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September 2016

TECHNICAL NOTE—BANKING SUPERVISION AND UPDATE ON THE ASSESSMENT OF OBSERVANCE OF THE BASEL CORE PRINCIPLES

This Technical Note on Banking Supervision and Update on the Assessment of Observance of the Basel Core Principles 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 August 2016.

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TECHNICAL NOTE

BANKING SUPERVISION AND UPDATE ON THE ASSESSMENT OF OBSERVANCE OF THE BASEL CORE PRINCIPLES

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Ireland. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

CONTENTS

Glossary

BCP	Basel Core Principles for Effective Banking Supervision
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ECB	European Central Bank
EU	European Union
IFRS	International Financial Reporting Standards
IMAS	ECB Information Management System
IMF	International Monetary Fund
JST	Joint Supervisory Team
LSI	Less Significant Institution
NCA	National Competent Authority
NPL	Non-performing loan
PRISM	Probability Risk and Impact System
SEP	Supervisory Engagement Plan
SI	Significant Institution
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism

EXECUTIVE SUMMARY

The effective operational implementation of the Single Supervisory Mechanism (SSM) is well established in Ireland, and all authorities are actively engaged and committed to the new ECB-led supervisory framework. The SSM has further strengthened the prudential regulation and supervision of banks since the time of the 2013 assessment, enhancing the consistency of supervisory practices across the euro area, and shielding supervision from undue pressures from special interests. The Irish authorities appreciate the benefits that the operational implementation of the SSM has in delivering effective supervisory discipline in Ireland.

The prudential regulation and supervision of banks in Ireland has improved greatly since the 2013 assessment of observance of the Basel Core Principles for Effective Banking Supervision (BCP). That assessment found that regulation and supervision were already generally effective and thorough. The relative strength of the prudential framework in part reflected improvements put in train in response to the financial crisis that began in 2008. Nonetheless, there were still some areas for improvement. Since then, action has been taken in most of the areas identified as in need of amelioration.

The transition to the operational implementation of the SSM has not resulted in major gaps in banking supervision, but some transitional challenges remain:

- Current practices in supervisory engagement suggest that the balance between the principle of proportionality and the need for harmonization is currently tilted towards the latter. Even if this tendency is natural at the initial stages of the operational implementation of a unified SSM framework, it may be creating possible unnecessary burdens on supervisors and credit institutions. Now that the initial construction phase is nearing its end, more attention can be paid to adjusting regulatory and supervisory demands to the diverse risk profiles of individual institutions.

- Further to the initial SSM-wide review and harmonization achieved in 2016, remaining areas of national discretion and ancillary national regulations can be revisited with the objective of being simplified and harmonized, respecting the specificities of the banking system of Ireland. This will result in gains in supervisory effectiveness and reductions of regulatory burdens to the local banking industry.

Ireland would benefit from an enhanced SSM-wide approach to effective and active supervision of credit risk and related provisioning and write-backs. Onsite credit-risk inspection to assess independently the quality of banks' assets is a priority in the SSM, including in Ireland, and the Central Bank of Ireland has substantial experience since the crisis in the supervision of credit risk. At the same time, the high level of NPLs remains a critical area of supervisory concern. Current SSM initiatives to develop timely, active, and intrusive supervisory guidelines that contribute to solving this Euro area-wide problem are welcome. These guidelines should be accompanied by ensuring that supervisors have effective powers to require credit institutions to adjust their classification of individual assets and increase levels of provisioning for prudential purposes (rather than just on accounting principles). In addition, and while respecting the different responsibilities, supervisors should also engage in a focused dialogue with external auditors to discuss differences in approaches and reporting outcomes in the area of loan classification and provisioning, and to reinforce the implementation of the International Financial Reporting Standards (IFRS)—particularly a strict application of IFRS 9, on financial instruments.

As Ireland and the euro area generally move beyond the immediate post-crisis period, supervisors will have occasion to analyze the stability implications of longer-term trends in the banking industry. In coming years, banks may be forced to adjust their business models and operating practices because of pressures on profitability and challenges from new entrants, for example, made possible by advances in information technology. In the case of Ireland, the government is expected to dispose of its ownership stakes in the commercial banks. The authorities are encouraged to reflect further on how these possibilities might affect prudential supervision in the future.

High turnover of Central Bank supervisory staff presents a challenge. Concerns regarding the Central Bank's ability to seek and retain experienced supervisors were already pointed out during the 2013 BCP assessment. Even if staff headcount has increased and the situation is broadly manageable, turnover has been exacerbated and the risks identified in 2013 have materialized—i.e., experienced Central Bank staff is attracted to the benefits of working directly for the ECB and in the private sector as the Irish economy picks up. Continued very high turnover may eventually compromise institutional memory and the depth of practical experience among the staff. The Central Bank needs to be able to offer an attractive and flexible package of material and non-material rewards and incentives that addresses its difficulties in recruiting and retaining appropriate experience and skill sets for particular positions.

It is worth noting that the authorities were very cooperative and open in assisting with the preparation of this note and the FSAP generally. The organizational skill and enthusiasm displayed supports the positive assessment of the quality of supervision in Ireland. The FSAP team is most grateful.

Table 1 provides the main recommendations to enhance the supervision of the banking activities conducted in Ireland with a direct bearing on its financial stability. These recommendations raise general topics that are expected to be present in future consultations on the effectiveness of the SSM supervisory discipline of the banking activities conducted in Ireland. Except the last two, which are directed at the Central Bank, the recommendations are not directed at any single institution but should be considered in the context of the SSM.

Table 1. Main Recommendations[1]	
Continue to streamline options under national discretion and ancillary national regulations and legislations within the SSM-wide thrust for regulatory harmonization (paragraphs 18–20).	MT
Further enhance the efficiency and enforceability of SSM supervision of credit risk by considering the effectiveness of supervisory powers to require banks to adjust classification and provisioning for prudential purposes (paragraph 38).	NT
Consider strengthening SSM supervisory guidance on credit risk by including time-bound requirements for uncollectible loans and a nonaccrual principle for the income recognition of NPLs (paragraph 39).	NT
Enhance the current SSM prudential engagement with external auditors regarding credit risk and IFRS application by banks (paragraph 39).	NT
Remain vigilant that harmonization of the SSM supervisory processes is balanced by application of the principle of proportionality (paragraph 25).	On-going
Analyze further the stability implications of longer-term trends in the banking industry and implications for banking supervision in Ireland (paragraph 23).	NT
Review Central Bank personnel policies to attract and retain experienced staff (paragraphs 44–45).	NT
Further enhance the efficiency of the preparatory work undertaken within the Central Bank which supports decision-making within the SSM (paragraph 16).	NT
[1] "NT-near-term" denotes up to 2 years; "MT-medium-term" denotes 2–5 years.	

INTRODUCTION[1]

1. Prevailing banking supervision in the run-up to the 2008–11 banking crisis had serious shortcomings in Ireland, making it a significant contributing factor to the crisis. Irish authorities conducted several postmortem reports that helped identify and analyze the most serious shortcomings in banking supervision.[2] The pre-crisis supervisory approach, for example, focused on process over outcomes, was unduly deferential and accommodating to the banking industry, and adopted a hands-off approach, particularly to credit risk. These are important lessons that have shaped the Central Bank's strengthening of its financial oversight functions in general, and banking supervision in particular.

