

Mr Noel O’Gorman
Second Secretary General
Banking, Finance and International Division
Department of Finance
Upper Merrion Street
Dublin 2

16 December 2005

Budget 2006 – Panel Comments

Dear Noel

Thank you for your letter of 9th December, 2005 seeking material from the Financial Regulator on the comments made by the Panels to the Minister pursuant to Section 57DF(3) of the Central Bank and Financial Services Authority of Ireland Act, 2003.

We have summarised the position on the range of the matters upon which the Consultative Industry and Consumer Panels have commented in the two attachments to this letter.

The main reasons for the increase in our 2006 budget were set out in detail in the Chairman’s letter to the Minister submitted with the 2006 Budget on 28 October 2005, which submission followed detailed consideration by the Budget Sub-Committee of the Authority and the Authority itself. The Board of the CBFSAI and its budget committee will, of course, have carried out a separate process in relation to its budget, which includes our services costs.

As you are aware, we have already provided considerable briefing and supplementary material to both Panels. During 2005 the Panels were also involved in discussions on the strategy, which links in directly with the budget, and we believe this process was generally constructive.

For future years, we are keen to involve the Panels earlier in the year when our work focuses on the strategic issues that drive our budget changes. We are of the view that, in future, it would be useful if panel queries on budgetary process and systems and individual budget items or headings were raised during this earlier period, before making comments on such items in the letter to the Minister. However, we also recognise that the Panels need to plan their own work programmes and we would find it useful for the Panels to consult with us about the process at an early date, with a view to adjusting the timetable to be increasingly effective.

In order to give effect to this, the Financial Regulator believes that it would be most helpful for each Panel to nominate someone now to work with it to develop the involvement of the Panels in the budgetary process further, so as to be as helpful as possible in briefing the panels to fulfil their role of commenting to the Minister on our sources of income.

It is a necessary part of the development of the unique processes set out in the CBFSAI Act, 2003, that we all need to work together to elaborate a system for achieving the correct balance in the budgetary process.

Yours sincerely

Liam O'Reilly

cc: Brendan Burgess, Chair, Consultative Consumer Panel

James Deeny, Chair, Consultative Industry Panel

Attachment 1 –

Briefing on matters referred to by Consultative Industry Panel

Budgetary and Levy Process

As previously advised to the Minister, the Authority views it as a critical part of its role to ensure that a robust annual budgetary process is undertaken, conducted under the guidance of a non-executive Budget Committee, and that costs and approaches to regulation are kept under regular and stringent review. The process for the 2006 budget involved a careful examination by the Authority of the broad range of additional regulatory functions which the Financial Regulator is being asked to carry out and a range of proposals from management for the further improvement of our regulatory work. As previously advised, the Authority believes that a sensible balance has been achieved in relation to various pressures.

We are very conscious of the timing of the issuance of invoices. We have discussed this with the Consultative Industry Panel, who are rightly concerned that firms need to be able to plan their own budgets. It is important to emphasise that the issue with the timing of the levy notices for 2006 is not to do with processes and systems. It is rather the function of both the timing of the submission and approval of the budget for 2006 and the availability of outturn figures for 2005, which by definition cannot be available until after 2005 ends. Both of these are key factors in the system that we have developed to determine the annual levy rates in an equitable fashion and with a view to the competitive position of financial services.

As the funding system beds down we expect that the levies for each industry sector should become more predictable. Most entities will now have received levy notices in respect of 2004 and 2005 and, accordingly, we expect that they should be in a position to prepare their budget estimates for the next year taking account of their previous years levies and their individual tariff data as well as factoring in a reasonable projected percentage annual increase. We stand ready to assist the industry with this process.

Within the current legislative framework, it is not possible to make significant improvements to the timing of the determination of levy rates without changing the

relationship between the levy and our budgeted costs. The system that we have developed links the annual budget requirement, net of any over/under funding in the previous year, with the relevant tariff data for each industry sector at a particular date to produce the rates set out in the Funding Regulations. We are planning to discuss this matter further with the Panel to ascertain if there is anything further that should be done to assist the industry in this regard. We are happy to provide additional information on our systems and procedures, in that context.

The development of a unique cost allocation model, which was created for the Financial Regulator with the assistance of external consultants, was a necessary exercise in setting up a new organisation which has such unique features under the law. We have created a model that allocates the Financial Regulator's costs to industry sectors taking account of the management accounting systems in place within the CBFSAI. Far from reflecting a lack of internal capacity or systems, this model was developed in accordance with best industry practice and has been independently reviewed by external consultants separate from those who helped design the system. External consultants were used to provide transparency and assurance to the public generally and to the industry in particular. The use of such a model provides assurances that there is a detailed, rigorous and equitable cost allocation procedure in place to facilitate calculation of industry funding requirements for each sector.

