Ensuring a Strong & Competitive EU & Irish Financial Services Sector

Banking and Payments Federation Ireland Policy Recommendations 2024 – 2029

Banking & Payments Federation Ireland

About us

Banking and Payments Federation Ireland (BPFI) is the voice of banking, investment firms and payment providers in Ireland. Representing over 110 domestic and international member institutions, we aim to mobilise the sector's collective resources and insights to deliver value and benefit to members, enabling them to build competitive sustainable businesses which support customers, the economy and society. Together with our affiliate organisations, the Fintech and Payments Association of Ireland (FPAI) and Federation of International Banks in Ireland (FIBI), we are the principal voice of the sector and advocate at a domestic and EU level on all issues impacting the operating environment for our membership, and work to promote an environment that is as supportive as possible for our membership to maintain and grow their operations in Ireland. At an EU level, BPFI is a member of the European Banking Federation (EBF) and the European Payments Council (EPC). For more information about BPFI please visit our website www.bpfi.ie or contact us at info@bpfi.ie

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Foreward

The forthcoming European elections will take place at a time of significant change globally. The economic and political order is shifting with the emergence of growing competition between regional blocs, rising protectionism, and greater fragmentation of supply chains. All of this comes against the backdrop of war, climate and demographic change, higher inflation, restrictive monetary policy, and the rise of new technologies like artificial intelligence. For the EU and Ireland to succeed the next mandate of the European Commission and Parliament will be crucial to ensure long-term growth and competitiveness. That is why it is vitally important that the EU and Ireland continue to show strong leadership on the global stage so that future economic success can be safeguarded.

Ireland is the fifth largest financial services centre in the EU and the eight largest exporter of financial services globally. What happens at an EU level matters hugely to Ireland both from a jobs and growth perspective. We cannot take the success of banking, payments and fintechs for granted. Irelands position as a leading centre for these services in the Eurozone must be protected.

Over the last five years, the EU has undoubtedly made solid progress in a number of policy areas while successfully managing several crises like Brexit, COVID-19, and energy supply challenges brought on due to the war in Ukraine. These were all crucial to the strong performance of the Irish economy. In recent decades, however, the EU has been losing out to other regions of the world. Its share of global GDP is now lower than it was in 2003, while its stock market capitalisation is less than half that of the US, in percentage of GDP, and also lower than that of Japan, China and the United Kingdom.

EU Banking Union is also not complete. We still do not have a common single market in banking even though significant progress has been made in areas of improved capital, liquidity, resolution planning, stress testing and the creation of the Single Supervisory Mechanism (SSM). That success of what is, a relatively new framework, was demonstrated in the first half of 2023 when despite significant international turbulence, EU banks remained solid and are now in a stronger position following a decade long "lower for longer" interest rate environment. But we can do more.

The EU must regain its competitiveness and the banking sector has a critical role to play in rebooting the EU Economy. Both wholesale and retail banks across the EU, remain the central capital intermediaries to support investment in businesses and households and play a pivotal role in the EU and Irish economies and the functioning of our markets. It is vitally important to have a resilient and profitable sector which is underpinned by a framework that supports competitiveness and competition. As the main sector funding the economy, we believe we have a unique vantage point from which to offer our opinion. It is for this reason that we are putting forward these proposals. The banking sector is ready to play its part in helping EU policymakers realise its future vision and in delivering funding and services for Irish and European businesses and customers. We look forward to continued dialogue and engagement with all relevant stakeholders in the coming months and years ahead.

Brian Hayes
Chief Executive Officer,
Banking & Payments Federation Ireland

A Snapshot of the sector

Types of Activities Offered by our Members

Banks, payment providers, fintechs and investment firms in Ireland provide a broad range of services to clients both domestically and globally, including deposit taking and lending facilities, markets and securities services, corporate and investment banking, debt origination, M&A advice, private banking, payment services and reg-tech solutions among others. The sector is fundamental to the functioning of the Irish economy and its continued growth and success. Our members enable the efficient flow of money in the economy and match savings to investments through their deposit and credit channels.

CORPORATE AND INVESTMENT BANKING

Capital lending, transaction banking (trade and payments), lending services for corporates, debt and equity raising services, green bonds & loans, M&A advice, syndicated loans, leasing and finance solutions, risk management solutions across rates, equities, credit FX, currency sales, along with markets insights and execution services.

MARKET-MAKING AND SECURITIES SERVICES

Providers of liquidity across fixed income, equities, derivatives, and FX markets alongside Treasury and Trade Solutions (TTS), cash management, derivatives, investor products, corporate finance, trade services, custody, fund administration, clearing and transfer agency.

CONSUMER, CARDS AND PAYMENTS

SEPA & International payment transfers, credit & debit card payments, online loans, instalment purchase financing, electronic point of sale financing.

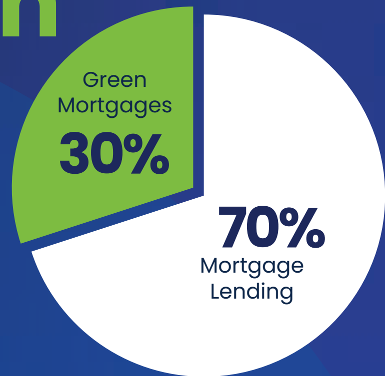
RETAIL BANKING

Deposit and loan products, green mortgage credit and investment solutions, mortgage origination and structuring.

By the Numbers

MORTGAGE LENDING (€BN) 2023

€11,6bn TOTAL



TAX CONTRIBUTION FOR FINANCIAL SERVICES

TOTAL €6,4bn

THE TOTAL TAX CONTRIBUTION FIGURE IS FOR THE ENTIRE FINANCIAL SERVICES SECTOR

Income tax & social charges €3.1bn (47.8%)

Corporation tax €2.7bn (41.6%)

VAT €0.6bn (9.2%)

Levies €0.087bn (1.3%)

EMPLOYMENT BY MEMBER FIRMS

44,400

INTERNATIONAL BANKING & WHOLESALE CAPITAL MARKETS 14,400

RETAIL BANKING & CREDIT SERVICING 26,300

FINTECH & PAYMENTS 3,700

NUMBER OF MEMBERS

8th LARGEST EXPORTER OF FINANCIAL SERVICES IN THE WORLD

17 OF THE TOP 20 GLOBAL BANKS HAVE OPERATIONS IN IRELAND

TOTAL DOMESTIC PAYMENT TRANSACTIONS 2023 (€TN)

€3,66

OUTSTANDING LENDING (€BN) 2023

SMEs 17,8

Corporate 65,7

Total 83,5

Priorities for the next five years

1 EU & Irish banks as drivers of economic growth

The European economy is at a crossroads. While some Member States, like Ireland, have continued to see reasonably strong economic growth over recent years, this is not the case across the Union. In fact, Europe's economic competitiveness and long-term growth prospects are now being brought into question – especially as the USA, China and other emerging economies, like India, continue to grow and make-up a larger share of global trade. To put this into perspective, Europe now only accounts for approximately 12% of global GDP compared to roughly 20% in 2003[1].

