Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Gabriel Makhlouf
Gobharnóir / Governor

Deputy John McGuinness
Chair
Joint Oireachtas Committee on Finance, Public Expenditure and Reform, and Taoiseach
Houses of the Oireachtas
Leinster House
Kildare Street
D02 XR20

1 November 2024

Dear Chair,

Re: Items arising from the Central Bank's appearance on 9 October

I attach responses to issues raised by members during my recent appearance at the Committee.

I hope that the attached information is helpful.

Yours sincerely,

Gabriel Makhlouf

Sráid Wapping Nua, Cé an Phoirt Thuaidh, Baile Átha Cliath 1, D01 F7X3, Éire
New Wapping Street, North Wall Quay, Dublin 1, D01 F7X3, Ireland

Appendix

1. Divestments from certain companies with potential activities in the Occupied Territories

At the meeting, we outlined the approach we took in relation to divestments from certain companies with potential activities in the Occupied Territories. We wanted to provide some additional background on that approach.

As previously outlined in our letter to the Committee, the Central Bank decided in May 2024 to divest from certain companies with potential activities in the Occupied Territories. The divestments related to shareholdings of approximately €369,000 in four Israeli banks. Our decision was based on a balance of risk considerations. These included, that there was higher risk that these entities – given their business models – may be associated with the financing of settlements in the Occupied Territories.

It is important to emphasise that this was a risk-based judgement. There is no consistent data or methodology for determining the precise geographical distribution of the full set of activities of companies included in our equity portfolio. We cannot, therefore, know with precision where companies' activities are, what these activities are, or how material activities in a given geographic might be. Our decision to divest was based on a judgement that there was a higher risk that these companies may be associated with the financing of settlements in the Occupied Territories.

The Office of the United Nations High Commissioner for Human Rights (OHCHR) has produced a list of companies with certain business activities in the Occupied Territories.[1] Nevertheless, there are limitations with relying solely on the OHCHR list to guide investment decisions. For example, the OHCHR list is not updated frequently to respond to changing circumstances.[2] In addition, in its June 2023 update, the OHCHR noted that the update does not purport to provide a complete list of business enterprises engaged in the specified activities.

As of end-June 2024, the Central Bank's equity investments in companies that are listed on the latest available version of the OHCHR database can be summarised as follows:

- The Central Bank holds no equity investments in Israeli-listed companies on the OHCHR database.

- The Central Bank holds c. €2.9 million of equity investments in multinational companies that appear on the OHCHR database. These holdings account for 0.017% of

[1] The OHCHR provides a database of all business enterprises involved in the activities detailed in paragraph 96 of the report of the independent international fact-finding mission to investigate the implications of the Israeli settlements on the civil, political, economic, social and cultural rights of the Palestinian people throughout the Occupied Palestinian Territory, including East Jerusalem.

[2] The first iteration of the database was released in 2020, and there were no additional updates prior to the published updated database in June 2023. The June 2023 update addressed a finite period up to 31 December 2022 only.

the Central Bank's total investment assets. With the information available to us, it is not possible to ascertain the materiality (if any) of potential activities of those global companies in the Occupied Territories.

2. Measures to safeguard resilience of property funds

Irish authorised funds investing in Irish property ("property funds") have become a key participant in the Irish commercial real estate (CRE) market, holding approximately €22.1billion of Irish property or about 35 per cent of the Irish 'investable' CRE (as at mid-2022). This growing form of financial intermediation entails potential benefits for macroeconomic and financial stability. Often established and funded by overseas investors, property funds provide an alternative channel of financing for investment in the CRE market, reducing reliance on domestic sources of capital.

This changing nature of financial intermediation also raises the potential that new vulnerabilities could emerge, so it is important that the macroprudential framework adapts accordingly. Given the growth in the property fund sector, the resilience of this form of financial intermediation matters more today for the functioning of the overall CRE market than it did a decade ago. In turn, dislocations in the CRE market have the potential to cause and/or amplify adverse macro-economic consequences, through a range of channels. These include potential losses on lenders' CRE exposures, funding constraints for borrowers using CRE as collateral, and potential adverse implications for activity in the construction sector.

Excessive leverage and liquidity mismatch are potential sources of vulnerability in property funds. The presence of high leverage and liquidity mismatch increase the risk that – in response to adverse shocks – some property funds may need to sell property assets over a relatively short period of time, causing and/or amplifying price pressures in the CRE market. Central Bank analysis highlights that there is a cohort of Irish property funds that have high levels of leverage and, to a lesser extent, liquidity mismatch. Leverage in Irish property funds is – on average – higher than leverage in EU property funds. Irish property funds have a low dealing frequency, but liquidity mismatch is still evident in a subset of these funds. Risks posed to financial stability by property funds were laid out in a 2021 Financial Stability Note[3], and the need to develop macroprudential policy was identified.

The Central Bank is introducing measures on Irish property funds to mitigate these vulnerabilities. The main risk that the Central Bank's interventions seek to guard against relates to the potential that financial vulnerabilities in the property fund sector lead to forced selling behaviour in times of stress. The proposed measures aim to safeguard the resilience of this growing form of financial intermediation, so that property funds are better able to absorb – rather than amplify – future adverse shocks. In turn, this would better equip the sector to continue to serve as a sustainable source of investment in economic activity. The new

[3] https://www.centralbank.ie/docs/default-source/publications/financial-stability-notes/property-funds-and-the-irish-commerical-real-estate-market.pdf

macroprudential measures for property funds will enhance the resilience of property funds, with broader benefits for macroeconomic and financial stability.

