Banking Regulation

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Abstract and Keywords

Although it bore a resemblance in some ways to crises in many other jurisdictions such as the USA and the UK, the crisis in Ireland was characterized by a number of uniquely Irish features. This chapter reviews the causes of the Irish banking crisis, focusing on the weaknesses in bank regulation, supervision and enforcement, and poor corporate governance in the banks. It examines the regulatory and structural reforms which have been introduced since then, and concludes that a significant number may be classified as endogenous reforms initiated or planned prior to the Troika programme in late 2010. These reforms represent a paradigm shift in regulatory approach which continues to develop now in the context of the European Banking Union and the SSM.

Keywords: banking crisis, bank regulation, corporate governance, enforcement, SSM, Troika programme

Introduction

In response to the 2007 global financial crisis and the frailties in banking regulation which it exposed, there has been an extensive programme of financial regulatory reform both at a national and supranational level. In late 2014, Mark Carney,
the chairman of the Financial Stability Board indicated, in his update to the G-20 leaders, that the task of agreeing measures to fix ‘the fault lines that led to the global financial crisis is now substantially complete’ (Carney 2014: 1). Indeed, the European Commission (EC) in September 2015 published a call for evidence on unnecessary regulatory burdens and rules, giving rise to unintended consequences (EC 2015b). This does not mean that the pendulum should swing back towards a ‘light-touch’ regulatory regime or even that the regulatory reform agenda has been completed. Carney emphasized the need to build on the regulatory successes to provide a safer and more resilient financial system. However, it is an appropriate time to take a step back to analyse the changes which have been introduced, and to assess the ability of the new regulatory regime to avoid the mistakes of the past and respond more efficiently to the new risks which will inevitably emerge.

In Ireland, where the blanket deposit guarantee effected in September 2008 by the Credit Institution (Financial Support) Act 2008 and the Credit Institutions (Financial Support) Scheme 2008 might be viewed as a tipping point in the Irish banking crisis, it is evident that the country has experienced a paradigm shift in regulatory approach since then, with significant reforms in banking regulation and supervision. Both macro- and micro-prudential regulation have been strengthened. (Though outside the scope of this chapter, it should be noted that a number of macro-prudential policy tools, including mortgage rules, counter-cyclical capital buffers, and other systemically important institutions buffers have also been introduced since the crisis.) An important element of improving regulation and supervision in this context was a strengthening of the Irish Central Bank’s legal mandate, and the manner in which this has been done is examined in this chapter. It is argued that the changes made will have a positive impact, promoting greater financial stability and consumer protection. The section ‘Brief Outline of the Banking Crisis in Ireland’ of the chapter provides a brief introduction to the Irish banking crisis. Although it bore a resemblance in some ways to crises in many other jurisdictions such as the USA and the UK, it was characterized by a number of uniquely Irish features. The next section, ‘Pre-Crisis Banking Regulation and Supervision’, sets out the weaknesses in bank regulation and supervision revealed by
the crisis in order to explain the rationale behind the various reforms. ‘The Prism Model’ section examines the new risk-based framework for the supervision of regulated entities introduced by the Central Bank and explores the impact of the single supervisory mechanism (SSM) on prudential supervision. The section ‘Corporate Governance Reform’ focuses on the crucial area of corporate governance and outlines the changes which have been introduced to remedy the deficiencies which undermine board effectiveness and oversight, strong risk management, and a responsible board culture. The ‘Enforcement’ section examines the Central Bank’s new enforcement strategy and the enforcement tools at its disposal. Finally, the ‘Conclusion’ section considers the extent to which reforms in banking regulation and corporate governance have contributed to recovery.

