What you need to know from the Central Bank of Ireland's recent conference on financial systems

On 8 November 2023, the Central Bank of Ireland ("**Central Bank**") held its now annual conference on financial systems. The event had a full, day long agenda with just short of 30 contributors speaking on multiple topics. We have already provided clients with details of Governor Makhlouf's opening speech as well as a brief summary of some of the key messages delivered by the Central Bank speakers regarding its own policy initiatives in the FIG Top 5 at 5 on 9 November 2023. In this Insight, we consider some of the key themes addressed during the conference to ensure our client base is aware of views voiced on the day and current key themes of concern and interest to the financial services sector. We have grouped these under three headings:

1. The impact of uncertainty on the financial services sector;
2. Consumer issues; and
3. The Individual Accountability Framework.

Should you have any queries in respect of any of the discussion points raised, please do not hesitate to reach out to any member of the Financial Institutions Group or your usual Matheson contact.

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1. Impact of uncertainty on the financial services sector

Openness and Fragmentation

The impact of open strategic autonomy and fragmentation was a dominant thread throughout the conference, beginning with Andrew Bailey, the Governor of the Bank of England's key note address. Governor Bailey spoke of the benefits of open economies and the risk of fragmentation, both in the world economy and the financial system. Regarding openness, while acknowledging its positives, Governor Bailey explained that regulators have to "*set out carefully what we mean and how it works*". With regards to fragmentation the Governor explained that it doesn't just reduce the size of markets, it makes them inherently less stable. Put simply he said "*large markets and their infrastructures, which are run safely and to high standards, will support rather than endanger financial stability*".

The Governor referenced the importance of having global standards for the operation and oversight of such infrastructures, and strong co-operation among the interested countries – not just where the operator is located but also those where firms which use the infrastructure and depend on it, are located. The Governor named the global Financial Stability Board, and the "*so-called standard setting bodies*", the Basel Committee for banks, CPMI and IOSCO for payments, infrastructure, securities and investment markets, and the IAIS for insurance as examples of such co-operations. Ultimately he maintained that the outcome of such activity is much stronger standards, and "*an overwhelming case for rejecting the false allure of fragmentation.*" This was a message which was further emphasised in later panels including in extensive comments made by Tanguy van de Werve, Director General, European Fund and Asset Management Association.

The Governor also spoke to the LDI pensions issue in the UK which also impacted other European Union ("**EU**") countries, including Ireland, where the funds are typically domiciled. He praised the Central Bank for its "*excellent assistance*" in addressing the matter and spoke to the collective response which both regulators are taking to the issue going forward.

Member of the Board of the Governors of the Federal Reserve, Lisa Cook addressed in more detail the specific geopolitical tensions affecting the world currently. She spoke of subdued growth and the possibility that these tensions could destabilise commodity markets and access to credit in an already high interest rate environment.

Michael McGrath, Assistant Secretary of the Department of Finance in his panel commented that while recent world events point to a huge level of instability, the frameworks and regulations that exist at an EU level have generally withstood these upheavals. This position was similarly echoed by Cornelia Holthausen, Director General, Macroprudential Policy and Financial Stability, European Central Bank who stated that despite the uncertainties in the world economy, the EU systems "*are holding up well*". In order for this to continue to be the case, many of the panellists stressed the need for the financial services sector to remain open but that a balance between open and strategic must be found. Specifically looking at Ireland, Michael McGrath explained that Ireland has put the emphasis on open, rather than autonomy, and remains focused on de-risking, not decoupling.

Non- Bank Financial Institutions

Several of the panels touched on the rise of non-bank financial institutions ("**NBFI**"). Michael McGrath noted that Ireland has the second largest NBFI in Europe and quoted Governor Makhlouf that the 'non-bank sector deserves our full attention'. The NBFI he explained, has as an important role to play in financing the transition, as the money required is not going to come from the banking sector alone, or from Europe alone. He cautioned against creating a situation where there are lots of rules and regulations in one area and the other areas are forgotten about. The approach must be balanced, and there is a need to make the NBFI more resilient and more relevant, which contributes to economic activity. Building on this point, several other panellists confirmed that as NBFI is novel, it falls outside prudential regulation and so remains a blindspot for supervision. The (unanswered) question is how to regulate it without stifling innovation. The slow rate of development of EU procedures compared to the speed of digital transformation and innovation is something that must be reflected on, particularly as BigTech is now entering the NBFI sector.

De-risking

John Berrigan, Director General, Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the European Commission ("**Commission**") spoke of the need to improve the international competitiveness of the EU economy if we are to be in a position to de-risk and that financial services will play a crucial role in that regard.

Sustainable Finance

John Berrigan described the need to address climate change as one of the great generational challenges that will require very heavy investment by the EU over the coming decade. The vast majority of this financing will have to come from private sources and to "*channel these private funding flows, the EU has developed the sustainable finance framework*". He maintained that the sustainable finance framework is "*not rocket science but essentially about market organisation*."

