Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Central Bank of Ireland
Regulatory & Supervisory Outlook

February 2025

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Preface

We are living through transformative times, with immense opportunities yet profound challenges. Digitalisation and innovation are creating new markets and more choice, enhancing customer experiences and providing greater efficiency; but they are also bringing new risks, for consumers and the financial system. Geopolitical tensions, economic fragmentation and the significant political, societal and economic changes underway, have the potential to re-shape our world. Together with climate change - and the uneven global commitment to climate policies – these represent some of the greatest challenges of our time.

The role of financial regulation

The Central Bank regulates the financial sector to ensure it is operating in the best interests of consumers and the wider economy. We do this by working to support positive outcomes, so that the sector contributes to the economic wellbeing of our citizens through good times and bad. This requires ensuring that financial firms are resilient and well run, delivering in the best interests of their customers.

A robust regulatory framework, based on international standards, acts as a foundation for stability and the achievement of those positive outcomes. Regulators are increasingly adopting integrated approaches to safeguard the financial system and prepare for future uncertainties. The Digital Operational Resilience Act, the European Artificial Intelligence Act, the Markets in Crypto Asset Regulation, the establishment of the EU Anti-Money Laundering Authority and our own revised Consumer Protection Code are significant developments that will shape 2025 and beyond.

Supervision is also evolving globally to address the complex, interconnected risks of the current era. This is of particular relevance for Ireland with its very large, diverse, and internationally-oriented financial sector. We too are transforming how we work at the Central Bank and have made changes to our supervisory model effective from January 2025. The new model remains risk-based, but

We want to see firms that are delivering in the best interests of their customers, and that the financial system as a whole can continue to play its important role through good times and bad.

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is evolving to deliver a more integrated approach. It draws on all elements of our mandate which covers more than 13,000 entities.[1]

The purpose of the Regulatory & Supervisory Outlook (RSO) report

This is the second edition of the RSO and, like last year, sets out the Central Bank's perspective on the key trends and risks that are shaping the financial sector and our consequent regulatory and supervisory priorities for the next two years. We also take the opportunity to restate our key expectations of firms and their responsibility to identify, mitigate and manage the risks specific to their business and customers, in addition to taking the opportunities provided in these changing times. It is important that senior executives and key decision-makers incorporate the content of the RSO report and other communications such as Dear CEO letters into their ongoing work and decision-making.

This report complements the Central Bank's publications that have a macro economic or financial stability perspective, notably the biannual Financial Stability Review (FSR) and the Market Based Finance Monitor. The FSR looks specifically at segments of the financial sector that are linked to the domestic Irish economy, while the scope of this report also covers the broader spectrum of internationally active regulated entities and the interests of the consumers and investors they serve.

The structure of the report mirrors the holistic approach we take to determining the Central Bank's supervisory priorities and plans. We consider, in the first instance, the exogenous trends and risks in the global macro environment that are affecting households, businesses and the economy. We then review the implications for the financial system as a whole and the various actors, both within the regulatory perimeter and beyond, having regard to feedback loops and spillovers.

[1] This figure includes approximately 9,000 investment funds. In this report, the terms "regulated entities", "firms" and "institutions" are used interchangeably.

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Overview of the RSO content

- Section 1 describes the global macro environment, major trends and drivers of risk.

- Section 2 outlines the Central Bank's assessment of the key risks facing the entities we regulate and the consumers and investors whose interests we seek to protect. This year, our overall assessment of the risk severity level and outlook for each risk area is given, considering a circa two year horizon.

- Section 3 sets out the Central Bank's cross-sectoral supervisory priorities in the context of the key supervisory outcomes we seek to achieve.

- *Spotlight 1* explores consumer risks in more detail while *Spotlight 2* provides an up-to-date supervisory perspective on artificial intelligence (AI) where the transformational journey is really only just beginning. Given the nature of the geopolitical forces at play, *Spotlight 3* considers how the wider use of scenario analysis and an examination of risk transmission channels can provide a framework to help firms (and supervisors) navigate the very high degrees of unpredictability and uncertainty we face.

- Section 4 sets out a sector-by-sector view, including the key areas of supervisory focus over 2025/26 that sit alongside the cross-sectoral initiatives covered in Section 3.

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Executive Summary

Introduction

The 2025 Regulatory & Supervisory Outlook report is set against the backdrop of an increasingly fast-moving, interconnected and uncertain world, which is being shaped by a complex interplay of geopolitical, economic, technological and environmental forces.

The global macro environment

The current geopolitical situation is characterised by ongoing tensions, regional conflicts and global power shifts. A further escalation in any of these areas of concern or other such developments could trigger a cascade of adverse economic, financial market, supply chain and operational impacts.

While the global financial system has remained resilient following several years of overlapping negative shocks, the near term growth outlook remains weak in many countries, with some facing significant fiscal challenges. Global inflation has fallen and is close to target in many advanced economies. Considerable uncertainty remains on the future path of economic growth, inflation and monetary policy globally, although the expectation is that interest rates will stay higher for longer relative to pre-pandemic levels.

Despite this highly uncertain backdrop, financial markets have been performing strongly. But sentiment is fragile, there is some evidence of mis-pricing of risk in some markets, and market volatility can rise quickly. The sharp equity price drop in August 2024, and its quick rebound, illustrate the point. Generally, movements in risk premia on different asset classes are unlikely to capture the evolving nature of global tail events.

In terms of the climate crisis, there is a continuing watering down by governments and corporations of earlier net zero commitments and timelines, with increasing gaps between progress actually made and that needed to slow down global warming. As a result, the rise in global temperatures could be accelerating and, according to some studies, breaching the 1.5°C goal appears increasingly likely, with the world already having temporarily passed this threshold. This could trigger multiple tipping points, such as the collapse of the Greenland ice sheets, with potentially irreversible effects.

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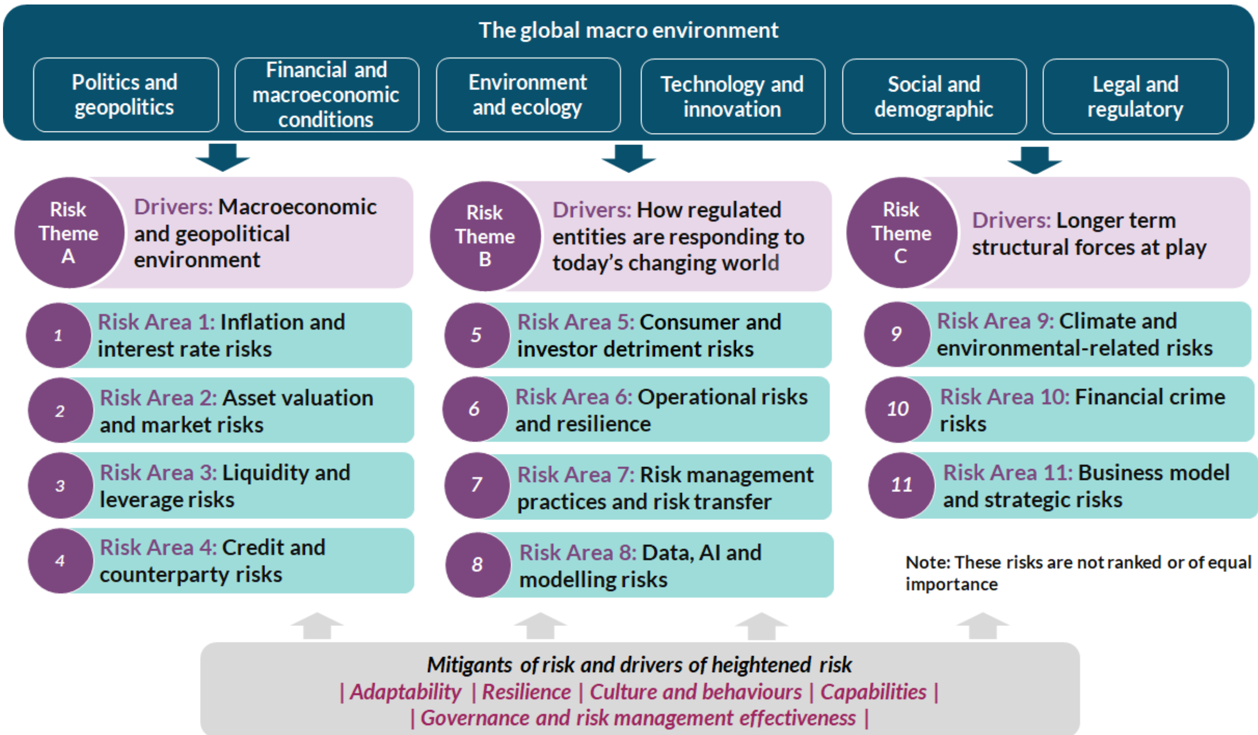
The rapid pace of digitalisation continues. Innovation in the financial services sector is leading to the development of new capabilities and new product offerings. While digitally-enhanced business models are providing many benefits for consumers and enhancing ease and speed of access to financial services, it is also leading to an increase in the risk of fraud and financial crime.

The potential of generative artificial intelligence (AI) continues to be explored by firms. While at present this is via various incremental use cases, with transformational change yet to be seen in the financial sector, deployment may be accelerating. AI will be increasingly challenged with problems relating to privacy and personal data protection, algorithm bias and transparency ethics.

Risk outlook

The Central Bank's supervisory priorities are shaped by a set of cross-cutting risk areas under three broad thematic headings which reflect different drivers of risk. (Figure 1) As noted in last year's report, these risks can crystallise in ways that affect all aspects of our mandate.

Figure 1– Overview of risk themes and risk areas



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A Risks that are predominantly driven by the macroeconomic and geopolitical environment

Interest rate and inflation risks: Although globally inflation has continued to fall, challenges remain for central banks. Geopolitical instability remains heightened, leaving open the prospect of further unexpected inflationary and growth shocks, which could be supply-side-driven. Therefore, although conditions have been improving, downside risks and the scope for surprises remain.

Asset valuation and market risks: Debt and equity markets remain volatile and susceptible to unforeseen changes to interest rates, with the continued potential for sudden shifts in outlook and market expectations. There are continuing concerns about the opacity and reliability of the valuation of some illiquid asset classes, for example private credit.