This comes at a time when Europe's population is ageing, geopolitical tensions are rife, monetary policy is tightening, and protectionism is on the rise. All the while, the EU and Ireland seek to transition to a low carbon economy, invest in public services and increase the supply of housing. Europe's ability to grow and regain competitiveness is therefore paramount, especially against the backdrop of higher interest rates and debt servicing costs.

Given the pivotal role the banking sector plays in the development of the European and Irish economy, having a resilient and profitable sector is in its long-term strategic interest. This will ensure that banks, who are determined to support policymakers' objectives, have the capacity to do so. Simply put, for Europe's ambitious political objectives to be realised, a greater recognition of the strategic role and purpose of the banking sector is needed when designing policy.

Unfortunately, however, over the past decade EU and Irish banks have not been earning an adequate return on equity, despite improvements in the last two years. There are a number of factors for this, like low economic growth, higher costs of doing business, limited scale, prolonged negative interest rates and sharp increases in capital levels, among others. While the downside consequences of this may not be directly apparent, a less profitable and competitive banking sector has implications in terms of long-term growth and the delivery of key investments.

This is not to suggest that EU authorities should significantly alter the regulatory framework, but rather that a more holistic approach to the development of regulation and legislation is pursued, which avoids overlapping domestic and EU requirements – like additional national taxes or gold plating of rules – and ensures a level playing field between all financial entities and jurisdictions in the EU. Having a more streamlined and proportionate regulatory framework can help ensure Irish and EU banks play a key role in boosting the EU's growth and competitiveness, while remaining resilient.

1 European Central Bank (2023), Occasional Paper Series: The EU's Open Strategic Autonomy from a central banking perspective, pg 9. Available here: https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op311~5065ff588c.en.pdf?c4795375918edb5dbf36c5d37920399c

Banking & Payments Federation Ireland

Key recommendations

- Before bringing forward new regulatory requirements, EU authorities (including regulators) should perform a competitiveness check to assess how proposals impact EU banks and its financial markets vis-à-vis other jurisdictions. This is to ensure that policy proposals can be adjusted in time before impacting EU entities and economic growth. This should form part of the usual Impact Assessment carried out by EU authorities in advance of proposals being published. This could look to draw upon similar competitiveness mandates adopted in other jurisdictions, like the FCA in the UK or AMF in France.

- Move towards further supervisory and regulatory convergence at EU level. This can help further develop the EU Single Market in financial services, while helping to ensure a level-playing field between EU Member States, like in the area of capital requirements, taxation, access to cash rules or remuneration requirements. At present, not all rules are harmonised at EU level and national requirements are still widespread. The consequence is widely different application of rules, which is a direct cause for market fragmentation and barriers to entry. A commitment should be made by Member States and NCAs to remove domestic rules where similar rules exist at EU level.

- Revise and reform the EU's macroprudential framework in order to ensure a consistent and harmonised application of EU rules, so that smaller Member States are not disadvantaged. We see a specific need for revising the methodology for assessing what firms should be considered Other Systemically Important Institutions (OSIIs), while we support simplifying the wider macroprudential framework to make it more predictable and useable.

- A simplification of the regulatory framework needs to be prioritised, especially when it comes to reporting requirements for financial entities. EU policymakers need to commit to harmonising and streamlining reporting requirements where possible in line with Commission President Von der Leyen's commitments[2].

2 European Commission Work Programme 2024. https://commission.europa.eu/document/download/79628203-f1b5-450d-9d6c-0a2f5374a9dc_en?filename=COM_2023_638_1_EN.pdf

Info box: How capital requirements differ across the EU

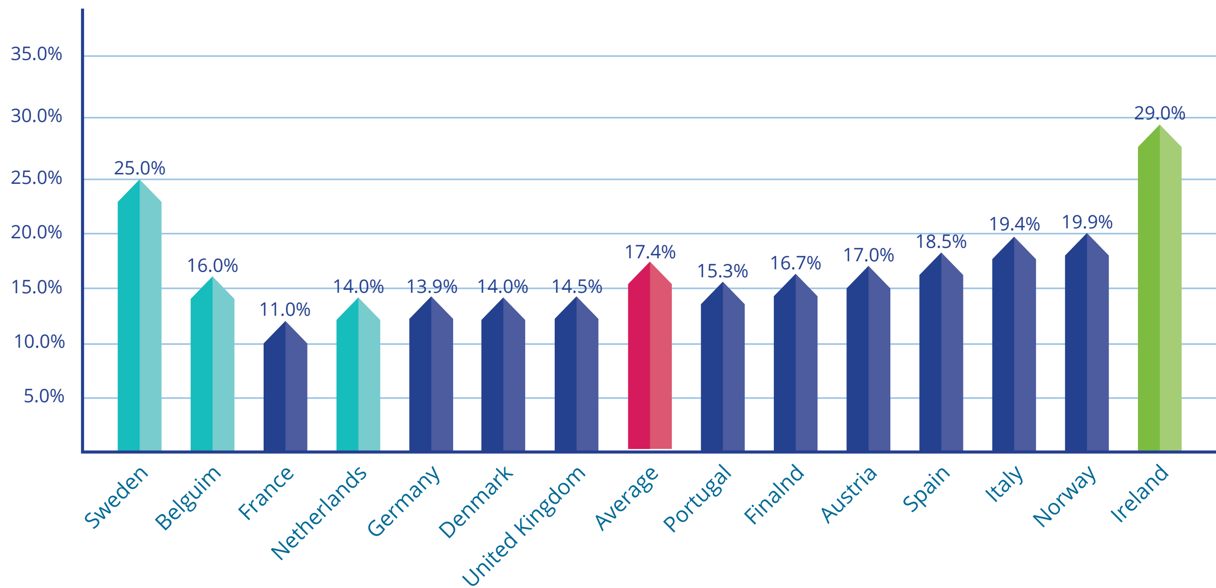
Since the Great Financial Crisis (GFC), the EU has significantly overhauled its bank prudential framework by swiftly implementing global standards, like Basel iii. These reforms mean that EU banks hold better quality and larger amounts of capital for the exposures on their balance sheets, alongside increased liquidity requirements, more frequent and robust stress testing arrangements, greater market disclosures, updated corporate governance rules and strict procedures on resolving banks in the event of failure. All of these reforms have bolstered and strengthened the EU banking sector, as evidenced from the various challenges faced in recent times (e.g., COVID-19 and the banking turmoil in the USA and Switzerland).