2. The IMF-led BCP assessment conducted in 2013 acknowledged substantive steps by the Central Bank of Ireland (Central Bank) to rebuild its reputation and make credible its commitment to deliver intrusive, outcomes-based supervision.[3] [4] The Central Bank had made significant progress to establish an intrusive approach to supervision and to build a strong and experienced supervisory staff, but the revamped framework was fairly new. The main findings and recommendations were in the areas of recalibration of the supervisory approach, insufficient resources, and first-hand independent verification and onsite work, as discussed in the second Section of this report.

3. On the European stage, the lessons of the global banking crisis resulted in an overhaul of regulation, supervision and resolution. The capital requirements regulation (CRR) came into force on January 1, 2014, and the capital requirements directive (CRD IV) was issued in 2013 and was transposed into national legislation in March 2014. The Banking Recovery and Resolution Directive (BRRD) was adopted in 2014 and transposed into national legislation to apply from 1 January, 2015, both with some transitional provisions. The SSM, led by the ECB, became operational in November 2014 and the Single Resolution Board (SRB) assumed its functions in January 2016. These new European regulations and institutional arrangements are designed to address the challenges of banking oversight and resolution at a European level, in lieu of the national decision-making that prevailed until 2014. They have, in the main, superseded the domestic response to the Irish banking crisis.

4. In particular, the introduction of the SSM on November 4, 2014, represented a "game changer," transferring the core banking supervision competences to the ECB.[5] The ECB is now

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[1] This Technical Note was prepared by Antonio Pancorbo, Monetary and Capital Markets Department, in the context of the 2016 Ireland Financial Sector Assessment Program.

[2] See, for example: "The Irish Banking Crisis - Regulatory and Financial Stability Policy 2003-2008" and "Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland."

[3] IMF: Ireland: Report on Observance of Standards and Codes (ROSC) https://www.imf.org/external/pubs/ft/scr/2014/cr14137.pdf

[4] The 2013 BCP assessment was part of the program conditionality of the joint EU-IMF Program of Financial Support for Ireland, which had a significant focus on banking supervision.

[5] SSM webpage: www.bankingsupervision.europa.eu.

the ultimate decision-maker for micro-prudential supervision in Ireland, and the rules and regulations underpinning micro-prudential supervision are determined by the European authorities. Therefore, the SSM—led by the ECB and with the collaboration of the national competent authorities (NCAs) of the participating Member States, including the Central Bank—is now responsible for ensuring that the prudential supervision of credit institutions in Ireland is conducted effectively and to the highest level of quality.

5. The operational implementation of the SSM is occurring under an incomplete repair of the banking sector in Ireland. The Irish banking system has not yet fully healed, and credit institutions' balance sheets remain weak. While non-performing loans are falling, they remain at a very elevated level and continue to be one of the main challenges, particularly for significant institutions (SIs), whilst low credit growth and low interest rates impact banks' profitability. Weaknesses in the banking sector distort bank business models and, thereby, call for continued strong supervisory practice to determine the sufficiency of provisions, solvency, profitability, and, in all, viability.

6. Hence, this fundamental change in banking supervision comes at a time when supervisory rigor is essential. The change is happening at a moment of pressures on banks' balance sheets and business models, particularly in those significant institutions under the direct supervision of the ECB. This situation demands strict supervision of the banking activities. Therefore, a successful completion of the SSM's ongoing and impressive achievements to build a credible and capable supervisor is of great importance in fostering financial stability in Ireland.

SCOPE

7. The purpose of this note is to provide an update the 2013 BCP assessment—significantly affected by the introduction of the SSM in November 2014—and to present the mission's findings of the discussions on current supervisory practices in Ireland that took place during this update. These discussions are part of the 2016 FSAP Update for Ireland, which took place in Dublin during March 2–16, 2016, and included visits to the ECB in Frankfurt on March 7–8, and 17; discussions with ECB Banking Supervision staff focused on Ireland country-specific aspects. This note uses the "Basel Core Principles for Effective Banking Supervision" as the reference framework, but it is neither a partial nor a full BCP assessment, nor does it update the 2013 BCP assessment or its ratings. This note is not intended either to represent an analysis of the state of the banking sector or crisis management framework. This note does not include explanation of supervisory approaches and processes as long as they are publically documented.

8. This note reflects on supervisors' "ability to act" and the conditions needed for supervisors' "will to act." As is well-established IMF policy,[6] a positive assessment of the

[6] Jose Viñals, *et al.*, (2010) *The Making of Good Supervision: Learning to Say No*, IMF Staff Position Note 10/08: http://www.imf.org/external/pubs/ft/spn/2010/spn1008.pdf.

supervisors' ability to act—based on its resources, authority, organization, and constructive working relationships—is not sufficient to ensure effective supervision. This must be complemented by the "will" to act in order to take timely and effective preventive actions in normal times, and corrective actions in times of stress. Developing this "will to act" requires clear and unambiguous supervisory mandate, operational independence coupled with supervisory accountability and transparency, skilled staff, and a relationship with the industry that avoids "regulatory capture." However, it also requires as a catalyst a political will that cannot be measured nor evaluated externally.

9. To understand this ability and willingness to act, the mission held extensive meetings with Central Bank and ECB officials and had access to high-quality documentation. The Central Bank and the ECB provided a joint information note on developments in banking supervision since the 2013 BCP assessment. In addition, the ECB shared with the mission the SSM-wide parts of the self-assessment of the BCP, as well as the SSM-wide parts of the detailed responses to the questionnaires that were prepared for the FSAP for Germany. In addition, the ECB provided evidence of practice of the supervision of SIs in Frankfurt, and the Central Bank provided evidence of practice of the supervision of less significant institutions (LSIs) in Dublin. Access to the highly informative and well-structured SSM Supervisory Manual was allowed only in the field. The mission appreciated the very high quality collaboration received from the SSM authorities and staff. The mission also expresses its appreciation to other third parties who shared, voluntarily, their personal views on supervisory practices for the Irish banking system.

10. The mission maintained close coordination and consistency with other FSAPs in the euro area working on banking supervision, particularly the work of the concurrent 2016 Germany FSAP, which undertook a full BCP assessment. The mission took place during a period of continuing development and enhancement of the SSM operational framework. These findings, therefore, may be affected by future modifications as SSM operations consolidate. The incipient experience did not allow for a full appreciation of the framework's effectiveness.

11. The rest of the note is divided into two sections: The first section discusses a selected list of relevant topics about supervisory practices for the banking activities conducted in Ireland. This first section stems from the discussions held in Dublin and Frankfurt to update the 2013 BCP assessment, and covers topics related to the SSM operational implementation in Ireland. The second section discusses the update of the 2013 BCP assessment itself and the actions taken by the authorities to address its findings and recommendations; principle-by-principle documentation of any updates is presented in Table 2.

