



CENTRAL BANK &
FINANCIAL SERVICES
AUTHORITY OF IRELAND

EUROSYSTEM

Address to Leinster Society of Chartered Accountants
Matthew Elderfield, Head of Financial Regulation, Central Bank
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Good afternoon. It is a pleasure to be with you here today for my first public appearance since arriving in Ireland from sunny Bermuda to a snow covered Dublin some ten weeks ago.

As you may know, the Government has decided to introduce legislation that will create a new Central Bank of Ireland encompassing activities currently carried out by the Financial Regulator. This legislation is expected very shortly.

I'd like to take this opportunity to use the next twenty minutes or so to set out - - for the first time in public -- my initial thoughts on my strategic priorities as Head of Financial Regulation in the new Central Bank.

In particular, I'd like to focus on three key priorities:

First, the need to overhaul the regulatory model for financial services in Ireland.

Second, the steps that are required to strengthen the banking system and therefore strengthen the economy.

And finally, the objective of continuing the Financial Regulator's successful work in consumer protection.

Let me start by discussing the need to overhaul our approach to financial regulation.

The devastating impact of the global financial crisis on Ireland's economy, finances and citizens is well known to you all and I will not use this occasion to analyse the causes and rehearse how we got here. As you know, the government has commissioned two preliminary reports requesting the Governor of the Central Bank, Patrick Honohan, and also Klaus Regling and Max Watson to report respectively on the regulatory and banking aspects of the crisis. Their work will be followed by a commission of inquiry later this year. I am certain that the Governor's analysis will be a frank and honest assessment of the performance of the Central Bank and the Financial Regulator.

But I do not think I'm stealing the Governor's thunder to state an obvious conclusion, one that has been acknowledged by the Financial Regulator itself. That obvious conclusion is that weaknesses in regulation contributed to the financial crisis in Ireland.

And I do not think it is necessary to await the Governor's conclusions to start work to reform the approach to financial regulation. Indeed, some of that work was already underway when I arrived.

It will be important to take a balanced and measured approach. While regulatory weaknesses did indeed contribute to the crisis, the Financial Regulator has also done a good job in many areas and has many dedicated and hard-working professionals fighting in the front line of the crisis to strengthen the financial system and protect Irish consumers.

With that said, it is already clear to me that we need to undertake a fundamental overhaul of the regulatory model for financial services in Ireland. We need to address the obvious weaknesses that have caused problems here and also keep pace with best practice internationally, as regulators around the world are reassessing their approach.

We need to move beyond the debate on rules versus principles-based regulation, where it's clear a judicious mix of the two is required, rather than swings between the extreme.

Instead, I intend to implement a framework of assertive risk-based regulation underpinned by the credible threat of enforcement. We need to insist that the

biggest and riskiest firms manage themselves better and that firms and their management are held more accountable for their actions.

A risk-based regulatory model will allow us to calibrate the intensity of our regulatory standards and day-to-day supervisory approach depending on the risk profile of the firms and sectors we supervise.

Rolling this approach out across all the firms we regulate will require a more rigorous analysis of the inherent impact of different financial firms in order to set the right level of resource and engagement by the regulator. It will also involve a more systematic assessment of the different potential sources of risk in a firm. This assessment must involve a better understanding of business risks – the front office of a firm – as well as the traditional regulatory assessment of control risks – the middle or back office.

A risk-based model means that we will not have a one size fits all approach. We need to be balanced and proportionate depending on the risk of the sector or firm in question. While we do need to improve our level of engagement across the board, a systemically important bank should expect a much more intrusive approach than a fund or wholesale insurance company with a lower risk profile.

I described the risk-based approach as “assertive.” Risk-based supervision is not just about identifying risk and pointing it out to a firm’s senior management to sort as they think best. Our risk-based approach must insist that risks are not only identified but are also managed effectively.

High impact firms and those with a poor track record should not expect to receive the benefit of the doubt from me or my staff when the best approach to addressing a risk is a point of contention between us. We will have an open and engaged dialogue with a firm’s senior management. But if we remain unconvinced by management’s plans we will be prepared to substitute our prudential judgement for their commercial one and say: Just do it.

To be effective this approach needs to be underpinned by a credible threat of enforcement. We don’t need to become an enforcement-led regulator who shoots first and asks questions later. But both financial firms and those that lead them need to be held much more accountable for their actions than has

happened in the past, and be subject to tougher sanctions. However, it is clear that it will take some time to bring this new approach on line.

We will be setting up a dedicated division to deal with enforcement matters, with special investigative units established for the first time and led at a senior level. The new head of enforcement will undertake a review of our current staffing, processes and powers later this year.

What is needed to make this new approach work? Ireland is competing as a premier financial services centre. But you can't referee a Premier League match with one linesman and no red card in your pocket. It's important that we have the resources and powers needed to do the job. As a result, there will need to be a substantial increase in resources at the regulator. And we will need new legislation informed by an assessment of the gaps in our current powers. I'm pleased to say that there is a strong commitment at the Board and in Government to do both.

Let me turn to the measures that are required to strengthen the banking system, and therefore the economy as a whole.

The immediate priority over the coming weeks is to complete our work necessary to recapitalise the banking sector. This is involving a rigorous assessment of the post-NAMA exposures of the banks under a base and stress scenario and setting a prudent target capital requirement that is informed by emerging best practice internationally.