Shared Services Costs

It should be noted that the reference in the Panel's letter that the Financial Regulator was not in a position to include any information on the Indirect Expenses component of the 2006 budget at the Panel meeting on 6 October, is not quite complete. While the presentation indeed noted that this figure had not been finalised by the CBFSAI at that time, we provided information on the main factors that would drive an expected increase in these costs (increase in our staff numbers, increase in number of CBFSAI staff providing services, increases in pay rates for CBFSAI staff which were the same as those outlined for the Financial Regulator staff, cost of specific Financial Regulator projects and depreciation on new capital projects). In addition we were able to note, even at that stage, that for 2005 indirect costs comprised 33% of 2005 total budgeted costs. It will be noted that the final figure for 2006 budget indirect expenses of €16.2million is also 33 %

of 2006 total budget. We are also happy to set out the composition of shared services costs, something we have done in our 2004 financial report. We have set out additional comments on the issue of budgeting and accounting for shared services in our comments on the Consultative Consumer Panel's remarks to the Minister.

Specific Points on 2006 Budget

We note the panel's concern about the €8.6 million (22 per cent) increase in the 2006 budget compared with the 2005 outturn. As previously indicated to the Minister, this has also been a concern to the Authority. However, the Authority is satisfied that more than half of the increase (€4.5 million) is attributable to the projected shortfall in spending between the 2005 budget and the emerging 2005 outturn. This shortfall is largely as a result of the difficulties in recruiting the required numbers of additional staff with the necessary skills needed to reach our 2005 complement of 345, the extent of which recruitment also had to take account of the number of seconded staff that opted to return to Department of Trade, Enterprise and Employment during the year as well as some staff resignations to take up positions within the financial services sector. It should be noted that in fact the level of gross recruitment (before taking account of resignations) was 48 to date for 2005. The budgeted staff complement for the end of 2006 is 350 and the 2006 budget is based on a projected average of 342 staff during 2006. Given the level of gross recruitment which has in fact been achieved to date during 2005, we judge the further level of recruitment required of about 37 to reach the 2006 complement is achievable, albeit a demanding target.

The balance (€4.1 million) of the €8.6 million increase in the 2006 budget is related mainly to the areas of pay of €1.6 million (increases in pay rates c€360,000, full year carryover effects of 2005 staff complement and cost of new staff approved for 2006 complement of €1.24m), non-pay of €0.9million (mainly Publishing/Consumer awareness and Professional Fees) and indirect cost increases are €1.6million (pay rates and increases in costs of these services arising from the budgeted increase in Financial Regulator staff numbers).

We are continually monitoring and reviewing the position to ensure that we reach our budgeted staff numbers as quickly as possible in 2006 . We agree with the Panel that this

conclusion will need to be tested against the 2006 outturn, in due course and we intend to include projected outturn figures in the briefing for both panels in 2006 as soon as reliable figures are available. This review process, involving both comparisons of 2006 budget with 2005 outturn as well as 2005 budget, is considered a necessary and valid exercise given that we are still in the process of recruiting staff, the timing of which recruitment is a significant driver for both outturn and budgeted expenses.

Office of Comptroller and Auditor General(C&AG) – Scoping Study

The C&AG have completed their fieldwork in relation to the conduct of a possible Value for Money Audit (VFM) and intend to begin their work shortly. We can update the Panel in due course on the outcome of this matter. It would of course be a matter for the C&AG staff as to who they would wish to meet in the event that that they decide to conduct such an audit.

Proposed Review of the 50% Approach

We note the comments of the Panel on this matter and their request to be involved in the process. We also note the proposal of the Department to establish a joint review group comprising representatives from the Department and the Financial Regulator to look at all the issues involved and we look forward to participating in the work of this group. We have forwarded details of our nominees to the Department as requested. We believe it is important that the Panels should be consulted on this, as the extent of the levy is the aspect of the Financial Regulator's budget which requires Ministerial consent and in relation to which the Panels advise the Minister.

Cost Control/VFM

We have noted comments suggesting that a further extension of our use of activity-based accounting or the use of three year budgets could prove an additional resource for the management of costs. We will be considering how best to develop our cost control further as part of the review of strategy currently underway and we shall consider these ideas further in that context. We would be happy to talk further to a representative of the Panel about this.