One of the key weaknesses identified by authorities in the aftermath of the GFC was the significant capital variability between regions and banks. In reaction to this, authorities sought to address this unwarranted variability through reforming the requirements for banks using internal capital calculations and by introducing an Output Floor in Basel iii. Specifically, the "output floor" is a measure that sets a lower limit (floor) on the Risk Weighted Assets (RWAs) (output) calculated by banks using their internal calculations. It has been agreed that the output floor, when fully implemented, will require that RWAs computed internally cannot fall below 72.5% of the RWAs computed using a standardised approach.

Ireland, however, will still remain an outlier in terms of capital requirements compared to peers located in other jurisdictions, despite the introduction of this output floor. This is largely a consequence of the significant downturn experienced during the GFC, higher than average probability of default (PDs) rates and larger losses experienced by Irish banks (e.g., higher Loss Given Defaults (LGDs)) due to the challenges recovering collateral. Although NPL levels have significantly decreased (e.g., approx. 3% ratio) and underwriting standards have improved due to strict Loan-to-Value and Loan-to-Income limits, the severity of the Irish downturn remains within banks internal models for a significant period. As the Central Bank of Ireland (CBI) has outlined[3], Irish LGDs remain exceptionally high due to the difficulty in repossessing collateral and the discounting requirements EU banks are required to apply to the book value of exposures when calculating LGDs under EBA rules. While the purpose of discounting is to take account of the time value of money so that banks accurately calculate losses, the rate at which it applies is excessive and results in overly conservative outcomes. We agree with the CBI that there is "merit in the matter (e.g., discount rate) being looked at further at the European level"[4]. A recent EBA assessment[5] of capital variability does conclude that LGD values continue to differ in certain portfolios due to discount rates, slow recovery processes and collateral valuations. If, for example, the discount rate was lowered, this would have the effect of reducing LGD values and RWAs due to the linear relationship between them.

3 Central Bank of Ireland (2022), Financial Stability Note, Risk Weights on Irish Mortgages, Pg 14
4 Central Bank of Ireland (2022), Response to the Retail Banking Review, pg 20
5 EBA Report on the 2023 Credit Risk Benchmarking Exercise. https://www.eba.europa.eu/sites/default/files/2024-04/8f1773d8-d37d-4c65-8bc5-f75b6c4825c3/EBA%20Report%20results%20from%20the%202023%20Credit%20Risk%20Benchmarking%20Exercise.pdf

Figure 1 Comparison of a selection of countries IRB RWA density on residential mortgages 2023



Note:Source: EBA 2023. Countries in light blue are based on internal calculations that take into account supervisory add-ons. The average shown is based off the selection provided, including the "add-ons". We would expect that an average based on the entire EU 27 to be lower.

Figure 2. Simplified example of capital requirements based off 2023 RWAs

Country	*Total Mortgage lending (bn)*	*RWAs*	*Starting capital requirement base (bn)*	*Capital (CET1)*	*Final capital requirement (per €100bn)*
Ireland	€100	29%	€29	15%	€4.35
Spain	€100	18.5%	€18.50	12.60%	€2.33
France	€100	11%	€11	15.90%	€1.75
Portugal	€100	15%	€15	14.60%	€2.23
Average	€100	17.4%	€17.4	15.90%	€2.76

Info box: The EU Macroprudential framework & why it matters to Ireland

Combined capital requirements (e.g., Pillar 1 & 2) are determined by micro and macro-prudential policies. The micro-prudential framework is highly harmonised, and the implementation of Basel iii in Europe will further harmonise the way in which banks risk-weight their assets. Meanwhile, the SSM supervises the largest banks in the Banking Union directly, whilst indirectly supervising at all other banks. This stands in stark contrast to the macro-prudential framework, which remains an unharmonised patchwork across the EU. This lack of harmonisation leads to significant divergences in combined capital requirements applicable to banks located in one Member State compared to others. These differences are not justified by objective criteria, as is intended in the CRD/CRR framework. This has been recognised by the EBA[6] and ECB[7] in their advice to the European Commission on its 2022 consultation on the macroprudential framework. A basic principle of the Banking Union and EU single rulebook has to be that banks' capitalisation is determined by the same criteria, irrespective of where in the EU they are headquartered. The current macro-prudential framework does not meet this basic level playing field principle. It puts banks at a competitive disadvantage based on their location and the national rules they are subject to.

How the OSII buffer impacts Ireland

The EBA framework, under which National Competent Authorities (NCAs), make their assessment of what banks located in their jurisdiction should be considered "Other Systemically Important Institutions" (OSIIs) is based on the peer set of institutions operating in the Member State. In the case of Ireland, this means that international banks – whose exposure to the domestic economy may be limited – are compared against a domestic peer set with very different business models. This can have the impact of driving a higher score event under the EBA framework, despite the small interlinkages international entities have with the Irish economy. In other words, the institution may have limited exposure to the Irish domestic economy and its exposure more broadly to other EU Member States may also be limited in comparison to other banks across the EU. As a consequence, the current rules create unintended 'level playing field' consequences for banks operating across the Single Market, particularly from smaller Member States. When the methodology is applied at the Member State level only, it is possible that two banks, comparable to each other in size, complexity, and risk profile, but domiciled in two different EU Member States could have very different OSII buffers applied by their respective NCAs. This issue will naturally disadvantage banks domiciled in smaller domestic banking markets, such as Ireland.

