



Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Gobharnóir / Governor

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A handwritten signature in black ink, appearing to read 'Gabriel Makhlouf'.

RE: FINANCIAL REGULATION PRIORITIES 2024

In line with past practice, this letter sets out my views on the macro-financial environment, the financial services landscape and the Central Bank of Ireland's regulatory and supervisory priorities for the year ahead. I have also set out in an appendix an overview of the delivery of our priorities in 2023. Overall, our objective remains to ensure we have a financial system that is stable and operates in the best interests of consumers and the wider economy.

The economic context

Our assessment of the outlook for the stability of the financial system continues to be shaped by the ongoing adjustment of the global economy to higher interest rates.

While economic activity slowed noticeably in 2023, the Irish economy is still expected to grow over the coming years. And despite some emerging signals of risks crystallising, the domestic household, business and banking sectors continue to demonstrate resilience in aggregate, as a result of a strong labour market, low levels of debt, prudent and appropriate macroprudential policy, and fixed borrowing costs for many.

However, while inflation has fallen in many economies, we have not yet seen the full extent of the lagged effect of monetary policy actions on borrower finances or economic demand. The global economy also remains vulnerable to bouts of volatility and shocks: there are significant risks to the economic outlook including increases in financial distress, the repricing underway in global and local commercial real estate markets, weakening loan growth and increased funding costs. These headwinds underline the (ongoing) need for carefully-calibrated macroeconomic policy.

The risk environment

The financial system in Ireland and across Europe has proved itself to be resilient – both financially and operationally – in the face of the turmoil of recent years largely as a result of policy action, robust regulation and supervision, and more prudent risk management practices from firms themselves. Looking ahead, the risk environment remains elevated, with a number of cross-cutting risks facing the system.

First, the adjustment to the changed interest rate environment and the uncertain path for inflation has potential implications for the financial resilience of firms (as a result of risks to asset valuations (in particular with illiquid and unquoted assets including commercial real estate), heightened market uncertainty, and credit and counterparty risks from the lagged economic impact of the sharp increase in euro area and global interest rates).

Second, there are a number of risks related to the interconnectedness of the financial system, and in particular the potential for economic shocks to be amplified due to liquidity mismatches and excessive leverage, and a potential for issues to cascade across firms, funds and the wider financial system.

Third, operational risk and resilience continues to be a priority for the year ahead, with risks driven by technological change, cyber security needs, an increasing reliance on outsourcing, and a concentrated cloud service provider market.

Throughout our work to address these challenges, we will continue to focus on ensuring that regulated firms are proactive and effective in identifying, mitigating and managing the risks to consumers and investors (including risks from rising costs of living, increased interest rates, firms' business practices, and an increasingly complex financial services sector).

In terms of specific sectoral risks, the heightened risk level associated with both the **payment/e-money** and **investment fund sectors** stand out. The former reflects significant control weaknesses identified in firms operating in this market, where their rates of growth and ambition have outpaced their operational, governance, compliance and risk management capabilities. Risks in the funds sector reflect structural vulnerabilities in parts of the sector such as leverage and liquidity mismatches, the impact of market volatility, market conduct risks, and the degree of interconnectedness with the wider financial system and economy.

In addition to these risks is a particularly difficult external environment with a number of short and longer-term challenges facing the economy and the system, including:

- risks related to significant and widening **geopolitical tensions** with potential ramifications for supply chains and markets, not to mention the risks from geo-economic fragmentation and a global economy that is less interconnected;
- **environmental and climate-related challenges**, including the implications of the increased severity and frequency of extreme weather events; and
- challenges from the increasingly **rapid digitalisation** of our economy and financial system.

Working with the Department of Finance

There are a number of areas where we will be working with the Department of Finance over the coming year. On domestic policy priority areas include:

- the continuing implementation of the Retail Banking Review;
- the development of a framework to protect consumers' and business's access to cash services and the resilience of the cash system;
- the National Payments Strategy;

- the completion of the 2030 Funds Review; and
- the Financial Literacy Strategy.

We will also support the Department on key international policy files including in the areas of banking, payments, capital markets, anti-money laundering and sustainable finance.

Our financial regulation priorities for 2024

Our financial regulation priorities are set in the context of our statutory mandate, our domestic and international responsibilities, and Ireland's large and increasingly complex financial sector.

