could be enhanced to form an accurate and timely assessment of the credit risk environment. For the banks assigned PRISM Impact ratings of below High (especially Medium Low and Low), the variance analysis might not necessarily provide insight into the application of credit risk management processes until after risks have begun to crystallize resulting in breaching Central Bank triggers for supervisory attention.

**53. The Central Bank has updated and expanded its guidance regarding provisioning and valuation practices and performed more frequent and in-depth onsite assessments.** Over the course of the last several years, the Central Bank has allocated considerable resources in an effort to encourage prudent provisioning practices with a significant focus on the covered banks. The update guidance by the Central Bank goes beyond that of other authorities in the region where IFRS is applied. The banking sector has also been subject to various externally led balance sheet exercises. There are a number of examples demonstrating the impact of the various activities in increasing the conservatism of banks' loan loss provisioning practices.

**54. Supervisory activities should place greater reliance on onsite verification of bank processes, particularly in terms of assessing processes for the early identification of problem assets; the application of prudent valuations for collateral; and testing assumptions that feed into provisioning models.**

There was evidence to suggest this process had commenced with the “covered” banks, those guaranteed by the Irish Government in September 2008, but was yet to be extended across the sector (with due regard to proportionality). Greater frequency and depth of analysis through onsite reviews will allow the supervisor an ability to more accurately verify bank provisioning practices by loan sampling and testing of assumptions to ensure they remain consistent with actual experience and are adjusted in a timely fashion to reflect changes in market conditions and the economy. Through this process, the supervisor will be better able to deem whether provisions are adequate for prudential purposes.

**55. In 2010 the Central Bank issued the RPL Code.** The code establishes requirements for transactions with affiliates to be at arms’ length and has a broad definition of related parties. However, only lending transactions are covered by the Code and items such as asset purchases and deposit terms are excluded.

**56. A country risk policy was issued in August 2013 and is in the process of implementation.** The policy is comprehensive and the Central Bank is in the process of developing monitoring procedures and conducting reviews. One bank examination has been conducted (with another examination ongoing) to test compliance at time of the BCP assessment. Monitoring compliance with the policy will require improved reporting by the banks, incorporation into the PRISM process and reviews of bank compliance. Additionally banks will need to implement the internal processes to meet the policy requirements.

**57. A detailed operational risk policy has been implemented and a number of onsite reviews conducted.** A report to be filed by banks has been implemented and the first reports are to be filed as of September 30, 2013.

**58. Anti-Money Laundering legislation was implemented in 2010. The scope of the legislation is comprehensive and the Central Bank is in the process of implementing its monitoring and enforcement program.** While the Central Bank has a strategy in place to deliver supervisory coverage, elements of this strategy remain to be implemented to accomplish effective supervision in this area including analysis of data from risk assessments and in-depth inspections to (a) underpin the publication of the findings from the in-depth inspections, (b) inform sector wide risk mitigation actions and (c) identify targets for thematic inspections. While the CJA 2010 is comprehensive the Central Bank’s position would be strengthened if statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, were issued. In addition to the onsite inspections carried out, compliance assessments, in the form of risk assessment questionnaires have been carried out on 21 banks.

59. Table 2 below provides additional summary comments on Ireland's compliance with individual Principles.<sup>4</sup>

| <b>Table 2. Ireland: Summary Compliance with the Basel Core Principles</b>   |          |
|--|----------|
| <b>Core Principle</b>  | Comments |
| <b>1. Responsibilities, objectives and powers</b>  |          |
| CBI is the primary regulator of the Irish financial system. Its objectives include proper and effective regulation of financial institutions and markets, while ensuring that consumers of financial services are protected.   |          |
| <b>2. Independence, accountability, resourcing and legal protection for supervisors</b>  |          |
| Although there is no observed interference, the legislation provides for the approval of the Minister for Finance for: setting the levy structure to fund supervision, denying a license application, involuntary revocation of a banking license, and budget setting.<br>CBI is the licensing authority but must receive Minister for Finance consent to deny a license application or revoke a license approved based on false information.<br>The Minister may remove Commission members for specified reasons which are broad in nature and interpretation. The Secretary General of the Department of Finance sits on the CBI Commission in an ex-officio capacity. |          |
| <b>3. Cooperation and collaboration</b>  |          |
| CBI is responsible for the regulation of financial service providers and markets in Ireland, and ensuring financial stability.   |          |
| <b>4. Permissible activities</b>   |          |
| Permissible activities are clear and subject to supervision.   |          |
| <b>5. Licensing criteria</b>   |          |
| CBI issues licenses to banks owned by unregulated entities. These banks are ring-fenced since the CBI lacks authority to perform fit and proper reviews on senior management in the unregulated parent, or take enforcement action against the unregulated parent.   |          |
| <b>6. Transfer of significant ownership</b>  |          |
| CBI has adequate prudential powers to supervise proposals to transfer significant ownership.   |          |
| <b>7. Major acquisitions</b>   |          |
| Requirement for major acquisition reviews was implemented in August 2013. Too early for a record of compliance and enforcement to be reviewed.   |          |
| <b>8. Supervisory approach</b>   |          |
| The CBI employs a mix of off- and on-site supervisory activities. The PRISM model is the centerpiece of the supervisory framework which is used to assign bank risk ratings and allocate supervisory resources and determines supervisory intensity and frequency of supervisory activities.   |          |
| <b>9. Supervisory techniques and tools</b>   |          |
| A primary concern is whether the calibration of PRISM is appropriate for the mix of onsite and offsite supervision for Medium Low and Low Impact banks. Analysis of regulatory returns should be strengthened as well as greater focus on testing and sampling of risk management processes.   |          |
| <b>10. Supervisory reporting</b>   |          |
| Supervisory reports are collected on a solo and consolidated basis, and independently verified.  |          |

<sup>4</sup> The reference BCP document, as updated in October 2012, can be found at: <http://www.bis.org/publ/bcbs230.htm>.