Table 2. Ireland: Actions Taken by the Authorities to Address 2013 BCP Recommendations

2013 BCP Recommendation	Actions Taken
CP2. Independence Amend existing legislation to detail the framework for Central Bank independence. Also address reasons for removal of Commission members to be similar to Governor.	**The Irish Authorities considered no action as necessary** The issue as it specifically relates to the independence of banking supervision has been addressed through the creation of the SSM. Furthermore, Central Bank independence was already considered in legal reforms after the financial crisis. The implementation of the SSM provides for independence in Article 19 SSMR.
CP2. Resources Take steps to fill vacancies in banking supervision.	**Addressed** The vacancies in banking supervision have been filled, as recommended by the mission, and the headcount has increased. However, as discussed in this report, human resources continue to be an issue for the effectiveness of supervision although of a different nature.
CP5. Licensing criteria Consider options for improving the Central Bank's ability to conduct fit and proper reviews during licensing of banks owned by unregulated parents. Study enforceability of special conditions to the license that must be accepted by parent company at time of approval to enhance Central Bank enforcement authority.	**Central Bank considered no action as necessary** In addition, with the implementation of the SSM, the Central Bank is no longer the competent authority for licensing and conditions can only be imposed by the ECB (other than for Third Country Branches).
CP9. Supervisory techniques and tools: Consider the distribution of resources and supervisory tasks across Medium Low and Low Impact ratings. Consider expanding key risk indicators in PRISM to include a broader suite of risk metrics i.e. operational risk and interest-rate risk in the banking book.	**Addressed** The implementation of the SSM, the efforts underway to achieve a consistent SSM-wide supervisory process for LSIs and amendments to the supervisory engagement model have addressed these recommendations.
CP15. Risk management process For banks accredited to use internal models, annual assessment that banks comply with supervisory standards (e.g. validation). Implementation of framework to assess IT across regulated banks.	**Addressed** The SSM requires an annual review of credit institutions' approved models. Only one LSI uses internal models, where the home supervisor performs this assessment. The ECB and a new dedicated Central Bank IT inspection team assess IT risks across banks.

CP17. Credit risk Increase frequency and loan sample size for Medium Low banks.	**Addressed** Since the recent implementation of the SSM, frequency and loan sample sizes have increased for medium low banks (now termed LSIs). The Central Bank has established a dedicated credit inspection team to conduct onsite inspections that had undertaken a number of inspections by the time of the FSAP mission.
CP18. Problem assets, provisions, and reserves Greater frequency and depth of onsite reviews of loan loss provisioning practices (e.g., testing of assumptions against experience, recognition of default, prudent valuations).	**Addressed** Since the recent implementation of the SSM, frequency and depth of on-site reviews has increased. The dedicated onsite inspection team for credit risk is aligned with the centralized inspections units at the ECB.
CP20. Transactions with related parties 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.	**Central Bank considered no action as necessary** The Central Bank completed a survey supporting the adequacy of the current code. Consequently, amendments have not been introduced. The Central Bank continues to monitor compliance and will amend as needed.
CP27. Financial reporting and external audit Enact legislation giving the Central Bank the power to reject or rescind external auditors.	**Central Bank considered no action as necessary** The Central Bank considers that it already has adequate powers in this area as it can direct credit institutions not to appoint or reappoint auditors. The use of such powers has not been required to date.

BANKING SUPERVISION IN IRELAND

A. The Implementation of the SSM

12. Since the 2013 BCP assessment, the implementation of the SSM has produced profound changes in the way banking supervision is conducted in Ireland. On November 4, 2014, prudential supervisory responsibilities and decision making powers moved to the ECB. This responsibility is executed through the SSM, of which the ECB is now the competent authority responsible for the micro-prudential supervision of the SIs operating in Ireland, whereas the Central Bank remains responsible for the supervision of the LSIs operating in Ireland.[8] Moreover, the Central Bank is responsible for ensuring that the supervisory teams operating in Ireland are adequately

[8] The Central Bank is designated as the National Competent Authority (NCA) for the purposes of S.I. 158 of 2014 and CRR, subject to the competences assumed by the ECB under Council Regulation (EU) No 1024/2013 ("SSMR") and Regulation (EU) No 468/2014 of the ECB ("SSMFR"). The European Union (Single Supervisory Mechanism) Regulations 2014 (S.I. 495 of 2014) thus amended, inter alia, S.I. 158 of 2014 in order to facilitate the smooth operation of the SSMR and SSMFR in Irish law.

resourced and that its direct responsibilities are conducted to the highest level of quality and effectiveness. The ECB oversees the Central Bank's supervision of the LSIs.

13. Banking supervision in Ireland is fully and effectively integrated into the framework of the SSM. The mission has gained evidence that common SSM methodologies, processes, and procedures supporting the consistent supervision of all banks within the SSM are fully operational in the Central Bank. Central Bank staff recognize the strengths of the SSM for Ireland, particularly in the SSM's role in determining and setting best supervisory practices in the euro area, including in its ability to leverage expertise from within the ECB and across all the NCAs, for example, in the supervision of credit risk.

14. The SSM unified supervisory system works well alongside the Central Bank's closer proximity to the supervised credit institutions. The balance between the principles of centralization and decentralization are critical for the successful operational effectiveness of banking supervision in Ireland. While there is a common approach across all banks and centralized decision-making at the ECB, there is a need to recognize the specific circumstances of the Irish banking sector. These specific circumstances reflect banks' different business models, risks and issues of the domestic SIs relative to the internationally owned LSIs.

15. After the implementation of the SSM, whereby the ECB is now the competent authority for banking supervision in Ireland, the Central Bank continues to have important responsibilities. These include functioning as part of the joint supervisory teams (JSTs), the direct supervision of LSIs, the performance of those defined as non-core supervisory responsibilities[9] for all banks, and conducting core supervisory responsibilities on behalf of the ECB—responsibilities that have substantial resource implications for the Central Bank. This transfer of competences in a new, unique, and unified supervisory system creates logical internal discussions about which institution is responsible for what on a practical basis, what are the different roles, how to interact, etc. These discussions, nevertheless, have not prevented the effective operational implementation of the SSM in Ireland.

16. The implementation of the SSM has placed much of the responsibilities for decision-making in the euro area directly at the Supervisory Board and Governing Council of the ECB. In light of the Central Bank's active membership in both the Supervisory Board and Governing Council, a significant amount of preparatory work for decision-making is undertaken by a small number of supervisory and policy experts at the Central Bank (as with other NCAs).[10] Some of the decisions may not be of direct relevance to the safety and soundness of the banking operations conducted in Ireland—for example, as they relate to banks operating in other jurisdictions. However, they do relate to the effectiveness of the SSM, and may have wider policy or precedent setting implications for the banking operations conducted in Ireland. Moreover, the Central Bank is

[9] Mainly conduct of business and anti-money laundering.

[10] To support the Central Bank's participation at the ECB's Governing Council and Supervisory Board, new teams have been created and new processes implemented, including the creation of an SSM Advisory Committee which provides inputs to the SSM Briefing Team on all agenda items that come before the Supervisory Board.

committed to making a strong contribution to the effectiveness of the SSM, including in its membership of the Supervisory Board. Nonetheless, as the SSM has been operating for more than a year and a half, it is timely for the Central Bank to review its approach to supporting and providing briefings for the decision-making in the SSM, to ensure that the approach is as efficient and effective as possible, as well as recognizing the strains on Central Bank supervisory resources, as discussed below.

B. Regulatory and Legislative Framework

17. Since the 2013 BCP assessment, a new prudential banking regulatory framework has been implemented across the European Union and within the euro zone, including in Ireland. The fourth Capital Requirements Directive (CRD IV)[11] and Capital Requirements Regulations (CRR)[12] came into force on January 1, 2014. The CRD IV/CRR are far-reaching in their scope and requirements. Crucially they require significant enhancements in the quality and quantity of capital that banks are required to hold; how capital requirements are determined; the setting of minimum liquidity requirements; and the quality and granularity of banks' regulatory reporting. These areas have also been enhanced by subsequent standards and guidelines issued by the European Banking Authority (EBA).