Liquidity and leverage risks: The financial market volatility we are seeing increases the risk of liquidity events occurring, particularly in situations with high levels of leverage. While there are currently generally strong liquidity positions across banks and the wider financial sector, the lessons from the Silicon Valley Bank and other episodes in other sectors, such as funds, illustrate how quickly circumstances can change.

Credit and counterparty risks: With the significant amount of corporate and other debt that is due to mature over the coming years, the additional expense that is incurred on refinancing in a higher interest rate environment, together with economic growth and profitability uncertainties, could potentially spark an increase in defaults. Looking more broadly at counterparty risk, the increasingly complex network of critical financial and operational dependencies amongst financial and non-financial firms increases the potential impacts of counterparty failures.

B Risks that are predominantly driven by the way regulated entities operate and respond to the evolution of their marketplace and today's changing world

Consumer and investor detriment risks: Risks to customer and investor interests continue to arise due to poor practices and customer service failures within some firms, value for money questions with certain types of products, opaque marketing and greenwashing. New types of complex or highly speculative products continue to emerge, many of which can now be readily accessed via

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digital channels, for example crypto-assets. Risks are compounded by generally low levels of financial literacy amongst the public.

Operational risks and resilience: Firms' increasing reliance on third parties, for example cloud service providers, exposes new vulnerabilities as a result of this broader network of players, together with the growing incidence and sophistication of cyberattacks. The widespread IT outages caused by the CrowdStrike software update in July 2024 and recent temporary losses of service from some banks have illustrated the disruption for businesses and consumers such points of failure can cause.

Risk management practices and risk transfer: The wider adoption of risk transfer strategies by firms gives rise to increasing cross-sectoral interconnections and highlights the convergence between banks, insurers, funds and financial markets. Sensible, and sometimes innovative, risk transfer arrangements between individual entities at a micro-level may be resulting in hidden concentration and counterparty risks, and potentially less capital being held against a given set of risks.

Data, AI and modelling risks: With exponential growth in the volume and variety of data available and used by businesses, the impact of flawed or misused data will be magnified and the potential risks to consumers more significant. Model risk represents a growing risk in a changed world, where the future is not like the past, and existing "black box" concerns about models' inner workings are compounded by the use of advanced AI and machine learning techniques. Several risks to consumers and investors arise due to how the financial sector uses data and, increasingly, AI tools, including privacy and targeted manipulation concerns.

C Risks that are driven by the longer term structural forces at play

Climate and other environmental-related risks: The world's climate is changing rapidly, with extreme weather events from widespread flooding to severe heatwaves and wildfires. There are concerns that the climate scenarios in the risk models used across the financial sector are too benign. From a consumer and investor perspective, there is the continuing risk of financial products' green credentials being overstated. In addition, extreme climate-related events will progressively make insurance more expensive and less available in

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high risk areas potentially resulting in protection gaps that could weaken the financial resilience of those affected.

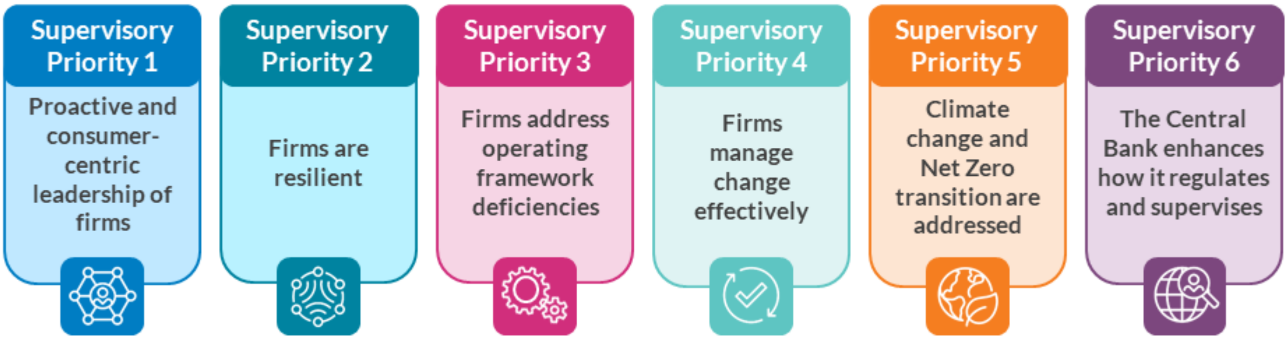
Financial crime risks: This risk captures a number of elements, including insider dealing, money laundering, terrorist financing and the provision of unauthorised financial services. The increasing number of firms in the technology-led payments, e-money and crypto sectors provides new opportunities for criminals, with a number of such firms having ineffective control frameworks. Fraud, and particularly the threat of fraudulent behaviour by external actors outside national borders, continues to be a persistent and growing problem globally.

Business model and strategic risks: The scale and speed of change in the financial services market and the volatile macro environment may adversely affect the long term viability of those firms which cannot adapt successfully or whose business model is insufficiency sustainable or resilient. While the Central Bank does not operate a no failures regime, this operating environment can heighten the risk of disorderly market exits.

Supervisory priorities

The Central Bank adopts a risk-based approach when setting our supervisory priorities, focusing on those areas that pose the greatest threat to the achievement of our safeguarding objectives[2] while working to ensure the financial system operates in the best interests of consumers and the wider economy. The focus of our work is on resilience, adaptability and trustworthiness in the provision of financial services. Our priorities and expectations of firms continue to be as set out in last year's report (Figure 2).

Figure 2 – Supervisory priorities



[2] Our safeguarding objectives are: to protect consumers and investors, the integrity of the financial system, the safety and soundness of firms and financial stability.

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The priorities and outcomes we seek are as follows:

Priority 1: Proactive risk management and consumer-centric leadership of firms. The leadership of regulated entities adopt a proactive and forward-looking approach to managing the risks and uncertainties facing their organisations and their customers.

Priority 2: Firms are resilient to the challenging macro environment. Firms have sufficient operational and financial resources, adaptability and recoverability, to be resilient and well-prepared in the face of risks in the macro environment, economic and financial market uncertainty and fragile sentiment, particularly given the breakdown in previously stable international relations, protectionism, and other political, technological and environmental developments.

Priority 3: Firms address operating framework deficiencies. Deficiencies identified in the governance, risk management and control frameworks of regulated entities are addressed to ensure they are effective, both in the current environment and into the future.

Priority 4: Firms manage change effectively. Regulated entities keep pace with changes in the financial system and in consumer needs and expectations through the well-managed evolution of their business strategies.

Priority 5: Climate change and net zero transition are addressed. Regulated entities continue to improve their responsiveness to climate change, the implications for their businesses and customers, and they must manage its impact and enhance their role in the transition to a net zero economy.

These supervisory priorities apply across all sectors and to the different aspects of the Central Bank's financial regulation responsibilities. They frame our more detailed supervisory strategies for the different sectors of the market. These, in turn, reflect our assessment of the trends and risks affecting each sector and their customers.

Our sixth priority relates to the Central Bank's own approach to regulation and supervision.

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Priority 6: The Central Bank enhances how it regulates and supervises. We continue the improvement and transformation of our approach to regulation and supervision to ensure that we can carry on fulfilling our mission and mandate in a rapidly changing financial ecosystem. We introduced a new supervisory framework in January. This remains outcomes-focused and risk-based, but is now delivered through a more integrated approach to the different aspects of our mandate and how we organise our work.

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Section 1 - The Global Macro Environment

Introduction

This section provides a high-level overview of the major developments and trends in the global macro environment that are drivers of both opportunities and risks within the financial system. New technologies are driving innovation, enhancing efficiency, and have the potential to expand economic opportunities globally. Demographic changes create new markets and add to workforce diversity. But risks are elevated, vulnerabilities heightened, and the future is highly uncertain. Should risks crystallise and vulnerabilities be exposed, they would disrupt the financial sector through various real economy and financial transmission channels, ultimately amplifying the "traditional" risks faced by providers and users of financial services.

Politics and geopolitics

The current geopolitical situation is characterised by rising tensions, regional conflicts, trade fragmentation and weaponisation, and global power shifts. Geopolitical fragmentation has moved from a risk to becoming a reality, affecting trade and foreign investment flows and challenging the post-war multilateral order. The war in Ukraine and continued instability in the Middle East, continued tensions between major superpowers, and emerging friction between the US and its traditional partners, create a heightened risk environment. A further escalation in any of these areas or other such developments could trigger a cascade of adverse economic, financial market, supply chain and operational impacts, including through instances of cyber warfare.

The political reorientations being seen in domestic politics across the EU, US, UK and some other countries are leading to widening differences in the handling of economic and social affairs, regulation, and the role of government, with potentially far-reaching consequences. For example, the diverging approaches to financial and crypto regulation, artificial intelligence and data protection, and climate change and diversity, equality and inclusion policies, are emerging due to differences in political priorities, economic philosophies, and regulatory traditions. Firms operating

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from Ireland across these different regions might face greater compliance challenges adapting to these diverging regulatory practices.

Addressing the growing performance gap between the US and Europe is at the top of the EU agenda. Last year's Draghi report[3] recommended a range of initiatives to revitalise Europe's economic growth and enhance its global standing. The EU's Savings and Investment Union initiative aligns with the Draghi recommendations and is important for the Irish financial sector given its significant role in the provision of pan-European financial services, investment management and capital markets.

Financial and macroeconomic conditions

The global financial system has remained resilient following several years of overlapping negative shocks, including the adjustment to a higher interest rate environment. Global inflation has continued to fall and is close to target for many advanced economies, allowing central banks to cut policy rates. The growth outlook remains weak in many countries, however, with indicators of activity in the euro area having weakened. Even before the concrete effects of more fragmented trade and economic relations materialise, heightened uncertainty will itself weight on economic activity, while fragmentation could also result in higher and more volatile inflation.