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| <b>11. Corrective and sanctioning powers of supervisors</b>   |
| CBI has an adequate range of supervisory tools to bring about timely corrective actions. Its enforcement powers were recently enhanced by the introduction of the Central Bank (Supervision and Enforcement) Act 2013. This gives the Central Bank greater information gathering powers and also provides for new sanctions and increased monetary penalties under the Administrative Sanctions Procedure.  |
| <b>12. Consolidated supervision</b>   |
| CBI undertakes supervisory activities to understand the overall structure of the banking group for which it is ultimately responsible and supervises and monitors material activities (including non-banking activities conducted by entities in the wider group, both domestic and cross-border).  |
| <b>13. Home-host relationships</b>  |
| CBI has an adequate framework to cooperate and collaborate with foreign supervisors.  |
| <b>14. Corporate governance</b>   |
| For those banks assigned a rating of Medium-low and Low, the range and frequency of supervisory activities to assess governance is not adequate to assess the robustness of governance. Does not appear to be an adequate level of attention to a board's stewardship and understanding of risk and corporate governance.   |
| <b>15. Risk management process</b>  |
| The range of qualitative and quantitative information to assess the status of business continuity was not sufficient to reliably monitor the robustness of arrangements on an ongoing basis (EC12).<br>The frequency of onsite testing and verification of model validation results needs to be enhanced (EC6).   |
| <b>16. Capital adequacy</b>   |
| CBI has set prudential and appropriate capital adequacy requirements.   |
| <b>17. Credit risk</b>  |
| The frequency and depth of onsite credit risk reviews for lower risk institutions and the allocation of credit risk specialists to perform file reviews is not sufficient to maintain an accurate assessment of the credit risk environment. For the banks assigned PRISM Impact ratings of Medium Low and Low, the variance analysis might not necessarily provide insight into the application of credit risk management processes until after risks have begun to crystallize resulting in breaching the Central Bank's triggers for supervisory attention.  |
| <b>18. Problem assets, provisions, and reserves</b>   |
| Greater frequency and depth of onsite reviews of loan loss provisioning practices (e.g. testing of assumptions against experience, recognition of default, prudent valuations)  |
| <b>19. Concentration risk and large exposure limits</b>   |
| Limits are in place and are prudent.  |
| <b>20. Transactions with related parties</b>  |
| Only credit transactions are covered by the regulation. Compliance monitoring is mainly offsite (with some onsite testing) but reports filed by banks lack information to monitor terms, rates and other requirements of the RPL Code.  |
| <b>21. Country and transfer risks</b>   |
| Requirements issued in August 2013. CBI has developed a monitoring process and is conducting initial reviews to determine compliance.   |
| <b>22. Market risk</b>  |
| In terms of onsite examinations of market risk, coverage by the Treasury Team has been limited, though proportional based on either the complete absence or very low level of traded market risk in most banks supervised. Insufficient testing of implementation of policies and procedures onsite to accurately assess the effective implementation of controls, especially in regard to verify that marked-to-market positions are prudently valued and revalued frequently. CBI's oversight of internal models on an ongoing basis is inadequate to ensure models are fit for purpose and calculating capital accurately (see Essential Criterion 4). |

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| <b>23. Interest rate risk in the banking book</b>  |
| While detailed reviews are conducted by the treasury team on High Impact banks, treasury team support is provided to lower impact banks as part of their Full Risk Assessments. As these are less frequent they are supplemented by the use of the quarterly risk dashboards and the twice yearly meetings with the head of the treasury team at which the main findings of the reviews conducted on the High Impact Banks are shared. A less intensive process is used for lower Impact banks with a reliance on a self assessment.   |
| <b>24. Liquidity risk</b>  |
| CBI requires each credit institution to establish and maintain a liquidity strategy and liquidity policy. CBI requires each credit institution to establish a contingency funding plan, developed by management and approved by the Board.   |
| <b>25. Operational risk</b>  |
| First monitoring reports filed by banks as at September 30, 2013. Effectiveness of monitoring and enforcement cannot be assessed at this time.   |
| <b>26. Internal control and audit</b>  |
| No requirement in regulations for the Board to take responsibility for establishing the internal control environment, although the regulations do require banks to maintain internal controls. For banks with an Impact rating below High, the supervisory activities to assess the effectiveness of the internal control function will rely upon desk based review of exception reporting without a sufficient suite of supporting documentation to make an accurate assessment of the effectiveness of the control environment required by essential criteria 4 and 5.   |
| <b>27. Financial reporting and external audit</b>  |
| The Central Bank does not have the power to reject and rescind the external auditor as required by the Essential Criterion 6. Existing legislation does not provide the Central Bank with the power to influence the scope of the external audit or establish the standards for such an audit.   |
| <b>28. Disclosure and transparency</b>   |
| CBI will ensure that the financial statements have an auditor's opinion expressing the opinion that they give a true and fair view.  |
| <b>29. Abuse of financial services</b>   |
| Branches of foreign banks have not been incorporated in AML compliance reviews. Additionally, most reviews of compliance have been through the review of risk assessment questionnaires sent to banks with limited onsite testing. While the CJA 2010 is comprehensive the CBI's position would be strengthened if statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, were issued.<br>CBI has not issued specific requirements for internal audit and/or external experts to independently evaluate the relevant risk management policies, processes and controls for AML.<br>There is no requirement to appoint a relevant dedicated officer to whom potential abuses of the banks' financial services are reported<br>CBI is planning to issue communications following its inspections setting out principal findings and its expectations as to how compliance with the CJA 2010 can be demonstrated. |



## C. Recommended Actions

60. Table 3 below lists the suggested actions for improving compliance with the Basel Core Principles and the effectiveness of regulatory and supervisory frameworks.

| <b>Table 3. Ireland: Recommended Actions to Improve Compliance with the Basel Core Principles</b> |   |
|---|---|
| <b>Reference Principle</b>  | <b>Recommended Action</b>   |
| <b>2. Independence, accountability, resourcing and legal protection for supervisors:</b>          | Amend existing legislation to detail the framework for Central Bank independence. Also address reasons for removal of Commission members to be similar to Governor.<br>Take steps to fill vacancies in banking supervision.   |
| <b>5. Responsibilities, objectives and powers:</b>  | Consider options for improving the CBI's ability to conduct fit and proper reviews during licensing of banks owned by unregulated parents.<br>Study enforceability of special conditions to the license that must be accepted by parent company at time of approval to enhance CBI enforcement authority. |
| <b>9. Supervisory techniques and tools:</b>   | Consider the distribution of resources and supervisory tasks across Medium Low and Low Impact ratings<br>Consider expanding KRIs in PRISM to include a broader suite of risk metrics i.e. operational risk and IRRBB  |
| <b>15. Risk management process:</b>   | For banks accredited to use internal models, annual assessment that banks comply with supervisory standards (e.g. validation)<br>Implementation of framework to assess IT across regulated banks  |
| <b>17. Credit risk:</b>   | Increase frequency and loan sample size for Medium Low banks  |
| <b>18. Problem assets, provisions, and reserves:</b>  | Greater frequency and depth of onsite reviews of loan loss provisioning practices (e.g. testing of assumptions against experience, recognition of default, prudent valuations)  |
| <b>20. Transactions with related parties:</b>   | Amend the Related Party Lending code to include asset sales, deposits and other areas addressed in the Principle. Also expand information in Related Party Lending regulatory reports so that a more complete offsite compliance assessment may be made.  |
| <b>27. Financial reporting and external audit:</b>  | Enact legislation giving the Central Bank the power to reject or rescind external auditors.   |
| <b>29. Abuse of financial services:</b>   | Expand supervisory scope to include branches of foreign banks,<br>Statutory guidelines, approved as envisaged by Section 107 of the CJA 2010, should be issued. Review the current balance between onsite and offsite reviews. Currently emphasis is heavily weighted on offsite.                         |