18. The ECB, in collaboration with the NCAs (including the Central Bank), is currently undertaking a review of the provisions across CRD IV/CRR that provide discretion to competent authorities. The ECB held a public consultation on the draft ECB Regulation on the exercise of options and discretions, and an ECB Guide on options and discretions available in Union law was adopted by the Governing Council in March 2016. Prior to the commencement of the SSM, the Central Bank communicated its policy positions in relation to options and discretions in May 2014.[13] However, following the assumption of supervisory responsibilities by the ECB in November 2014, the Central Bank is no longer solely competent to determine policy in relation to such options and discretions.

19. The Central Bank should consider updating its Implementation Notice on options and discretions once the ECB harmonization exercises advance further. At this moment, and in the vast majority of cases, the ECB's policy positions on a range of options and discretions under review have been consistent with the Central Bank's policy positions prior to SSM. For example, and of particular prudential importance for Ireland, deductions of Deferred Tax Assets existing prior to 2014 can preserve a transitional phase-in to end-2023. There are a small number of options and

[11] As a European Union (EU) directive, CRD IV required transposition into Irish national law. This occurred via the European Union (Capital Requirements) Regulations 2014 (S.I. 158 of 2014), as well as certain consequential amendments to the Central Bank Acts 1942, 1971, 1989 and 1997, the Building Societies Act 1989 and the Trustee Savings Banks Act 1989.

[12] While CRR is a directly applicable maximum harmonization EU regulation not requiring transposition into Irish national law *sensu stricto*, the operationalization of certain provisions in CRR was achieved via the European Union (Capital Requirements) (No. 2) Regulations 2014 (S.I. 159 of 2014). See http://www.irishstatutebook.ie/eli/2014/si/159/made/en/pdf

[13] 2014 Implementation Notice on S.I. 158 of 2014 and the CRR.

discretions where the ECB's policy proposal and the Central Bank's pre-existing policy stance are not entirely consistent, for example, large exposure waivers for covered bonds. Finally, the ECB is not legally able to harmonize those areas of options and discretions allocated in CRD IV/CRR to member states as opposed to competent authorities, as discussed before. These relate mostly to macroprudential measures and systemic capital buffers.

20. An additional challenge for a single supervisory framework is that the ECB needs to comply with national legislation, for LSIs and SIs alike, as most of the European legal framework is harmonized only to a certain degree. This is due to differing transpositions of directives in each of the Member States and domestic legislation and requirements existing in each of the Member States that are not related to any (European Union) EU Directives. The initial setup might not have anticipated to its full extent the legal and regulatory challenges of unifying 19 national systems not previously harmonized. In Ireland, for example, licensing applications must be assessed by national authorities in compliance with national ancillary legislation, with analysis and decision making conducted by the ECB in accordance with EU legislation. All fit and proper authorizations of members of the supervisory body for SIs are assessed against national criteria in conjunction with the ECB and then submitted to the ECB Governing Council for decision. Enforcement and sanctioning powers of the ECB are also largely based on national legislation, and the third-country branch authorizations fall within the NCA competence, the latter of relevance for Ireland as a hub for international financial groups. Other competencies were not clearly defined, such as limits to related parties. Delays in decision making can also be attributed to the need for further regulatory harmonization. Enhanced harmonization of supervisory practices will require further harmonization of the regulatory and legislative framework. While regulatory harmonization is a desirable goal for an effective unified supervision, this has to be conscious of national particularities and needs at the current stage of SSM operational implementation.

C. The Supervisory Approach

21. Carrying out intrusive and effective banking supervision is the overall supervisory approach of the banking activities conducted in Ireland, with the general objective of contributing to the safety and soundness of the banking system and the stability of the financial system. These objectives are actively and fully shared by the Central Bank, which in its responsibilities within the SSM aims to take a proportionate approach to its actions in an intrusive and assertive manner. Even if intrusiveness and effectiveness in a proportionate manner has been enhanced with the implementation of the SSM in Ireland, this approach to supervision is not new to the Central Bank. As already noted in the 2013 BCP assessment, the Central Bank's response to the 2008–11 financial crisis resulted in a period of unprecedented changes towards more intrusive, intensive and outcomes-focused supervision.

22. Banking supervision is risk-based within the framework of the SSM, including in Ireland. The SSM has implemented a prudential supervision framework for euro area banks based on sound practices for independent, forward-looking, and risk-based supervision.[14] The Central Bank introduced its Probability Risk and Impact System (PRISM) in 2011,[15] its new framework for the supervision of regulated firms that operates under a risk-based and proportionate approach. The ECB purchased PRISM as the basis for its Information Management System (IMAS). This puts Central Bank supervisory staff in an excellent position to migrate to IMAS at reduced transition and learning costs.

23. For the future, priority work areas should continue to include the analysis of bank business models, and advance preparation regarding supervisory issues that may arise in the course of bank privatization and other structural changes. The supervisory authorities are already undertaking thematic and bank-specific reviews of business models, something that also takes into account market-wide effects and form a good basis for further work in these areas. Looking forward, in the next few years there are likely to be significant changes in the Irish banking system. These may include, *inter alia,* the partial or full sale of the state's stakes in commercial banks and changes in competitive pressures arising from, for example, new financial technology providers. This may result in potentially significant changes relating to bank ownership and the provision of payments and lending services, and may alter competition conditions in ways that give rise to prudential and consumer-protection concerns.

D. The Supervisory Process

24. Credit institutions operating in Ireland that are covered by the SSM are targeted to be supervised according to the same methodology. The central piece of the SSM supervisory process is the Supervisory Review and Evaluation Process (SREP), as developed by the ECB along the lines of the EBA guidelines. Under the SSM SREP, JSTs and supervisory teams analyze business models, internal governance, profitability, banking risks and their effects on capital, and liquidity in order to issue SREP decision letters. In light of this the Central Bank took the decision that the overall approach to the supervision of LSIs would be the same as that for SIs. Thus, the SSM Supervisory Manual—which is currently being updated—provides the direction for LSI supervision. This approach ensures that all credit institutions in Ireland are subject to consistent and homogenous supervisory practices. From this perspective, the ECB's role in ensuing consistency across jurisdictions by developing joint standards and applying the principle of proportionality is key.

25. Nonetheless, and going forward, somewhat more attention needs to be paid to the application of proportionality in SSM supervisory processes lest unnecessary burdens be imposed on supervisors and credit institutions. During the crisis and the establishment of the SSM, emphasis was, rightly, on developing more rigorous and pro-active procedures, and achieving harmonization. As this initial phase comes to an end, more attention can be devoted to

[14] See ECB: *Guide to Banking Supervision:*
https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmguidebankingsupervision201411.en.pdf

[15] See Central Bank of Ireland: *PRISM Explained:*
http://www.centralbank.ie/regulation/processes/prism/Pages/default.aspx

differentiating across banks based on their complexity and inherent risks. Especially in light of strains on resources, the authorities need to be conscious of the risk that banking supervision becomes an excessively process-driven exercise for the sake of harmonization, rather than providing effective and efficient supervisory discipline for SIs and LSIs. For example, the SREP process specifies that supervisors go through a robust and detailed list of risk indicators, the practice of which eventually may constrain proportionality in the supervision of both LSIs and SIs. Supervisory engagement planning is another area that may well benefit from an enhanced focus on proportionality and flexibility.

