Philip R Lane: Selective overview of the Central Bank of Ireland's current work programme

Introductory statement by Mr Philip R Lane, Governor of the Central Bank of Ireland, at the Oireachtas (National Parliament) Committee on Finance, Public Expenditure & Reform, Dublin, 26 January 2016.

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Thank you for inviting me to the Committee to present a selective overview of the Central Bank of Ireland's current work programme. I will especially focus on our domestic activities; as part of the eurosystem and the EU system of financial regulation, the Central Bank is also heavily engaged in a wide range of European policy committees.

In recent years, there have been considerable changes to the mandate and structure of the Central Bank, in response to the many lessons from the domestic and international financial crises. With the passing of the most intensive phase of crisis management, it is important to establish new priorities for the Central Bank. Our recently-published *Strategic Plan 2016-2018* provides a detailed guide to our plans for the next three years. Our mission statement "safeguarding stability, protecting consumers" encapsulates the dual priorities for the Central Bank in the period ahead: the preservation of financial stability, while also working to ensure that the financial sector operates in the best interests of its customers.

Much of the Central Bank's policy work takes the form of contributions to a wide range of EU regulatory committees and the eurosystem's committees that support the formulation and execution of the European Central Bank's monetary policy. In common with similar initiatives by the other major central banks, the ECB has recently adopted a number of unconventional measures in pursuit of its inflation target. These measures include the expanded asset purchase programme (EAPP) that will run until at least March 2017. In implementing the EAPP, the Central Bank of Ireland has been actively engaged in asset purchases. To illustrate the scale of the eurosystem's intervention in asset markets, total cumulative purchases of euro area public debt securities amounted to close to €500 billion by the end of 2015. This aggregate includes purchases of €7.6 billion of Irish sovereign debt.

The ECB's accommodative monetary policy has contributed to Ireland's excellent recent economic performance. For instance, the low interest rate environment has been a boon to many indebted households, while the government has been able to issue debt at low yields. More generally, as indicated in the introductory statement to the press conference after last week's monetary policy meeting, the assessment of the Governing Council is that the monetary policy measures that have been adopted since mid-2014 are working; noting the increase in downside risks in recent weeks, the Governing Council will review and possibly reconsider the monetary policy stance in early March.

In relation to the longer-term agenda for the euro area, the financial crisis also made clear that the original institutional design of the euro area suffered from a lack of risk-sharing and crisis management mechanisms. While there has been significant progress in reforming the institutional setup of the euro area, the recent Five Presidents' Report highlighted that further reforms could help in improving the resilience of the monetary union. This reform agenda should be a high priority for European policymakers.

Our latest Quarterly Bulletin was published this morning. It projects that that the economy will continue to grow strongly this year, with GDP growth expected to moderate only slightly to 4.8 per cent. This reflects the confluence of several positive factors, including the employment-rich nature of the recovery, a less constrained policy environment, the boost to purchasing power from lower energy prices, the on-going easing of the balance sheet legacies of the crisis and broadly favourable conditions in Ireland's main export markets. It is the positive alignment of

all these factors that has helped growth to strengthen and supports a continued favourable outlook.

However, while much has improved, vulnerabilities remain. The strong growth outlook provides an opportunity to address the legacies stemming from still-high levels of public and private sector indebtedness. Externally, the main current global risk factor relates to economic and financial conditions in some emerging economies. Closer to home, the Central Bank is also keeping a watchful eye on Brexit-related risks to the economy and the financial system.

More generally, small, highly-globalised countries such as Ireland are inherently more volatile than larger economies: we can grow strongly for extended periods but are also especially vulnerable to negative shocks. For this reason, it is essential that the Central Bank is pro-active in the deployment of macroprudential policies that can improve resilience and mitigate the procyclical dynamics associated with excessive leverage.

The new rules that impose loan-to-value and loan-to-income limits on most mortgages were introduced to protect borrowers and contribute to a safer financial system, which in turn also contributes to a more stable economy over the longer term. As I have already stated, The Central Bank is firmly committed to deploying such tools on an ongoing basis, with periodic reviews to ensure that the measures are appropriately calibrated. I expect the first review of the mortgage rules to be published by November this year. This review will be based on an analysis of the evidence provided by data on the first year of the operation of the rules, while taking into account other factors that may have influenced the mortgage market during this period. The rules-based framework is intended to promote the resilience of both banks and households and, as such, should be viewed as a permanent feature of the system. The Central Bank is open to tightening or loosening the calibration of these rules in response to the evidence; still, the value of stability in a rules-based framework means that the evidence threshold to justify adjustments to these rules is significant. Tools such as mortgage rules and the recently-introduced system of counter-cyclical capital buffers would have mitigated the costs of the boom-bust credit cycle in Ireland in the mid-2000s. The Irish economy remains vulnerable to adverse shocks, with limits to household leverage offering protection to households and banks.

In relation to financial regulation and supervision, the banking sector is in the middle of a multi-year transition to higher capital requirements, reduced leverage and increased balance sheet liquidity. The Single Supervisory Mechanism (SSM) has been in place in the euro area for just over a year: the SSM represents the first pillar of Banking Union by implementing a common area-wide approach to banking supervision, with centralised responsibility for the supervision of the circa 130 largest banking groups (including the main Irish retail banks). The second pillar consists of the Single Resolution Mechanism (SRM), which came into effect on January 1st. By ensuring that financial institutions can be resolved in an orderly manner, the SRM should significantly reduce the adverse impact of an institution's failure on the wider financial system and the taxpayer. The third pillar is the European Deposit Insurance Scheme (EDIS): this is still under negotiation at a European level.