6 European Banking Authority (EBA) (2022), Advice on the Review of the Macroprudential Framework, pg 14. Available here: https://www.eba.europa.eu/sites/default/files/document_library/Publications/Other%20publications/2022/1031866/EBA%20advice%20on%20the%20review%20of%20the%20macroprudential%20framework.pdf

7 ECB (2022), Response to the European Commission's call for advice on the review of the EU macroprudential framework, pg 27. Available here: https://www.ecb.europa.eu/pub/pdf/other/ecb.responsetothecallforadvice~547f97d27c.en.pdf

Priorities for the next five years

2 Driving forward the EU Capital Markets Union agenda

Over the coming decade, European economies will require significant investment if they are to become carbon neutral and meet their 2050 climate targets. The same is true if the EU wants to meet its ambitious objective of moving towards a more digital economy. Combined, it is estimated that this twin transition will require additional investment of approximately more than €700bn annually[8]. To achieve this, huge sums of public and private sector investment will be needed. And while the banking sector is committed to supporting these political objectives, balance sheets will be constrained due to the capital intensity associated with lending in the EU, and in particular Ireland. It is therefore vitally important that Europe looks to revive its Capital Markets Union (CMU) initiative if it wishes to attract the necessary investments required over the coming decade. Having well-functioning and deep capital markets is crucial for Europe's global competitiveness. As the Eurogroup statement[9] from March 2024 rightly pointed out:

> **"Europe is at risk of falling further behind globally in terms of competitiveness, growth, and prosperity of its citizens [and] European capital markets need to be urgently developed into globally competitive markets"**

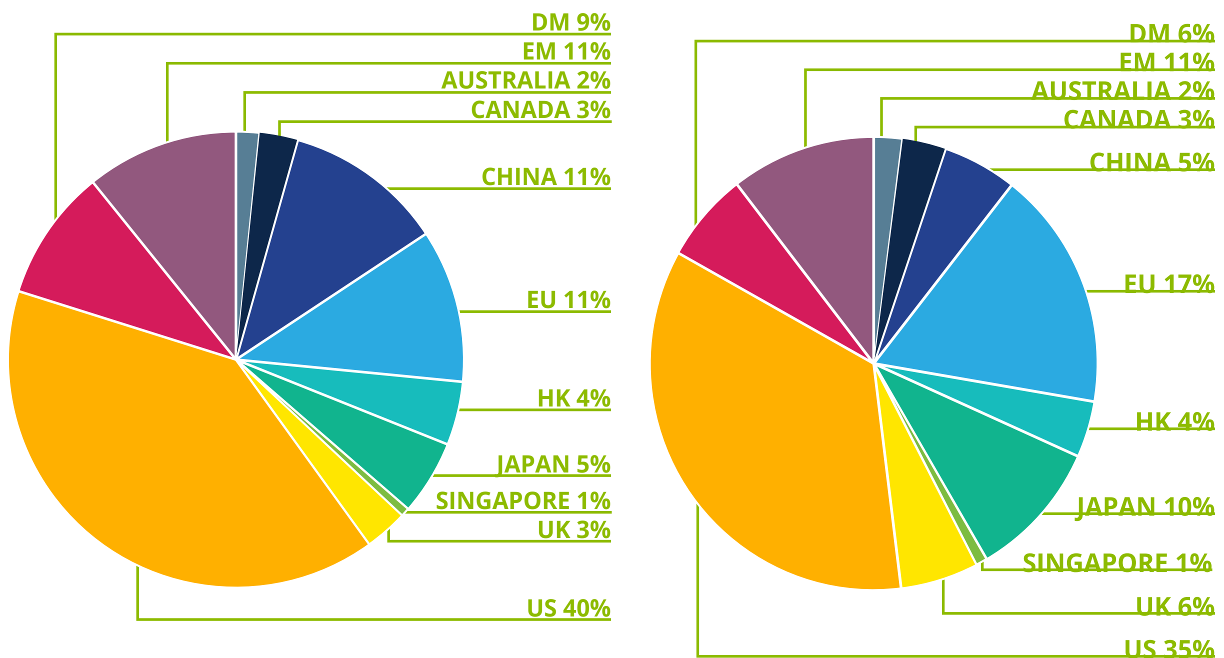
8 European Commission Strategic Foresight Report 2023. https://commission.europa.eu/document/download/ca1c61b7-e413-4877-970b-8ef619fc6b6c_en?filename=SFR-23-beautified-version_en_0.pdf

9 Eurogroup (2024), Statement of the Eurogroup in inclusive format on the future of Capital Markets Union. Available here: https://www.consilium.europa.eu/en/press/press-releases/2024/03/11/statement-of-the-eurogroup-in-inclusive-format-on-the-future-of-capital-markets-union/

And while the objective is widely recognised by EU policymakers, progress has been slow over recent years. ECB analysis shows that financial integration in Europe is still much lower than before the global financial crisis: large investors, especially from outside the EU, are deterred by European market structures, which are often less liquid, less attractive and fragmented across 27 Member States[10]. Alongside this, since the UK decided to leave the bloc, the EU has lost its largest single capital market ecosystem, while simultaneously gaining a competitor within close proximity. Data shows that the global share of EU-27 equity markets has fallen from 17% in 2008 to 11% in 2022 and is expected to fall further over the coming years unless coordinated action is taken to reverse this trend. In Ireland, we have also seen a decline of capital markets related activity, with a number of delistings from the Irish stock exchange in favour of New York and London. For the next Irish and EU champions to emerge in agri-food, artificial intelligence or clean-technologies, this trend needs to be reversed.

