

Rebuilding Confidence in Financial Services in Ireland

The Eurogroup and ECOFIN Ministers in their statement on 21 November 2010 acknowledged the need to build on the strong fundamentals of the Irish economy. Whilst acknowledging the measures taken prior to November 2010 to address the difficulties in the Irish banking sector, one of the pillars of the programme was and remains the need to strengthen and to carry out a comprehensive overhaul of the banking system – including deleveraging and restructuring. Matthew Elderfield, Head of Financial Regulation at the Central Bank of Ireland in an address on March 22, 2011 commented that “to enable the Irish banks to meet the required international metric of liquidity, the Irish banking system will have to be slimmed down and right-sized over time.”

Following recent elections, the new Government and the Central Bank are actively implementing new legislation and regulatory measures to fulfil our commitment to overhaul, right-size and improve the banking system.

This Article provides a timely summary of the key legislative and regulatory measures enacted or proposed which will shape, mould and assist in restoring the Irish banking system in line with requirements of the EU/IMF Programme. This Article is not a comprehensive account of all recent regulatory enactments and specific and detailed advice ought to be obtained on matters outlined below.

CENTRAL BANK & REGULATORY REFORM

The Central Bank Reform Act 2010 established the Central Bank as a single fully integrated structure with a unitary board – the Central Bank Commission – replacing the Boards of the Central Bank and the Irish Financial Services Regulatory Authority (IFSRA).

The Act enhances the system of regulatory control and confers additional powers on the Central Bank and its Governor (see examples below) to support the stability of the banking system and to protect users of financial services.

Some of recent initiatives include: (1) Corporate Governance Code (2010); and (2) Consultation Paper on Fitness and Probity (2011).

1. Corporate Governance Code for Credit Institutions and Insurance Companies (2010)

Corporate Governance is defined in the Code as;

“procedures, processes and attitudes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision making”.

The Code was introduced in November 2010 and applies to existing boards and directors of financial institutions with effect from 1 January 2011. To allow time for transition and implementation, institutions will have until 30 June 2011 to introduce required changes. In specific circumstances such as board membership compliance, the period may be extended to 31 December 2011.

The governance structure of each credit institution is required to be sufficiently sophisticated to ensure effective oversight of the activities of the institutions taking into account the particular facts, scale and complexity of such business.

The Code contains specific provisions relating to; the composition of the Board; the Chairman; CEO; Independent Non-executive Directors; Non Executive and Executive Directors; Role of the Board; Committees of the Board; Appointments; Risk Appetite; Conduct of Meetings; Reserved Powers; Consolidated Supervision; and Compliance Statements.

Contravention of the Code shall permit the Central Bank to use its regulatory powers including (i) imposition of administrative sanctions; (ii) prosecution of offences; (iii) deny/refuse applications by a proposed director to any pre-approval controlled function where prescribed by the Central Bank pursuant to Part 3 of the Central Bank Reform Act 2010; and/or (iv) suspension, removal or prohibition of an individual from acting in a controlled function which is prescribed by the Central Bank pursuant to Part 3 of the Central Bank Reform Act 2010.

Matthew Elderfield commented that improving corporate governance is high on the supervisory agenda of the Central Bank and is critical to raising standards. He expressed confidence that the Code represents a balanced and proportionate approach to strengthening the governance of Irish banks and insurance companies and acknowledged that the standards outlined in the Code are more demanding than those in place in other jurisdictions. The aim of the Code is to set high standards which do not merely match best practice elsewhere but which raise the bar. The real challenge for the Central Bank will be monitoring and policing these new qualitative requirements.

2. Consultation Paper on new Fitness and Probity Standards (March 2011)

The paper sets out the framework to ensure that the people operating at senior levels in credit institutions are fit and proper. The new requirements will apply to all entities regulated by the Central Bank (except credit unions).

Following the consultation process, which concludes in May, it is anticipated that new statutory powers will be introduced to allow the Central Bank to apply an enhanced fitness and probity regime to individuals and entities – it is expected to come into effect in September 2011. When implemented, the Central Bank will be able to act both as a gatekeeper for individuals entering and an enforcer to remove individuals from positions where the required standards are not met or fail to be maintained.

