



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

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Gobharnóir / Governor

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

FINANCIAL REGULATION PRIORITIES 2023

In line with past practice, this letter sets out my views on the macro-financial environment, the financial services landscape and the Central Bank's regulatory priorities for the year.

The economic context

There is no doubt that the macro-financial environment remains very challenging. Over the past 18 months, inflation has risen sharply across the world, as well as becoming more broad-based and proving more persistent than previously expected. These inflationary challenges are being experienced most acutely as shocks to people's real incomes and an erosion of living standards. Monetary policy globally is tightening to bring inflation back to target, the global economy is slowing and the outlook for the year ahead remains clouded by high uncertainty.

This rapid adjustment in the macro-financial environment follows a prolonged period of very low global interest rates and accommodative financial conditions. As we have highlighted in previous Financial Stability Reviews (FSR), this has resulted in the build-up of potential vulnerabilities across parts of the global financial system, including in non-bank financial intermediaries and segments of global financial markets.

In the Central Bank's most recent FSR, we outlined the key risks facing the financial system and the resilience of the economy and financial system to adverse shocks. In light of the abrupt shift in the macro-financial environment, we judge that global markets remain vulnerable to further shocks, in particular shocks to asset prices. There is potential for disruption in segments of the non-bank financial system, where leverage or liquidity mismatches are higher. Domestically, while the central expectation for the economy remains for positive (although lower) growth into 2023, the Irish economy is facing increased downside risks, given the size of the energy and inflation shock and the slowdown in the global economy.

The evolving financial system

The financial sector provides valuable services to European consumers and investors and continues to grow rapidly. Ireland is a global financial centre with the third largest funds sector in the world, the fifth largest insurance market in the EU (in terms of assets) and has seen significant growth in credit institutions' aggregate balance sheets (in particular coming from cross-border assets held by third country subsidiaries). Growth is also evident elsewhere, such as in the payments and electronic money sectors.

Moreover, growth in the sector is complimented by rapid change through digitalisation and technological innovation which is supporting the entry of new players – some of whom have global/cross-border ambitions – and new business models. These changes bring both opportunities and risks to the economy and community as a whole and will require us to adapt our regulatory approach.

This economic context will be central to our regulatory focus during 2023. We will be focused on ensuring that the financial system and firms operate to support the interests of consumers and users as they cope with the challenges that arise, and on ensuring that the system itself remains robust and stable. It is important to note that we do not operate a no-failures regime. In a properly-functioning system it is quite normal and expected that some firms will fail and our focus is that this happens in an orderly way. In order to support positive outcomes and the community's financial wellbeing, our regulation will continue to be outcomes-focused and follow six principles; forward looking, connected, proportionate, predictable, transparent and agile.

Working with the Department of Finance

There are a number of areas where the Central Bank and Department of Finance share strong common interest. In particular we will continue to engage with colleagues in the Department on:

- addressing the recommendations of the Retail Banking Review;
- the ongoing development of EU policy proposals and legislation (building on our expertise and role in the European regulatory and supervisory system);
- talking forward the recommendations made by the International Monetary Fund following its quinquennial review of the financial sector (which recognised Ireland's considerable progress in strengthening the framework for financial sector regulation, supervision and crisis management);
- Considerations around the opportunities and risks stemming from the further development of the international financial services sector, via the Ireland for Finance Strategy.

While the Competition and Consumer Protection Commission has the statutory responsibility in relation to financial education in Ireland, it remains highly relevant for the Central Bank's mandate which supports the overall welfare of the public (through the range of functions we perform including on consumer protection). As the financial system changes, there will be a need for financial literacy and education to continue to support consumers more generally.

Finally, I welcome continued engagement with your Department to ensure the effectiveness of Ireland's approach to the EU's sanctions regime (in particular following Russia's war in Ukraine).

Our priorities for financial regulation for 2023

Our financial regulation priorities for this year will support our strategic objectives and the need to respond to the dynamic and growing financial services system in Ireland. This growth increases complexity in the system and creates risks as well as benefits. We will work to ensure the broader domestic regulatory framework and EU and international regulatory frameworks adapt to the changing landscape.

Our regulatory priorities for 2023 are:

- Consulting and engaging widely on the development of our **consumer protection framework** (following the discussion paper we published last year);
- Consulting and engaging on the operationalisation of the **Individual Accountability Framework**, to ensure it is properly embedded by firms and individuals in order to enhance governance and standards of behaviour in financial firms;
- Continuing to progress actions on the **systemic risks generated by non-banks** (in particular advancing the development/operationalisation of a macro-prudential framework for non-banks, improvements to our legislative frameworks and investor protections in the investment fund sector);
- enhancing the **governance, oversight and investor outcomes in the funds sector** including the implementation of new ESG requirements and measures to mitigate greenwashing risks;
- the implications of the **UK's Overseas Funds Regime** (including the ongoing equivalence process) to ensure that Irish domiciled funds can continue to service UK investors;

- Implementing **changes to credit union regulations/guidance** arising from the Department of Finance-led Policy Framework Review, including through engaging with sectoral stakeholders;
- Strengthening the resilience of the financial system to **climate change risks** and its ability to support the transition to a climate-neutral economy, along with implementing the EU's **Sustainable Finance Disclosures Regulation**;
- Publishing a consultation paper on our **Innovation Hub** that will include an exploration of new ways of engagement with innovators and their products;
- Ensuring that the **EU's Anti-Money Laundering Action Plan**, including the establishment of a single supervisory authority (the Anti-Money Laundering Authority), results in a consistent and robust EU-wide framework;
- Contributing to the review of the **Payment Services Directive (PSD2)** and the functioning of open banking;
- Implementing new EU regulations on **digital operational resilience** and **markets in crypto assets**.

In supervising firms, we apply a risk-based approach which will need to continue to evolve to reflect the changing environment. Our 2023 supervisory priorities include the assessment and management of risks to financial and operational resilience, continuing to drive for fair outcomes for consumer and investors, overseeing the withdrawal of Ulster Bank and KBC from the Irish market and detecting and sanctioning market abuse.

Conclusion

Last year saw some important milestones in the Central Bank's work programme, including the completion of our Mortgage Measures Framework Review, new regulations on differential

pricing, the introduction of measures to manage risk in the property funds sector and the development of a structured framework for engagement (and our first Financial System Conference). Our broad regulatory mandate covers many sectors that serve Irish, European and global consumers and markets. The growth of these sectors – not least as a result of the Ireland for Finance Strategy, the UK's withdrawal from the EU and the focus of technology firms on financial services – poses challenges to our mandate. Our aim is to ensure the Central Bank continues to deliver its mission through a period of significant change.

I look forward to discussing the contents of this letter with you.

Yours sincerely


Gabriel Makhlouf