Figure 3: 2022 Global Equity Markets Capitalisation - Value $ bns

Source: SIFMA 2023 capital markets factbook



10 ECB (2023).

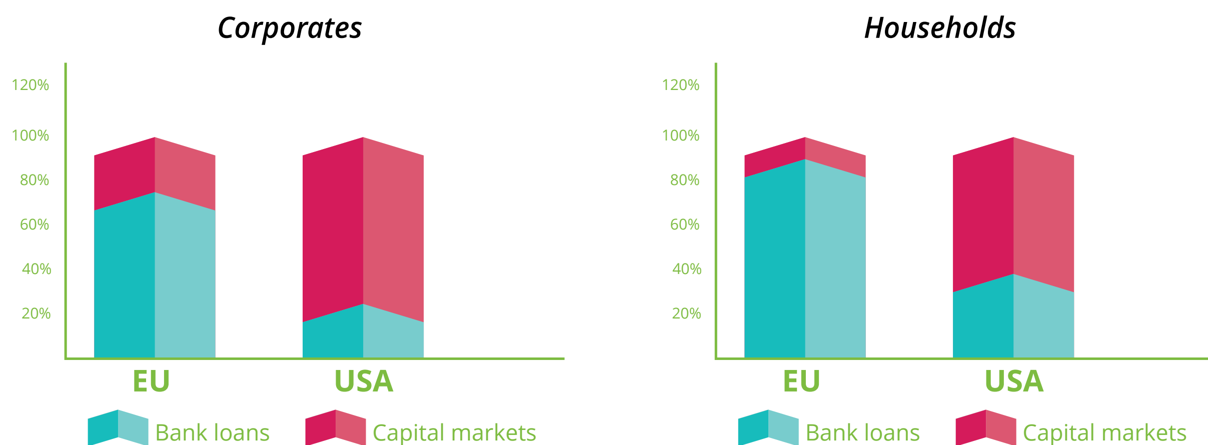
Structural challenges

The challenge for the EU is that its capital markets are less developed and integrated than those of other advanced economies, like the USA. In the EU, bank loans account for 75% of corporate borrowing and bond markets for 25%[11]. The inverse is true in the United States. The EU also falls behind on public equity-based financing. Although equity represents firms' main source of funding in both jurisdictions, in the Euro area it is mainly unlisted, while in the U.S. most equity is listed[12]. The same is also true – and even more pronounced - when comparing sources of funding for households between the two jurisdictions. But as we look to the future, EU banks and governments will face constraints in their lending capabilities due to the changing interest rate environment but also as a result of the large fiscal deficits since COVID. As such, EU financial markets emerge as the most viable option to bridge the funding gap and address the substantial additional investments required within the EU for the twin transition.

Figure 4 Comparison of ultimate sources of funding in Eurozone versus US

Bank Loans versus Capital Markets

Source Oliver Wyman 2023



11 Oliver Wyman (2023), The EU Banking Regulatory Framework and its impact on Banks and the Economy. https://www.ebf.eu/wp-content/uploads/2023/02/The-EU-banking-regulatory-framework-and-its-impact-on-banks-and-the-economy_30Jan-1.pdf

12 Panetta, Fabio, ECB (2023), Europe needs to think bigger to build its capital markets union. Available here: https://www.ecb.europa.eu/press/blog/date/2023/html/ecb.blog230830~cfe3be0960.el.html

1. Develop Europe's securitisation market

One area in particular where further progress is needed is in respect to securitisation. As an instrument it is important in connecting the capital market to corporate debt financing, while at this current juncture where the ECB is shrinking its balance sheet, a well-functioning securitisation market can be a vital funding mechanism for banks, as well as providing additional EU investment opportunities for investors. Developing the securitisation market would therefore not only contribute to the growth of the CMU it would also enable banks to significantly increase their financing volumes in a changed interest rate environment. It is also an effective way to manage risks and avoid overconcentration on banks. In the US, this market is significantly more developed and dynamic, reaching over €3 trillion in 2020, while in Europe, it remains marginal, amounting to slightly under €200 billion during the same period[13]. To put this into context, securitised assets represent only 8% of the Eurozone GDP, compared to 47% of GDP in the US[14].

Figure 5 Comparison of securitisation volumes US versus Europe (including UK) €bn

Source ESM 2021

We therefore believe the time is now right for a more holistic review of Europe's framework to ensure securitisation remains a usable and attractive instrument for banks and investors, building on recent changes in the finalisation of Basel iii in the EU and on the Eurogroup's statement, which specifically highlighted the need to boost the market in Europe. The US market shows that there is significant headroom for growth in this area, to the benefit of banks, investors and the overall EU economy. Having a strong and resilient securitisation market will help play an important role by raising funding/liquidity for banks and non-banks and by helping them to manage their balance sheet exposures to support future lending activity, including Europe's significant green transition funding requirements.

13 EBF Oliver Wyman (2023)
14 Prime Collateralised Securities https://pcsmarket.org/

Key recommendations

- Make permanent the recent changes to the capital charges of securitisations and also extend these to banks using both the Standardised Approach and Internal Models Approach for calculating capital requirements.

- Revise the treatment of securitisations (both for STS and non-STS transactions) under the EU's Liquidity Coverage Ratio (LCR) to align the haircuts with that of covered bonds. In our view, this would greatly increase the liquidity of the market by opening up bank treasury desks and support the pricing of deals with tighter spreads.

- Streamline the approval process for Eurosystem collateral eligibility with a 4-week time period. This would be a very practical and supportive measure to support industry going to the market when the prices and liquidity are at their most optimal.

Info box: What is Securitisation and why is it important for Ireland?

Securitisation is a mechanism by which illiquid loans originated by banks are packaged and either transferred to third party investors (e.g., asset managers, insurance companies, sovereign wealth funds, specialist credit funds, etc.) or used to create collateral for secured funding. Based on the type of assets and loans, the bonds are tranched into different risk profiles. This process allows for the financing and, importantly, risk sharing of real-economy assets (e.g., mortgages, consumer/car loans, corporate loans, equipment leasing etc), which helps free up banks' balance sheets and ensures the continued lending to the real economy. It also offers professional investors access to asset classes that otherwise may not be available to them. Importantly, through securitisation there is a diversification of risk, which ensures that investors obtain lower risks than those associated with an individual asset. Unfortunately, in recent years the EU has not witnessed any significant up-take in the level of securitisations despite changes to the regulatory framework. By comparison, other jurisdictions - in particular the US - have seen considerable growth in their respective securitisation markets over the last five years, highlighting the potential funding opportunities that could be made available to the EU economy.