There is evidence of compressed risk pricing in corporate debt markets and stretched equity valuations in some sectors, while some sovereign bond yields have increased in recent months. The heightening geopolitical risk environment does not seem to have been priced-in by global markets, leaving them vulnerable to sudden price adjustment. Liquidity and leverage vulnerabilities in parts of the non-bank financial sector may amplify adverse market dynamics through forced asset sales, low market liquidity and procyclical selling behaviour. This exacerbates the risk of disorderly conditions in financial markets. These risks can spread through the financial system due to increased interconnectedness, including common holdings, between banks and non-banks.

Growth in the Irish domestic economy has been robust, and this is expected to continue over the near-to-medium term, supporting the financial position of borrowers, lenders and savers. But Ireland is particularly exposed to heightened geopolitical and economic risks

[3] Draghi, M. The Future of European Competitiveness, September 2024

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as a small, open economy. In particular, an increase in global trade tensions or a fundamental change in US trade and tax policy pose significant downside risk to the domestic economic outlook. Medium-term domestic risks have increased on balance, with capacity constraints and housing shortages posing risks to growth and future foreign direct investment.

An expansionary fiscal stance coupled with an expectation of easing monetary policy could aggravate existing imbalances and contribute to overheating in the economy. Households and businesses remain resilient, but are also exposed to global developments through trade exposures and high concentration of employment with multi-nationals enterprises in some sectors. Global and Irish commercial real estate (CRE) markets continue to adjust as higher borrowing costs and weak demand are factored into price declines; however, the domestic banking system has remained resilient to this downturn.

Environment and ecology

In spite of increasing evidence of the physical risks climate change presents, some governments and corporations are watering down previous net zero commitments and timelines. There are increasing gaps between the progress actually made and that needed to slow down global warming. The rise in global temperatures could be accelerating and, according to some studies, breaching the 1.5°C goal appears increasingly likely, with the world already having temporarily passed this threshold. This could trigger multiple "tipping points", such as the collapse of the Greenland ice sheets, with potentially irreversible effects. The climate could be more sensitive than expected. While often referred to as a "tail-risk", the probability of significant temperature rises may be surprisingly large.[4]

Flooding, storms and windstorms represent the most severe types of natural catastrophe events in Europe, with the region experiencing an increase in the likelihood and severity of flooding events since the mid-20th century. This trend has continued in the most recent data, with 24 major flood events in the euro area since January 2023, affecting over 1.6 million people in Spain, Italy, Slovenia, France and Greece.[5] The catastrophic events in Valencia in October 2024 demonstrate the very severe impact of flooding on

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[4] For example see Climate Scorpion – the sting is in the tail Institute and Faculty of Actuaries and University of Exeter, March 2024

[5] Source International Disaster Database (EM-DAT)

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lives, communities and livelihoods, and the subsequent need for state emergency relief (with €10.6bn allocated by governments to date). Ireland has also experienced some large flood events, for example, Storm Babet caused approximately €200m in damages to 400 homes and 300 businesses in 2023.[6] Storm Éowyn, which struck Ireland in January 2025, could surpass this damages figure.

The financial sector faces both short and longer term exposure to both transition and physical risks. The most immediate risk arises from transition risk, which could impact asset values and the financial health of business and personal customers, in particular where there is an insufficiently just transition. On physical risk, while the direct impact of flooding and other natural catastrophes is more visible, the second-round (post-event) impacts are less clear. It is possible that affected businesses and households may experience reduced insurance availability and affordability, and tighter lending conditions, particularly if collateral values are lowered. Broader second-round macro-financial linkages are also uncertain, for example, through acute regional flooding affecting wider economic conditions and supply chains.[7]

Technology and innovation

The rapid pace of digitalisation continues. This includes the latest technology that is being used to replace various operational processes and facilitating new products, notably crypto and tokenisation. The ECB itself is in its preparation phase on the digital euro.[8] These developments can bring both cost reduction and speed benefits, facilitating the transfer of assets in a more efficient, safer and effective way. It also enables new ownership models by lowering entry barriers, with tokenisation allowing small investors, for example, to participate in markets previously dominated by large institutional and high net worth private investors. However, investment in more complex or risky products – and the risk of fraud and financial crime related to such products - could increase risks for consumers.

AI technologies can offer significant benefits for consumers and the financial sector, but transformational change is yet to be seen. At

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[6] See Carroll, J, Box B: Flood Damage and Financial Sector Linkages, Financial Stability Review 2024:II, Central Bank of Ireland, December 2024
[7] See for instance The economic impact of floods, ECB Economic Bulletin Issue 1, 2025
[8] A decision on whether to issue the digital euro will only be considered by the ECB Governing Council once the relevant legislation has been adopted.

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present incremental use cases appear to be largely focused on tasks such as customer service utilising chatbots, personalised financial advice, fraud detection, automated report generation, algorithmic trading and computer code generation and testing. However, this may be changing with the latest focus on AI Agents. Autonomous AI agents are programs that sense their environment and make decisions independently to achieve specific goals without human intervention.

Spotlight 2 - AI: Balancing Opportunities and Risks provides our latest supervisory perspective on AI. (Page 36)

Social and demographic

Countries like Ireland with ageing populations face a shrinking labour force and increased old-age dependency ratio.[9] In Ireland, the number of people aged 65 years and over is projected to grow by more than one million to 1.9 million by 2057 compared to 2022, while the number aged 15-64 is projected to grow by 0.4 million from 3.4 million to 3.8 million, increasing the dependency ratio from 23% to 50%.[10] This has potential medium to long-term implications for economic growth, productivity, government finances with increased spending on health and pensions, alongside reduced income taxes.[11] An ageing population will influence interest rates and inflation - although there are differing views on the direction of such changes[12]- as well as having implications for the financial products consumers will demand.

To help fund the retirement income needs of the growing number of future retirees, the government plans to launch in late 2025 the national auto-enrolment retirement savings scheme in Ireland called "*My Future Fund*". *My Future Fund* aims to increase both pension coverage and overall pension adequacy by making it easier for employees to save for their future. Experience from other countries suggests that auto-enrolment will reshape the Irish pensions market and will bring Ireland in line with other OECD countries that already have this or a similar system for promoting retirement savings.[13] In the UK, for example, auto-enrolment (introduced in 2012) increased

[9] See speech by Governor Gabriel Makhlouf, The tangle of ageing populations and productivity growth at the Society of Professional Economists, November 2024
[10] See CSO Population and Labour Force Projections 2023-2057 July 2024
[11] See IMF, Macroeconomics of aging and policy implications, 2019
[12] See IMF paper in footnote 11 and BlackRock Investment Institute: Demographic divergence.
[13] See Dáil Éireann, Automatic Enrolment Retirement Savings System Bill 2024: Second Stage, April 2024

participation[14], and has spurred changes in private sector pensions regarding digital service delivery, fund management choices and responsible investing.[15] Other countries with such schemes have also seen a deepening of their capital markets.

Among potential tail risks, while the perceived risk posed by infectious diseases has been falling according to global surveys[16], the likelihood of another globally significant pandemic remains. Although it is impossible to predict when the next pandemic will occur as they are random events, it is generally accepted there will be another pandemic and that, through many of the same activities that fuel climate change, humans are giving pandemics more opportunities to occur, for example, through deforestation, urbanisation and the scale of livestock husbandry.

Legal and regulatory

As noted above, at an EU level, there is an increased focus on competitiveness and productivity growth against the backdrop of geopolitical challenges, the innovation gap in Europe and climate targets to decarbonise the economy. The Letta[17] and Draghi reports both clearly signal that capital markets within the EU remain too highly fragmented and insufficiently deep to meet the needs of its citizens and businesses into the future. The completion of the Capital Markets Union (CMU) through a proposed EU Savings and Investment Union (SIU) has been identified as a key enabler in meeting these growth and competitiveness objectives, with regulatory and administrative simplification an important supporting enabler. This is clearly reflected in the objectives outlined by the new European Commission which took office last year and the "Competitiveness Compass" it recently introduced.[18]

Financial regulation is part of ensuring the safety and soundness of the financial system and protecting consumers. A period of potential consolidation and review of rules to ensure regulations are

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[14] See UK Department for Work & Pensions, Ten years of Automatic Enrolment in Workplace Pensions: statistics and analysis, October 2022

[15] See National Employment Savings Trust Corporation, An independent review of the National Employment Savings Trust (Nest), February 2022

[16] See for example the 2024 Global Risks Report from the World Economic Forum (WEF) where the perceived risk posed by Infectious Diseases, as captured in its annual survey, had fallen to 23rd and 19th place over 2 year and 10 year horizons respectively, from much higher rankings two years previously.

[17] Letta, E. Much More than a Market, 2024

[18] See European Commission, A new plan for Europe's sustainable prosperity and competitiveness

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meeting their intended purpose and do not create unintended consequences or an undue burden is timely. However, there is a risk in the current geopolitical context that any changes could go too far and could remove the important protections and resilience that the current framework delivers. The Central Bank will work with peers and other stakeholders on the simplification agenda and look to enable properly-functioning markets that support innovation and productivity without undermining core policy objectives such as financial stability, resilience and consumer and investor protection.

The Central Bank will work with peers and other stakeholders on the simplification agenda.

A number of EU initiatives have been recently implemented or are being developed to respond to the evolving financial system and external environment. This includes modernisation of payments regulation, assessing Europe's sustainable finance disclosure framework, as well as the implementation of a number of a recent cross sectoral legislative initiatives – including those related to money laundering, operational resilience, crypto assets, AI and the European Single Access Point – plus sectoral initiatives such the Solvency II review for insurance and Basel III finalisation for the banking sector.

In addition to the EU priorities outlined above, there are a number of key domestic policy initiatives in train:

- The revised Consumer Protection Code enhances clarity and predictability for firms on their consumer protection obligations, including their obligation to secure the interests of their customers.
- Implementation of the recommendations from the Department of Finance's Funds Review 2030 Report.[19]
- Continuing embedding the Individual Accountability Framework and implementation of relevant recommendations of the National Payments Strategy.
- Progressing changes to the credit union lending regulations including our proposed changes to concentration limits for house and business lending and lending practices for specific categories of lending.
- Implementation of the Finance (Provision of Access to Cash Infrastructure) Bill 2024.

[19] See the Department of Finance Funds Review 2030 report.