26. The introduction of the SSM provided the opportunity for further strategic review of the structure of banking supervision at the Central Bank. This materialized in the creation of three separate but inter-dependent banking divisions to mirror the SSM operating model. On-going Supervision (Supervision Division—BSSD); On-site Inspections (Inspections Division—BSID); and a specialist horizontal function (Analysis Division—BSAD). The inspections division (BSID) is complementary to the ongoing supervision division (BSSD). The additional input from both on-site inspections and BSAD has provided supervisors with materially enhanced evidence to support and challenge their supervisory assessments and to inform the proposed Risk Mitigation Programs required of the credit institutions. These new Central Bank divisions are closely aligned with their respective centralized divisions in the Directorate General Microprudential Supervision of the ECB.

27. The SSM Supervisory Manual has resulted in significant changes to the manner in which the Central Bank performs supervision of credit institutions. The ECB has developed the SSM Supervisory Manual, a comprehensive methodology in support of both ongoing and onsite supervision. The SSM Manual sets out specific procedures that must be followed when carrying out the supervisory process in the SSM. Prior to the SSM (and the regime in place at the time of the 2013 BCP assessment), inspections in Ireland were generally carried out by the team responsible for the supervision of a particular credit institution, i.e. the ongoing supervision team. The number and focus of inspections were determined by the minimum engagement cycle as set out in the PRISM framework. Additionally, a number of specialist teams could undertake inspections, or assist the ongoing supervisory team with inspections, in the areas of credit, treasury and internal models. While the duration of these inspections varied, they rarely exceeded two weeks of onsite work. Currently, inspections for an SI can last 12 weeks, including some 8 weeks spent onsite. For an LSI, the inspections can last an average of 8 weeks, with 4-5 weeks spent onsite. Finally, the granularity of inspections has increased as a result of both the guidance provided by the SSM in its Manual and the amount of time now spent on-site.

E. The Supervision of Individual Institutions

28. With the introduction of the SSM, the ECB became the competent authority for the supervision of credit institutions in Ireland. SIs are supervised directly by the ECB and are no longer supervised for prudential purposes through PRISM, but under the guidance of the ECB Supervisory Manual.[16] The Central Bank remains responsible for the direct supervision of LSIs through PRISM, with oversight by the ECB. The Central Bank, though, is adapting its supervision of LSIs to the ECB Supervisory Manual. The SSM is also working towards migrating the supervision of the LSIs to IMAS in an SSM-wide effort.

The supervision of SIs and subsidiaries of SIs

29. The supervision of the four SIs and five subsidiaries of SIs operating in Ireland is the exclusive responsibility of the ECB through dedicated JSTs (total assets of €284bn and €64bn respectively, end-2015). Under the lead of a JST coordinator, based at the ECB, with the collaboration of a JST sub-coordinator based at the Central Bank, all JSTs work with the uniform methodology of the SSM Supervisory Manual and comprise ECB and Central Bank staff in an average proportion of one to three. This makes the support of the Central Bank staff a critical factor for the success of the work of the JSTs. The Central Bank indicates that staff assigned to the four SIs is full time dedicated to JST work. This reduces the risk that Central Bank staff may be unavailable at times to work on their assigned SIs. In addition, the Central Bank indicates that there is flexibility to reassign its staff to specific assignments if needed.

30. Even if the JSTs operating in Ireland present a solid record of outstanding performance, structural challenges in their functioning and design need to be monitored. The mission had evidence of the high-quality outcomes and supporting processes produced by the JSTs operating in Ireland. Interaction between ECB and Central Bank staff is based on trust and the sharing of similar views. However, remote team working and multinational cultural factors can be complicated to manage. Communication within the SSM and the ECB has to continue to cascade to the Central Bank at its appropriate levels. The managerial competence of the current JST coordinators and sub-coordinators are successfully smoothing these issues, which, however, have to be monitored on an ongoing basis as the operational procedures of the JSTs continue to mature.

The supervision of LSIs

31. The supervision of LSIs is the direct responsibility of the Central Bank, which interacts at the highest level of collaboration with the ECB. There are 13 LSIs operating in Ireland with total assets of €116bn as of end-2015. In 2015, the ECB categorized seven of the Irish LSIs as High Priority, three as Medium Priority, and another three as Low Priority.[17] The re-alignment of the

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[16] The list of institutions under SSM can be found at: https://www.ecb.europa.eu/pub/pdf/other/ssm-listofsupervisedentities1409en.pdf?59d76de0c5663687f594250ebf228c6b

[17] The prioritization category for the LSIs impacts the way in which the Central Bank communicates with the ECB. The feedback received from the ECB is not binding on the Central Bank.

Medium Low PRISM impact credit institutions with the High Priority and Medium Priority LSI categorization has resulted in an increased supervisory effort, and addresses some of the recommendations of the 2013 BCP assessment as discussed below.

32. LSI supervision, with ECB oversight, continues to be conducted by the Central Bank in accordance with PRISM principles and practices. With the introduction of SSM, supervisory engagement under PRISM was amended to reflect the priority level (High, Medium or Low) assigned to LSIs in line with the SSM LSI prioritization methodology. Priority in this regard is determined by a combined assessment of Impact and Risk profiles and the PRISM engagement model has been amended accordingly. Looking forward, the ECB, in conjunction with colleagues within the NCAs, regularly develop joint supervisory standards to foster consistent supervision practices and outcomes for the supervision of LSIs. The ECB is also reviewing the methodology of its risk assessment system and updating the SSM Manual in respect of the supervision of LSIs. This will impact upon the engagement models conducted by all NCAs in respect of the LSIs under their supervision. All these activities contribute importantly in achieving convergence of supervision between Ireland and the remaining SSM members.

The supervision of foreign bank branches

33. Against the backdrop of CRD IV and the establishment of the SSM, the Central Bank has developed a Supervisory Engagement Strategy and associated SEP for the 30 bank branches from the European Economic Area operating in Ireland.[18] None of these foreign branches are deemed significant in the context of CRD IV and all are rated as Low impact under PRISM. As of end-2015, 17 branches are considered "SSM branches" supervised by the JSTs (total assets €80bn), effectively removing the supervisory distinction between home and host supervisory arrangements. 13 branches are "Non-SSM branches," under direct Central Bank responsibility (total assets of €17bn). A bespoke supervisory strategy and engagement plan has also been developed for the one third-country branch recently established in Ireland.

The supervision of credit unions

34. The Central Bank assumed the regulation and supervision of the 437 credit unions operating in Ireland in 2003 (as of 31 December, 2015 there were 354 registered credit unions with total assets of €15bn). Credit unions are regulated and supervised under credit union legislation by the Registry of Credit Unions, which is a division of the Central Bank headed by the Registrar of Credit Unions, reporting to the Director of Credit Institutions Supervision. In 2015, the International Credit Union Regulators' Network (ICURN) conducted a peer review of the Registry of Credit Unions,

[18] All foreign bank branches operating in Ireland are under the "single passport" to operate in the European Economic Area —CRD IV, ART. 41. This considers that the prudential responsibility and supervision of branches is within the home-country competent authority under CRD IV.

the first such peer review. [19] The review concluded that the Central Bank effectively performs its functions and has effectively undertaken the demanding task of introducing a comprehensive regulatory structure.[20] The Registry is actively engaged in addressing the peer review's recommendations, which include adjusting PRISM engagement to expand onsite supervision, enhancing the Registry's communication and engagement with the sector, and refocusing scarce resources on key risks areas—particularly credit risk. The sector, in general, is going through an intense restructuring process, with the Registry monitoring and intervening in accordance with its statutory functions.