Our priorities are:

- Putting in place a revised and modernised **Consumer Protection Code** to ensure consumers are protected in a more digitalised financial services sector;
- Continuing to progress work both internationally and domestically to address systemic risks from the **non-bank sector** and deepening our analysis and understanding of macroprudential risks in this sector;
- Implementing the **Individual Accountability Framework** (including within our supervision of firms) and supporting external stakeholders to embed the new standards;
- Preparing for the implementation of the **Digital Operational Resilience Act**, in particular in the context of Ireland's large technology sector;
- Implementing the **Markets in Crypto Asset Regulation**, including technical standards and engaging with firms seeking authorisation under the new regime;
- Implementing the **Credit Unions (Amendment) Act 2023**, including updating the Credit Union Handbook and amending Central Bank Regulations;

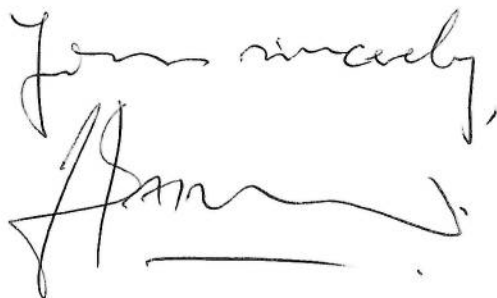
- Developing policy work and supervisory expectations related to the use of **artificial intelligence (AI) in financial services**, including preparing for the implementation of the EU's AI Act.

Our overarching supervisory objective remains ensuring we have a stable, resilient and trustworthy financial sector, operating sustainably in the best interests of consumers and the wider economy. We will continue to take a risk-based approach: we do not operate a no-failures regime but rather work to ensure any firms that fail do so in an orderly way.

In addition to our work within ECB Banking Supervision and the wider European System of Financial Supervision, specific supervisory priorities for 2024 include ensuring consumers are protected, firms are resilient and the system is stable in the face of the expected further pass-through of interest rates. We will also continue to improve on our authorisation processes, ensuring there is clarity, predictability and transparency for firms looking to be authorised, while maintaining the high standards the public expects for regulated providers of financial services.

Sectoral supervisory priorities include addressing deficiencies identified in the governance, risk management and control frameworks of some payment and e-money institutions and continuing to develop our approach to the investment fund sector, given its size and the vulnerabilities identified in recent years. In relation to our ongoing work on climate change, we will continue to work on the flood protection gap with the aim of assessing the materiality of the gap in Ireland (and the implications of the increased likelihood of extreme weather events).

I look forward to discussing these priorities with you, and to continuing the positive working relationship with your Department over the course of the year.

A handwritten signature in black ink, appearing to read 'Gabriel Makhlouf', written in a cursive style.

Gabriel Makhlouf

Appendix

LOOKING BACK AT 2023 PRIORITIES

Progress on the Central Bank's financial regulation priorities for 2023 (the Governor's letter of 17 January last year to the Minister for Finance) and the areas of collaboration with the Department of Finance included:

- An engagement programme with the public and other stakeholders on the evolution of the **Consumer Protection Framework** was completed ensuring we have a diverse range of perspectives to shape the consultation which will launch in Q1 of 2024.
- A consultation on the **Individual Accountability Framework** was completed and informed the Guidance and Standards that were published in December 2023. Work will continue in 2024 to embed the framework.
- We published a discussion paper on macroprudential policy for investment funds and a consultation on macroprudential measures for GBP liability driven investment (LDI) funds in July 2023, as part of our work to tackle **systemic risks generated by non-banks**. Engagement on both will continue into 2024.
- We continued to engage with UK authorities as they progress their work on the **Overseas Funds Regime** and the onboarding of Irish funds into the new regime. The work will continue in 2024 with the possibility of an equivalence assessment by the UK of regulated Money Market Funds (MMFs).
- We supported the Department in the drafting of the **Credit Unions (Amendment) Act 2023**.
- We continue to support the review of the **Sustainable Finance Disclosures Regulation** and the potential development of European ESG product categories/labels for sustainable funds.
- We launched a consultation on our **Innovation Hub**, which will run until early February 2024.
- We provided support and input at all levels into the development of the **EU's AML** package.
- We contributed to the review of the current **Payment Services Directive (PSD2)**.
- We worked on the policy development of cross sector Regulation for **Digital Operational Resilience** at EU. The work continues in 2024, with policy products submitted to the EU Commission in January and July 2024.

- We provided support for the Department's consultation on **MiCAR**.
- We continued to drive for **fair outcomes for consumers and investors**, particularly in the context of rising costs of living, ensuring the financial system was ready to deal with any increase in borrower distress. This will also be an area of focus in 2024.
- We continued to oversee the withdrawal of **KBC and Ulster Bank** from the Irish market, including their transfers of business activities and the orderly migration of c.1.2 million bank accounts.
- We continued detecting and sanctioning **market abuse** and supported the Garda National Economic Crime Bureau in the first criminal prosecution for insider dealing in the State's history.