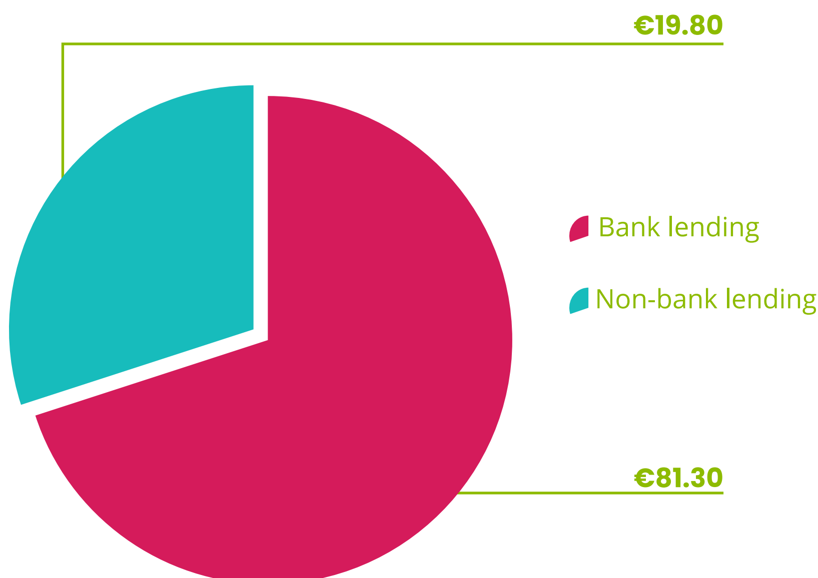
The Irish context

Securitisation is an important instrument to make accessible additional capital pools to finance the Irish economy. Today, Irish and European banks retain most of the loans they extend to borrowers on their balance sheet, binding capital and funding. And given the very high capital levels Irish banks are required to hold compared to EU peers (e.g., see priority 1), securitisation – either placed or retained – offers an important mechanism to Irish banks and non-banks lending in the mortgage market. Arguably, securitisation is an even more important mechanism in Ireland since the departure of KBC and Ulster Bank from the retail market and the loss of their capital to support mortgage lending. On the one hand, it offers Irish retail banks the opportunity to securitise mortgages by taking them off their balance sheet to free up capital for future lending or broaden their funding base, while it is the principal source of financing for the very active and growing non-bank mortgage sector in Ireland which is largely dependent upon securitisation as a funding mechanism. Looking at Irish Residential Mortgage-Backed Securities (RMBS) transactions in 2023, one can see the vital role it plays in supporting mortgage lending, particularly for non-bank lenders, with €7bn issued[15]. It further plays a role in financing nonperforming or reperforming loan portfolios, with €0.6bn issued in 2023. Irish banks also make use of retained RMBS transactions over covered bonds, with €5bn retained out of the €7bn issued.

Figure 6 € value of bank and non-bank mortgage lending outstanding in Ireland 2023

Bank Vs non-bank mortgage lending - outstanding €bn

Source Central Bank of Ireland banking statistics 2023



15 KBRA (2024), Irish Mortgage and Housing Trends. https://www.kbra.com/publications/QNvMXVJp/irish-mortgage-and-housing-trends?format=file

2. Promote a transparent & diverse set of capital market actors in Europe

A transparent, well-functioning and resilient EU capital market supports the real economy by opening up new sources of funding for European businesses, facilitating more efficient capital formation, attracting investments and fuelling growth across the EU. Importantly, Europe has taken steps to develop its capital markets and bring more transparency to investors through the recent agreement to develop a consolidated tape across asset classes. This will help provide investors with a comprehensive view of the prices and volumes of various financial instruments traded across the EU. Bringing such transparency to EU markets will help drive competition and capital formation, allowing for more efficient price discovery, more effective allocation of capital and investments, reducing transaction cost and enhancing liquidity. This is a perfect example of the types of bold initiatives required in order for the EU's capital markets to develop and compete against other global jurisdictions. However, more needs to be done to boost EU markets.

One of the key reasons behind the depth of US capital markets is the diverse and active range of market participants investing and trading in securities. Having highly liquid markets helps to keep prices and costs for investors down, supporting further activity. A key differentiator between the EU and US markets is the diversity of participants making markets and offering liquidity across all asset classes.

Traditionally, European markets were dominated by universal banks, who operated across both debt and equity markets. And while in other jurisdictions, like the USA or UK, universal and investment banks play a similar role, markets are also complemented to a larger extent by non-bank market-makers. These firms are often the largest market-makers across most asset classes and are crucial to the daily functioning of capital markets. One of the main distinctions between these firms and traditional banks is that they trade on their own capital, in comparison to risking shareholder equity and deposits. Additionally, these firms tend to take on limited balance sheet risk beyond that of a few days. Through a combination of prudent risk management and putting their own capital at risk, these firms help reduce systemic risk and moral hazard in the system.

While the EU has already taken the important step in recognising the difference between these firms and that of traditional banks through the creation of a tailored prudential framework, we believe targeted adjustments should be made to further refine and future-proof the framework. Specifically, we believe the existing Investment Firms Regime (IFR) remains too heavily dependent on the banking framework, which was designed to address different risks and for vastly different business models. If the EU wants to boost its capital markets and promote a diverse range of market participants, then it should look to prioritise targeted reforms early in the new mandate.

Key recommendations

- The classification of investment firms should not be based solely on balance sheet size, but complemented with other metrics like business model, to determine the firms' risk to the EU market more broadly.

- Adjust investment firms' liquidity requirements, like for instance, the types of assets that are deemed eligible to qualify as liquid assets. Under the current rules, the definition of liquid assets is linked to that used for banks to calculate their liquidity coverage ratio (LCR). This is a very bank specific metric, which was developed with a specific business model and risk profile in mind.

- Create a consolidated IFR prudential piece of legislation to avoid cross-referencing the Capital Requirements Regulation/ Directive (CRR/D) to avoid situations where the rules do not necessarily fit the business model of investment firms.

- Avoid any extra-territorial application of the EU prudential framework to non-EU assets. This will help preserve the attractiveness of the EU as jurisdiction for investment firms – both home grown and non-EU entities.

- Create a tailor-made wind-down framework for investment firms and remove them from the scope of the Bank Recovery and Resolution Directive (BRRD). At present, investment firms are subject to BRRD requirements, like contributing to the resolution fund (despite not being able to avail of it in the event of crisis) and having to comply with bank recovery and resolution planning requirements, which are not appropriate for the size and complexity of these firms.

Info box: Why investment firms matter for Ireland & the EU

Ireland is home to a large and diverse number of investment firms that are engaged in various capital markets activities ranging from the provision of liquidity across all EU exchanges to supporting the underwriting and syndication of the EU's Next Generation EU bonds. In fact, Ireland has become a significant hub in the EU for leading global market makers providing liquidity in equities, ETFs, derivatives and fixed income. However, for this sector to operate effectively and continue to grow in Ireland, it is important to have a proportionate prudential framework that reflects the nature, size and complexity of these entities. With it, Ireland can become the go-to location for investment firms growing or establishing their EU business, placing it in a unique position to build a deeper and more sophisticated financial services industry.

More broadly, having a diverse set of financial entities to provide liquidity or originate fixed income products in EU markets is vital to their overall success, while preventing any concentration or overdependence on the traditional banking sector. This is vitally important to the smooth functioning of EU markets, particularly in the event of market disruption in the banking sector. If Europe is keen to further develop its financial sector, and in particular key infrastructure like derivative clearing, then having a prudential framework which does not penalise investment firms is vital. For example, the vast majority of investment firms in Europe trade derivatives subject to the clearing obligation and can, with the right incentives, play a leading role in supporting the development of EU clearing landscape. However, the current prudential framework applies certain bank requirements to investment firms of a certain size (including having to become a bank), even though they have vastly different business models and risk profiles. Such an approach seems at odds with the objectives of the CMU and growing EU financial markets.