## **D. Authorities' Response to the Assessment**

### **Recognition of Financial Sector Reform and Strengthening of Supervision of Credit Institutions**

The Irish authorities wish to express their appreciation to the IMF and its Mission team for their detailed assessment of Ireland's compliance with the Basel Core Principles for Effective Banking Supervision.

We welcome the IMF's acknowledgement of the continued strengthening of the supervisory process through substantial changes to both regulation and legislation, achieved in collaboration with our external partners under Ireland's financial support programme, in a challenging environment, which included the restructuring and stabilisation of the Irish banking sector.

A risk based supervisory approach to banking supervision was implemented by the Central Bank in 2011 by means of a new risk assessment framework. This framework was accompanied by a substantial increase in resources and encompasses a much more intrusive approach than existed previously. Our supervisory regime is determined further by our assessment of the impact risk of each credit institution and our resources are allocated to conduct supervisory engagement further to that assessment. In addition, significant changes to the legal framework have been achieved, which have resulted in enhanced powers for the Central Bank.

### **Specific Comments on IMF Findings and Ratings**

While the Irish Authorities are generally in agreement with the report, the Irish Authorities would make the following comments in relation to those Core Principles which have been rated by the IMF as Materially Non-Compliant:

#### **CP 2 Independence**

The Irish authorities are pleased to note that there was no observed political interference with the Central Bank of Ireland. While we are disappointed with the IMF finding regarding CP2, we note that this relates to hypothetical concerns regarding a small number of legislative provisions from within the corpus of Irish financial services law, rather than any manifest experience of the Central Bank's statutory or regulatory independence being compromised.

The independence of the Irish Central Bank is a core pillar of the Irish financial system and is essential for both the system's effectiveness and its international credibility. For this reason, when introducing reforming legislation to restructure the Central Bank following the financial crisis, the Government took great care to reaffirm the Central Bank's independence. To underline this point, the Government has further introduced a range of measures to strengthen the powers of the Central Bank and to extend its remit into new areas of responsibility such as bank resolution.

While the Irish authorities do not fully agree with the IMF view under this category, we will consider the recommendation for a more detailed framework for Central Bank independence in the context of any future review of the statutory basis of the Central Bank.

### **CP 9 Supervisory Techniques and Tools**

Ireland's approach to supervision is risk based and starts with the premise that all firms are not equally crucial in the banking system and the wider economy. Supervisory efforts and resources are focused on those firms whose failure would have a significant impact upon the banking system, the economy, the taxpayer and the consumer. This approach to supervision is in keeping with the IMF's and the Basel Committee's principle of proportionality.

The IMF has rated Core Principle 9 as being Materially Non-Compliant. However, the specific issues raised by the IMF mainly relate to potential calibration issues with the supervisory engagement model for the least risky and non-systemically important cohort of Irish licensed banks i.e. medium low impact banks. This cohort of 10 non-retail institutions comprises 3 percent of total Irish banking system assets, does not take retail deposits, comprises 2 percent of all Irish corporate deposits, is not involved in retail lending, and transacts with counterparties who are predominantly business to business and intra-group. Moreover, although the IMF views the Medium Low Impact engagement model as heavily reactive with light data validation/verification, this description is only accurate for low impact credit institutions, i.e. branches of EU Banks operating in Ireland, which are primarily under foreign prudential supervision. No Irish licensed bank has been categorised as low impact.

The Central Bank will follow the two recommendations made by the IMF relating to CP 9. We will review the distribution of resources and supervisory tasks across medium low and low impact credit institutions as the Single Supervisory Mechanism ("SSM") enters into force. As part of our implementation of the SSM requirements we will adhere to the requirements of the SSM Supervisory Manual which sets out the processes, procedures and methodology for the supervision of both Significant and Less Significant institutions, including supervisory tasks and KRIs.

### **CP 20 Related Party Transactions**

Related party transactions in the Irish banking system are predominantly in respect of lending rather than service contracts or deposits, and accordingly the Central Bank has tailored its supervisory regime to capture higher risk transactions in this area. The supervisory approach includes a Code of Practice ("the Code") to which all licensed credit institutions must adhere and a detailed reporting framework is in place to ensure that the requirements set out in the Code are being met on an on-going basis. The framework also includes on-site testing, lending limits and the requirement for the prior approval of the Central Bank for transactions over €1m.

While the Irish Authorities therefore do not entirely agree with the IMF's rating of Materially Non-Compliant in relation to related party transactions, the Central Bank will undertake an evaluation of

related party transactions and will evidence any potential risks outside the scope of the current Code. The Code will be amended accordingly.

### **CP 29 Abuse of Financial Services**

The Irish Authorities will follow the IMF recommendations in relation to CP 29. In relation to Guidelines envisaged by Section 107 of the Criminal Justice Act 2010, the Central Bank will request that the appropriate authority, the Minister for Justice, issues such guidelines. Furthermore, the Central Bank will communicate its principal findings to the banking sector following the Anti-Money Laundering reviews undertaken in 2013. The Irish Authorities also note the comments regarding the balance between onsite and offsite reviews and will undertake a review to ensure the appropriate balance exists.

The Irish Authorities acknowledge that branches of foreign banks have not been inspected, and while this is considered to be consistent with our risk focused approach to AML supervision, branch inspections will be performed.