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- Supporting implementation of Ireland's first National Financial Literacy Strategy.[20]

Further detail on EU and domestic key regulatory initiatives, is set out in Appendix A.

A transition to a structurally different world

The dynamics described in this section point to the transition to a structurally different and faster-moving world, where the past is likely to be a less reliable guide to the future. Alongside the enduring focus regulated firms need to have on the basic technical and operational aspects of running their businesses in a sound, prudent and customer-focused way, they need to plan for the unexpected and ensure they have the adaptability and resilience to manage adverse developments. This is particularly the case where plans and expectations may be formulated around the assumption of more benign conditions. By being adaptable and resilient, firms continue to ensure the sustained provision of the services the economy and society needs into the future.

[20] See National Financial Literacy Strategy.

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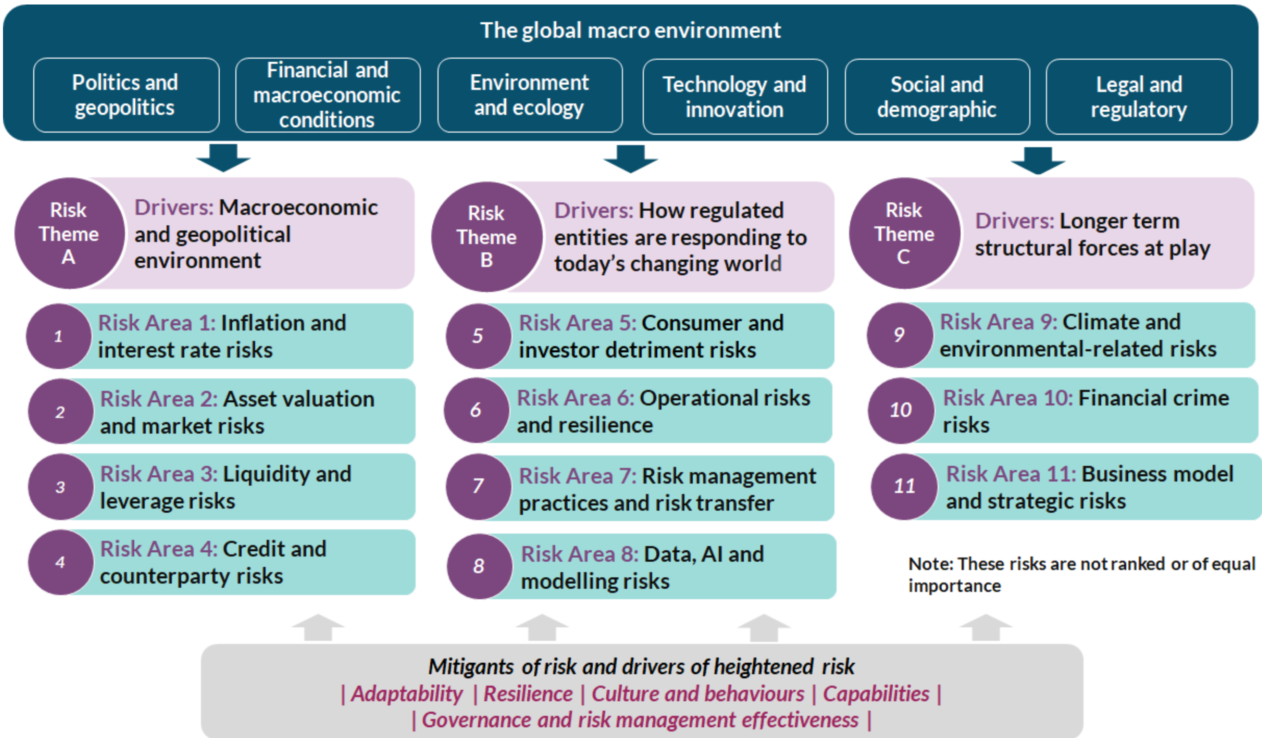
Section 2 - Risk Outlook

The structural shifts, volatility and uncertainty being seen in the global macro environment, as described in Section 1, have the potential to amplify risks across the financial sector. This section draws out our latest assessment of the cross-cutting risks that could threaten, should they crystallise, the safety and soundness of regulated entities, the interests of consumers and investors, the effective functioning and integrity of the financial system, or financial stability.

The key risks are set out in Figure 3 and have shaped the Central Bank's regulation and supervision priorities for 2025/26 covered in Section 3. There are eleven risk areas grouped into three broad risk driver themes which remain the same as those described in last year's Regulatory & Supervisory Outlook report.

Figure 3 – Overview of risk themes and risk areas



It is important to note that the risks cannot be considered in isolation and are interlinked. Each can be both the cause and effect of other risks, with such interconnections making the navigation of the risk landscape increasingly complex. Appendix B provides a stylised view of our holistic approach to considering the interconnections within the financial sector, transmission channels and feedback loops. At a sectoral level, the importance of each risk

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area will vary depending on the nature of the sector's underlying business model and consequent inherent risk profile, and the idiosyncrasies of individual entities.

In this year's report, we are also showing our assessment of the risk level for each risk area over a two year horizon, its trajectory since last year and outlook, using the indicators shown in the legend below. (Table 1) The aim is to draw out relativities between the risk areas and trends. The assessments reflect the sectoral assessment of risks we undertake as part of our supervisory risk assessment process, a "top down" holistic view, and are also informed by the risk assessments undertaken by the European Supervisory Authorities (ESAs), ECB Banking Supervision and other international bodies. [21]

Table 1 – Risk assessment legend

Risk level		Change in assessment since last year	Outlook over next two years
(red)	Severe	Risk is assessed to be higher	Increasing
(orange)	Significant	Risk is assessed to be broadly at the same level	Stable
(yellow)	Moderate	Risk is assessed to be lower	Reducing
(grey)	Limited		

By their nature, such risk ratings are subjective and lack nuance. They are, however, generally considered to be a useful risk management device to add colour and to help stimulate discussion on risk relativities, changes over time and outlook. In a few instances, the risk assessment has been set between two risk levels in an effort to provide more nuance.

[21] Appendix C provides a description of each risk level and the meaning of the arrows. As we did not give risk level ratings last year, the changes since last year shown by the arrows reflect what those ratings would have been.

Table 2 – Risk assessment overview

Risk Theme A: Risks that are predominantly driven by the macroeconomic and geopolitical environment

1. Inflation and interest rate risks		Since last year	Outlook

- Although globally inflation has continued to fall, challenges remain for central banks. Geopolitical instability remains heightened, leaving open the prospect of further unexpected inflationary and growth shocks.

- Uncertainty means that market participants' ability to accurately forecast future inflation and interest rates may be limited. Therefore, although conditions have been improving, downside risks and the scope for surprises remain, which may catch out firms and funds without effective hedging strategies in place. This requires a continued focus on sound inflation and interest rate risk management to ensure that uncertainties are being prudently incorporated into the future projections of solvency, liquidity and funding needs, reserving/provisioning and the product pricing firms undertake in the different sectors and in their stress testing.

- For those individuals or household that may still be experiencing the effects of the higher cost of living or interest rates, particularly those in vulnerable circumstances, financial institutions have a key part to play in helping their customers cope with financial stress. The risk remains that not all firms take these obligations seriously.

- Given the attention paid to these topics by both firms and supervisors, there is a more mature approach evident, and while not being complacent about the downside risks, the risk level is assessed to be trending towards "moderate" (yellow) from "significant" (amber).

2. Asset valuation and market risks		Since last year	Outlook

- Debt markets remain volatile and susceptible to unforeseen changes to interest rates, with the high equity market volatility seen in August 2024 demonstrating fragility and the continued potential for sudden shifts in outlook and market expectations.

- Certain segments of the market, such as technology stocks and crypto show signs of stretched valuations that may not align to their long term earning potential or underlying fundamentals.

- There are continuing concerns about the opacity and reliability of the valuation of some illiquid asset classes that are not actively traded, specifically private credit and private equity related assets.

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3. Liquidity and leverage risks

	Since last year	Outlook
	→	→

- Continuing financial market volatility increases the risk of unanticipated liquidity stress events occurring, particularly in situations with high levels of leverage.

- Across the banking sector, the current assessment is that there are strong liquidity positions despite the steady reduction in excess liquidity, with good access overall to retail and wholesale funding. However, the lessons from the Silicon Valley Bank episode illustrate how fast circumstances can change. In insurance, the underlying business model mitigates liquidity risk, although a confluence of extreme events and exposure to illiquid assets – or a distressed reinsurer[22] - could lead to liquidity challenges even here.

- At a more macro level, concerns have been expressed about the "layered leverage" that private equity firms are using to return cash to investors with some structures (as noted earlier) being opaque and involving complex forms of debt. Although exposure to private debt/equity may be limited in Ireland and with interest rates on a downward trend potentially relieving pressures, an unexpected interest rate shock or deterioration in the profitability of indebted businesses, could have implications for this area of the market that affect financial markets more widely.

4. Credit and counterparty risks

	Since last year	Outlook
	→	→

- In their Autumn Joint Committee Report on Risks and Vulnerabilities in the EU Financial System[23], the ESAs highlighted credit risk as an area of concern. They cited the significant increase in borrowing and debt-servicing costs since 2022, the significant amount of corporate bond debt that is due to mature over the next 3 years, and the additional expense that will be incurred on refinancing in a higher for longer interest rate environment which could potentially spark an uptick in defaults.

- The extent of exposure through lending and through debt securities varies across the different sectors. In the Irish banking sector, pockets of risk have been noted around commercial real estate, but non-performing loans levels remain low, albeit that future stress could be driven by both structural and economic developments. In insurance, direct lending exposure is limited and over 90% of bond holdings are investment grade. Bond funds and money market funds, of course, have significant credit exposure across the full range.

- Looking more broadly at counterparty risk, the increasingly complex network of critical financial and operational dependencies that underpin the financial system

[22] Reinsurance is insurance protection purchased by an insurance company from another insurance company (the reinsurer).
[23] See Joint Committee Report on risks and vulnerabilities in the EU financial system, September 2024

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means that a failure to properly measure, monitor and mitigate counterparty risk could result in significant losses due to preventable counterparty default.