One important point needs to be made at the outset. With the exception of the European Union (EU) banking union reforms discussed in ‘The Prism Model’ section, the significant majority of the reforms described could be classified as endogenous reforms emerging out of Ireland’s own identification of regulatory failings, a belief on the part of the Financial Regulator and the legislature that change was a prerequisite to economic growth and financial stability, and a sometimes resigned acceptance by stakeholders that reform was inevitable. Christine Lagarde, managing director of the International Monetary Fund (IMF), acknowledged that many of the measures of the joint EU–IMF Programme of Financial Support (‘Troika Programme’) had already been agreed by the Irish Government and were at various stages of development when it commenced in November 2010. She therefore complemented the Irish response to the crisis on ‘the sense of ownership’ displayed (Lagarde 2013). Government action prior to November 2010 included: the nationalization of Anglo Irish Bank; the injection of capital into the larger domestic banks; the establishment of the National Asset Management Agency (NAMA); and the introduction of the eligible liabilities guarantee scheme. As discussed in ‘The Prism Model’ section, work had already commenced on developing a new regulatory infrastructure and a new supervisory system for credit institutions. The Troika Programme thus referred to ‘continuing’ the efforts to strengthen banking supervision (para.15) and the Financial Measures Programme (FMP), which implemented the Central Bank’s obligations (p.109)
under the Troika Programme, referred to intensifying ‘existing policy’ (FMP 2011: 3). Before examining these developments, however, it is useful to consider the regulatory structures and systems which existed in the run-up to the crisis.
Brief Outline of the Banking Crisis in Ireland
The Financial Crisis Inquiry Commission charged with determining the domestic and global causes of the crisis in the USA attributed it to: ‘widespread failures in financial regulation; dramatic breakdowns in corporate governance; excessive borrowing and risk-taking by households and Wall Street; policy makers who were ill prepared for the crisis; and systemic breaches in accountability and ethics at all levels’ (Financial Crisis Inquiry 2011: 27). If one were to replace the reference to ‘Wall Street’ with a reference to Irish credit institutions, this explanation would serve to explain many of the causal factors of the Irish crisis. However, it has been convincingly argued that ‘Ireland’s banking crisis bears the clear imprint of global influences, yet it was in crucial ways “home-made”’ (Regling and Watson 2010: 5).

Reports were commissioned by the government from banking experts into: the conduct of the banking sector (Regling and Watson 2010); the performance of the Central Bank and Financial Regulator (Honohan 2010); and the policies, practices, and linkages that contributed to the Irish crisis (Nyberg 2011). The latter report, which focused on the reasons why a number of public and private institutions had acted in an imprudent or ineffective manner in the run-up to the crisis, was entitled Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland. The title provides an immediate insight into the report’s findings and epitomizes the crux of the crisis. In early 2016, a parliamentary Joint Committee of Inquiry into the Banking Crisis (‘the Banking Inquiry’), charged with establishing the reasons Ireland experienced a systemic banking crisis, published its report having heard oral evidence from 131 witnesses and reviewed over half a million pages of documentation. It concluded that there were in reality two crises, a banking crisis and a fiscal crisis, and that they were caused by key failures in banking, regulation, government, and Europe.

Ireland was not, of course, the only country whose banks needed financial support. Support programmes for banks entailed non-recovered fiscal costs of about 5 per cent of gross domestic product (GDP) or more in Belgium, Greece, Luxembourg, the Netherlands, Austria, and the UK (EC 2015a: 9). Unusually, however, Ireland’s enormous banking exposure was almost entirely related to (p.110) property speculation, fuelled by the greater availability to the Irish banks of cheap
European finance and to the unchecked domestic housing bubble of the preceding ten years (Clarke and Hardiman 2012). Between 2002 and 2008, domestic property-related lending had increased by almost €200 billion, representing 80 per cent of all growth in credit. This raised the share of property-related lending from below 45 per cent of total credit in December 2002 to above 60 per cent in December 2008 (Nyberg 2011: 14). This level of expansion and concentration was facilitated, according to Nyberg, by ‘silent observers’ (2011: 6), in the form of external auditors, and by the public authorities acting as ‘enablers’ (2011: 7). There was evidence of widespread failings in corporate governance over and above the poor risk management and inappropriate remuneration structures also found in banks in other countries. Regling and Watson found that lending guidelines and processes appeared to have been quite widely circumvented and that there were ‘very specific and serious breaches of basic governance principles concerning identifiable transactions in specific institutions that went far beyond any question of poor credit assessment’ (2010: 35). The Banking Inquiry too attributed the banking crisis to decisions of bank boards, managers, and advisors to pursue risky business practices with a view either to protecting their market share or growing their business and profits.