### **Concluding Authorities' Comments on IMF Findings and Ratings**

The Irish Authorities acknowledge the importance of continually monitoring and seeking to improve the regulatory framework and supervisory practices and remain strongly committed to so doing. To that end, the Irish Authorities will evaluate and consider the IMF's recommendations, in the context of the IMF's endorsement of Ireland's supervisory approach, as reflected in the compliant rating for CP 8. We are currently preparing to implement the SSM requirements from 4 November 2014. The Single Supervisory Mechanism will fundamentally alter the manner in which credit institutions are supervised within the euro area and will consequently change the way in which the Central Bank supervises credit institutions in Ireland.

## ASSESSMENT OF IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

**61. Ireland exhibits a high level of implementation of the International Organization of Securities Commissions (IOSCO) principles.** The legal framework is robust and provides the Central Bank with broad supervisory, investigative and enforcement powers. There are arrangements for on-site and off-site monitoring of regulated entities. Thematic reviews in selected areas have complemented such monitoring. The Central Bank and the Irish Stock Exchange have also developed sound systems for market surveillance. The Central Bank's key objectives include monitoring and mitigating systemic risk. It routinely reviews the perimeter of regulation. Its powers to cooperate with domestic and foreign counterparts are extensive. Accounting and auditing standards are high.

**62. Some areas of supervision and enforcement require strengthening.** In particular, the Central Bank should make more use of on-site inspections for all types of market intermediaries. It should also pursue the use of all of its available enforcement authority, including criminal prosecutions, where appropriate.

**63. Certain aspects of the legal provisions regarding the governance structure of the Central Bank raise concerns about its independence, although there were no indications of any interference with day-to-day operations.** The presence of a member of the Department of Finance on the Commission of the Central Bank and the authority of the Minister to remove a Commissioner for reasons other than misconduct or incompetence may be threats to the Central Bank's independence.

**64. The regime that applies to entities that have issued their securities to the public where their securities are not admitted to trading on a regulated market needs to be strengthened.** General disclosure requirements for issuers with securities admitted to trading on a regulated market (RM)<sup>5</sup> are detailed and the full ambit market abuse rules apply to these securities. However, there are few equivalent provisions for issuers who offer securities to the public but elect not to have their securities admitted to trading on an RM. Further, both the Irish companies legislation and EU prescribed deadlines for publishing annual and interim reports should be reduced for all issuers, including collective investment schemes.

**65. The Central Bank lacks the power to appoint administrators to investments firms in the event of financial difficulties within the firm.** The Central Bank does not have authority to appoint an administrator or monitor to step in and run a firm that is in crisis, nor does it have

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<sup>5</sup> "Regulated market" is used as that term is defined by Markets in Financial Instruments Directive 2004/39/EC (MiFID). "Admitted to trading" means admitted to trading on a regulated market situated or operating within an EU or EEA member state and whose home state is Ireland (Transparency (Directive 2004/109/EC) Regulations 2007, Reg. 4(1)). The Main Securities Market of the ISM is the only regulated market in Ireland under this definition.

authority to take possession/control of assets held by a firm that is in financial difficulty. The absence of these powers effectively means that the only alternative course of action available is to liquidate a company, thereby crystallising potentially significant losses for investors and delaying the investors' access to their assets. In addition, the timeliness of the process of actually appointing a liquidator may put client assets at risk.

**66. There are impediments to the Central Bank's ability to attract and retain high-calibre staff.** The Central Bank needs to be able to structure its compensation programs to accommodate the difficulty in recruiting and retaining persons with the appropriate skill sets for particular positions.

## A. Background Information and Methodology Used

**67. The assessment was carried out using the 2011 IOSCO Methodology for Assessing Implementation of the IOSCO Principles (the Assessment Methodology).**<sup>6</sup> As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties. Principle 22 regarding credit rating agencies (CRAs) reflects an assessment of the European Securities and Markets Authority (ESMA), as the direct supervisor of CRAs in Europe, in a review conducted by the IMF in December 2012.

**68. The IOSCO Assessment Methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice.** The ongoing global financial crisis has reinforced the need for assessors to make judgments about supervisory and other operational practices and to determine whether they are sufficiently effective. Among other things, such judgments involve reviewing the inspection programs for different types of supervised entities, the cycle, scope and quality of inspections, as well as how the relevant authorities follow up on findings, including by using enforcement actions.

**69. The assessment relied on information from a detailed self assessment submitted by the authorities,** as well as extensive interviews with the staff of the Central Bank, a review of legislation, regulations, guidelines and related materials, along with interviews with the staff of other competent authorities in the jurisdiction, including the Irish Stock Exchange (ISE), Irish Accounting and Auditing Supervisory Authority (IAASA), the Financial Services Ombudsman, and the Office of the Director of Corporate Enforcement, and with market participants and other stakeholders.

## B. Main Findings

**70. Table 4 below provides a detailed summary of implementation Principle by Principle.**<sup>7</sup>

<sup>6</sup> The assessment team comprised Tanis MacLaren and Mark McGinness, both external technical experts.

<sup>7</sup> The Methodology for the assessment on the level of implementation of the IOSCO Principles, as updated in September 2011, can be found at: <http://www.iosco.org/pubdocs/pdf/IOSCOPD359.pdf>.