STABILISATION OF THE IRISH BANKING SECTOR

It is generally accepted that the Irish banking system will have to be slimmed down and right-sized over time. To allow for efficient and effective rightsizing the former government enacted legislation in the Credit Institutions (Stabilisation) Act, 2010 (December 2010) to provide for the reorganisation and restructuring of the retail banking system. In addition, in February 2011, a bill entitled The Central Bank and Credit Institutions (Resolution) Bill 2011 was presented to parliament with similar objectives.



THE CREDIT INSTITUTIONS (STABILISATION) ACT 2010

The Act provides for the reorganisation and restructuring of the retail banking system as agreed in the joint EU/IMF Programme for Ireland. The Act conferred powers on the Minister for Finance, after consultation with the Governor of the Central Bank, to direct the affairs of and restructure certain credit institutions and reorganise their assets and liabilities.

The Act is intended to cease to have effect on 31 December 2012 (although this date may be extended) and permits the Minister, following consultation with the Governor, to apply to the High Court seeking judicial order in support of;

- Direction Order – an order to direct a credit institution to take specific action or to refrain from or cease taking action.
- Special Management Order – an order to appoint for a period of 6 months (which may be extended) a suitably qualified manager to take over the management of a credit institution's business and to carry on as a going concern with a view to preserving and restoring its financial position.
- Subordinated Liabilities Order – applies to those institutions in receipt of financial support from the State, where the Minister may seek an order related to subordinated liabilities.
- Transfer Order – Minister may seek a transfer order in respect of assets of liabilities of a relevant institution.

The Act creates a number of judicial procedures which regulate and serve to check the exercise of the new powers by the Minister. Each order requires judicial approval and as such this safeguard is intended to serve as an objective review and assessment of the proposed action. On the 14 April 2011 Mr. Justice McGovern of the High court made the first such orders following an application by the Minister of Finance for subordinated liabilities orders in relation to Allied Irish Banks plc pursuant to Section 29 of the Act.

THE CENTRAL BANK AND CREDIT INSTITUTIONS (RESOLUTION) BILL 2011

The Bill was published on 28 February 2011 to make provision for an effective and expeditious resolution regime for certain credit institutions at minimum cost; amend certain existing enactments and permit actions related to main purpose. It seeks to confer on the Central Bank certain powers to take swift action in relation to distressed credit institutions and to protect the stability of the banking sector.

The legislation was initiated prior to the change of government (March 2011) and as prepared contemplates an effective date of 1 January 2013. It remains to be seen if the new government will require revisions to the legislation.

The 2010 Act shall cease to have effect from December 2012 (unless otherwise extended), and the 2011 Bill is intended to give effect to a more permanent resolution regime. The Bill will apply to all authorised credit institutions in Ireland and not just those in receipt of financial support from the government. However the regime proposed in the Bill will not apply to those institutions subject to the 2010 Act, unless the Minister agrees to disapply the 2010 Act.

In the Bill, the powers of resolution are conferred on the Central Bank. A summary of the purposes of the Bill include:

- To provide an effective and efficient resolution regime for authorised credit institutions that are failing or are likely to fail;
- To provide for a resolution regime for such credit institutions that is effective in protecting the Exchequer, the stability of the financial system and the economy;
- support and respect the independence of the Central Bank;
- Establish the Credit Institutions Resolution Fund;
- To facilitate the orderly winding up of an authorised credit institution that is insolvent;
- Permit establishment of a bridge bank – entity to receive assets and/or liabilities of relevant institution;
- If specified intervention conditions (defined in the Bill) are met, empower the Central Bank to order assets and liabilities of a relevant institution to be transferred to a third party including a bridge bank;
- If specified invention conditions are met appoint a suitably qualified special manager to take over the management of credit institution; and
- Empower the Central Bank to require an authorised credit institution to prepare and implement a recovery plan and the Central Bank to prepare and implement a resolution plan.

The 2011 Bill will not immediately apply to domestic institutions which are covered by the 2010 Act, but does apply to all other banks authorised to carry on business in Ireland, foreign owned subsidiaries and banks operating in the IFSC.

CONCLUSION

The legislative and regulatory initiatives serve to reinforce Ireland's commitment to resolve and restore confidence of the public in this sector and greater transparency in relation to fitness and probity of senior executives working in financial institutions.

This will be achieved through the process of open and transparent regulation; effective and efficient resolution regime for failing institutions; and the active process of deleveraging and downsizing some of the existing institutions in an orderly and transparent manner. The proposed changes and the commitment of the Central Bank to implement such changes will assist in remedying some of the disparities in the system and with renewed confidence lead the institutions into the future.



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