The aforementioned three expert reports into the Irish crisis in 2010 and 2011 reflected a widespread acknowledgment that the banking system was broken and that, in order to affect the changes necessary to stimulate economic growth, credit would have to be restored and Ireland’s image as the ‘Wild West of European finance’ (O’Toole 2010) transformed. One positive consequence of this introspection and national reflection was that the mistakes made were acknowledged and addressed at an early stage.
Pre-Crisis Banking Regulation and Supervision
The Central Bank and Financial Services Authority of Ireland Act, 2003, established the Central Bank of Ireland and Financial Services Authority (CBIFSA) in the form of two separate entities: a monetary authority carrying out functions related to the European System of Central Banks and a regulatory authority entitled the Irish Financial Services Regulatory Authority (IFSRA) responsible for the supervision of financial services firms. Honohan has suggested that ‘the division of responsibilities between the Governor, the CBIFSAI and IFSRA was novel and contained the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis’ (2010: 36). It also (p.111) encouraged the establishment of institutional silos, leading to poor coordination and communication between economists and supervisors.

An issue even more problematic than the flawed structure of regulation was the manner in which supervision was implemented in practice (Regling and Watson 2010: 36). Like many other jurisdictions at the time (Black 2010), the Irish regulatory regime was founded on ‘principles-based regulation’. This phrase is generally understood as referring to a reliance on high-level, broadly stated rules or principles as a means of setting conduct of business standards for regulated entities, thus eschewing more detailed prescriptive rules. The attraction of such an approach was that it promised to provide greater flexibility to the regulated entities whilst promoting a high ethical standard of behaviour. IFSRA’s regulatory approach was not to be prescriptive in terms of product design, pricing, and the specific risk decisions of regulated firms but to trust each firm to determine its own governance structure and control system (Honohan 2010: 44). Supervisors focused on verifying these structures and systems rather than making their own independent assessment of risk. The difficulty with this system of supervision is that it depends very much on the competence and probity of the directors and managers of the regulated entities. The aforementioned weaknesses in the Irish governance system left the Irish institutions particularly exposed in this regard. A further problem identified by Honohan, which was perhaps not so commonplace in other countries, was that the philosophy of trust led to ‘the emergence of a somewhat diffident attitude on the part of the regulators so far as challenging the decisions of
firms was concerned’ (2010: 44). Reflecting one aspect of regulatory capture, this created what was described as a ‘very accommodating’ supervisory approach (Regling and Watson 2010: 38). This was compounded by an unduly hierarchical CBFSAI culture, discouraging challenge. One significant consequence of this was that quantitative assessment was neglected and insufficient focus was placed on ensuring that banks’ capital could meet their property-related risks (Honohan 2010: 16).

Honohan also described unwillingness on the part of the CBFSAI to acknowledge the real risk of a looming crisis and to pre-empt it. This was attributed in part to a fear that ‘rocking the boat’ would lead to a potential adverse public reaction (Honohan 2010: 16). This fear may have been accentuated by the fact that section 5A(1)(b) of the Central Bank Act 1942 as amended, set out as one of the CBIFSAs’s statutory duties as the duty ‘to promote the development within the State of the financial services industry (but in such a way as not to affect the objective of the Bank in contributing to the stability of the State’s financial system)’. Despite the bracketed caveat, this encouragement to push the ‘green jersey agenda’ was unhelpful and clearly created a potential conflict with CBIFSAs’s financial stability objective. The Banking Inquiry strongly criticized regulators for underestimating and not responding fully to the systemic risk. (p.112)

The Prism Model
A significant and innovative regulatory response was envisaged to address the problems identified. In July 2010, the Central Bank Reform Act, 2010 (‘the 2010 Act’), established the Central Bank of Ireland as a new single unitary body, ensuring that the central banking and financial regulation roles are integrated and coordinated. The Central Bank is charged under this Act with ensuring inter alia Eurosystem effectiveness, financial stability, proper and effective regulation of the financial institutions and markets, independent high-quality economic analysis and markets, consumer protection, and the resolution of financial difficulties in credit institutions. It is no longer required to promote the financial services industry and so this potential conflict of interest is eliminated. The 2010 Act also serves to enhance the
system of regulatory control and to confer additional powers
on the Central Bank, as discussed in the paragraphs below.