**Table 4. Ireland: Summary Implementation of the IOSCO Principles**

| <b>Principle</b>   |
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| Comments   |
| <b>Principles 1–8, Principles relating to the regulator</b>  |
| <b>1. The responsibilities of the Regulator should be clear and objectively stated.</b>  |
| CBI has a clear mandate defined by law. The ISE and IAASA are also assigned discrete responsibility for aspects of the securities markets. Five other competent authorities, the Office of the Director of Corporate Enforcement, the Takeover Panel, National Consumer Agency, the Financial Services Ombudsman and the Garda Síochána, also play a role. CBI has established formal and informal cooperation arrangements with these agencies. Despite the number of bodies, there is a consistent regulatory approach among them.   |
| <b>2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.</b>   |
| CBI operates free of influence from the government and the industry on a day-to-day basis. Operational issues are under the control of the Commission of the Central Bank and delegated appropriately to senior management. However, there are two impediments to independence. The Minister for Finance may remove an appointed member of the Commission from office for reasons other than misconduct or incompetence. Secondly, the Secretary General of the Department of Finance is an ex-officio member of the Commission. Persons affected by decisions of CBI are afforded a full range of protections, including the right to be heard, to written reasons and to rights of appeal.<br>While Central Bank officers and employees are covered by legal immunity provisions, there is no provision for CBI to pay those persons' legal costs if sued. As a matter of practice, CBI reimburses staff for legal expenses but does not indemnify them so that costs are met during the course of a suit. |
| <b>3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.</b>   |
| CBI has sufficient powers to carry out its functions in the capital markets. It has full authority to license, inspect, enforce and regulate the participants in the capital market in Ireland. CBI has effective policies and governance practices in place. Training programs for staff have been enhanced. CBI has an active Consumer Protection Unit.<br>The effect of the government's recent legislation imposing a pay-cut on Central Bank staff has a constraining effect on CBI's ability to seek and retain experienced regulators.<br>Resources required for the breadth and number of institutions and the resource demands of the PRISM process may result in under-resourcing allocated to the medium and low impact institutions. Additional resources are required.  |
| <b>4. The Regulator should adopt clear and consistent regulatory processes.</b>  |
| CBI publishes consultation papers ahead of legislative changes. CBI website makes available its rules, codes of conduct and guidance materials but the laws and regulations need to be consolidated. Regulatory actions undertaken by CBI are fair and reasonable, transparent and comprehensible to the affected persons and the marketplace, and there is consistent application of relevant principles. Persons affected by decisions of CBI are afforded a full range of protections, including the right to be heard, to written reasons and to rights of appeal.   |
| <b>5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.</b>  |
| CBI staff observe high standards of professional conduct and are subject to a Code of Ethics, including provisions on conflicts of interest and confidentiality. However the Code is not publicly available. Employee Trading Rules impose restrictions and require disclosure. A disciplinary procedure is in place to deal with employee misconduct.   |

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| <p><b>6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.</b></p>  |
| <p>A key objective of CBI is to monitor and mitigate systemic risk. The Financial Stability Committee and Risk Governance Committee share expertise with Central Bank personnel. A Cross-Sector team within the Risk Division of CBI identifies common risk for supervisors. The Supervision Divisions and its risk-based program, PRISM, underlie a comprehensive new regulatory process. Domestic authorities have protocols in place and meet regularly to address systemic issues.</p>  |
| <p><b>7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.</b></p>  |
| <p>CBI regularly reviews the perimeter of regulation. The Supervisory Risk Committee, the Financial Stability Committee and the Policy Committee provide fora for senior management to discuss risks posed to investor protection, markets and systemic risk. CBI's Unauthorized Providers Unit also monitors unauthorized activity. The output of these activities can and have led to law reform. In the European context, CBI is represented on the European Systemic Risk Board. CBI also shares information with ESMA through its MOU and within its expert groups.</p>  |
| <p><b>8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.</b></p>   |
| <p>CBI and the legal regime have processes and requirements in place to address conflicts of interest and misalignment of incentives. CBI staff, issuers, intermediaries, the ISE, self-regulatory organizations and CIS are subject to extensive requirements regarding the avoidance, mitigation, management and disclosure of conflicts of interest.</p>   |
| <p><b>Principle 9, Principle relating to self-regulation</b></p>  |
| <p><b>9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.</b></p>   |
| <p>There are three organizations in Ireland that exercise some direct oversight responsibility for certain market participants. These approved professional bodies have rules that bind their members who have been approved to provide limited investment business services and these rules are subject to meaningful sanctions. All three are professional accounting associations that are subject to the oversight of CBI (and other regulatory and governmental bodies in Ireland). They are required to observe high standards of conduct in carrying out their tasks. The confidentiality rules that bind all authorities (including the SROs) may inhibit efficient cooperation in oversight efforts. Further, the conditions that are imposed on the ISE and the oversight arrangements that are in place at the Central Bank meet the standards under this Principle.</p> |
| <p><b>Principles 10–12, Principles relating to enforcement of securities regulation</b></p>   |
| <p><b>10. The Regulator should have comprehensive inspection, investigation and surveillance powers.</b></p>  |
| <p>CBI has broad inspection, investigation and surveillance powers.</p>   |
| <p><b>11. The Regulator should have comprehensive enforcement powers.</b></p>   |
| <p>CBI has comprehensive powers to investigate and take action against anyone who breaches the laws it administers. Its ability to investigate and sanction has been enhanced by changes to Central Bank Act in 2013 increasing fines, allowing for restitution and investigation costs and giving CBI the authority to obtain an order restraining a person from contravening financial services law.</p>  |
| <p><b>12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</b></p>  |
| <p>CBI's risk-based system, PRISM, informs its supervisory and investigative program supplemented by thematic reviews, formal and informal reports. Apart from CIS which have a dedicated team for Low Impact funds, the supervisory approach for firms that fall into the Low Impact category relies heavily on reactive processes. For Low Impact firms no minimum frequency of onsite reviews and engagement is prescribed. An Administrative Sanction Procedure has proved a successful approach to obtaining significant monetary</p>  |



