

Matthew Elderfield: Effective enforcement – encouraging compliance and good practice

Opening remarks by Mr Matthew Elderfield, Deputy Governor of the Central Bank of Ireland, to the Central Bank Enforcement Conference, Dublin, 11 December 2012.

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I would like to welcome you to the first conference on enforcement that we are hosting at the Central Bank of Ireland. We are very glad to be hosting this event and that you are able to join us here today.

Enforcement is an important element of our regulatory strategy at the Central Bank. Our approach of assertive, risk-based supervision is underpinned by having a credible enforcement deterrent in place. Effective enforcement certainly has a corrective element that is designed to ensure accountability for non-compliance with regulatory requirements, both by firms and – as I would like to talk about briefly in a moment – ideally also for individuals. But effective enforcement is much more powerful than simply being about bringing a particular firm or its management to account.

The broader benefit, which supports supervision, is the deterrent effect of enforcement. If firms think there is a credible risk that their own non-compliance with regulatory standards would lead to sanctions from the Central Bank, then that provides a very powerful motivation to boards of directors and senior management teams to ensure a high standard of conduct. The fact that the Central Bank has sanctioned firms and has published details of these sanctions has made some in the industry uncomfortable and leads to pleas to ease up on the use of the enforcement tool. We do not apologise for taking enforcement actions or publicising them. There is no deterrence value unless firms, investors, consumers and the public are aware that we will respond with enforcement action where behaviour and practices fall short. I am firm in my belief that this is a necessary and best practice element in the regulatory toolkit of the Central Bank. And, unless these sanctions are published with enough detail about what occurred and the sanctions imposed the deterrent effect will be diluted.

We have purposefully made an effort to be more explicit and detailed in the publicity statements involving enforcement sanctions. The purpose of this is to provide greater transparency to industry, the markets and the public about the nature of breaches that have been committed. The publication of the enforcement action has a reputational impact on the firm and management concerned. A consequence of this approach is that the impact of our enforcement efforts is greater because, frankly, the message is clearly communicated to industry and the public that breaches will not be tolerated. Consequently all firms are powerfully incentivised to avoid enforcement action by being more diligent in respect of regulatory compliance.

This raises standards generally in the financial services sector. It shows that there are consequences for non-compliance. And it is an efficient use of resources. Rather than trying to individually mark all the firms that we supervise, the risk of enforcement action has a multiplier effect across the regulatory population in terms of encouraging compliance and good practice. It is, for example, particularly useful for the large population of smaller, low impact, firms where we cannot have a routine supervisory interaction.

The benefits of enforcement are therefore very clear in terms of raising standards. These benefits are not only recognised in Ireland but, of course, across many other jurisdictions in Europe and more generally internationally elsewhere. Enforcement actions are taken by supervisors in Ireland, in the UK and the US, and also across the European Union including France, Germany, Sweden, Malta and Luxembourg for example. So, I think concerns over the competitiveness impact of taking enforcement actions, which is a point sometimes put to me, is somewhat overstated.

And to be clear, I don't think it makes sense to somehow ring fence international firms from the scope of potential enforcement action. We see weaknesses in governance, systems and controls and other breaches amongst international firms, just as we do for domestic ones. Protecting Ireland's reputation as an international financial centre is important and means that both firms and the Central Bank need to be vigilant about standards in this sector.

What about the argument that it's not fair to take enforcement action for mistakes? Or that when a management team self-reports a breach they should get an exemption from enforcement? These are, frankly, well-trodden and somewhat hackneyed arguments. These are certainly relevant factors to consider during the enforcement process, and typically would be given consideration when assessing the correct sanctions. But the clear international practice is that enforcement still takes place in such circumstances. It is important that the deterrent effect still applies to inadvertent breaches and to self-reported ones as well. To do otherwise, would be to effectively turn a blind eye to the requirements which we are required to uphold and would encourage a culture of slackness that would sow the seeds of significant detriment to consumers and damage the financial stability.

So, let me be clear, enforcement in the financial sector in Ireland is here to stay. We aim to be transparent about our particular enforcement priorities in any given year and publicly state what these are. We are clear that certain types of breaches will be more likely to attract enforcement action than others. Additionally, we allocate resources to take cases on a reactive basis so that we can respond appropriately to serious breaches. Enforcement is not automatic for all breaches and involves collaborative effort between the supervisory teams and the enforcement directorate. We exercise judgement and discretion in using the tool.

I'm very pleased by the progress we have made over the past three years with our enforcement strategy. We have established a good track record of taking cases against financial services firms for a wide range of breaches. In the last three years, the Central Bank has concluded 30 administrative sanctions cases and imposed approximately €13.3 million in fines. We can see the benefit of this in terms of behaviour in the industry. For example, financial firms' efforts to provide restitution in overcharging cases tended to drag on interminably prior to setting a strict deadline backed up by the threat of enforcement action – and by taking a couple of cases. We have targeted transaction reporting as an area of concern and see firms tightening up the procedures as a result. We have sent a strong signal to firms both domestic and international that their systems and controls need to be strong and robust. We have also, as part of our mandate to protect consumers, focused on how firms handle complaints from their customers, emphasising to firms the importance of consumer protection and professional interaction.

I would like to thank the staff of the enforcement directorate of the Central Bank and also those supervisors will help prepare enforcement cases for the good work in making this happen.