In relation to mortgage arrears, the number of accounts in arrears over 90 days was just below 66 thousand at the end of September 2015. There is some progress to report however. Overall arrears levels started to decrease over two years ago and the number of households in long-term arrears (over 720 days) started to decrease in the third quarter of 2015. While the economic recovery has gained pace, the number of legal proceedings against mortgage holders have also been increasing. The Central Bank's continued role in this area is to ensure that the banks adhere to the Code of Conduct of Mortgage Arrears, meet the criteria for sustainable solutions and continue to engage with their customers to find non- repossession solutions whenever possible. The Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 seeks to ensure that borrowers whose loans are sold to unregulated transferees maintain the regulatory protections they had prior to the sale.

It is imperative that lenders continue to work with over-indebted consumers to try to resolve any arrears situation and to achieve sustainable solutions with co-operating borrowers. Clearly for many, there is no quick remedy or solution to long term arrears and careful, empathetic but realistic approaches need to be taken. I welcome the new coordinated programme of assistance for those in long-term arrears, with MABS acting as a "one stop shop" for borrowers in need of advice and support.

For credit unions, the Central Bank's new regulations came into effect on 1 January this year. These will enhance soundness and provide for enhanced confidence in the sector, supporting its role in providing important financial services to the community. We will continue to work with credit unions to support appropriate restructuring measures, the embedding of the strengthened regulatory framework, and to facilitate prudent and appropriate development.

This is also a landmark year for the insurance sector, with the Solvency II framework going live. The "whole balance sheet" approach to capital calculation combined with the strong emphasis on a firm's risk management and supervisory review will result in a much-transformed regulatory and supervisory framework. This year, Central Bank supervisors and the supervised firms will be putting this framework into operation for the first time.

In December, we released new regulations on SME lending**.** The regulations aim to strengthen protections for SMEs, while also facilitating access to credit. The regulations provide for greater transparency around the application process and the reasons for refusing credit applications, greater protections for guarantors and an expansion of the grounds for an internal appeal.

There is growing international recognition that financial regulators should be more pro-active in protecting consumers, in view of the complexity, risks and costs of financial products. It is not our role to run the firms we regulate nor is it to determine their business models or strategies (including in relation to the setting of prices and rates charged). Rather, our work on consumer protection is primarily focused on increasing transparency to enable people make informed decisions with full clarity about the risks, costs and long-term impact of financial products. This year, we will further enhance our engagement with boards of the larger retail firms to push for a more consumer-focused culture within firms, and will carry out on-site consumer risk assessments across a number of retail firms.

Firms must be able to demonstrate that their products are fit for purpose – this means that firms must ensure that products are fully understood by customers and are suitable for their individual needs. We therefore expect firms to conduct consumer-testing on their products (including their product literature) and to simplify them where necessary; to use plain language; and to go beyond disclosure and *caveat emptor* to ensuring consumers' general understanding of products before launch and individual consumer's understanding of the product during the sales process. They must also continuously satisfy themselves that products remain suitable for the target market and provide the best solution for existing as well as new customers.

We also plan to continue our product-focused supervisory work, including the tracker mortgage examination, and reviews of structured products and health insurance. We will also increase our firm-specific engagement with low-impact firms, including intermediaries and debt management firms. Further work will be done to strengthen consumer protection code requirements, including for variable rate mortgage holders, as well as carrying out an examination of the impact on consumer outcomes of commission payments to insurance intermediaries.

You will have seen a good deal of enforcement activity reported in the press in recent months. This reflects our approach whereby high-quality supervision must be underpinned by a rigorous approach to enforcement.

Our role in the collection of financial data will also be further expanded through the establishment of the Central Credit Register (CCR). The credit reporting obligations will apply to over 500 lenders, including banks, credit unions, asset finance houses, local authorities and money lenders and will be fully operational from 2017.

The expansion in the scope of monetary policy, the adoption of a more intrusive approach to financial regulation, the introduction of new EU regulatory mandates, the ongoing growth of the investment funds sector in Ireland and the professionalisation of corporate services in the Central Bank have resulted in a significant expansion in staff numbers. As our mandate expands, we expect continued growth in our staff numbers; we anticipate recruitment of an additional 150 staff this year, bringing our staff numbers to about 1650.

As we expand, we will begin the move to our new headquarters on North Wall Quay at the end of 2016. The layout of the new building has been designed to promote a collaborative working environment, which will facilitate the teamwork that is so critical to the delivery of the Bank's multi-faceted mandate. In parallel, we expect to complete the design of new organisational and reward models in the next few months.

A greater level of openness about how the Bank conducts its activities can help improve the level of public trust in our organisation: we believe that people will be more confident that we act independently and in the public interest if they have greater insights and understanding about what is going on inside the Bank. To this end, we have recently announced plans to publish the minutes of the meetings of the Central Bank Commission. While information on the supervision of regulated firms and market-sensitive financial operations activities cannot be disclosed, the publication of these minutes should contribute to greater understanding of our corporate governance, internal debates and the initiatives we take to deliver on our mission. Second, we have also released data on our salary structures and pay scales, which will be updated on an annual basis. Furthermore, by providing greater details on our human resources policies, we aim to enhance understanding about the Central Bank as a public organisation and prospective employer.

In summary, during my tenure as Governor, my aim is to build on the progress that has been achieved in recent years in recasting the Central Bank as an efficient and effective central bank and financial regulator. The staff of the Central Bank can be proud of these achievements, which were recently recognised by our international peers through the Central Bank of the Year award from centralbanking.com and the *Central Banking* journal. Peer reviews provide another important benchmark for our performance: an independent assessment of five recent external peer reviews of the Central Bank's regulatory functions is available on our website and recognises the Central Bank's consistent adherence to the highest international standards over the last several years.