In order to make this growing form of financial intermediation more resilient to shocks, the Central Bank introduced new macroprudential measures for property funds. These are the first policy measures to be introduced under the third pillar of the Central Bank's macroprudential framework, which covers non-banks. In particular, the Central Bank introduced two policies that are part of its framework on property funds macroprudential policy:

1. A sixty per cent leverage limit on the ratio of property funds' total debt to their total assets and;
2. Central Bank Guidance to limit liquidity mismatch for property funds.

More details on the specificities, as well as background information, can be found on the Central Bank website[4].

3. Standard Life 'Global Absolute Strategies Fund'

As we wrote in our letter of 3 May[5], on the Standard Life 'Global Absolute Strategies Fund' (GARS), you will understand that it is not possible for the Central Bank to comment on, or provide detail of any specific supervisory engagement in relation to this fund with individual regulated firms. This would include providing information on the volume of a specific product sold by an individual regulated firm in the manner sought by the Committee.

The GARS fund was available to Standard Life retail customers from 2008 to 2023, during which time changes were made to regulatory requirements that strengthened the consumer protection framework and the obligations on firms, as outlined in our original response to the Committee. In our earlier correspondence, we also outlined the role of the Central Bank in supervising firms providing such products.

When the GARS fund was originally launched in 2008, it was a non-Irish fund, authorised in the UK, prior to the UK leavings the EU, and Standard Life in Ireland was a branch of a UK registered insurer. The UCITS Directive provides for funds authorised in one member state to market its units for sale in other member states. In addition, it is common for unit linked life insurers operating in Ireland to offer policyholders various fund options that are accessed by the insurer investing in the underlying UCITS. We understand that this fund was available to Irish retail investors both directly through investment intermediaries and as a fund option of

[4] https://www.centralbank.ie/financial-system/financial-stability/macro-prudential-policy/nbfi/property-funds/framework and https://www.centralbank.ie/financial-system/financial-stability/macro-prudential-policy/nbfi/property-funds/framework
[5] https://www.centralbank.ie/docs/default-source/publications/correspondence/oireachtas-correspondence/response-finance-public-expenditure-and-reform-and-taoiseach-committee-appearance-on-14-february-2024-published-03-may-2024.pdf?sfvrsn=b0be631a_4

insurance firms through insurance intermediaries. Of the investments that were made via Standard Life, the vast majority were sold via intermediaries.

As set out in the Consumer Protection Code, any consumer who is not satisfied with how a regulated firm has dealt with them in the course of providing a service, can make a complaint directly to the regulated firm. As the Committee is aware, if a consumer is not satisfied with how their complaint is dealt with, they have the option of then making a complaint to the Financial Services and Pensions Ombudsman, which is the statutory officer who deals independently with complaints from consumers about regulated financial service providers and pension providers.

We can confirm that we have considered all information provided to us on this matter. Nevertheless, we continue to welcome any information about regulated firms that can inform our supervisory engagement and ensure that we continue to protect the interests of consumers. If there is any specific information or evidence of concerns that the Committee wishes to share with the Central Bank we will review it in detail in the context of our work.

4. Mica/Defective blocks

We are examining the issues that Deputy Doherty raised in relation to banks' mortgage processes, which has also been brought to our attention in recent engagements with affected homeowners. It is important to note that, within the applicable regulatory framework, it is a matter for each lender to set its own credit policies and to make its own lending decisions on applications for mortgages or other kinds of credit; however, when pursuing their commercial objectives, banks must comply with the Consumer Protection regulatory framework.

As discussed with the Committee at meetings in May, which the Central Bank attended (along with representatives from the Department of Housing, Department of Finance, Engineers Ireland, Banking and Payments Federation of Ireland and Insurance Ireland), many of the issues around 'mortgageability' are directly linked to the current engineering standards and relevant provisions of the Defective Blocks Grant Scheme. This is in turn linked to the ongoing review by the National Standards Authority of Ireland of I.S. 465 and the planned public consultation process on same, which we would expect all relevant stakeholders to engage with.

5. Our new organisation chart

Our new organisation chart will be available in December, before the new structures become effective in January.

6. Recent Central Bank publications discussing capital investment

As mentioned during our appearance, two recent Central Bank publications have included discussions on capital investment.

In our June Quarterly Bulletin[6] we discussed the need to increase investment to support the transition to a low-carbon economy. In the section on "Fiscal Priorities for the Short and Medium Term" we outlined how much additional investment would be needed over the coming years in order for Ireland to meet its decarbonisation objective given the progress achieved to date. We then used the Bank's semi-structural model of the Irish economy to assess the macro-fiscal implications of that necessary additional investment.

Our September Quarterly Bulletin included a signed article on "Economic policy issues in the Irish housing market."[7] This analysis included different scenarios around potential future population dynamics, which will be an important consideration in future decisions on capital investment, in the context of the EU's net spending rules.

[6] https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2024/quarterly-bulletin-q2-2024.pdf?sfvrsn=49e4601a_6
[7] https://www.centralbank.ie/publication/quarterly-bulletins/quarterly-bulletin-q3-2024