Even before the 2010 Act, the approach to supervisory
engagement with the banks had fundamentally changed. Since
the commencement of the blanket deposit guarantee, site
inspections had increased, there was a greater focus on the
quality of governance structure, and regulatory resources
were augmented. In June 2010, a new strategy on banking
supervision in Ireland was announced, which articulated these
changes and marked a departure from the principles-based
regulatory approach. It involved a broadening of the approach
to financial stability and changes to supervisory structures,
supervisory culture and approach, corporate governance, and
international supervisory cooperation. Although this strategy,
like its predecessor, was described as ‘outcome focused’, it
was envisaged as a more systematic risk framework which
would serve as ‘the engine of [the Central Bank’s] supervisory
strategy’ (Brady 2010) and would be ‘challenging, and where
necessary, intrusive’ (Central Bank 2010). Matthew Elderfield,
the then head of Financial Regulation, explained:

I am asking our supervisors to ask firms difficult
questions, to be sceptical, to challenge established truths
and to not necessarily take the first answer they are
given. I wish them to be assertive…I will support our
supervisors in being robust where they need to be robust
in the face of obfuscation. (2011b)

The terms ‘difficult’, ‘sceptical’, ‘challenge’, and ‘robust’ are in
stark contrast to earlier descriptions of the previous regime as
‘trusting’, ‘diffident’, and ‘accommodating’.

In 2011, the Central Bank introduced its new model the
Probability Risk and Impact System (PRISM). The title refers
both to the supervisory tool introduced to make the risk
assessments and also to the software application employed.
The innovative model involves a number of quantitative impact
metrics which allows the Central Bank to attribute an
empirically driven score (p.113) to each financial firm it
supervises, which approximates to the ability of the firm to
negatively impact financial stability and consumer welfare if it
experienced problems, and also the probability of such
problems arising. The objective of PRISM is not only to
facilitate the adoption by supervisors of a consistent way of
thinking about risk across all supervised firms but also to enable the Central Bank to allocate scarce supervisory resources appropriately. Under PRISM, the most significant firms which are capable of having the greatest impact on financial stability and consumer welfare receive a high level of supervision with structured engagement plans, leading to early interventions to mitigate potential risks. Risk mitigants include internal controls, organizational changes, ownership structures, and access to capital. Regulated firms which have the lowest potential adverse impact are supervised reactively and through thematic assessments. A further benefit of the PRISM tool is that it allows the Central Bank to identify patterns emerging across the different sectors within financial services more easily and more quickly. This is crucial in light of the fact that the apparent failure by the CBFSAI to grasp the scale of the potential exposure of the banks in the Irish market was a major contributor to the crisis (Honohan 2010: 9). The Central Bank has emphasized that the ultimate goal is not the prevention of failure:

Firms will and must be allowed to fail in a functioning market economy—the direct costs of staffing the Central Bank to guarantee absolutely no failures ever would be prohibitive. Because economic dynamism and growth in the economy call for a degree of risk taking, the indirect damage to the economy that such a style of regulation would cause would be greater still. What PRISM does is to focus attention on the firms with the highest impact, making it materially less likely that they will fail in a disorderly fashion. (Central Bank 2016b: 2)

In November 2014, following a comprehensive EU-wide assessment of the credit institutions that were likely to fall under direct European Central Bank (ECB) supervision, the SSM came into operation. The SSM Council Regulation (EU) No 1024/2013 and SSM Framework Regulation (EU) No 468/2014 (insofar as was necessary) have been implemented further by the European Union (Single Supervisory Mechanism) Regulations 2014. The SSM, one of the twin pillars of banking union, involves the prudential supervision of all credit institutions in participating member states, including Ireland. Its primary objectives are to ensure the soundness of the European banking system; to increase financial integration and stability; and to ensure consistent supervision. Like the PRISM system, the supervisory practices of the SSM are
proportionate to the systemic importance and risk profile of the credit institutions under supervision. The ECB now directly supervises the four Irish institutions classified by the ECB as ‘significant’, namely Bank of Ireland (BOI), Allied Irish Banks (AIB), Permanent TSB, and Ulster Bank, together with about 1,200 other credit institutions in the Eurozone, covering close to (p.114) 85 per cent of total banking assets. Supervision is carried out by joint supervisory teams led by the ECB but comprising staff from the ECB and the national competent authorities. In practice, most of the supervision is carried out in the member states where the institutions are located, but the substantive decisions are made in ECB headquarters in Frankfurt. The Central Bank remains responsible for the supervision of activities defined in the Regulation underpinning the SSM as ‘non-core’, which includes anti-money laundering and consumer protection. For the 3,500 or so smaller institutions in the EU described as ‘less significant supervised entities’, supervisory responsibility has remained with the national competent authorities. Supervision for all the institutions is conducted in accordance with European law, national law as applied by the Central Bank, European Banking Authority technical standards, the European Banking Authority’s European Supervisory Handbook, and harmonized standards and processes developed by the SSM. The overall approach to supervision has continued to be risk-based and to take into account both the impact and likelihood of an institution failing (Central Bank 2015a). In response to the establishment of the SSM, the Central Bank also created a three-divisional supervisory function with responsibility for: banking supervision; onsite inspections supervision; and banking supervision analytics.