Risk Theme B: Risks that are predominantly driven by the way regulated entities operate and respond to the evolution of their marketplace and today's changing world

5. Consumer and investor detriment risks		Since last year	Outlook

- Risks to customer interests continue to arise due to poor practices and customer service failures within some firms, also value for money questions with certain types of products, opaque marketing and greenwashing. In addition, consumers and investors remain exposed to the risk that conflicts of interest along the value chain may mean that their interests are not being served.

- New types of complex or highly speculative products continue to emerge, many of which can be increasingly readily accessed via digital channels (for example crypto assets). In parallel, the opening up of access to alternative asset types to retail investors and the retirement savings market (such as private equity, private credit and other unlisted type assets) may heighten the potential for harm due to a misunderstanding of the complexities and risks involved.

- All of this can be compounded by levels of financial literacy amongst the public not being commensurate with that required to allow individuals to effectively manage their financial wellbeing in an increasingly complex and fast-changing environment, together with a lack of clarity in some product marketing and disclosure material. This may mean that consumers are not seeking financial advice where that could be of value to them; or the level of life insurance they have in place is inadequate or that their home is underinsured due to impact of rebuild cost inflation; or they may not be making adequate provision for retirement.

- *Spotlight 1 Safeguarding Consumer Interests* explores consumer risk in more detail.

6. Operational risks and resilience		Since last year	Outlook

- The risk level of "severe" reflects firms' increasing reliance on third parties (for example cloud service providers) which exposes new vulnerabilities as a result of this broader network of players, together with the growing incidence and sophistication of cyberattacks. Quarter 4 of last year, in particular, saw an intensification of the threat landscape across Europe with a greater level of "distributed denial-of-service" (DDoS) attacks being experienced by banks.

- As the marketplace evolves, notably in the provision of banking services, operational risk is heightened at a sectoral level as incumbents try to address the risks posed by legacy systems while undertaking a digital transformation. New start-ups, on the

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other hand, have the advantage of modern systems and a digital-first mind-set, but often display poor risk management, controls and regulatory maturity.

- This increasingly complex operating environment gives rise to interconnections and dependencies between entities (including unregulated 3rd parties) and concentrations. The widespread IT outages caused by the CrowdStrike software update in July 2024 illustrated the disruption a single point of failure can cause. Similarly, the "technical issues"' that periodically affect customers' ability to access bank accounts or payments services show how operational failures can mean significant disruption for businesses and consumers.

- Risk is heightened in a context of digitalisation, with 24/7 access expected, ageing legacy IT platforms in some firms, and the deployment of frontier technology being potentially faster than the ability to manage it. Operational disruption due to cyberattacks or other causes can have material financial consequences for a firm. Insurance cover can help mitigate those impacts, although stricter underwriting criteria, and increasing claims costs could lead to insurance protection gaps adversely affecting the financial resilience of a firm and the speed at which it can recover from serious incidents.

7. Risk management practices and risk transfer		Since last year	Outlook
		→	→

- The wider adoption of risk transfer strategies by firms in response to the more volatile operating environment and for balance sheet and profit and loss optimisation purposes, gives rise to increasing cross-sectoral interconnections and highlights the convergence between banks, insurers, funds and financial markets.

- Sensible, and sometimes innovative, risk transfer arrangements between individual entities at a micro-level (such as "significant risk transfer" arrangements by some banks[24] and traditional reinsurance and "alternative arrangements"[25] used by insurers and reinsurers) may be resulting in hidden concentration and counterparty risks at a macro-level, thereby potentially weakening the resilience of individual entities and sectors. This could, for example, be due to risk becoming concentrated in a particular jurisdiction or with a set of entities.

- Such arrangements could also potentially mean less overall capital being held against a given set of risks. An example is what EIOPA terms "innovative reinsurance structures" such as mass lapse reinsurance with limited real transfer of risk.

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[24] Significant risk transfer (SRT) transactions encompass a broad set of cash or synthetic securitisations that can be valuable risk-management tools for banks to share credit risk with third-party investors, such as private credit funds, other private investors and insurers.
[25] Alternative arrangements include the transfer of risk to capital markets using vehicles such as catastrophe bonds and risk securitisation.

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8. Data, AI and modelling risks

Since last year | Outlook

- Data inaccuracies, staleness and gaps can undermine the integrity of firms, the financial system and the effectiveness of regulation and supervision. With exponential growth in the volume and variety of data available and used by businesses, the impact of flawed data will be magnified and the potential risks to consumers more significant.

- Financial modelling risks relate to the appropriateness, in a changed world, of the current models used by firms that underpin fundamental aspects of financial organisations' activities, such as if the future is not like the past, and how model output is utilised. Models can go wrong and they might contain fundamental flaws leading to misguided decisions. Model risk represents a growing risk, particularly in an era where advanced AI and machine learning techniques compound existing "black box" concerns regarding models' inner workings, with transparency, bias and explainability challenges increasing.

- While there has generally been limited deployment of the latest generation of AI tools across the financial sector, one area that has been getting traction is in the building and coding of financial models, assumption setting and, in insurance, personal lines pricing. Given the number of entities based in Ireland that are part of an international group (many of which provide services to the local business alongside external third-party providers), risks may arise both within and beyond Ireland.

- Several risks to consumers and investors arise due to how the financial sector uses data and AI tools. These include privacy concerns, potential data breaches, discriminatory practices, overreach in how data on consumers is used including targeted manipulation, plus a lack of transparency so that consumers do not fully understand how their data is being used.

- *Spotlight 2 – AI: Balancing Opportunities and Risks* examines AI in more detail.

Risk Theme C: Risks that are driven by the longer term structural forces at play

9. Climate and other environmental-related risks

Since last year | Outlook

- Physical climate-driven risk, transition risk and litigation risk are no longer simply emerging risks but reflect present day realities that are getting more severe and impactful and unpredictable as time goes by. As the fastest warming continent, Europe's climate is rapidly changing.

- Millions of people have been affected by extreme weather events from widespread flooding to severe heatwaves and the largest European wildfire ever recorded. Near term and longer term climate, weather and environmental-driven trends, risks and events serve to magnify "traditional" risks such as liquidity, credit, market and

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insurance. There are concerns that the models and scenario pathways commonly used in forward planning and risk assessments across the financial sector are too benign.

- This risk area also covers the potential for near term tipping points and asset value "Minsky moments"[26] of sharp revaluations as the transition to net zero results in impaired and stranded assets or businesses. Stress test analyses undertaken at a European level and locally have shown that transition risk losses on the asset side of balance sheets from so-called *"Run-on-Brown"*-type shocks, considered in isolation, would be limited.[27] It should be noted, however, that the results are before any second round macroeconomic effects and the work is generally hampered by scope limitations, data gaps and data quality issues. There is already evidence of some commercial real estate values being adversely affected by decreased demand in high risk areas and the shift towards sustainable properties.

- The increasing instances and unpredictability of extreme climate-related events, notably inland and coastal floods and storms in the case of Ireland, will progressively make insurance more expensive and less available in high risk areas potentially leading to increased protection gaps and affecting property values and causing disruption, including possibly to critical infrastructure.

- Where cover is not available or is limited, or insurance premiums are judged to be prohibitive, affected households and businesses may be less financially resilient in the face of adverse events. Where large cohorts of households or business suffer uninsured or uninsurable material losses, there could be wider ramifications for local economies. The Central Bank's recent study into the outlook for the availability of insurance cover in known flood risk areas identified that today 1 in 20 buildings have limited access to flood cover, with that number set to rise over the coming years.[28]

- The financial sector plays a key role in financing transition to a low carbon economy, while from a consumer and investor perspective, there is the continuing risk of greenwashing and consumers being misled in relation to products choices if green credentials are overstated.

[26] In this context a "Minsky moment" (named after economist Herman Minsky) would involve a sudden adjustment of investor expectations about future climate policies and the resulting revaluation of affected assets as risk is repriced.
[27] "Run-on-Brown" was the label adopted for one of the scenarios in the "Fit-for-55" cross-sectoral stress test undertaken by the European Supervisory Authorities in 2024. It captures a situation where carbon-intensive firms lose investor support, slowing their green transition efforts since "brown" firms may not have the financing they need to "green" their activities and adversely affecting their value.
[28] See the Central Bank report, The Flood Protection Gap, October 2024. The flood risk of each residential and commercial address in the State was analysed, down to Eircode level. Whether each address is likely to be able to access flood insurance, based on typical underwriting criteria in the Irish market, was then assessed.

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10. Financial crime risks

Since last year | Outlook

- This risk area covers key elements of our mandate in preventing financial crimes such as insider dealing, market manipulation, money laundering, terrorist financing, sanctions breaches, fraud and the provision of unauthorised financial services. The risk level is judged to between "significant" (amber) and "severe" (red).

- The increasing number of firms in the technology-led payments, e-money and crypto sectors provides new opportunities for criminals to use the Irish financial services sector for the purposes of money laundering/terrorist financing or circumvention of financial sanctions. Such firms tend to have immature risk cultures which leads to inappropriate or ineffective control frameworks.

- Fraud, and particularly the threat of fraudulent behaviour from external actors outside national borders, continues to be a persistent problem globally. While still at relatively low levels, fraud levels are increasing, with a 26% rise in fraud between 2022 and 2023 in the Irish payment system.[29] There is increasingly sophisticated use of technology by fraudsters making it ever more difficult for consumers to protect themselves and for the private and public sector to combat it.

- Where fraud or the perceived threat of fraud becomes pervasive, it risks diminishing the benefits of financial services if consumers and businesses become reluctant to make the most use of the financial system for fear of being the subject of a fraud. This can include consumers not availing of innovations or product offerings that could bring benefits to them. It can also mean businesses do not get the proper benefit promised by digital commerce if their (potential) customers are afraid to engage.

11. Business model and strategic risks

Since last year | Outlook

- The scale and speed of change in the financial services market and the volatile macro environment may adversely affect the long term viability of those firms which cannot adapt successfully or whose business model is insufficiency sustainable or resilient. While the Central Bank does not operate a no failures regime, the operating environment can heighten the risk of disorderly market exits.