But while we have quickly delivered on our enforcement strategy in terms of actions against firms, we still have some way to go to conclude successful actions against individuals involved in the management of financial firms. Generally speaking, firms tend to settle but individuals tend to fight their corner to the bitter end. So be it. That means that the process is protracted, both for financial regulators and other enforcement authorities. So, there is a need for considerable patience and determination.

The introduction of the fitness and probity regime was an important step forward in developing a comprehensive and effective regime. The ability to remove persons occupying important functions within regulated firms where they fail to meet the required standards of fitness and probity, and indeed prevent those who do not meet such standards from entering the industry, will ensure greater confidence and trust in persons occupying important functions within regulated firms.

All that said, I think it would be useful to find an appropriate mechanism to provide a measured analysis of and reflection on our overall structures in Ireland for taking cases

against individuals for breaches of financial regulation or indeed for cases of white collar financial crime. This is a challenging area in most, if not all, countries, but I think many people in Ireland have the impression that the national track record here could be stronger. The Central Bank, and its predecessor the Financial Regulator, has only applied financial sanctions to seven individuals during the past 10 years. We do have some substantial cases against individuals in the pipeline, but they are taking a lot of time. Similarly, on the criminal front, despite the efforts of the Gardaí, DPP and ODCE, we are still some way from the start of criminal proceedings, never mind their successful conclusion, of the cases arising from the financial crisis. Looking further back, we can see that it has taken a long time for high profile cases and tribunals to reach their conclusions.

Taken together, this track record arguably undermines public confidence in the “enforcement system” broadly defined and weakens its deterrent impact to head off the next crisis or scandal. Surely, then there is a case to step back and ask some rather fundamental questions.

This is not just a question of delivering speedier enforcement action against individuals – but without cutting corners – although that is part of it. It is about examining whether the current enforcement system is able to really deliver results when it comes to individuals who are responsible for financial failures that impose costs on society, for breaches of financial regulatory standards and for financial white collar crime more generally.

This is clearly a difficult area where frankly many other countries struggle as well. But let me very briefly suggest a few possible areas that could be explored.

A coordinated strategic approach is necessary for effective enforcement. At a high level, it would first make sense to examine the respective roles and missions of the principal enforcement bodies involved with financial white collar crime and, as part of this, to assess the capabilities and resources for delivering their objectives.

It would additionally make sense to assess whether there are best practice enforcement techniques that can be adopted from other leading jurisdictions.

It would also be useful to carefully review whether the existing legal framework for collecting evidence and pursuing cases is appropriately calibrated to ensure success. In November 2010 the then Director of Corporate Enforcement made a commendable submission to the Department of Justice on their White Collar Crime white paper, highlighting the problems with the current system, and suggesting possible reforms. He also raised a concern over the rules governing questioning of suspects and, to its credit, the government is acting quickly on this matter. It seems to me that these proposals have merit.

More fundamentally, I would argue that we should use the opportunity to examine some of the underlying legal offences in the area of financial white collar crime and to consider whether they need amendment or bolstering. For example, regarding administrative sanction cases taken by the Central Bank, how strict a test of responsibility should be applied to directors and senior management – i.e. the individuals themselves – of a firm that has been in breach of regulation and is itself subject to sanctions? Should we, like the FSA has proposed and the UK Treasury committee is considering, introduce some degree of presumptive liability or sanctions for directors of banks which failed and required public support? Should there be a general offence – either civil or criminal – for reckless trading of a financial services company? What other adjustments to the legislative framework might result in more effective enforcement action against individuals in cases of financial white collar crime? These matters require close scrutiny and careful debate, and not all should necessarily make it to the statute book. But it is important that these issues are examined systematically in a thoughtful and considered way as part of a broader, strategic initiative to strengthen Ireland enforcement capability and effectiveness.

These matters deserve some public debate, as well as expert study. Indeed such an approach can be seen from the Department of Justice’s white paper on Crime – currently

being prepared – which includes a section on organised and white collar crime, and has been the subject of public consultations and submissions, with many of the matters referred to here being raised. This may usefully lead to a package of policy proposals to enhance the Irish enforcement system. This will not change the rules of the game or prospects of the financial crisis cases that are currently in the pipeline at the Central Bank or shortly before the courts (although the lessons from the proceedings should also inform the reform agenda) – but it will strengthen the system for the future.

What is the best way to go about this? The Law Reform Commission? A Government Green Paper? A Wise Persons Report? Some mechanism for a measured and careful analysis of the issues in the round would seem to make sense, alongside a thoughtful public debate on the issues. Perhaps some of the leading academic bodies in Ireland might facilitate and stimulate discussion in this area, for example.

But we should somehow take the opportunity to ask some searching questions about how we can raise our collective game to ensure that we have a truly effective enforcement system that delivers deterrence where it really counts: at the door of the individual who breaks the rules. Only then will we be able to take comfort that we have created a system that will help deter the origins of the next financial crisis.

Just as the impetus for our internationally lauded criminal assets bureau came from the tragic circumstances surrounding Dublin's gangland problem in the 1990s, so too should the recent financial crisis provide a catalyst and opportunity for Ireland to create a truly effective system to assist in the fight against white collar crime, bringing with it individual responsibility for the actions of persons who hold senior positions in financial institutions.