The Credit Institutions (Stabilisation) Act 2010 was introduced with the express objective of giving the Minister for Finance the necessary powers to effect the restructuring and stabilization of the banking sector that the government committed to in the National Recovery Plan (NRP) 2011–14. It provided for: direction orders requiring institutions to take or refrain from taking any action in support of the government’s banking strategy; transfer orders relating to institutions’ assets and liabilities to facilitate the restructuring of the banking sector; and, under certain conditions, subordinated liabilities orders to achieve appropriate burden-sharing by
subordinated creditors in institutions which have received state support.

An effective supervisory system must operate in conjunction with an effective resolution system for failing institutions. The Troika Programme identified the need for a permanent resolution regime (2010: para.14) and this was subsequently introduced in the form of the Central Bank and Credit Institutions (Resolution) Act 2011 (‘the 2011 Act’), which empowers the Central Bank to resolve authorized credit institutions. It provided for the establishment of the Credit Institutions Resolution Fund, financed both by the institutions and the Minister for Finance, to fund the resolution of financially unstable credit institutions. The 2011 Act empowers the Central Bank to establish a ‘bridge bank’ to hold assets and liabilities transferred from a distressed institution, to seek a High Court transfer order to compel a distressed credit institution to transfer its assets and liabilities to another entity, to present a petition to wind up a credit institution, and to appoint a special manager to take over its management and operate it within defined terms. The fund has been used for four resolution cases concerning credit unions, constituting three transfers of business to other institutions and one winding-up order. The resolution component of banking union, the EU Bank Recovery and Resolution Directive 2014/59 (‘BRRD’), was implemented by means of the European Union (Bank Recovery and Resolution) Regulations 2015 (‘2015 Regulations’) and applies to all banks licensed to operate in Ireland. Since the introduction of BRRD, all member states of the EU have to apply a single rulebook for the resolution of banks and large investment firms. If an institution subject to the SSM faces serious difficulties, its resolution will be managed through the Single Resolution Mechanism and resolution decisions will be made by the Single Resolution Board. The BRRD and the 2015 Regulations superseded the 2011 Act for banks and required the establishment of the Bank and Investment Firm Resolution Fund. The 2011 Act will continue to apply only to credit unions.
Corporate Governance Reform
Honohan identified three specific areas in the lead-up to the crisis where IFSRA failed to implement sufficiently robust requirements to underpin its supervisory approach. These were: corporate governance; fitness and probity; and directors’ compliance statements. Changes to the legal rules in all three of these areas have been introduced since then. These changes reflect the fact that boards of directors and senior management are acknowledged to be ‘the first line of defence in ensuring that a bank is well managed, with systems and controls, appropriate to the nature, scale, complexity and risk of its operations’ (Elderfield 2011a); weaknesses in these areas, as we have seen, may be extremely costly.