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| sanctions through settlement. These sanctions are published. However, the success of this approach may have been at the expense of criminal remedies; since 2010 no matters referred by CBI to the criminal authorities have resulted in a conviction – either summarily or on indictment.   |
| <b>Principles 13–15, Principles for cooperation in regulation</b>  |
| <b>13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.</b>   |
| CBI has the ability and capacity to share information and cooperate with other authorities in Ireland, within Europe, and internationally. It can share confidential information with any other foreign regulatory authority and has a record of active cooperation.   |
| <b>14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.</b>   |
| CBI is a signatory to the IOSCO Multilateral MOU, an MOU with ESMA and a number of bilateral MOUs with its international counterparts. It participates in a Supervisory College overseeing an international fund manager. It has bilateral MOUs with the ISE, the Financial Services Ombudsman, the ODCE, and the IAASA.   |
| <b>15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.</b>   |
| CBI became a signatory to the IOSCO Multilateral MOU in December 2012 and it has shared information under that agreement. CBI does not require the permission of any outside authority to share or obtain information; nor does it require an independent interest in the matter to obtain or share information.   |
| <b>Principles 16–18, Principles for issuers</b>  |
| <b>16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.</b>   |
| The initial disclosure requirements for offers of securities to the public are extensive. All public issuers are required to prepare audited annual financial statements. Issuers with securities admitted to trading on an RM and ESM companies are required publish half yearly reports. Only annual financial statements are mandated for wholesale debt securities on GEM and other public issuers. The reporting deadlines for the issue of financial statements prescribed by the EU directives and Irish companies law are slow compared to reporting practices in major markets outside the EU. For all issuers, a change of auditor must be notified within a month of the change, unless the securities of the issuer are admitted to trading on an RM and the information is deemed to be price sensitive.<br>IAASA examines whether the annual and half-yearly financial reports of Irish issuers admitted to trading on an RM have been drawn up in accordance with the relevant reporting framework. CBI and the ISE contribute to the monitoring and review of the non-financial disclosure of issuers admitted for trading on an RM and/or quoted on ESM. ISE reviews the disclosure by companies on its three markets. Very little continuing disclosure is required of public issuers who offered securities to the public but whose securities are not admitted to trading on an RM or traded/quoted on an MTF (however, CBI advised that there are few of these companies) and no one is responsible for review of any of the continuing disclosure of these other public issuers. |
| <b>17. Holders of securities in a company should be treated in a fair and equitable manner.</b>  |
| Investors are treated equitably with respect to voting and the ability to participate in any takeover bid. Full information must be provided for any takeover bid and the price paid to shareholders must be equitable. There are extensive disclosure requirements for substantial shareholders, officers, directors and other parties. However, the trigger thresholds vary, as do the persons caught, the timing applicable to the disclosure, the associates who must be included and the relevant securities (or transactions) that must be disclosed. Only some of the requirements apply to public issuers that are not admitted to trading on an RM. The information required to be provided to shareholders of companies other than ones admitted to trading on an RM is limited.   |
| <b>18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.</b>  |

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| <p>Companies generally are required to prepare their accounts using either: IFRS or UK and Irish Generally Accepted Accounting Principles (GAAP).</p> <p>Certain issuers can also use alternative bodies of accounting standards (US GAAP, Canadian GAAP and Japanese GAAP). Where certain third country accounting standards have been deemed equivalent by ESMA, they also are permitted to be used in Ireland. UK and Irish GAAP are the accounting standards comprising the Financial Reporting Standards (FRS) issued by the Financial Reporting Council (FRC) in the UK. If the company is required to prepare consolidated accounts and admitted to trading on an RM (or is a bank or insurance company that has listed equity or debt on an RM), it must use IFRS as endorsed by the European Union.</p>                    |
| <p><b>Principles 19–23, Principles for auditors, credit rating agencies and other information service providers</b></p>   |
| <p><b>19. Auditors should be subject to adequate levels of oversight.</b></p>   |
| <p>There is a system in place that subjects auditors to appropriate levels of oversight. Auditors must be a member of and supervised by a Recognized Accountancy Body, which is then overseen by the IAASA, an independent statutory body. The Recognized Accountancy Bodies conduct examinations of auditors. The IAASA examines the Recognized Accountancy Bodies' exercise of these powers. Both have the power to sanction breaches of the standards. The resources at IAASA are not sufficient for the tasks assigned.</p>   |
| <p><b>20. Auditors should be independent of the issuing entity that they audit.</b></p>   |
| <p>There are extensive requirements for auditors to be independent of the entities they audit and these requirements are enforced by the Recognized Accountancy Bodies, subject to oversight by IAASA.</p>  |
| <p><b>21. Audit standards should be of a high and internationally acceptable quality.</b></p>   |
| <p>The financial statements included in prospectuses, listing documents and publicly available annual reports must be audited in accordance with the International Standards on Auditing (UK and Ireland) as issued by the Financial Reporting Council in the UK. The International Standards on Auditing (UK and Ireland) are based on International Standards of Auditing as issued by the IAASB.</p>   |
| <p><b>22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.</b></p>   |
| <p>This principle has to consider that ESMA is the direct supervisor of CRAs in Europe. It was reviewed in December 2012. All CRAs that provide services in Ireland were subject to a thorough registration process, through colleges of European regulators. ESMA has conducted on-site inspections of the large CRAs. There are no local CRAs in Ireland. All CRAs that provide services in Ireland were subject to a thorough registration process by colleges of European regulators. ESMA has conducted on-site inspections of the large CRAs and is in the process of implementing a risk framework to support its supervisory program. Additional resources are necessary for ESMA to carry out its functions effectively.</p>   |
| <p><b>23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.</b></p>  |
| <p>Entities that provide analytical or evaluative services are caught either by MiFID or the Investment Intermediaries Act 1995, and have to be authorized by CBI.</p>  |
| <p><b>Principles 24–28, Principles for collective investment schemes and hedge funds</b></p>  |
| <p><b>24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.</b></p>   |
| <p>CBI authorizes and supervises two CIS regimes - under the UCITS Regulations and the EU UCITS Directive 2009/65/EC and under the Alternative Investment Fund Regulations and Alternative Investment Fund Managers Directive 2011/61/EU. Funds offered to the public and their operators and distributors are subject to authorization and reporting requirements. Both regimes require the operator and fund manager to have appropriate organizational and operational structures in place, including risk management systems and internal controls. There is an extensive and detailed reporting process. On-site inspections and off-site reviews are informed by PRISM and supplemented by thematic reviews, sampling and reports. Outsourcing is permitted and has been availed of but subject to detailed requirements.</p> |