The recapitalisation exercise will help draw a line under the banking crisis and therefore help get credit flowing again. It is not for the benefit of the banks or their management but is an essential step for the recovery of the finances of Irish businesses and Irish households by improving confidence in the economy.

And just like the actions that have been taken to control the budget have created clear blue water between Ireland and some other euro zone countries, taking decisive action on the banking recapitalisation will improve our international standing in the financial markets.

While the recapitalisation exercise is the immediate short-term priority, there are some important medium-term priorities for banking regulation.

Many of these medium-term priorities will be set internationally, as there is a step change in banking capital and liquidity standards underway in the Basel Committee on Banking Supervision and the EU. A robust recapitalisation exercise will ensure that Ireland's banks start this process in a stronger position and with a better funding outlook. But like many banks internationally, it will take some time to rebalance the funding profile between retail and wholesale sources and to exit funding support measures. Appropriate transitional arrangements will therefore be needed before the new liquidity framework comes into force.

While much of the bank regulation agenda will be set internationally, to reflect the common international drivers of the global financial crisis, it is important to recognise that aspects of the banking crisis in Ireland were home grown.

Our strategy for banking regulation will therefore include measures aimed to prevent future excesses of concentrated lending against individual sectors by developing tougher standards for concentrated exposures, for example. More details on approach will be published in due course.

Also, it is clear that there have been fundamental failings in corporate governance. We will be coming forward with a package of proposals covering corporate governance standards, tougher fitness and probity requirements and guidelines on remuneration and risk taking. Many of these will extend beyond the banking sector to other categories of financial services firms but will be developed, in line with our risk-based approach, in a proportionate manner.

This agenda – a prudent recapitalisation exercise, implementation of international standards, tougher requirements on credit concentrations and improvements to governance standards – add up to a stronger banking sector and therefore a stronger economy.

Finally, let me say a few brief words about consumer protection. Brief not because consumer protection is unimportant, but because this has been an area

of success at the Financial Regulator under the leadership of my predecessor Mary O'Dea.

This is an area where I am committed to building on the good work that has gone on before. I am not one of those who subscribe to the theory that weaknesses in prudential regulation were caused by too much consumer regulation. Consumer protection must remain a top priority in the new regulatory structure.

We will therefore have a busy agenda for our consumer protection work in the years ahead. A key objective this year will be to review our Consumer Protection Code. This will be an opportunity to take stock of the Code and see where it needs to be strengthened. We will be launching a consultation exercise and I would invite interested stakeholders to start thinking about what changes they feel are necessary to the Code.

We will also be reviewing our Minimum Competency Requirements so that consumers can be confident that the people providing them advice are qualified and competent.

In the meantime, we will continue our programme of so called thematic reviews, where we assess the consumer protection practices in firms in a particular area and publish the results. These are a valuable tool in raising standards.

In addition, I am keen to see firms move more quickly to clear backlogs in handling overcharging cases. We will be writing to firms setting out deadlines for communicating with customers and providing compensation, making it clear that enforcement action will follow if our timelines are not met. I would encourage firms to act now to accelerate their work before we get in contact with them.

Perhaps the most pressing area of consumer protection concern is that of mortgage arrears. We recently amended our Code in this area to give home owners more time – now twelve months – to work out a solution to an arrears problem before legal action can be taken by their bank. We will be conducting a thematic review to check up on how banks are complying with this and other aspects of the Code. And we are contributing to the recently formed government working group to help develop other solutions to alleviate the arrears problem.

I believe this agenda shows that we will continue to be committed to having consumer protection at the core of our mission.

There will be other important elements to our strategic plan for the coming three years, which we will be publishing later this year. There are a number of important regulatory projects that need to be implemented, such as the Solvency II directive for insurance companies and UCITS IV and the so-called hedge funds directive for the funds industry. These measures combined with the raft of proposals on banking supervision are just the start of a significant agenda of international regulatory reform in the aftermath of the global financial crisis.

We need to enhance our advocacy and policy capability so that we can punch above our weight to influence these debates in Europe and to help assist industry with the process of implementation in Ireland.

The programme I have outlined today has the goal of delivering continued consumer protection, a stronger banking system and a more robust regulatory framework. It will take some time to implement and we will communicate these developments as they are finalised but I believe that more robust regulation will benefit Irish households and businesses.

What does this agenda mean for Ireland as an international financial services centre? I believe that the fundamentals of what make Ireland a successful financial services centre remain in place. Ireland is an attractive base of operation, with a well-educated English speaking workforce. Firms based in Ireland enjoy EU financial services passport rights and a favourable time zone. There is a well established infrastructure of professional services firms.

It is therefore no surprise that the IFSC has world class businesses and that the funds and insurance sectors, for example, have weathered the financial storm well.

The strategy I have outlined today will in my view add to the attractions of Ireland as a financial centre by establishing a reputation for strong regulation based on a rigorous assessment of risk.

The costs of weaknesses in regulation are already very evident in Ireland.

Over the next ten weeks and beyond, I therefore look forward to working with you and other stakeholders in developing the new approach that I have outlined here today to help ensure the regulatory framework contributes to a stronger economic future for Ireland.

Thank you.