Prior to the commencement of the Troika Programme in 2010, the Central Bank drafted and introduced its own Corporate Governance Code for Credit Institutions and Insurance Undertakings in 2010. The Code was revised, renamed as Corporate Governance Requirements (‘Requirements’) and divided into two separate documents for credit institutions and insurance undertakings in 2015. Unlike the vast majority of corporate governance codes across the world which are applied on a ‘comply or explain’ basis, the Requirements, like the Code before it, have statutory effect. The decision to adopt a higher governance standard here was explained by Matthew Elderfield on the basis that ‘Ireland has suffered more than most countries in the financial crisis and now needs to get to grips with the home grown elements of that crisis’ (2010). The Requirements seeks to ensure that the boards of banks and insurance companies are composed of suitably qualified and committed individuals who (p.116) are in a position to advise, monitor, and challenge executive management on key issues such as strategy, internal controls, risk management, and remuneration. Mandatory rules prescribe the role and composition of the board and its committees. More onerous requirements are imposed on high-impact-designated institutions and credit institutions which are deemed significant for the purposes of the Capital Requirements Directive 2013/36/EU. The Central Bank monitors adherence to the Requirements through ongoing supervision of the institutions and it also requires each institution to submit an annual compliance statement and to alert it promptly if it becomes aware of a material deviation from the Requirements during the year, advising of the background and the remedial
action it proposes to take. One of the advantages of a statutory code over a self-regulatory one is that formal sanctions are available for breaches. Contraventions of the Requirements may lead to the imposition of administrative sanctions, prosecutions, the refusal to appoint a proposed director to any pre-approval controlled function, or the suspension, removal, or prohibition of an individual from carrying out a controlled function, as described in the next paragraph.

Pursuant to the Central Bank Reform Act 2010, the Central Bank introduced a statutory fitness and probity regime for directors and senior management of financial institutions, including credit institutions, in 2011, and the Central Bank issued a Code setting out the relevant standards of fitness and probity. This Code was amended in 2014. The regime involves the classification of a number of senior positions as controlled functions or pre-approval controlled functions, the latter requiring the prior approval of the Central Bank before an individual can be appointed. Section 2.1 of the Code requires that the Central Bank provides that an individual performing a pre-approval controlled function or a controlled function is required to be: competent and capable; honest, ethical, and to act with integrity; and financially sound. In relation to the first criteria, the Central Bank advises that ‘the person shall have the qualifications, experience, competence and capacity appropriate to the relevant function’ (2014: 3.1). This specifically requires the person to have ‘a clear and comprehensive understanding of the regulatory and legal environment appropriate to the relevant function’ (2014: 3.2(e)). Defining the rather general standard of ethics and integrity is always going to be difficult, and the examples provided by the Central Bank refer to the absence of a restriction or disqualification order, a complaint to the Financial Services Ombudsman, disciplinary proceedings, a dismissal for breach of trust, and so on. The Central Bank has a range of powers available to it under Part 3 of the Central Bank Reform Act 2010 to investigate, suspend, or prohibit individuals from pre-approval controlled functions and controlled functions in order to ensure that those entering the industry are fit and proper. Since November 2014, the ECB has had exclusive competence for the fitness and probity assessments of the boards of significant credit institutions and all credit institutions applying (p.117) for authorization. These assessments are carried out on the basis of the
provisions of the Capital Requirements Directive 2013/36/EU in accordance with the suitability assessment guidelines produced by the EBA. Article 91(1) of Directive 2013/36/EU requires member states to ensure that board members will ‘at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties’.

Although the Companies (Auditing and Accounting) Act 2003 introduced the concept of a mandatory wide-ranging directors’ compliance statement, the relevant section was never commenced. Following a recommendation of the Company Law Reform Group, published in 2005, the Companies Act 2014 required directors of public limited companies and other companies meeting certain size thresholds to make a statement in their Directors’ Report acknowledging their responsibility for securing the company’s compliance with specified relevant obligations under companies and tax legislation. They are also required to set out the company’s policies in respect of its compliance with these obligations, to confirm that the company has appropriate arrangements or structures in place to provide a reasonable assurance of material compliance, and to review these arrangement and structures annually. In an effort to make compliance more practical, the Companies Act 2014 specifically provides that the arrangements can include reliance on the advice of a suitably qualified employee or service provider.