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| <p><b>25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</b></p>   |
| <p>Fund prospectuses are obliged to contain detailed information on the legal form of the CIS and the rights of investors. Assets are segregated from those of the operator and distributor and are required to be held by a depository or custodian. While there is no prohibition of separation of management in a group, it is prohibited for the function of the custodian or the depository to be performed by the same legal entity responsible for the investment functions. There must be functional independence between these entities and no persons are permitted to sit on the boards of both entities.</p>  |
| <p><b>26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</b></p>   |
| <p>All publicly offered funds must be approved by CBI, which reviews the detailed prospectus containing comprehensive information about the CIS. Material changes must be notified. Prospectus amendments require the consent of CBI prior to registration. Investor protection provisions are robust. The reporting requirements for both AIFs and UCITS, although regular and adopted through the EU, are too slow to be effective</p>  |
| <p><b>27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.</b></p>  |
| <p>Securities and assets are required to be valued fairly and independently. The prospectus of the fund must contain information about valuation, pricing and the applicable provisions governing purchase and redemption of funds. Continuous disclosure of the price is also prescribed. However, it is not clear that the valuation of CIS assets is to be performed in accordance with IFRS or UK and Irish GAAP, or some other high quality accepted accounting standard. While there is industry guidance, CBI has not issued rules prescribing how pricing errors are to be treated by CIS.</p>  |
| <p><b>28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.</b></p>  |
| <p>"Hedge fund" is not a defined term in Ireland but it is treated by CBI as a CIS regardless of its legal structure under national law. The AIFM framework governs registration, internal organization and operational conduct. The operator must be authorized by CBI and subject to inspection in accordance with PRISM and supplemented by other supervisory initiatives.</p>   |
| <p><b>Principles 29–32, Principles for market intermediaries</b></p>  |
| <p><b>29. Regulation should provide for minimum entry standards for market intermediaries.</b></p>  |
| <p>A framework is in place for authorization and to apply on-going requirements for market intermediaries. Applicants are subject to detailed off-site reviews before being authorized. On-site reviews are not routinely performed as part of the authorization process other than by the ISE. There are some gaps in the information posted on CBI's website regarding authorized firms.</p>  |
| <p><b>30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</b></p>   |
| <p>There are initial and ongoing capital requirements for all types of intermediaries to ensure that they have adequate resources to meet their business commitments and address the risks of their businesses. The capital requirements for MiFID firms trading on their own account or holding client assets are based on the EU Capital Requirements Directive and address the range of risks to which the firms are exposed, including market and credit risk. Liquidity and operational risk are addressed via the Basel II 'Pillar 2' Internal Capital Adequacy Assessment Process. The capital formulae for other intermediaries are fairly simple, reflecting the nature of operations that are carried on in practice.</p> |
| <p><b>31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.</b></p>   |
| <p>Market intermediaries are required to have systems of risk management and internal controls in place. If a</p>   |

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| <p>MiFID firm has an internal audit function, this function must review these systems annually and the results of that review must be reported to the Board of Directors of the firm. If an intermediary holds client assets, an auditor's review of the systems and controls of the intermediary in relation to the safekeeping of and accounting for client assets is required on at least an annual basis. Otherwise there is no compulsory review of the internal controls by an objective party. There are regulations for proper protection of clients, including requirements for segregation of clients' assets and business conduct rules, such as 'know your client' and suitability. The rules regarding conflicts of interest and protection of client assets are extensive.</p>  |
| <p><b>32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</b></p>  |
| <p>CBI has plans in place for dealing with a firm's failure. The plans are flexible to include action to restrain conduct, to ensure clients' assets are properly managed and to provide relevant information to the regulators. CBI does not have the authority to appoint an administrator to run a firm that is in crisis, nor can it take possession of the assets held by the intermediary. In relation to insolvent firms the appropriate option of liquidation is available to the Central Bank under both MiFID and the Investment Intermediaries Act, 1995. There are investor compensation funds available in the event of losses, but the amounts available are fairly low at €20,000, the EU minimum pursuant to the EU Investor Compensation Scheme Directive. Where a failure has cross border implications, MOUs are in place to facilitate information sharing.</p> |
| <p><b>Principles 33–37, Principles for the secondary markets</b></p>  |
| <p><b>33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.</b></p>  |
| <p>Securities exchanges, as RMs, and MTFs, are subject to authorization by CBI. There are specified criteria that any applicant must meet, including requirements regarding systems and other infrastructure capacity, technical competence, etc. No routine on-site visits are performed before authorization is granted. The conditions that are imposed on the ISE and the oversight arrangements that are in place at CBI generally meet the standards under the Self-Regulatory Organizations Principle 9.</p>   |
| <p><b>34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</b></p>  |
| <p>There is a comprehensive oversight system for exchange supervision that includes on-site examinations and off-site reviews of rules and other matters. CBI may suspend the operations of a stock exchange or MTF. Surveillance of the markets is carried on by the ISE and CBI.</p>  |
| <p><b>35. Regulation should promote transparency of trading.</b></p>  |
| <p>There is both pre-trade and post-trade real-time transparency of prices on the ISE for trades, in accordance with the provisions of MiFID. The exceptions are subject to clearly defined conditions and prompt post-trade reporting. Certain specified trades are permitted to take place outside the automatic trading system, subject to clearly defined conditions and prompt post-trade reporting. A specific waiver from pre-trade transparency must be granted for these types of transactions. All transactions in any securities undertaken by market intermediaries must be reported to CBI by T+1 at the latest.</p>   |
| <p><b>36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.</b></p>  |
| <p>There are rules in place with respect to market manipulation and insider trading that apply only to securities admitted to trading on RMs. Trading conducted on securities quoted/traded only on MTFs or trading that takes place off-exchange is currently subject only to insider trading prohibitions provided for in the companies legislation. Proposed EU amendments to the Market Abuse Directive are expected to address this gap.</p>   |
| <p><b>37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.</b></p>   |
| <p>Trades in Irish securities are settled on systems physically located outside Ireland and supervised by foreign regulators. No ISE clearing member is established in Ireland. The functions of monitoring market exposures</p>  |

that are sufficiently large to create a substantial risk to the market or to a clearing firm are performed by supervised entities outside of CBI's jurisdiction. CBI is relying on the supervision of the regulator in those jurisdiction without conducting any independent due diligence on relevant issues. There are large exposure limits in place, coupled with reporting requirements. The default rules at the clearing and settlement systems are public. CBI has does not have specific information sharing MOUs relating to these matters in place with all of the relevant regulators. However, they are all parties to the general ESMA and IOSCO Multilateral MOUs. There are provisions in place addressing short selling.

**38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.**

Not assessed.