- While new entrants and innovative business models can have a positive impact on competition and the choice available to households and businesses, in some instances the increase in competition for customers may lead to a "race to the bottom" in terms of decision making and risk management resulting in, for example, unsustainable price levels across the market. It can also manifest itself as gaps in the provision of essential products and services.

[29] See Central Bank of Ireland publishes new data on Irish payment fraud, January 2025

Across all the risk themes described above, a consistent risk mitigant is that a firm has a culture and approach that supports the management of its operation in a prudent, proper, forward-looking and consumer-centric way. This includes having the expertise, experience, infrastructure and governance structures in place to run it well. History teaches that problems generally occur, and the propensity for misconduct rises, when external shocks or major change coincide with poor risk management and oversight. This risk is accentuated as consumers and investors may need to make more financial decisions than normal in the changing economic landscape, and to do so in an increasingly digital environment where decision making is accelerated and the lines between regulated and unregulated services may be less clear.

The key risks facing the financial sector outlined above provide the backdrop for the Central Bank's regulatory and supervisory priorities for the period ahead. They inform our supervisory focus. Section 3 explains the Central Bank's supervisory priorities, with Section 4 providing a sector by sector view.

Spotlight 1 – Safeguarding Consumer Interests

Introduction

Ensuring that consumers and investors of financial services are protected against harm or unfair outcomes is at the heart of the Central Bank's work. As highlighted in last year's RSO report, risks to the achievement of positive outcomes for consumers can materialise when financial service providers fail to adopt a consumer-centric approach, including considering those risks their customers face emanating from the external environment.

The landscape that consumers and investors are dealing with is increasingly complex, and they are having to take more responsibility for their own financial futures. This is evident in the changing ways in which financial services are provided and in how consumer needs, preferences and behaviours are evolving. We also see this through the emergence of new financial firms and operating models.

In this context, the Central Bank continues to focus its supervisory efforts on five cross-sectoral key drivers of consumer risk, with the aim of securing a material positive difference for the users of financial services (Figure 4).[30]

Figure 4: Key drivers of consumer risk

[30] For the detail behind these drivers, see the 2024 Regulatory & Supervisory Outlook report, pages 25-28.

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Consumer Risk Drivers and Impact on Consumer Outcomes

Consumer Risk Driver 1: Poor business practices and weak business processes. Issues related to poor customer service continue to dominate consumer concerns, as evidenced by the number of complaints in this category reported to firms, the Financial Services and Pensions Ombudsman (FSPO) as well as customer sentiment analysis from the Department of Finance. These include, long call waiting times, and issues relating to the quality of customer service, such as for people in or facing early arrears on their mortgage. The latter was covered in the Central Bank's review of early mortgage arrears support, with the outcome published in a Dear CEO letter issued in April 2024.[31]

The Central Bank expects firms to identify and address customer complaints speedily, efficiently and fairly, in particular those that may indicate a broader or more systemic issue. There is a lot firms can do at a practical level to make improvements to deliver the service consumers legitimately expect.

Consumer Risk Driver 2: Ineffective disclosures to consumers. Ineffective disclosure can make it difficult for consumers to understand the benefits, risks and terms of products or services and the potential influence of ancillary costs related to the provision of the financial service, such as fees and commission payments. This could affect their decision making. A recent mystery shopping exercise carried out by the Central Bank on investment firms found that the way firms describe risks and fees in their marketing materials can be more technical than the way they explain the benefits of their products or services.[32]

Firms should, in particular, consider the challenges posed by continuing financial innovation coupled with the wide variety of information sources. Consumers may find it difficult to differentiate "trusted" sources from those that are less reliable, particularly when engaging online.[33]

The Central Bank expects firms to inform consumers effectively by meeting their obligations under the Standards for Business

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[31] See Thematic Review on Early Mortgage Arrears Dear CEO letter, April 2024
[32] See Common Supervisory Action on the MiFID II Marketing Communications Requirements Dear CEO letter, October 2024.
[33] See Financial Literacy - Empowering consumers to protect their financial future - Remarks by Deputy Governor Derville Rowland, July 2024

Regulations of the Revised Consumer Protection Code when it becomes applicable. Informing consumers effectively allows them to compare products and services, shop around for better value, and to have trust and confidence in financial services. Firms are required to ensure that all information is provided to customers in such a way that the material features of the product or service can be reasonably understood.

Low levels of financial literacy can be a particular challenge. 43% of Irish adults do not reach what the OECD identifies as the minimum level of financial literacy and 44% do not have the minimum level of digital financial literacy needed to navigate their day-to-day finances. Financial literacy is more than just being able to read a statement or digest lengthy risk disclosures accompanying a product or service. It is about having a broader understanding of finances, including where there are risks and how to go about understanding these in a meaningful way. The financial decisions consumers make at different points in their lives can have a profound impact on their long term financial well-being, and as a result, their overall quality of life. The launch of Ireland's first national financial literacy is a welcome development and one which the Central Bank wholly supports.[34]

Consumer Risk Driver 3: The changing operational landscape. There are risks to consumers where firms fail to effectively respond to the impact of the changing operating environment. Although inflation has eased significantly since its peak in 2022, cost of living increases continue to impact consumers. As reported in the Central Bank's Q4 2024 Quarterly Bulletin[35], consumers' perception of inflation may inform their choices around financial services, for example their savings and investment intentions. Given the uncertain economic environment, with cost of living and other financial pressures being faced by some households, firms need to remain ready to support customers in financial difficulty.

Firms also need to ensure that they have sufficient operational resilience to manage change without creating risks to consumers, with capacity to deal with consumers' needs in a timely and appropriate manner and provide support for consumers when they need help.

[34] See Ireland's National Financial Literacy Strategy, published on 20 February 2025.
[35] See Central Bank's Q4 2024 Quarterly Bulletin, December 2024

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Consumer Risk Driver 4: Technology-driven risks to consumer protection. This relates to the risks associated with the increasing reliance by firms on information and communications technology in the delivery and consumption of financial services, as well as the potential threats to consumer protection posed by technological innovations.

Cybercrime remains the most prevalent type of fraud committed in Ireland with recent research indicating a 22% year-on-year increase in the frequency of cyberattacks and over 70% of Irish businesses suffering a cyberattack in 2023.[36] Recent Central Bank research found that 72% of consumers listed "technical issues" as a key issue in relation to the digitalisation of financial services.[37] System outages can have a significant effect on continuity of services for consumers as evidenced by both global and local IT outages in 2024. Due to the innovation in digital delivery, several organisations who attended a 2024 Civic Society Roundtable highlighted the challenges that consumers in vulnerable circumstances face accessing financial services using online and digital channels.[38]

The Central Bank expects firms to have well-defined and comprehensive information technology and cybersecurity risk management frameworks, supported by sufficient resources to achieve resilience and protect the interests of consumers, particularly those who face vulnerable circumstances. These frameworks should include their responsibilities under the Digital Operational Resilience Act (DORA) implemented in January 2025.

Consumer Risk Driver 5: The impact of shifting business models. This covers the risks associated with the move by firms to pursue strategies and implement new business models with insufficient focus on securing consumers' interests. There is a risk that firms are not consistently demonstrating a consumer-focused culture. This is evidenced generally by a lack of sufficiently mature consumer risk management frameworks. In less mature sectors, firms may not have an appropriate risk and compliance culture. This may mean, for example, that the consumer risk aspects of new business development or cost efficiency drives are not properly considered or addressed.

[36] See Hiscox Cyber Readiness Report 2023
[37] See Central Bank of Ireland, Review of the Consumer Protection Code – Consumer research report, March 2024
[38] See Central Bank of Ireland, Civil Society Round Table, May 2024

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The Central Bank expects firms to be appropriately established and effectively managed to meet the financial and operational requirements of their business model. They must also have a consumer-centric culture that is evident in their business models, decision-making and compliance with regulatory standards.

Given these drivers of risk, our 2025 consumer risk priorities will include:

- Safeguarding consumer and investor interests in the delivery of high quality, risk-based supervision through a program of supervisory engagements across all financial sectors.

- Undertaking thematic reviews and inspections to assess how the key consumer risks and risk drivers identified in this report are managed by firms, with a particular focus on customer service, disclosure and sustainability requirements.

- Assessing lenders to ensure they are resolving distressed debt in the system, with a particular focus on the appropriateness and sustainable nature of Alternative Repayment Arrangements.

- Assessing the quality and effectiveness of regulated firms' reporting of conduct-related data across sectors.

- Conducting research to understand the attitudes and behaviour of consumer cohorts based on their financial needs and motivations, including those most vulnerable, or at risk of financial or digital exclusion.

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Spotlight 2 - AI: Balancing Opportunities and Risks

KEY TAKEAWAYS

- AI tools and technologies can deliver significant benefits for consumers and the financial sector, but risks arise that have the potential to adversely affect firms, their customers and wider society in various ways.
- Regulated firms should be clear that their use of specific types of AI is appropriate to the business challenge being addressed.
- Under the European Artificial Intelligence Act (AI Act), the Central Bank expects to be designated as a "Market Surveillance Authority" (MSA) by the Government as part of a multi-lateral system of AI supervision in Ireland and the EU, and we are preparing accordingly.
- An effective and efficient national supervisory system will help foster innovation and lessen the implementation complexity of the AI Act.

Background

AI is the concept of creating computer systems able to perform tasks that would normally require human intelligence. As noted in last year's report, AI tools and technologies have potential to bring significant benefits to consumers, the financial services industry and the economy, as well as to help deal with major societal challenges. While AI adoption is currently confined to narrow usages, the impact of AI deployment can already be seen in a range of functions, albeit often on a pilot basis. These include anti-money laundering and fraud prevention, cybersecurity, customer service delivery, market trading, insurance underwriting and reserving, credit scoring, and computer code development and testing.

In this Spotlight chapter, we focus on the use of AI across the financial services sector, setting out our current perspective on the regulatory and supervisory implications.