Banking & Payments
Federation Ireland

Priorities for the next five years

3 Making the EU Sustainable Finance Framework more user friendly

While the EU is facing multiple challenges, there is perhaps none greater than the fight against climate change. As outlined above, the transition to a low-carbon economy will require massive sums of public and private sector investment to meet this challenge, somewhere in the region of €700bn annually. This will inevitably result in structural changes to the ways our economies and businesses operate, which need to be managed carefully. The EU has, however, taken a leading role in tackling the problem of climate change through the EU Green Deal and through the development of a sustainable finance framework to help channel funding to economically sustainable projects. By laying this groundwork, the EU is well positioned to become the global leader in sustainable finance, yet this cannot be taken for granted given the fierce competition from other jurisdictions.

Nonetheless, the EU and Irish banking sectors are fully committed to helping the EU achieve its ambitious climate targets and are uniquely placed to support this endeavour given the role banks play in the EU economy. In fact, the sector has already been playing a key role through the provision of green bonds, mortgages, loans, and other investment products to customers, corporates and governments – all of which have been steadily growing over the past number of years.

To do this, the banking sector has, and continues to go through, significant change to how it has historically operated. New rules have been implemented in terms of greater disclosure on green products, sustainability reporting, a common green taxonomy, climate stress testing and the integration of ESG considerations into banks internal risk management practices. All of this is geared towards creating a harmonised, understandable, and transparent sustainable finance framework that can support the transition – both for investors, regulators and consumers.

And while significant progress has been made in developing this framework, it does not come without its challenges. This is understandable considering the short timeframe in which it was developed. However, as we enter a new legislative mandate, we believe the time is right for fine tuning the existing framework before attempting to expand its scope beyond environmental objectives. In other words, policymakers should focus on making the framework more useable and coherent for the financial sector by ensuring standardisation across regulations, ironing out inconsistencies and removing unnecessary complexity, especially when it comes to reporting requirements. In addition, a key metric such as the Green Asset Ratio (GAR) should accurately reflect the activity underway in the banking sector to decarbonise their portfolios. We welcome the European Commission's planned review of the GAR in early 2025. Without such changes, the EU risks undermining its global leadership role in sustainable finance, potentially losing ground to other jurisdictions.

What is needed are clear consistent rules and pragmatic approaches that will effectively guide direct investments and bank-led financing to industries, including carbon-intensive ones, for which the transition is critical in contributing to reaching net zero. For this to happen, we think it is important that policymaker's attention also shifts towards transition finance. Most high emitting sectors will need funding to support their decarbonisation efforts, and this should be recognised in the regulatory framework. Equally, it is important that access to high-quality data remains a key element of the framework so that financial institutions and businesses understand environmental risks and can adapt appropriately.

Key recommendations

» Incorporate transition finance into the EU Sustainable Finance Framework to better support companies and sectors in their decarbonisation efforts. This should provide clear transition pathways for which companies can benchmark themselves against. It should also look to allow companies benefit from alignment with sustainability standards that are flexible, and market driven.

» Simplify the existing EU Sustainable Finance framework to make it more usable and to address inconsistencies and overlapping requirements, like those outlined below in EU's Green Asset Ratio (GAR). In particular, we believe further refinement of the reporting framework should be prioritised to reduce the burden on financial institutions and to ensure interoperability between the sustainability reporting requirements for banks operating within and outside Europe

» Continue to prioritise the need for high-quality data, both for companies and SMEs. If the EU is to successfully transition to a low-carbon economy, it is vital that banks and investors have access to high-quality data. For the banking sector this is extremely important in understanding risks and avoiding a build-up of stranded assets on bank balance sheets.

» Ensure global consistency on sustainability standards to avoid fragmentation. As other jurisdictions seek to develop their own sustainable finance frameworks, it is important that requirements and standards align and are interoperable. This will ensure a level-playing field and support the wider objectives of decarbonisation. These standards should however be coordinated at global level and EU requirements should be adjusted to ensure alignment.

Info box: Challenges with the Green Asset Ratio

What is the GAR?

As part of the EU Taxonomy Regulation, provisions were included to require banks disclose what assets, as a percentage of total covered assets, were taxonomy aligned. The idea behind this was that such disclosures would help investors, regulators and customers understand how a bank was contributing to environmental and climate objectives. Simply put, the ratio would be expressed as follows:

GAR = (Taxonomy Aligned assets)/(Total Covered Assets)

Key challenges

The objectives of the GAR are well-intentioned. Bringing more transparency to the levels of bank lending towards environmentally sustainable activities can help drive market discipline and reinforce good lending practices. However, because of the way the GAR is constructed it will not be able to tell the whole story of the transition efforts of banks. The challenge arises due to design limitations and practical implementation difficulties. The most impactful being the actual GAR calculation, where there is no alignment between what activities should be included in the numerator and denominator of the ratio. As such, it is important that policymakers look to address these limitations to ensure the GAR is a useful and understandable metric for all stakeholders.

Examples that don't qualify

- **Case 1**. A bank lends funds to a small agrifood SME client (10 FTEs) looking to upgrade its production systems in order to make it more energy efficient. The SME's current system has been identified as outdated and very energy intensive. In line with the bank's policies, this type of green loan will come with a discount as once completed the SME will have a higher energy rating overall, in line with government climate objectives. However, this loan will not count towards the bank's GAR. The reason being that exposures to many SMEs – even if green – cannot be used in the numerator of the ratio. This is because the majority of SMEs are not required to report climate related information under EU accounting rules, regardless of the SME and bank gathering the appropriate information. On the other hand, the bank would need to include the loan in the denominator of the ratio.

- **Case 2**. A homeowner decides to take out a renovation loan to upgrade the building's energy efficiency. The house currently has a very low rating (G BER in Ireland) but an upgrade will improve the energy rating to D2. Similar to case 1 the financing of this renovation loan will not be reflected in the GAR unless a higher energy efficiency level is achieved but the exposure will be counted in the denominator. Unfortunately, the building owner does not have the available funding to undertake a deep retrofit, despite progress being made on energy efficiency.

Priorities for the next five years

4 Ensuring a digitally secure and innovative financial services sector

Financial services have gone through a period of rapid digitalisation over the last decade, bringing new and innovative services to customers and businesses and greater efficiency in the provision of banking. This has radically transformed the way in which the sector interacts with customers in their daily lives and supports a more effective customer journey. While this shift towards digitalisation has been trending upwards for some time, it has rapidly increased since the onset of COVID-19. Over this period, the EU has seen a sharp increase in online transactions along with a commensurate decline in traditional means of payments. In Ireland, for example, between 2018 and 2023 online and mobile payments have jumped by 60%, with credit and debit transactions accounting for approximately €22.7bn[16]. This is in stark contrast to the value of ATM withdrawals which has fallen by almost a third since the pandemic. More broadly, we have also seen the volume and value of domestic and international payment transactions significantly rise over the last decade standing at €10.3 tn and €3.6 tn respectively[17]. Such significant change ultimately requires the sector to adapt to meet customer demands and expectations, while ensuring its safety and soundness. At the same time, recognising the vital importance that cash continues to play and the commitment to ensure that this remains accessible to across the EU.