## C. Recommended Actions

### 71. Table 5 below lists the suggested actions for improving compliance with the ....

Recommendations are proposed on a prioritized basis.

| <b>Table 5. Ireland: Recommended Actions to Improve Implementation of the IOSCO Principles</b>  |
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| <b>Principle.</b> Recommended Action  |
| <b>High priority</b>  |
| <b>12.</b> A more proactive approach to supervision of firms designated by PRISM as Low Impact should be implemented.<br>More prosecutions should be pursued against individuals.   |
| <b>3.</b> The government should give the Central Bank additional resources and the flexibility to depart from the civil service compensation rules.   |
| <b>18 and 19.</b> As for the Central Bank, IAASA should be given additional resources and greater freedom to contract with staff on appropriate terms in order to recruit and retain staff with the necessary expertise.  |
| <b>31.</b> The Central Bank should introduce a general requirement that all firms conduct an annual review of risk management and controls. This review should be required to be performed to objective standards and by a function or entity that is independent of the business of the firm.  |
| <b>36.</b> The Companies Law should be amended or other legislation introduced to prohibit the full scope of activities that are abusive to the market regardless of where that trading takes place or whether the securities are admitted to trading on an RM.   |
| <b>37.</b> The Central Bank should carry out reasonable due diligence on the regimes where the principal clearing and settlement of trades by Irish intermediaries or in Irish securities take place, both on the regulatory oversight conducted and the effects of bankruptcy/ insolvency regimes on positions (client or intermediary) held in that jurisdiction. Obtaining opinions from legal counsel on the treatment of assets and positions on insolvency, particularly in Belgium, the UK and Germany, would also be prudent. The MOU with the UK authorities regarding oversight of CREST should be updated and one should be put in place with BaFin regarding the oversight of Eurex Clearing to ensure an effective gateway for clearing related information. |
| <b>Medium-high priority</b>   |
| <b>32.</b> The Central Bank should be given the authority to appoint an administrator or monitor to step in and run a firm that is in crisis.   |
| <b>9.</b> Consideration should be given to exploring adjustments that might be made to the confidentiality  |

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| requirements to facilitate more open discussions and greater sharing of information among the relevant authorities.   |
| <b>12.</b> The government should consider raising the maximum fines that the District Court can impose on defendants in summary criminal matters to provide a more significant deterrent.   |
| <b>16.</b> A change in auditor should be considered to be a material change that gives rise to an obligation for all public companies to immediately inform the relevant authorities, both IAASA and the Central Bank. Larger companies should be expected to issue their audited financial statements in a maximum of ninety days; smaller issuers may be given somewhat longer. The reporting period for interim statements of ESM companies should be shortened from three to two months at the longest. |
| <b>27.</b> The Central Bank should issue clear guidance that the valuation of CIS assets are to be performed in accordance with IFRS or UK and Irish GAAP, or some other high quality accepted accounting standard applied on a consistent basis.   |
| <b>Medium priority</b>  |
| <b>2.</b> The law should be amended to state that a Commission member may only be removed for specified, objective causes (such as bankruptcy, persistent failure to attend meetings, acting in conflict of interest, etc.)<br>The Government should amend the Central Bank Act of 1942 to remove the inclusion of a Ministry official on the Central Bank Board.   |
| <b>16.</b> All companies that have issued shares to the public should be subject to continuing disclosure requirements, regardless of their status as a listed company or the nature of the system on which their securities are traded or quoted.<br>The continuing disclosure documents issued by public companies should be subject to at least a periodic review by a competent authority.  |
| <b>17.</b> The Central Bank should issue detailed guidance on the information that must be included in any materials sent to shareholders in connection with a shareholder meeting and those requirements should apply to all public issuers.   |
| <b>26.</b> The periods within which CIS are required by EU directives to publish annual and semi-annual financial statements should be reduced to enhance transparency for investors and the ability to take prompt investigative or remedial action. (See also the recommendation in Principle 16.)  |
| <b>33.</b> As part of the review conducted by the Central Bank before a new trading venue is authorized it would be prudent to conduct an on-site inspection either immediately before the venue is given authorization or very shortly thereafter.<br>See also the recommendations under Principle 37 (high priority)  |
| <b>Medium-low priority</b>  |
| <b>2.</b> Consideration should be given to including provisions permitting the Central Bank to indemnify staff, officers and Commissioners for their legal costs in the event they are sued and make those moneys available to pay costs during the course of the suit.   |
| <b>4.</b> The process of official consolidation of the laws for public use needs to be accelerated. In the meantime, a competent authority in the State or some part of the government should prepare and post 'unofficial' consolidated versions of the key financial services acts and regulations.   |
| <b>17.</b> Consideration should be given to rationalizing and simplifying the requirements that apply to substantial shareholders, officers, directors and other parties. This regime should apply equally to all public issuers.   |
| <b>27.</b> The Central Bank should publish rules relating to pricing errors.  |
| <b>29.</b> The Central Bank should supplement the information made available to the public on the register of firms posted on its website to add: (i) the permitted activities for each investment product intermediary under the Investment Intermediaries Act, 1995; and (ii) the identity of senior management and names of  |

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| other authorised individuals who act in the name of a MiFID investment firm or an Investment Intermediaries Act firm.   |
| <b>Low priority</b>   |
| 5. Publish the Employee Code of Ethics on the website so that the public are informed of the high standards of ethical behavior that Central Bank staff are expected to meet. |

## D. Authorities' Response to the Assessment

The Irish authorities welcome the IMF's review of Ireland's supervisory and regulatory framework for securities and markets regulation. After significant changes over the last three years, the review comes at an important time in the evolution of the framework. The Irish authorities wish to express their appreciation to the IMF for the co-operative and positive manner in which the assessment was performed, and for the open and helpful dialogue throughout.

The IMF's overall assessment recognizes that Ireland exhibits a high level of compliance with the IOSCO Objectives and Principles of Securities Regulation. In that light, the Irish authorities note all the recommendations made in the report, in particular those made in the *Summary*. The Irish authorities commit to critically appraise current practices in light of the IMF recommendations with a view to taking action where appropriate, proportionate and practical.

The Irish authorities would like to make an important observation in relation to principle 37. This principle is clearly aimed at jurisdictions that have domestic clearing and settlement market infrastructures. As pointed out in the report, Ireland does not fit easily with the Principle given that trades in Irish securities are cleared and settled on systems physically located outside the State. The Central Bank disagrees with the assertion in the report that the State has "outsourced" its clearing and settlement functions. It is more correct to state that clearing and settlement for the Irish securities markets is provided within the EU Single Market by regulated service providers in other EU Member States. The European System of Financial Supervision allows Member States in the EU to mutually recognize and rely on the supervisory practices of other EU competent authorities. These practices are subject to monitoring and oversight measures at EU level by the ESAs and the European Systemic Risk Board. This avoids duplication and, in particular, the need for numerous bi-lateral agreement with other EU competent authorities. Given the purpose and intent of this Principle, the Irish authorities believe that a "*not applicable*" rating is more appropriate.

Finally, the Irish authorities wish to acknowledge that the assessment report provides a valuable point-in-time assessment of the Irish regulatory and legislative regime. The Irish authorities will carefully consider the comments and recommendations made in the report which will inform priorities and work-load for the coming years.