The Central Bank's approach

One of the Central Bank's key supervisory objectives is to keep abreast of how the use of AI is creating new value chains, business

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models, techniques and processes, including providing new sources of value to consumers. Through our regular supervisory engagement and the Innovation Hub, the Central Bank will continue to engage with firms to understand how AI is being used in practice and provide regulatory advice and support for innovative projects. We will assess how current regulations and standards can be applied to the emerging use of AI. It is important to recognise that many of the risks associated with its use are not new risks and are already covered by existing regulations and standards, including at an EU level. Our approach is to be responsive to evolving circumstances.

Many of the risks associated with the use of AI are not new and are already covered by existing regulations and standards

The Central Bank strongly supports the effective implementation of the EU AI Act. The Department of Enterprise, Trade and Employment (DETE) as the implementing department have notified us of their intention to designate the Central Bank as one of the MSAs under the Act. The national and EU supervisory system will require significant effort to establish the supervisory system that protects Irish and EU citizens' fundamental rights while enabling the potential value from AI to be realised in Ireland and the EU.

Identifying and addressing the risks

The application of AI technologies is becoming a significant contributor to the changing risk landscape for financial services firms. As new approaches move from proof-of-concept and pilot phases to become increasingly embedded in business processes, financial sector risks will transform. Existing challenges faced by firms associated with digital transformation, their management of cyber and IT risk, and governance are likely to become more accentuated. Risk concentrations in cloud service providers including AI providers are likely to increase.

Different risks can occur in the various parts of an AI system, and firms remain responsible for managing these risks appropriately. These include "input risks", "algorithm or model risks", "output risks", as well as "overarching risks".

- **Input risks** involve the data an AI model uses. These include risks related to the provenance of the data and its quality. There may be biases in data, as well as data privacy and protection risks.

- **Algorithm selection and implementation risks** include inappropriate use of black-box AI in high stakes settings and incorrect parameter selection.

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- **Output risks** relate to decisions taken on the basis of or informed by AI leading to individual or collective harm, for example bias leading to financial exclusion.

- **Overarching risks** are linked to the use of AI such as cyber resilience, operational resilience and governance. Among the key governance aspects is the clear assignment within organisations of accountability for AI systems' use and decisions taken based on AI.

Where a firm is using AI, it should be clear what business challenge is being addressed and why their use of specific types of AI are an appropriate response to the business challenge. Many of the considerations that apply to conventional (non-AI) business challenges continue to be relevant, including clarity of accountability and responsibility for business use of AI and ensuring the interests of consumers of financial services are taken in account. Moreover, the use of AI may require more consideration of accountability and recourse as well as issues like interpretability, explainability, fairness and the ethical usage of data.

Context is key when using AI: just because AI can be used to address a particular business challenge does not mean it is always appropriate for it to be used. The AI Act includes a risk-based classification for usage of AI as they relate to risks to fundamental rights. The classification ranges from the concept of "unacceptable risk" (that is activities in which the use of AI is prohibited) to usages of AI which can be considered to have minimal risk (for example, spam filters). Given the broad spectrum of potential uses for AI, as well as the various types of AI, there will be cases where judgements need to be made about whether it is appropriate to use AI for a particular process or business problem. The decision-making process around any such judgements should be transparent, with clarity over who is a responsible and accountable for the decision to use AI for a given process within regulated financial services firms. It is important to note that while the AI Act is not specific to financial services, it will become part of an existing set of financial services regulations and requirements.

Traditional digital transformations in parts of the financial sector have proven challenging in the past and it is likely that AI transformations will face similar challenges. Transitioning from legacy systems, or maintaining such systems in parallel to a new AI-enabled process, has the potential to introduce risks to operational

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continuity. From a supervisory perspective, it is important that throughout any transition financial services firms identify and prepare for any new source of risk to their operational resilience. Firms should be ready to respond and adapt should such risks crystallise as this may result in, for example, failure to meet customer obligations, regulatory requirements or supervisory expectations.

Establishing effective and efficient national and EU supervision

Under the AI Act, the Central Bank is likely to be the MSA for Irish regulated financial services usage relating to creditworthiness assessment and life and health insurance risk assessment and pricing. The AI Act came into force in August 2024. Requirements for regulated firms and member states through various provisions and articles will be progressively implemented from February 2025 through to 2030.

Irish and EU supervision of the AI Act will be a multi-lateral and, therefore, interdependent system, with its effective and efficient organisation and implementation being critical. The AI Act itself is grounded in protecting the fundamental rights of citizens and is a complex piece of cross-sectoral legislation involving numerous supervisory authorities and other public bodies, as well as government departments. A coherent national implementation plan and clear assignment of responsibilities is required. The new tasks carried out by the MSAs - including the Central Bank - will have to align with the existing body of regulation for regulated financial service providers.

This inherent interdependence will require close collaboration, co-operation, and co-ordination across all of the organisations involved in implementation. While this remains to be fully worked out, it could include market surveillance, risk identification and impact assessment, information sharing, and common approaches for generative AI supervision in conjunction with the EU AI Office. This last point is of particular relevance. The EU AI Office will supervise General Purpose AI (GPAI) technology. However, it is highly likely that the AI systems those models form part of will be part of national MSAs' mandates, as well as open-source GPAI. Therefore, it is likely in practice, that joint supervision across sectors will be required. It is therefore important that a harmonised approach and a level-playing field is adopted.

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Our work in the coming months will include further advancing our thinking and position on AI topics such as bias, interpretability, explainability, and evaluation of AI. We plan to engage further with industry, civil society, academia and other stakeholders, and use our position in international bodies and in other forums to contribute to the deliberations on AI and learn from others.

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Section 3 – Supervisory Priorities

Introduction

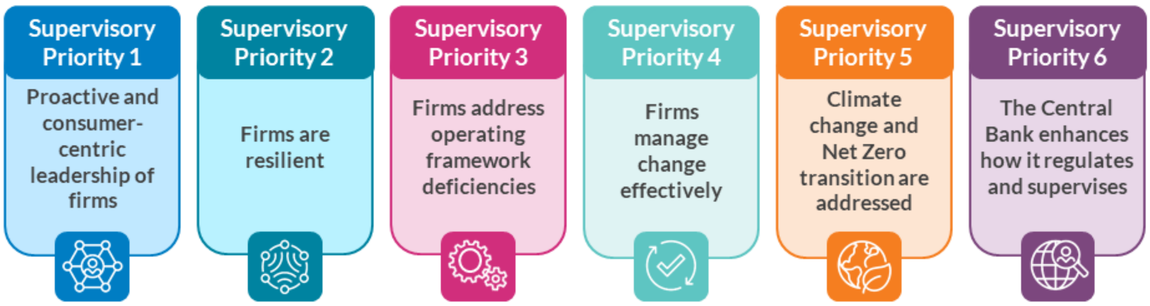
The Central Bank adopts a risk-based approach when we are setting our supervisory priorities. We focus on those areas that pose the greatest threat to the financial system and the achievement of our safeguarding objectives while working to ensure the financial system operates in the best interest of consumers and the wider economy.

Our focus is on resilience, adaptability and trustworthiness in the provision of financial services. As described in Sections 1 and 2, firms - and regulators - face an increasingly volatile, unpredictable, fast changing and complex operating environment. A consistent risk-mitigant is that regulated firms and their leadership conduct themselves in a prudent and consumer-centric way, and sufficiently consider the implications of uncertainty for their strategies, customers, and their resilience and recovery options should extreme, but plausible, events or circumstances arise.

Key supervisory priorities

The Central Bank does not operate a no-failures regime, but rather works to ensure the effective management of risks and the mitigation of impacts on consumers and the wider economy should risks crystallise. Our supervisory priorities for 2025/26 are informed by the wider risk environment as well as sector specific trends, risks and vulnerabilities and continue to reflect the key supervisory priorities that were presented in the 2024 Regulatory & Supervisory Outlook report (Figure 5).

Figure 5 – Key supervisory priorities



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Priority Outcome 1: Proactive risk management and consumer-centric leadership of firms. We expect the leadership of regulated entities to adopt a more proactive and forward looking approach to managing the risks and uncertainties facing their organisations and their customers. This includes ensuring that their approaches are in line with the scale and complexity of their business models, the changing operating environment, the heightened risks and uncertainties they face, while throughout actively considering their customers' interests.

Priority Outcome 2: Firms are resilient to the challenging macro environment. Regulated firms should have sufficient operational and financial resources, adaptability and recoverability, to be resilient and well-prepared in the face of risks in the macro environment, economic and financial market uncertainty and fragile sentiment. This is particularly important given the breakdown in previously stable international relations, protectionism, and other political, technological and environmental developments.

This also includes being mindful of the consequences of this environment for their customers who may face financial difficulty and vulnerable circumstances, and provide adequate support to them.

In an era of heightened uncertainty traditional approaches to quantifying risk and to stress testing have limitations. They may be too narrowly focused, rely on historical patterns, and may not sufficiently capture forward-looking unpredictability. *Spotlight 3 - Geopolitical Risks: A Framework for Navigating Heightened Uncertainty* describes a scenario-based framework that can be used to consider how geopolitical events might transmit through the real economy and financial system and affect customers and more traditional risk categories. The aim is to help answer "what if" questions.

Priority Outcome 3: Firms address operating framework deficiencies. Deficiencies identified in the governance, risk management and control frameworks of regulated entities are addressed to ensure they are effective, both in the current environment and into the future. This ranges from the need to consider financial and operational resilience in a holistic way, given the interdependencies between risks, to ensuring firms have sufficiently robust anti-financial crime controls as the financial system evolves and risk levels rise.

It also relates to dealing with situations where Ireland-based boards and executives are not effectively exercising control of local entities in group situations.

Priority Outcome 4: Firms manage change effectively. Regulated entities should keep pace with changes in the financial system and consumer needs and expectations through the well-managed evolution of their business strategies.

The adequacy of firms' investment in, and their ability to adapt to, rapidly developing technology will have consequences for firms' business models, their interaction with consumers, their operational resilience, and cost profile. Cyber security, data security and the maintenance of customer trust, including the ethical use of customers' data – particularly as AI tools are increasing deployed - require continuing investment and focus by firms.

Supervisors will expect firms to be able to simultaneously manage change, with processes and oversight in place that are commensurate with the scale and complexity of that change, while maintaining business as usual operations and continuity of service to customers.