35. The Registry will continue to support restructuring as an important contributing factor to putting the sector on a sounder footing and contributing to the maintenance of financial stability and well-being of credit unions generally. An important consideration in the supervisory approach for 2016 and beyond is to ensure an appropriate focus on viability and strategic planning. The slow pace of progress by the credit union sector in achieving necessary transformation of its relatively stagnant business model is a key concern and the Registry will continue engaging with and challenging the sector for success in this area.

F. The Supervision of Credit Risk

36. The high level of NPLs is a significant source of stress in banks' balance sheets and profitability in Ireland, and a high-priority concern for supervisors both at the Central Bank and the ECB. High NPLs tie up bank capital, reduce bank profitability, and raise funding costs, thereby dampening credit supply. Resolving impaired loans could stimulate sound demand for new loans from restructured, viable firms, while promoting the winding down of unviable firms. The general problem of the high NPLs in European banks is well documented.[21] Notwithstanding the falling level of NPLs in Ireland, the situation remains challenging, particularly in the SIs under the direct supervision of the ECB.

37. International experience shows that a comprehensive strategy has to be in place to deal with a structural NPL problem, which has to include a strong supervisory framework and practices.[22] The authorities have established a good track record in this area, but it remains a high priority going forward.

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[19] ICURN *Peer Review: Central Bank of Ireland Performance of its Regulatory Functions in Relation to Credit Union,* July 2015, https://www.centralbank.ie/about-us/Documents/ICURNCreditUnionPeerReviewReport_July2015.pdf

[20] The performance of the Central Bank's functions in the regulation and supervision of credit unions was assessed against the ICURN Guiding Principles for Effective Prudential Supervision of Cooperative Financial Institutions, which used the Basel Committee's Core Principles for Effective Banking Supervision (2006) as a guide and two additional Guiding Principles on Governance and Major Acquisitions which were included to take account of updates to the Basel Principles in 2012 and the restructuring of the credit union sector that is currently underway in Ireland.

[21] IMF Staff Discussion Note, *A Strategy for Resolving Europe's Problem Loans*, September, 2015: http://www.imf.org/external/pubs/ft/sdn/2015/sdn1519.pdf

[22] Ibid.

Measures to strengthen the regulatory framework

38. The regulatory framework for addressing credit risk would be strengthened if supervisors directly require credit institutions to adjust their classifications of individual assets and the levels of provisioning for prudential purposes. An alternative route through capital add-ons to enforce supervisory expectations is also possible; however, international experience suggests that the supervisory power to require reclassifications and increase loss provisioning is more effective and efficient. Using this power affects the profit and loss accounts and, thereby, banks' payout and compensation policies. This approach also disciplines bank managers, forcing them to collect impaired loans and to reduce operational expenses. It is more transparent and presents a fair view of financial statements for prudential purposes.

39. Some additional measures should be considered for inclusion in supervisory guidance. Implementing time-bound requirements for uncollectable loans and a nonaccrual principle for the income recognition of NPLs for prudential purposes are critical in the efforts to cover supervisory deficiencies. In a broader commitment to increase market transparency, public disclosure of granular information of NPLs, following the example of the EBA 2015 EU-wide transparency exercise, can be considered, including disclosure of the accrual treatment of NPLs. In addition, the dialogue between supervisors and banks' external auditors should be further enhanced, particularly on approaches to reinforce IFRS implementation based on supervisory guidance and expectations consistent with and complementary to accounting standards. This dialogue should also aim at ensuring a strict application of IFRS 9, on financial instruments. SSM current initiatives to collect good practices and propose ECB Guidelines, notably the newly-created SSM NPL Taskforce, are expected to discuss and eventually strengthen SSM-wide supervisory guidance on credit risk.

Current supervisory practices

40. The Central Bank has undertaken work over a number of years before the SSM was established to adjust its prudential supervision in ways to facilitate NPL resolution. The Central Bank has issued supervisory guidance on impairment triggers and provisions that represent a sound precedent,[23] and has intervened to address identified NPL misclassification and under-provisioning. The Central Bank has also gained significant experience on the supervision of credit risk, further enhanced by the implementation of the SSM. Since the crisis, the Central Bank has gained experience in conducting deep dives based on credit file reviews and has undertaken a number of supervisory exercises such as the 2013 Balance Assessment, the SSM/ECB 2014 Comprehensive Assessment, and recently the 2015 Impairment Provisioning Review, in collaboration with the JSTs. With the implementation of the SSM, the Central Bank has strengthened its dedicated credit inspection team, which is now aligned with the centralized onsite inspection units at the ECB. Its activities allow identification of poor practices, which are then addressed to banks to remediate through risk mitigation plans. The SSM/ECB comprehensive assessment and other across the board

[23] The Central Bank of Ireland: *Impairment Provisioning and Disclosure Guidelines*, May 2013, https://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Documents/Impairment%20Provisioning%20Guidelines%20May%202013.pdf

exercises have assisted in the efforts to enforce prudent loan classification and provisioning in Ireland. The experience which Ireland has gained in dealing with NPLs has been recognized across the SSM, with the Central Bank's Director of Credit Institutions Supervision being asked to chair the SSM NPL task force.

41. Against this backdrop, current practice regarding how supervisors can enforce correction to credit classification and provisioning can be further enhanced. Under current practice, when a bank does not meet supervisors' expectation on classification and provisioning for prudential purposes, supervisors consider whether such deficiencies can be reflected in supervisory ratings or through a higher capital requirement under Pillar 2. The mission gained evidence of instances where this procedure was applied with excellent results. However, it is widely recognized that the Pillar 2 approach is less effective and less transparent than requiring banks directly to adjust their classifications of individual assets and increase the levels of provisioning, as provided for in the Basel Core Principles.[24] Pillar 2 requirements, as a fallback approach to enforce supervisory expectations on credit risk classification and provisioning, even if possible, are not the most effective way to address prudential concerns in credit portfolios, as acknowledged by some SSM supervisory staff during the mission.

Final considerations

42. Across Europe, supervisory practices diverge regarding requiring banks to adjust their loan classifications and levels of provisions for prudential purposes. There is a deep "philosophical" divide regarding the role of the supervisor vis-à-vis loan classification and loss provisioning. Some supervisors consider bank capital to be supervisors' exclusive domain. Requiring adjustments to banks' classifications and provisioning is considered an intrusion into the accountancy domain reserved for accountants and auditors. Those supervisors, thus, can express their expectations about classification and provisioning, but enforcement of such expectations can only be done through capital add-ons, which, even if they eventually provide the same results in terms of bank capital (but not in terms of profitability), constitute a lengthy and cumbersome process that requires a good deal of supervisory determination. Some supervisors, on the other hand, have the powers to enforce their expectations by requiring adjustments to banks' classification and provisioning directly. These adjustments are required for prudential purposes only and are different from the accounting purposes, which are recognized as the domain of accountants and auditors.

43. It also has to be considered that accounting standards, as implemented across Europe, weaken the incentives to resolve NPLs.[25] The incurred-loss approach to loan provisioning under

[24] BCP—Principle 18: Problem assets, provisions and reserves; EC7: "The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.

[25] IMF Staff Discussion Note, *A Strategy for Resolving Europe's Problem Loans*, September, 2015, p. 16.

IFRS is backward-looking (this is expected to be addressed when IFRS 9 becomes effective in 2018) and leaves much room for judgment, something that may result in insufficient provisions. IFRS also allows for the accrual of interest income from NPLs, which tends to inflate profitability and lowers the incentives to dispose of NPLs. Finally, while collateral is taken into account in impairment loss recognition, guidance on its valuation is unclear. Remedying these disincentives and ambiguities does not require a change in the accounting standard, but can be done through strict implementation guidelines and intrusive and active supervision.

