

Central Bank spells out enforcement strategy

The '2011-2012 Enforcement Strategy' document is the first publication from the Central Bank's Enforcement Directorate. The launch of this new entity in Irish financial services regulation, led by Peter Oakes former managing director of Compliance Ireland, is a new direction for financial regulation in Ireland. Oakes' former colleague at Compliance Ireland KEVIN O'DOHERTY looks at the Directorate and its new philosophy

There was a rash of publications coming from the Central Bank in the week before Christmas. Prime amongst these was the 2011-2012 Enforcement Strategy document. Matthew Elderfield has repeatedly summarised the mission of the Central Bank as "assertive risk-based supervision" coupled with a "credible threat of enforcement". This strategy document is the first elaboration of that latter element and is the first publication from the Enforcement Directorate. What it reveals about the Central Bank's need to establish the credibility of its enforcement role and the intentions of the Assistant Director-General for Enforcement, Peter Oakes, is very telling.

On the same day as the strategy document was issued, 21 December 2010, the Central Bank underlined the importance of robust enforcement as a regulatory tool by publishing notices of two Settlement Agreements. The timing and extent of these settlements have to be taken as a very clear signal by the Enforcement Directorate of its intentions for the future.

One of these settlements, against Allied Irish Banks plc, was for €2 million and was in relation to breaches of the Consumer Protection Code over a number of years.

While the size of the AIB settlement gained it significant media attention, the second Settlement Agreement with NCB Stockbrokers is also worthy of scrutiny. While it paled against the €2 million penalty levied on AIB, the sanction amount of €100,000 was also a not insignificant amount.

People and powers

If it is to do its work properly, there must be sufficient resources made available. Starting from scratch, the Enforcement Directorate, under former Compliance Ireland managing director Peter Oakes, intends to have 75 staff on strength by end-2011. It appears there is still much work to be done to build out the function –



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mention is made of a number of public consultations in 2011 (and through into 2012) and additional powers being sought in future legislation. Most notable of these is a proposal to increase the existing levels of fines (to €1 million for individuals and

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to the greater of 10 per cent of turnover or €10 million for corporates). The introduction of a percentage-based fine ceiling serves to automatically increase the penalty for large 'systemically important' institutions where the existing €5 million ceiling may not be large enough to act as a meaningful deterrent. By way of illustration, the Financial Regulator imposed a fine of €2.75 million

on Merrill Lynch International Bank Limited in October 2009 but this was dwarfed by the \$461 million in trading losses that gave rise to the sanction in the first place. A second desired legislative proposal is the power to direct firms to commission reports (presumably at their own expense) from acceptable third parties on issues at question with the regulator.

Having said that the Central Bank acknowledges that it has extensive existing powers under the Administrative Sanctions Procedures introduced in 2004 although it concedes "work is ongoing on intensifying the use of our securities markets sanctioning powers".

The Central Bank has powers to pursue firms under the Administrative Sanctions regime and in certain areas to seek summary criminal convictions for offences. The document states that firms will be pursued under one or other method, but not both. The Enforcement Directorate has stated its preference for the Administrative Sanctions regimes as a tool. While the possibility of the Central Bank taking criminal prosecutions against firms cannot be ruled out, it would appear that this will be a rare occurrence indeed give the 'ease of use' of the Administrative Sanctions' regime for enforcement purposes.

Mindful of recent corporate governance failings, the document stresses the importance of behaviour by management at regulated firms and stresses that behaviour below the standard reasonably to be expected will result in individuals being subjected to enforcement action as well as firms.

Perspective on enforcement

It is intended that the Enforcement Directorate will function in harmony with the two Supervisory Directorates. As such the strategy document gives a useful insight into future supervisory activity. It is estimated that 60 per cent of targeted enforcement effort will come from 'Pre-Defined' enforcement cases.

The balancing 40 per cent is expected to be allocated to 'Reactive' enforcement, i.e. arising from general supervisory work or 'other sources' presumably firms self-declaring detected issues to the Central Bank.

The 'Pre-defined' enforcement efforts are explained as cases arising from thematic inspections. This heralds a major shift in emphasis away from general supervisory reviews and a move towards themed inspections into areas of prime concern. As the Central Bank has recently been conducting extensive in-depth general supervisory reviews for perceived higher-risk firms this is a significant change in approach.