Enforcement
Regulators have been criticized not only for failing to supervise and enforce the rules that did exist but also for not ensuring that an appropriate enforcement framework was in place. The Banking Inquiry concluded that the Financial Regulator had sufficient powers to deliver their prudential supervision of the banking sector in a more intrusive manner and that it could have imposed conditions on banking licences, revoked or suspended licences, and, after late 2005, imposed administrative sanctions for breaches, including breaches of lending limits (Joint Committee of Inquiry into the Banking Crisis 2016: 158). However, the excessively deferential regulatory approach adopted by IFSRA, together with its apparently limited appetite for legal challenge, led to a failure to move ‘decisively and effectively enough against banks with governance issues’ (Central Bank 2010: 9).
Although a persistent pattern of breaches of regulations in certain credit institutions occurred (Honohan 2010: 72), no administrative sanctions were imposed before 2008 on a credit institution in relation to a prudential matter. One egregious case made public involved a detailed report by an IFSRA supervisor recommending ‘tough action’ in response to ‘severe governance deficiencies’ and ‘failings at every level’ in a particular bank (Honohan 2010: 73). Instead, eight years of correspondence ensued in a vain endeavour to correct the problem. Honohan noted that this ‘protracted engagement approach to dealing with a series of serious issues was by no means atypical’ (2010: 73). He concluded that ‘the seeming lack of a credible threat of action by the Financial Regulator reduced the urgency of dealing with issues (by all parties)’ (2010: 74).

As has been evidenced from the earlier examination of reform in the area of corporate governance, a substantial number of regulations have been introduced since the crisis in order to incentivize and encourage appropriate behaviour. These are part of the Central Bank’s commitment to operate a risk-based supervisory model of regulation ‘underpinned by a credible threat of enforcement’. The most important change in this context has been the Central Bank (Supervision and Enforcement) Act 2013, which provides enhanced powers under its administrative sanctions regime, including increased financial penalties. The quantum of the penalties which may be levied against individuals and regulated entities is doubled to €1 million and €10 million respectively, and it may be based now on the turnover of the regulated entity. The Central Bank was given stronger powers in relation to investigations, including the very valuable power to require the production of a skilled person’s report into possible contraventions. It was also authorized to give a direction to allow it recover the costs of an investigation and to require a regulated entity to make appropriate redress to customers that have suffered or will suffer loss as a result of its widespread or regular defaults. It was described by the Minister for Finance as ‘not a piece of crisis legislation’ but one which provides a long-term regulatory framework for supervision and enforcement.

As earlier experience indicates, strong enforcement depends not only on the availability of enforcement tools but also on the readiness of the regulator to employ them. In this respect too, there has been a marked change in approach. In early 2010,
the Enforcement Directorate was established as a separate and distinct directorate with an overarching objective of safeguarding stability and protecting consumers. The Central Bank acknowledged that a failure to establish such an independent entity in the past suggested ‘the lack of use and lack of value placed on the role of enforcement as a necessary component of an efficient and effective regulatory framework’ (Rowland 2014). A new enforcement strategy was published in 2010, and between 2010 and 2014 there were sixty-two administrative sanctions procedure cases against regulated entities for breaches of prudential and consumer obligations arising from a mix of pre-defined themes and reactive actions. These cases led to the imposition of approximately €27.5 million in monetary sanctions and a number of disqualifications (Rowland 2014). All these administrative sanctions cases settled, making this an efficient means of resolving disputes. Public disclosure (p.119) of the outcomes brings a reputational cost to the firm sanctioned in addition to the fine levied. It also makes firms, individual managers, and regulators more accountable. The Central Bank correctly anticipated that a referral of two administrative sanction procedure cases to inquiry stage would lead to legal challenge, and its acceptance that this is ‘an unavoidable part of the refining and maturing of the procedure’(Rowland 2014) is to be welcomed. The contrast between this approach and the timid and reluctant pre-crisis approach is stark.

The allocation of enforcement and sanctioning powers between the ECB and the Central Bank under the SSM is dependent on the nature of the alleged contravention, the person responsible, and the measure to be adopted. In the case of significant institutions, the ECB may adopt enforcement measures in respect of breaches of relevant directly applicable EU law. For less significant institutions, the ECB may pursue breaches of ECB regulations or decisions that impose obligations on such institutions vis-à-vis the ECB. It may also request the Central Bank make use of its enforcement powers under national law or open proceedings as a means of ensuring that appropriate penalties are available. It may do this, for example, in the case of penalties to be imposed on natural persons, non-pecuniary penalties, or breaches of Irish law transposing relevant EU directives.