G. Supervisory Resources

44. Current headcount and skill set support the quality of the supervision of banking activities in Ireland; however, the increasing expansion of supervisory tasks has to be mindful of the full-time equivalent employees needed to carry them out. Central Bank supervisory staff has significantly increased since the 2013 BCP assessment; meanwhile, the ECB has already started a second general recruitment process for additional staff to cover ECB supervisory responsibilities. Both the Central Bank and ECB are conscious about matching staff and skills to the intensity and the diversity of the work undertaken in Ireland. However, authorities are encouraged to monitor properly the work load of the supervisory functions, including resources allocated to perform their respective activities. Anecdotal evidence suggests that there might be a sense of fatigue after this first intensive initial period of work, something that the competent authorities are encouraged to monitor.

45. The Central Bank has to retain and attract sufficient numbers of experienced staff to carry out their supervisory responsibilities, both to staff JSTs and inspection teams, to supervise the LSIs, and to provide horizontal analysis. The Central Bank banking supervisory functions have difficulty in retaining and recruiting new and experienced staff. Even if staff headcount has increased since the 2013 BCP assessment and the situation is currently manageable, high turnover has been exacerbated and the risks identified in 2013 have materialized—i.e. experienced Central Bank staff has been recruited by the ECB, and by the private sector as the Irish economy is picking up. Approximately two thirds of staff in the banking supervision divisions in the Central Bank has been there for less than two years. While this is in part driven by the increased headcount in banking supervision and is mitigated by the recruitment of industry experience, continued very high turnover may eventually compromise the effectiveness of the Central Bank contribution within the SSM project. A Central Bank internal organization review could consider this issue and develop a strategy to address material disparities within an SSM wide context. The Central Bank needs to offer an attractive and flexible employee value proposition that addresses its difficulty in recruiting and retaining appropriate experience and skill sets for particular positions.

H. Corrective Actions and Resolution Powers

46. Since the inception of the SSM, corrective actions for SIs operating in Ireland have been achieved through means of expressing supervisory expectations. After ongoing supervisory work and inspections, JSTs normally issue supervisory acts (in the form of recommendations or risk mitigation programs) to enforce corrective actions. These supervisory acts express supervisors' expectations and are not legally binding; however, this has been sufficient for supervisory discipline in Ireland. If these supervisory expectations were not met in a timely fashion, supervisors have the possibility to escalate them as a decision to the Supervisory Board. This option has not been used in Ireland but is operational in the SSM if need be.

47. In relation to LSIs, the Central Bank takes corrective actions to address unsafe and unsound practices and sets out risk mitigation programs to be addressed by LSIs. Central Bank supervisory teams use risk mitigation programs, as was the case at the time of the 2013 BCP assessment, as the mechanism to require credit institutions to address findings from inspections and supervisory reviews. The Central Bank's corrective and sanctioning powers have been enhanced through the implementation of the SSM updated supervisory practices and additional legislation that has been enacted since 2013, as discussed below.

48. Sanctioning is a shared responsibility between the ECB and the Central Bank.[26] The ECB has exclusive competence for imposing pecuniary sanctions on SIs in respect of breaches of directly applicable EU law relating to the tasks of the ECB. With regard to the imposition of non-pecuniary penalties on SIs, and the imposition of pecuniary and non-pecuniary penalties on SIs in relation to breaches of national legislation transposing relevant EU Directives, the Central Bank may impose sanctions in these circumstances if the ECB requires it to "open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed," and similarly, with regard to the imposition of pecuniary and non-pecuniary penalties on natural persons concerned in the management of SIs.[27] The Central Bank has the power to impose sanctions on LSIs and their management for breaches (although the ECB has exclusive competence to impose sanctions on LSIs for breaches of ECB regulations, which impose obligations on the LSIs vis-à-vis the ECB). The Central Bank also retains the power to impose sanctions in relation to breaches by SIs and LSIs and their management of national law that do not relate to the tasks of the ECB.

49. The Central Bank operates as Ireland's National Resolution Authority. The "2015 Regulations" transpose the Banking Recovery and Resolution Directive into Irish law and introduce a regime of recovery and resolution planning for credit institutions.[28] Under the Single Resolution Mechanism (SRM), the SRB has assumed direct responsibility for resolution planning and decision-making for SIs and pan-European banks while the Central Bank maintains such responsibility for other LSIs. The Single Resolution Mechanism and the 2015 Regulations provide the SRB/Central Bank with tools to achieve their orderly resolution in the event of failure. Following these regulations, the part of the Central Bank that carries out resolution-related responsibilities has to be structurally separate from the part that carries out supervisory responsibilities. To this effect, the

[26] With the exception of credit unions where the Central Bank retains responsibility for sanctioning.

[27] Council Regulation (EU) No 1024/2013 (SSM Regulation) of 15 October, 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, Article 18, on administrative penalties.

[28] 2015 Regulations include: the Central Bank and Credit Institutions (Resolution) Act 2011, and the European Union (Bank Recovery and Resolution) Regulations 2015 – S.I. No. 289 of 2015.

Central Bank has established the Resolution Division to assist the Governor in the exercise of his resolution functions. This division sits in the Central Banking side of the Central Bank, rather than in the Financial Regulation side, and reports directly to the Director of Resolution and Corporate Affairs. Notwithstanding this structural separation, there is cooperation on recovery and resolution matters with the banking supervision and crisis management teams.[29]

I. Interaction between Macroprudential and Microprudential Analyses

50. The Central Bank is active in providing internal structures that facilitate the interaction between macroprudential and microprudential analyses. Flexible and efficient committees with cross participation of senior officials and staffs from various Central Bank Divisions with financial stability and micro-prudential responsibilities are set up within the Central Bank (e.g., the in-house Financial Stability Committee and the Supervisory Risk Committee). These structures promote the exchange of information and collaboration between the two Central Bank functions. The analysis of the impact of "Brexit" was mentioned as a good example of both parts working together. The Central Bank also seeks the views of industry participants, academics, other regulators, as well as the public through consultations.

51. Macroprudential policy regarding banking is a shared competency between the Central Bank and the ECB. The SSM Regulation confers on the national authorities and the ECB specific tasks relating to macroprudential instruments for the banking sector set out in the CRR and CRD IV, which was transposed into Irish law using Statutory Instrument No. 158 of 2014. The ECB can apply more stringent measures than those applied by Central Bank ("top-up power"), but cannot set lower requirements than those set nationally. These two institutions actively engage in formal and informal discussions on an ongoing basis. For instruments outside of the CRR and CRD IV, such as limits on loan-to-value and loan-to-income, the national authorities have the full powers and responsibilities, but the ECB can suggest national authorities to use their powers over these instruments.[30]

FOLLOW UP ON FINDINGS FROM THE 2013 BCP ASSESSMENT

52. The IMF-led Basel Core Principles assessment, finalized in November 2013 and published in May 2014,[31] resulted in an overall satisfactory level of compliance with the BCPs. Substantive steps had been taken by the Central Bank post-banking crisis in terms of amending the institutional setting, increasing the quantity and caliber of supervisory staff, designing and

[29] See further the accompanying Technical Note on Financial Safety Net, Bank Resolution, and Crisis Management Framework.

[30] See further the accompanying Technical Note on the macroprudential Framework.