A key catalyst of the shift towards digital mediums, is a direct result of the reformed regulatory landscape in the EU over the last 10 years. With the introduction of open banking through the revised Payment Services Directive (PSD2), the EU has helped spur innovation in the field of payments. However, these technological advancements have also resulted in new risks emerging to the sector and their customers, alongside increased competition from non-bank players. Not surprisingly with the greater adoption of digital services offering unparalleled convenience and efficiency for users has also paved the way for a corresponding increase in fraud. The interconnected nature of digital platforms, coupled with the vast amounts of personal and financial data exchanged online, creates the perfect environment for cybercriminals. Layered on top of this, is new legislation which increases the speed at which payments are made (e.g., Instant Payments Regulation), making it easier for fraudsters to execute their schemes with minimal risk of detection. As individuals and businesses increasingly rely on digital channels for everyday tasks including banking, shopping and communication, the sheer volume and variances of online transactions provides ample opportunities for malicious actors to perpetrate fraud, necessitating robust cyber security measures to mitigate risks and protect customers balancing with the need for efficient and fast services.

16 Banking and Payments Federation Ireland (BPFI) Payments Monitor Q2 2023. https://bpfi.ie/publications/bpfi-payments-monitor-q2/
17 Central Bank of Ireland (2024), Payment Statistics Quarterly. https://www.centralbank.ie/statistics/data-and-analysis/payments-services-statistics

Over recent years, the sector has invested heavily in strengthening internal controls, enhancing payment security, improving fraud monitoring and IT systems, and running extensive educational awareness campaigns. However, fraud and cybersecurity threats can take many different forms and are rapidly evolving. It is therefore vitally important that the regulatory framework keeps pace and remains sufficiently flexible and proportionate to allow banks appropriately address and combat emerging risks, especially given the changing geopolitical environment and the involvement of state-sponsored actors in cyber-attacks. In other words, banks cannot combat this crime alone. What is needed is a fraud prevention strategy that is centrally led and takes 'whole of system' approach where social media companies, telecoms, financial services, governments, and law enforcement collaborate to devise appropriate strategies to better share intelligence, implement protections for consumers and develop barriers to criminals. In Ireland, when we look across the fraud categories in 2022, 90% of authorized push payment fraud originates online, when it comes to card fraud, 82% of card fraud accounts for Card Not Present transactions . This is why the regulatory framework needs to concentrate on fraud prevention and include all relevant stakeholders within its scope.

In addition to this, as the EU's payments landscape continues to evolve with the forthcoming implementation of instant payments and the ongoing work on a digital euro, it is important that firms are provided sufficient time to embed these changes before making further adjustments. Given the significant changes that have/are taking place within the banking and payments sector, EU policymakers need to be cognisant of the resource constraints within individual firms. That is why it is important that there is a regulatory pause for a period of time before further wholesale changes are made, including for any potential adoption of a digital euro.

Key recommendations

- In order to help prevent online fraud, it is important that policymakers allow banks to share fraud related information with peer institutions and law enforcement. Allowing collaboration and sharing of information about known fraudsters, fraud schemes and emerging trends allows the industry to act in real time and prevent fraud from taking place. A shared fraud database also helps law enforcement to investigate and prosecute more effectively. Current legal impediments to the sharing of information need to be addressed at EU level so that all Member States can establish such databases.

- EU policymakers need to ensure that all relevant stakeholders in the chain leading to fraud fall within any forthcoming customer liability regime. Given the vast majority of fraud scams begin online or through text messages, we believe that these entities should be legally required to establish proper due diligence requirements to prevent fraud and should have legal liability assigned to them directly in the case of reimbursement.

- EU and national authorities should commit to undertake educational awareness campaigns to tackle fraud. We have seen real results from our FraudSMART programme and believe that education and awareness give consumers the skills and knowledge necessary to protect themselves. A more concerted effort, with the support of authorities, can be a powerful prevention mechanism.

- With the potential introduction of a digital Euro, it is crucial that banks and other payment service providers and merchants have sufficient time to upgrade systems and offer the service. This is vitally important given the scale of investment needed to build and maintain such a system. In addition, the design of the currency needs to take due consideration of the impact it could have on the current banking sector (e.g., from a liquidity perspective) and must leave room for the market to continue to develop and innovate from a payments perspective.

Info box: Authorised Push Payment Fraud (APP) and Unauthorised Payment Fraud

Fraud related to Authorised Push Payment fraud

In authorised push payment (APP) fraud, a customer is duped into authorising a payment to another account which is controlled by a criminal. This is sometimes referred to as bank transfer fraud. Fraudsters manipulate customers into making transfers directly, particularly as the methods used are constantly evolving and in most cases the criminal will trick the consumer or business into sending money directly from their account to an account which the criminal controls. In most cases, the customer fully believes they are making a legitimate payment, even at times when it has been flagged to them by their banking provider that it is high risk. They will trick the consumer or business into sending money directly from their account to an account which the criminal controls.

APP fraud losses continue to be driven by the abuse of online platforms used by criminals to scam their victims. These include investment scams advertised on search engines and social media, romance scams committed via online dating platforms and purchase scams promoted through auction websites. In any legislative initiative aimed to tackle fraud, it is crucial co-legislators ensure a coordinated approach is taken across sectors involved in the chain of the fraud. In particular, any framework which mandates automatic reimbursement of fraud needs to take into consideration the mitigating measures undertaken by banks and the role played by other service providers, like social media companies, which fall outside the banking sectors remit.

Fraud related to Unauthorised payment transactions

In an unauthorised fraudulent transaction, the account holder themselves does not provide authorisation for the payment to proceed and the transaction is carried out by a third-party. This category of activities targets bank customers' payment services (eg cards, credit transfers, direct debits, e-money). It includes unauthorised payment transactions resulting from theft or the misappropriation of a customer's payment data or access to their online banking account. Examples of such fraudulent activities include the theft of a customer's payment card data through the installation of malicious scripts on e-commerce sites or social engineering techniques (eg phishing emails or SMS), and its use by the fraudster to make payments or to sell them on hidden and obscure parts of the Internet.

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