The pre-defined versus reactive distinction is an interesting one. It means that the majority of enforcement action is expected not in relation to breaches which have occurred, but where breaches could in future occur because controls are inadequate or not fit for purpose. The importation of this philosophy into Ireland will mean firms will be held to a much higher standard for their operational processes and procedures by the regulator than was previously the case. The Central Bank will now be holding firms to account, not for just actual breaches which have occurred, but also on the basis of judgemental assessments of the adequacy of internal controls and processes implemented at the firm.

Focus for 2011

The strategy document gives us an insight into the themes of prime concern for supervisory scrutiny in 2011.

These are:

- Governance and risk management (including the role of risk committees);
- Systems and controls, including accounting, auditing and other internal controls;
- Controls around charging issues including prevention of, follow-up and resolution of charging errors;
- Compliance with the Mortgage Arrears Code;
- Compliance with client money rules/client asset requirements, and
- Timeliness and accuracy of regulatory reporting to the Central Bank by firms.

The strategy document notes an aim is to drive regulated entities 'towards the adoption of a proactive attitude towards compliance with financial services legislation and the ethics that underpin it.'

New responsibilities

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all decision making in that case will become the responsibility of the Enforcement Directorate.

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The Enforcement Directorate has some limited supervisory responsibilities of its own, having been assigned a competence in the areas of Anti-Money Laundering/Countering Terrorist Financing/Financial Sanctions and it intends to conduct thematic inspections in this area. It also announced responsibilities for perimeter regulation – dealing with unauthorised providers. It is to be welcomed that the Central Bank has assigned specific responsibility for the unglamorous area of financial services regulation. Less mainstream regulated financial services firms such as money transmission businesses go to considerable effort and expense to obtain authorisation to the Central Bank's high standards and then often face being undercut in the field by unauthorised competitors. For the Central Bank to fail to enforce the requirement for market players to be licensed would significantly dilute the incentive for firms in these peripheral areas to seek regulation and would leave consumers, particularly those in vulnerable groups exposed.

Approach to enforcement

The philosophy of the Enforcement Directorate is very explicitly set out. Mr. Oakes states in the introduction that "Once we commence an enforcement case you can assume that a proportionate and robust sanction is likely to follow under our administrative sanction powers. This will act as a deterrent to others..." This pugnacious tone is designed to establish the credibility of the division by emphasising that the job of the Enforcement Directorate is sanctioning.

In explaining the workings of the Enforcement Directorate, the document states that once a case has been handed over to Enforcement from Supervision "all decision making in that case becomes the responsibility of the Enforcement Directorate". Firms are to be left in no

doubt that they are dealing with an enforcement situation which has a fairly specific range of potential outcomes.

A degree of frustration with the settlement agreement experience to date is evident in the document with the statement "We will not engage in protracted settlement negotiations". While the benefits of settlement are conceded, the document outlines a very aggressive attitude by the Enforcement Directorate – "we usually facilitate only one settlement meeting in each case" and an intention to thereafter pursue prosecution rather than entertain further efforts negotiate a settlement. While the intention to forestall delaying tactics by firms under investigation is sensible, such an aggressive approach may prove ultimately counter-productive by encouraging the firms to 'lawyer-up' at an earlier stage to protect their interests.

The Enforcement Directorate also trails its readiness for the hard slog by stating "we are committed in the coming years to taking cases all the way to Inquiry and further where necessary." It is generally regarded that a willingness to take cases to court (and risk losing them) is the ultimate test of an enforcer's credibility.

Conclusions

The Enforcement Directorate has come out of its corner fighting with a very extensive document conveying a very determined, aggressive approach to building the credibility of the Central Bank as a capable and willing enforcer.

The detailed considered manner in which the Directorate's principles have been drawn from the high-level strategic goals of the Central Bank and the underlying legislation telegraphs a more intellectually robust approach than has occasionally been demonstrated by the old Financial Regulator in the past. The promised additional detailed information to be released with enforcement decisions is to be welcomed as is the intention to consult publicly on future strategic direction.

The document warns "Enforcement results do not always come quickly", but it is important for public confidence in the Central Bank as a fit-for-purpose regulator that some tangible results be demonstrated for the enormous recent investment in that entity.

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