[31] IMF: Ireland: Report on Observance of Standards and Codes (ROSC) https://www.imf.org/external/pubs/ft/scr/2014/cr14137.pdf

implementing a proactive and intensive approach to supervision, expanding prudential requirements, and improving enforcement powers.

53. **However, the reform process was relatively young and the mission found that some areas required continued attention for its effective implementation**. The Central Bank had set up sound foundations, but gauging the full effectiveness of the reforms required time for the new framework to season and for staff to gain experience through its use. The main topics are discussed below. Table 2 summarizes the actions taken by the authorities to address the specific recommendations of the 2013 BCP assessment, presented sequentially according to the principles. In this discussion, the implementation of the SSM is a fundamental factor in the way several recommendations have been addressed.

A. Approach to the Supervision of Credit Risk

54. **While the 2013 BCP assessment recognized progress by issuing sound prudential requirements for loan loss provisions and classification, it encouraged the Central Bank to review banks' practices to determine whether provisioning fully reflected loss experience**. The Central Bank issued "Impairment Provisioning and Disclosure Guidelines" in May 2013, as part of the discussions of the joint EU-IMF Program of Financial Support for Ireland. This encouraged prudent provisioning practices with an initial focus on the covered banks (those guaranteed by the Irish Government in September 2008). Post 2013, the SSM, including the Central Bank, conducted considerable work in terms of the Asset Quality Reviews (AQR), Mortgage Arrears Resolution Targets (MART), and a detailed provisions review in 2015 in collaboration with the JSTs.

55. **The 2013 mission also recognized that while the Central Bank had enhanced its guidelines regarding loan classification and provisioning, it did not have direct powers to reclassify assets and increase provisions, which impacted its direct influence on provisioning practices**. Also, the Central Bank did not have the legal power to overrule a decision (e.g., on provisioning) by a bank's own external auditor. Instead, in circumstances where a credit institution decided not to amend its level of provisions as requested by the Central Bank, the Central Bank would rely upon its own regulatory powers to increase capital as per Regulation 70 of SI 661.

56. **The mission recommended greater frequency and depth of onsite reviews of loan loss provisioning practices** (e.g., testing of assumptions against experience, recognition of default, and prudent valuations). Greater frequency of onsite supervision would allow for verifying 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 would be better able to deem whether provisions are adequate for prudential purposes. Given that the "Impairment Provisioning and Disclosure Guidelines" applied only to covered banks, a greater onsite presence would provide supervisors the ability to identify approaches that depart materially from the Central Bank's guidance but remain compliant with accounting standards.

57. Since the implementation of the SSM, onsite inspections have increased for SIs and LSIs. Onsite inspection is a consistent practice in the SSM approach for credit risk assessment. The Central Bank has established a dedicated inspections division (BSID), which includes a credit inspection team. While the implementation of the SSM approach is still relatively new, the frequency and depth of credit inspections for LSIs has increased. This addresses the deficiencies identified in 2013 and discussed in the previous paragraphs.

58. In addition, the 2013 mission recommended the Central Bank to amend and strengthen the monitoring of banks' compliance with the Related Party Lending Code. To address the recommendation, the Central Bank conducted a survey of all credit institutions in July 2014 to ascertain the extent of non-credit related party transactions and to determine whether there were any potential risks outside the scope of the current Code. The results concluded that lending remains the most significant area of related party transactions. In order to ensure that this conclusion remains valid in the future, a similar exercise will be undertaken in 2016. The Central Bank remains satisfied that the Code incorporates a detailed reporting framework to ensure monitoring compliance. However, the Central Bank will continue to monitor the extent of adherence to the Code and should evidence of non-compliance emerge, a review of the reporting framework may be undertaken.

B. Calibration of the Supervisory Approach (PRISM)

59. The 2013 BCP assessment raised the issue of the calibration of PRISM for Medium Low and Low Impact banks. The Central Bank made significant progress in implementing a risk-based, proactive, and intensive approach to supervision, PRISM. The calibration of the system was based on the impact of the failure of an individual firm as regards financial stability. However, activities in the PRISM engagement model were heavily skewed to the eight highest impact banks. The approach to firms in lower impact categories was reactive. Risks could accumulate across a number of lower impact firms that were significant in aggregate without receiving proper supervisory attention. A more proactive approach would mitigate this risk.

60. The engagement model for the lower risk categories was reviewed as the SSM entered into force. The SSM Supervisory Manual sets out the processes, procedures, and methodology for the supervision of both Significant and Less Significant institutions, including supervisory tasks and key risk indicators. The supervisory approach has been amended so that the minimum prudential engagement level is no longer determined by "Impact" but by "Priority." Priority is determined by a combined assessment of impact and risk profiles, thereby ensuring that those entities with a higher risk profile receive a higher priority and proactive level of supervision. Since November 4, 2014, the ECB is the competent authority for the supervision of SIs, while the Central Bank remains responsible for the supervision of LSIs, with oversight by the SSM. LSIs and Third Country branches continue to be supervised through PRISM. The authorities note, though, that the SSM is considering that the LSIs will also migrate to IMAS and, in this regard, an SSM sponsored pilot project has commenced to assess such migration.

C. Supervisory Resources and High Staff Turnover

61. Limited supervisory resources and high staff turnover were identified as areas of concern that may slow the pace and effectiveness of the reforms. High-quality and experienced staff retention was identified as a problem at the time of the assessment and turnover in some areas of supervision was high. A strategy to retain staff was, therefore, needed to implement effectively current reform efforts and the mission recommended starting by filling the vacancies in supervision. Following the recommendations of the 2013 BCP assessment, the headcount has increased; however, human resource constraints continue to be an issue, although of a different nature as discussed previously in this report: staff retention and turnover are further exacerbated at the Central Bank, as already anticipated by the 2013 mission, and the ECB is also reconsidering its staffing needs.

D. Legislative Changes to Foster Central Bank's Powers and Actions

62. While there was no observed political interference with day-to-day operations, the 2013 mission encouraged Irish authorities to propose legal amendments to codify and foster the independence of the Central Bank. The legal framework in 2013 exposed the regulatory process to political considerations as it provided the Minister for Finance with several points of influence into the policy making process. The legislation provided 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. The Central Bank was the licensing authority but had to receive Minister for Finance consent to deny a license application or revoke a license approved based on false information. 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 Central Bank Commission in an ex-officio capacity.

63. The authorities indicate that the Government took great care to reaffirm the Central Bank's independence when introducing reforming legislation following the financial crisis. For example, 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. In addition, in the context of the introduction of the SSM, the independence of banking supervision has been materially enhanced as the ECB is now the competent authority for banking authorizations (with the exception of third country branches) and revocations, and directly supervises SIs. The Irish authorities are very cognizant and committed to the independence of the Central Bank.

64. The mission recommended enacting legislation giving the Central Bank the power to reject or rescind external auditors; however, the Central Bank understands that it can exercise other powers to the same effect. Section 46(2) of the Central Bank Act, 1989, states that, where the Central Bank is of the opinion that it would not be in the interest of persons maintaining deposits with the holder of a license or of the orderly and proper regulation of banking, it may direct, as the circumstances require, that holder not to appoint or not to re-appoint to the office of auditor, or the directors not to fill a casual vacancy in that office with a named person, and the direction shall be complied with. In addition, a credit institution is required to provide the Central

Bank with at least 15 days' notice prior to filling the post of the auditor of the firm (Section 46(1) of the Central Bank Act, 1989). This power enables the Central Bank to direct the credit institution not to appoint the proposed auditor.