Conclusion
The legal response to the crisis in Ireland has been strong and sustained. Attempts were made at an early stage to address the significant problems identified with the previous system of bank regulation and supervision. Lessons seem to have been learned and innovative solutions introduced and, in many cases, reviewed and developed. Rather than relying on the EU to drive legal change, the Central Bank’s PRISM model and its fitness and probity regime saw Ireland provide leadership in the regulatory field. Honohan has described the smooth transition of the prudential aspects of Ireland’s supervision of banks to the SSM as a testament to the credibility of the transformation that was achieved in the Central Bank in regulatory and supervisory staffing, methodology, and culture in the years from 2009 to 2013 (2015: 9).

Banking union too has brought its own challenges in terms of application and coordination. At this early stage, the SSM is still bedding down and although the initial signs are positive, the scale of the task involved in ensuring a consistent and effective system of regulation should not be underestimated. There has been some complaint in Ireland about what is seen as an over-reaction to the crisis and the introduction of excessive regulation. A not infrequent observation is that current participants in the financial services industry are being forced in this way to ‘pay for the mistakes of the bankers’. This, it is submitted, is a skewed view of the reforms described in this chapter and it is more correct to view them as the product of efforts to learn from the mistakes of the bankers. Regulation should not be resisted as an inhibitor to growth and development but rather as a stimulant to them.

As this chapter indicates, the majority of the initiatives discussed were already underway by the time the Troika Programme was published. Chalking up these reforms as successful outcomes of the Troika is thus open to challenge. It is clear, however, that the follow-through of many of the actions planned were updated to reflect the FMP (Central Bank 2016a: 323). The latter facilitated the reorganization of the banking sector and the recapitalization of the main banks and was itself described by Kevin Cardiff, former secretary general at the Department of Finance, as ‘a key turning point in the rescue of the Irish banking system’ (Joint Committee of Inquiry into the Banking Crisis 2016: 301).
A related issue is the extent to which the reforms in banking regulation and corporate governance discussed in this chapter contributed to economic recovery. The correlation is clear but proving causation is always more difficult. It might be argued that the fact the remaining banks have been able to access the capital markets is evidence of market confidence in their governance structures and the quality of their supervision. However, our recent experience has taught us the fallibility of the markets. A further measure of success might be the fact that there has been no disorderly failure of an Irish financial service provider under the Central Bank’s prudential supervision and the aggregate transitional total capital ratio of the banks active in the Irish retail sector has improved (Central Bank 2016c: 17). The Central Bank has indicated that:

significant progress has been made by Bank supervisors identifying areas of risk in regulated firms and conclusively mitigating these areas of risk. Bank supervisors have now conducted inspections and assessed the risks of Higher Impact regulated firms over multiple assessment cycles and this has allowed supervisors to progressively focus on new areas of weakness which were of a lower priority in previous years. Significant changes are apparent in the culture and compliance of firms across a broad range of areas including prudential requirements, corporate governance and conduct of business. (Central Bank 2015b: 9)

The ECB Comprehensive Assessment has concluded and is continuing to drive the continued resolution of financial difficulties. In addition, the IMF upon completion of its 2016 Financial Sector Assessment Program Mission to Ireland reported that the authorities have been ‘effective and vigorous in strengthening prudential regulation and supervision’ (IMF 2016). However, while domestic banks have returned to profitability, the sector remains weak and non-performing loans and related provisions remain elevated (Central Bank 2016d: 3). The economic uncertainty which follows the UK vote in favour of Brexit will place significant pressure on this exposed sector.

The Central Bank has acknowledged that, despite a new and more robust regulatory infrastructure, no amount of regulation, supervision, or enforcement can prevent breaches
or ‘change behaviours on their own’ (Rowland 2014). It has thus added its voice to calls for a real and substantive industry-wide cultural change. While the role of corporate culture in organizations has been increasingly recognized as central to good governance, defining what exactly this concept means, reshaping those institutions, and creating the desired ethos, remains, for the moment at least, a work in progress.

Note
The views set out in this chapter are the views of the author and do not represent the views of any other person or body.

References

Bibliography references:


