## Matthew Elderfield: Central Bank of Ireland's progress in improving financial regulation and supervision

Opening statement by Mr Matthew Elderfield, Deputy Governor of the Central Bank of Ireland, to the Public Accounts Committee, Dublin, 13 June 2013.

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I would like to thank the Committee for inviting me back to discuss the progress that has been made in improving financial regulation and supervision since I was last here in May 2010, at which time we discussed the Comptroller and Auditor General's report on the lessons of the financial crisis. There is a lot of ground we could cover, but I think that is best done through our discussion, so let me be extremely brief in my opening remarks.

I would like to spend just a few minutes to describe the progress that has been made in three key areas: supervisory capability and approach, regulatory standards and powers and, finally, regulatory philosophy, including the role of enforcement. And then let me just mention one final loose end from the CAG's Special Report 72, which relates to auditor assurance statements. But can I just sound a note of caution at the outset: while good progress has been made in improving financial regulation and supervision in Ireland, we are by no means all the way there yet. Indeed, as a supervisor you are almost always playing catch up with industry and it is dangerous to think you will get to a point when you can rest on your laurels. So, it is important to maintain the momentum of improvements, to keep the regulatory framework up to date and to ensure supervisory capabilities are always at their best. It's also especially important to be vigilant against backsliding and attempts to compromise the independence or dilute the diligence of regulation, especially when times start to get good.

In terms of supervisory capability and approach, it was clear that supervision was under-resourced in a range of areas and therefore staffing levels have necessarily increased in the last few years. My original estimation was that the regulatory function of the Central Bank would need to be some 725 persons-strong, but based on experience, process improvements and efficiencies, I would think that a target level of around 600 is sensible for the end of the current three year Central Bank Strategy in 2015. Continually striving to improve quality is also important, by ensuring the right mix of experience and investing in training, so that your supervisors have the skills to challenge firms effectively. Ensuring that the Central Bank can attract and retain the skills it needs will no doubt become an increasingly demanding challenge as the market for the relevant specialised skills improves.

Six hundred supervisors into more than ten thousand regulated entities requires some strategic choices about resource allocation, which we do through the new risk-assessment framework we have developed called PRISM (probability risk and impact system). This involves an implicit exercise is setting risk appetite, in terms of ensuring adequate resource levels for those firms that pose the biggest potential impact on customers and financial stability should they fail. Our PRISM system also provides a framework for systematically scoring firms on the risk they pose against particular categories (like credit risk or market risk), then communicating these along with a risk mitigation plan – a "to do list" in plain English – for firms to address. This system is new to the Central Bank in the past couple of years and reflects best international practice in how to assess risks in an organised, consistent and systematic manner. This framework does not provide a guarantee that failures will never occur – indeed we should expect that they will continue to do so in smaller firms – but it does mean that we will closely "man mark" the largest firms in order to reduce the risk of their failure.

If supervision is about how you police the rules, regulation is about setting the rules themselves. There is a very busy international agenda of regulatory change which is feeding into Ireland via the European Union. I do have some sympathy with industry about the volume of change that is taking place and the challenges that poses for implementation. At a domestic level, the Central Bank has been focused in the initiatives it has taken, with the statutory Code on corporate governance and the new framework for fitness and probity the major changes that impact most sectors. These have helped fill important gaps in regulation. I am also very grateful to successive governments and to the members of this house for the support they have provided in upgrading the supervisory and enforcement powers available to the Central Bank, with legislation in this area close to final adoption. This is a welcome step to improve the regulatory framework. Going forward, it will be important to keep fine tuning the rules based on emerging international best practice.

Finally, in this very brief survey, a word about regulatory philosophy. The lessons of the financial crisis are clear, in that supervision and regulation was too light touch. As the IMF says, good supervision is in fact intrusive. And as Patrick Honohan said in his review, supervisors need to be decisive in following through on issues. Our PRISM system is designed to provide a framework that prompts such action; for example we closely track progress against risk mitigation plans. But at the heart of the approach there needs to be a robust regulatory philosophy that encourages challenge: we have described this as "assertive risk based supervision underpinned by a credible enforcement deterrent". This is designed to put a few concepts front and centre: that we operate a risk-based approach, differentiating based on impact and probability; that there are consequences and accountability for non-compliance; and that our supervisors are empowered to insist upon actions to mitigate risk where we are not satisfied by the explanation from a firm's management.

As today's session is, I understand, formally designed to help close off the Committee's review of the CAG's report into the lessons of the financial crisis, Special Report 72, let me note that there is one loose end in the recommendations that still needs to be concluded, relating to the introduction of auditor assurance statements. We have conducted some preliminary consultation with stakeholders and believe that a risk-based framework, with the obligation applied to the highest impact firms only, is the best and most proportionate way forward. The Central Bank Supervision and Enforcement Bill provides a clear mandate to introduce such assurance requirements, so when the legislation is adopted this can be progressed to a conclusion.

There is a lot more ground that we could cover and I am sure more areas the Committee is interested in discussing. This short introduction was by way of highlighting some of the key areas from my perspective. I thank the Committee for its attention and look forward to our discussion and to answering your questions.