Retail Investment Strategy

John Berrigan maintained that increasing retail investor participation is crucial for the success of the Capital Markets Union ("**CMU**"). Retail investor participation in capital markets "*can only be durably increased if those investors feel they are fairly treated and sufficiently empowered within a strong regulatory framework*." The Retail Investment Strategy he explained, takes account of the fundamental issues that the Commission has identified as needing to be addressed to boost investor participation in this market. Mr Berrigan acknowledged that many aspects of the proposal have proven controversial in the financial services industry but that was to be expected given how the financial services industry has organised itself to provide investment advice. However, it is the Commission's view that retail investors cannot and should not be encouraged into capital markets to meet the EU's CMU objectives unless the Commission is satisfied that the outcomes for those investors are adequate.

Derville Rowland spoke of the importance of the Central Bank's work at a European level to make sure that European policy frameworks, particularly the retail investor strategy, when it is brought in, does so in a way that is core and effective for retail participation in capital markets.

The EU over the coming months

Some discussion was had around the importance of the coming months at an EU level, particularly around scheduled and unscheduled elections in the Member States. The fact that we will have a new Parliament and Commission was highlighted as a point of particular importance. Stability from regulators, policymakers and politicians will be crucial to manage this period.

On the focus of the next Commission, John Berrigan stated that while he cannot prejudice the decisions of the next Commission, he felt that "*clearly the focus will remain on financial stability, competitiveness, sustainability, digitalisation and making financial services work for citizens but equally clearly the macro financial situation is in flux and this high level of uncertainty must be taken fully into account in our thinking for the future*".

2. Consumer Issues

Transformational point in financial services

Derville Rowland, Deputy Governor, Consumer and Investor Protection at the Central Bank, opened the session titled '*Securing Customers' Interests: Achieving Good Outcomes in an Uncertain World*' by reflecting on one of the threads which was seen throughout the prior sessions, that we are really at a transformational point in financial services. The accelerated pace of change is something we are experiencing particularly with sustainability challenges and digitalisation. She stressed that "*it is pivotal that we have and continue to build trust and confidence in the financial system so people can get on with making good decisions for their lives without worrying about the financial system being a conduit of uncertainty for them.*"

Much discussion was had around the need for regulation to keep pace with this change. Alessandra Perrazzelli, Deputy Governor, Banca d'Italia, noted that technology has reshaped the way in which companies sell and produce financial services and the way in which consumers relate to organisations. She noted that while much discussion had been on fragmentation, the focus should be on coming together to understand how rules can be developed and implemented effectively, as technology is effectively now teaching the regulators and policymakers. In demonstrating how innovation is outpacing regulation, she commented that MiCA is in the process of coming into effect but it already does not cover some elements of technical innovation that are already in existence.

Consumer Protection Code ("CPC")

Derville Rowland explained that the Central Bank's consumer policy framework "*has served us well*" but is going through its own dialogue around modernising and updating to address digitalisation, sustainability and innovation. She also confirmed that the consultation paper pertaining to the CPC review would be published early in the new year.

Cross border financial services for consumers

There was discussion around the marginal access to cross border financial services for consumers in the EU. Despite passporting, panellists confirmed that there is little to no appetite to do so. This is further exacerbated by the issues which arise from contract law and the safeguarding of securities across borders. Collectively, these have a negative impact on consumer choice and in the cost of financial services. Additionally, it was stressed that some of the issues with passporting are a lack of financial education, competence and awareness of the products that out there which is the responsibility of firms to address.

Financial Literacy

The importance of financial literacy arose throughout the day and the need to modify financial services products to meet the needs of both the younger and older generations. It was stressed that the unrelenting pace of online adoption in the financial services sector has had a profound impact on the fall in financial literacy. However, there was also an acknowledgement that there has been a simplification in how certain financial services are being provided such as the transfer of cash and that this will probably spread to some of the more complicated products in time.

Interactions with customers

Distribution channels were discussed and the benefit of and the need for face to face interactions to be retained, not just for older generations but for younger generations making life long decisions as in the case of mortgages as well as for SMEs. Observations from the closure of the two retail banks were also discussed. In particular, it was noted that despite communications and education, certain types of customers need to be supported through the full financial services journey.

Discussion was had about how customer inertia has become more prevalent and an issue which needs to be considered by firms. The question was posed as to whether financial services are trading on that inertia and at what point is there an obligation on a firm to act to rectify that inertia.

Myles O Grady, CEO of Bank Ireland, expressed the view about there is an obligation on banks in Ireland to have a balanced approach as regards how they act in an increasing interest rate environment such as not to push mortgage holders into affordability issues but also to reward deposit customers - "*As a CEO of an Irish Bank, I want to see customers moving from non-interest bearing accounts into interest bearing accounts.*"

Online platforms

Much was discussed about the use of online platforms and that there has been a commensurate increase in the rate of online fraud, something with financial services firms are very aware of. One observation was made about the advantage which online entities have over retail banks when it comes to levies, and that should be addressed.

3. Individual Accountability Framework ("IAF")

Gerry Cross, Director of Financial Regulation - Policy and Risk at the Central Bank opened the session titled '*Making Individual Accountability Work – The Challenge for Industry and Regulators*', explaining that for the Central Bank, at the heart of the IAF were the concepts of proportionality, predictability and reasonableness. He stressed that it was the Central Bank's aim, throughout the consultation process, to relay how the Central Bank saw the IAF operating on the basis of those concepts. He explained that the Central Bank received a lot of challenge from stakeholders during the process but a lot of "*fair challenge*". He provided a brief overview of some of the concerns which were voiced during the consultation process including concerns about -

- timelines;
- being overly detailed in terms of the Prescribed Responsibilities;
- the configuration of the job sharing rules; and
- the impact on INEDs.

He confirmed that the feedback statement on the consultation paper, the final guidance and final regulations would issue during the week beginning 13 November 2023.

Concerns around the IAF

As well as the concerns which Gerry Cross noted at the outset of the discussion, there was a general concern that with newness comes nervousness and that that is inevitable in the context of the IAF. However, Amanda Blanc, Group Chief Executive of Aviva, explained that companies that already have the right culture should not be concerned about the introduction of the IAF. She stressed that where customers are at the forefront of decision making, where the right behaviours are exemplified at the top and where there are consequences for those who do not live up to those standards, these companies are already acting in ways which will be aligned to the purpose of a senior managers regime. She added that regimes like this do not alter good practices but rather encourages them for a more consistent approach across the industry.

A concern was voiced that within firms there is an apprehension that the IAF will engender a fear based culture which will result in staff being afraid to speak up to highlight errors due to concern around consequences. In response the consensus from the panellists was that in order for this to be avoided, the framework will have to be supported by leadership and that the tone from the top will be very important.

A further concern articulated was around the possible operation of hindsight bias. Given the difficulties which boards currently face making decisions in these uncertain times, there is a real fear that those decisions will be reviewed later through the benefit of a hindsight lens.

Some discussion was also had around the importance that this legislation does not create an expectation within the general public that in order for it to be a success, the Central Bank must take immediate enforcement actions pursuant to it. From a reputational perspective, if firms are complying with the legislation and there are no enforcement actions, the hope will be that the public will trust that this means firms are being compliant.

Implementation of the IAF

The importance of dialogue between the Central Bank and firms was a common theme in the IAF session.

Amanda Blanc stated that "*it goes without saying that there should always be good constructive dialogue between firms and regulators to ensure the right balance is held between regulation which achieves its purpose but doesn't become overly burdensome. That constructive dialogue has allowed the SMCR in the UK to evolve over time*". Blathnaid Clarke, Professor of Corporate Law at Trinity College Dublin, echoed this position and explained that from the Central Bank's perspective implementation will have to be rewarding honest dialogue. Perfection is not the required standard as detailed in the guidance but the question is whether the Central Bank will hold true to this.

Gerry Cross explained that the Central Bank's implementation of the requirements will be focussed on embedding reasonableness. He provided two examples, the first that where a director is appointed for the first time, he/she will not be expected to have the same experience, insight and wherewithal as a long established director would have. Similarly, as the Central Bank is implementing the framework it will not be expecting the same things on day one as it will when things are embedded over a while.

Regarding the extent of the effort required to implement the framework, Amanda Blanc advised, based on Aviva's experience in the UK, that firms should not underestimate the length of time it will take, that "*it is not a side of the desk job*".

Gerry Cross reiterated that the objective of the framework is an optimally performing financial services system which is delivering optimal results for users and for the economy. He explained that there is an opportunity over the months and years ahead to deepen and enhance the levels of trust. As the Central Bank and firms work mutually and reciprocally to implement the IAF, better understandings, predictabilities and consistencies will result. "*This is not a once and done thing, we want to review where we are but in the meantime we know there is a lot at stake and it behoves us all to work in the right spirit to deliver over the coming periods.*"

It was agreed that the next twelve months will help to close the expectation gap between what the regulator wants and what individuals perceive the requirements to be.

INEDs/NEDs and the IAF

As regards the general application of the IAF to INEDs/NEDs, there was a consistent view amongst the panellists that if the rules are clear on the scope and the application, then the IAF will work. Blathnaid Clarke reminded attendees that under company law there is no distinction between executive and non-executive directors in terms of obligations. She developed this point further by stressing that as both the conduct standards and the SEAR require reasonable steps to be taken, this aligns with what good executive and non-executive directors do anyway, so INEDs/NEDs should be comfortable.

The panel considered the perceived need for INEDs to now be more broadly accomplished and qualified before taking on a role in a financial services' entity. In particular, Amanda Blanc acknowledged why INEDs without financial services experience might be nervous to come on to a financial services board under this framework. Consequently, she cautioned against discouraging a diversity of thinking and experience at a board level as a result.

Much discussion was had around the deferral of the implementation of SEAR for INEDs/NEDs and whether it is fair to give INEDs/NEDs the years grace and not others. Many contributors questioned how clarity could be the reason for the deferral, as surely any issues of clarity are relevant to everyone. Many of the contributors spoke of the need to understand how the Central Bank explains the decision in the feedback statement before making any further comment.