Priority Outcome 5: Climate change and net zero transition are addressed. Regulated entities will continue to improve their responsiveness to climate change, the implications for their businesses and customers, and they must manage its impact and enhance their role in the transition to a net zero economy. This includes ensuring that their risk management practices for physical, transition and litigation risk are fit for purpose, and that alongside the part they are playing in supporting sustainable finance, they avoid greenwashing and other misrepresentation practices.

Key priorities

Our priorities for 2025/26, as set out below, are aligned with the corresponding priorities of the European System of Financial Supervision and ECB Banking Supervision. They also sit alongside the sector-specific work that is outlined in Section 4.

- Ensuring regulated firms meet their **obligations to consumers and investors.** The expectation is that firms address internally or externally identified shortcomings around poor practices in order to reduce the risk of consumer detriment and prepare for changes stemming from the revised **Consumer Protection Code** coming into effect in 2026.

- Seeking assurance that regulated firms' **risk management capabilities and practices** are robust. As noted above, the expectation is that firms' risk management capabilities and practices, including stress and scenario analysis, are forward-looking and commensurate with the heightened risk environment, including the risks derived from digitalisation, climate change and the volatile and unpredictable geopolitical environment.

- Enhancing **operational resilience, including cyber-related resilience**, across the financial sector. A key element is seeking assurance regarding the effective implementation of DORA obligations by regulated firms, including critical third party information and communications technology (ICT) providers, many of which are part of Ireland's large technology sector.

- Continuing to embed the **Individual Accountability Framework,** including extension of the Senior Executive Accountability Regime (SEAR) to (independent) non-executive directors from July 2025 and supporting external stakeholders via additional engagements and workshops. The expectation is that firms have effective governance underpinned by a strong ethical culture and robust systems of delivery.

- Preparing for the **EU Artificial Intelligence Act** with further engagement in connection with the **use of AI in financial services**. This includes preparing to implement the requirements of the Act within our supervisory functions as well as undertaking various types of engagment with firms. The expectation is that firms implement the requirements of the AI Act, and have robust frameworks that allow the identification and mitigation of the specific risks driven by AI.

- Taking an increasingly holistic approach to fulfilling our remit in connection with **financial crime and market integrity**. The expectation is that firms are developing and implementing preventative measures to mitigate fraud. The Central Bank will

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also be engaging with technology providers to introduce protections to help mitigate against the risks to the public from scams and fraud. We will also be making a material contribution to the work of the Anti-Money Laundering Authority (AMLA) which will become administratively operational in 2025.

An overview of the work the Central Bank has underway is set out in Box 2 "Financial crime – Preventing Abuse of Financial Services" on page 49.

- Implementing the **Markets in Crypto Assets Regulation** (MiCAR), including engaging with firms seeking authorisation and furthering our work to raise awareness of risks relating to crypto for consumers. Box 6 "The New Regulatory Framework for Crypto-assets" provides further information on MiCAR, which can be found on page 117.

- Implementing changes to our **Fitness and Probity** processes, embedding the recommendations of the Fitness and Probity Review conducted in 2024 by Mr. Andrea Enria. Significant progress has already been made in implementing these recommendations, including the establishment of a dedicated Fitness and Probity Unit. A new Fitness and Probity assessment approach has been developed enhancing our process, in particular, relating to interviews and the provision of feedback. This will be published shortly. Furthermore, we are preparing a public consultation on the Guidance on Fitness and Probity Standards.

- Continuing to deploy appropriate **enforcement mechanisms** to address serious breaches of regulatory requirements and misconduct by firms and individuals. The goal continues to be to maintain a credible deterrence and promote a culture of effective governance and accountability within the financial sector.

- Continuing to work in partnership with the wider financial sector to address **climate and environmental-related challenges,** exploiting our data and research capability, and as convener of relevant stakeholders and bringing together national and international experts. We will be building on the work we have been doing related to understanding the materiality of the flood protection gap in Ireland.

- Delivering our first thematic **Innovation Sandbox Programme focusing on combating financial crime** and expanding the programme to continue to support innovation while safeguarding the integrity of the financial sector.

- Progressing changes to the **credit union lending regulations** including our proposed changes to concentration limits for house and business ending and lending practices for specific categories of lending.

Finally, amidst a changing and uncertain macro environment, the Central Bank will continue to focus on its mission of maintaining monetary and financial stability while ensuring that the financial system operates in the best interests of consumers and the wider economy. In particular this year, we will work with peers and other stakeholders on the simplification agenda and look to enable properly-functioning markets that support innovation and productivity without undermining core policy objectives such as financial stability, resilience and consumer and investor protection. In any drive to simplify, we need to be clear that we do not compromise on delivering the stability, resilience and protections that consumers and the wider economy need and that the public expects.

Alongside these priorities, we will be undertaking a range of sector and firm-specific supervisory work covering the spectrum of risk areas described in Section 1. This includes direct engagement with firms and deep dive inspections, thematic reviews and data analysis, backed up by a proportionate recourse to enforcement. Section 4 provides a sectoral view and highlights key areas of focus for 2025/26.

Our new supervisory approach

Our sixth priority, as set out last year, relates to the Central Bank's own approach to regulation and supervision.

Priority 6: The Central Bank enhances how it regulates and supervises. Our objective is to continue the improvement and transformation of our approach to regulation and supervision to ensure that we can carry on fulfilling our mission and mandate in a rapidly changing financial ecosystem. This includes continuing to enhance authorisation processes, continuing to develop a proportionate, responsive regulatory framework and evolving our supervisory approach.

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In pursuit of this objective, in January we introduced a new supervisory approach, which remains outcomes-focused and risk-based. It builds on our existing supervisory approach and practices. It is designed to further support the achievement of a well-functioning financial system delivering for citizens and the economy. The new framework does not change the safeguarding outcomes we are pursuing as a regulator, but we have changed how we work to achieve these outcomes in a changed financial services landscape. Our supervisory principles and evolved supervisory approach are summarised in Box 1 below with more detail set out in *Our Approach to Supervision* document.[39]

We expect this year to be a year of dialogue about our new approach as part of supervisory engagements with firms and sectors, as both firms and the wider system become more familiar with its implementation.

Box 1: Overview of Our Approach to Supervision

Our supervisory principles underpin how we approach delivering on our safeguarding outcomes. (Figure 6)

Figure 6: Our supervisory principles

Risk Based: We focus our supervisory efforts on material risks to our safeguarding outcomes. We deploy supervisory effort towards the greatest potential impacts of risks, threats or vulnerabilities, to ensure that the financial system operates in a manner that supports the effective and sustainable functioning of the economy, delivers positive outcomes for the users of financial services and protects the integrity of the financial system.

[39] See Central Bank of Ireland, Transforming Regulation and Supervision – Our Approach to Supervision

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Outcomes Focused: We clearly communicate to sectors and firms, highlighting the outcomes we want to see and the timelines in which we expect them to be achieved. We use our regulatory and supervisory powers proportionately, escalating as required, to achieve our desired outcomes.

Firms' Responsibilities: The focus of our work is resilience, adaptability and trustworthiness in the provision of financial services. Responsibility for risk identification, management and mitigation rests first and foremost with the boards and management teams of firms.

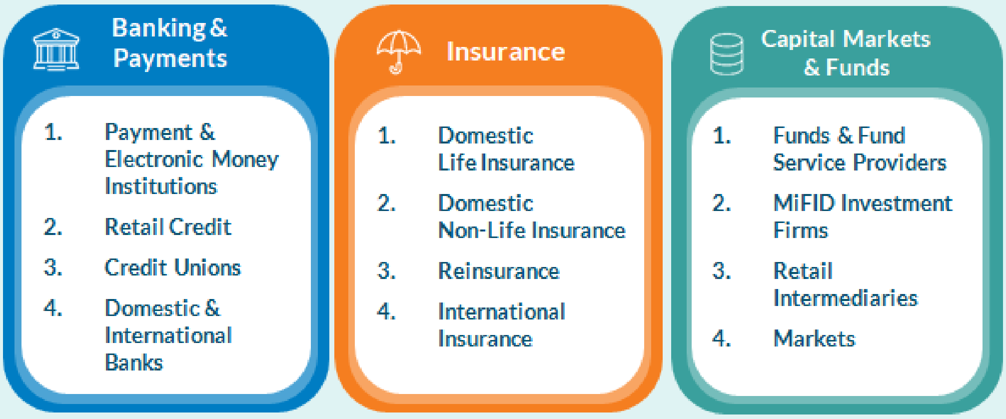
Forward Looking: We take a longer-term view, anticipating the impact of current trends and emerging risks in a national and international context, so that we are better positioned to respond quickly and effectively.

Judgement Led: Our approach to supervision uses data, analysis and information we receive in the course of our activities and is informed by our professional judgement. This increases our ability to react to new developments, intervene in a timely manner, leverage our integrated mandate, and escalate where and when necessary.

Industry categories

We consider the financial system as consisting of three overarching industry categories of related products and services. These are Banking & Payments, Insurance, and Capital Markets & Funds. Each category contains a number of sectors which cover all supervised entities. (Figure 7)

Figure 7: The sectors we supervise



Each sector is supervised in an integrated, holistic way with a multi-year supervisory strategy. These strategies articulate the targeted outcomes we seek to achieve, and the proportionate supervisory or regulatory actions we will take at a sectoral, or individual firm level. The strategies are refreshed annually to ensure current and emerging risks, threats and vulnerabilities are considered.

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We take an integrated approach to the prioritisation of risks. We focus on those risks most likely to threaten the delivery of our safeguarding outcomes and/or those risks significantly beyond our risk tolerance levels.

The sectoral supervisory strategies ensure that there is consistency in our approach to supervision. We deliver supervision through a broad range of supervisory actions and interventions, which are used to prevent or mitigate risks posed to our safeguarding outcomes. These actions and interventions, range from awareness and expectation setting activities, to programmatic supervision with individual firms and sectors, escalating to policy and/or enforcement and resolution actions.

Our supervisory approach recognises that certain firms could have a significant impact on the achievement of our safeguarding outcomes. These firms are closely supervised on a continuous basis, at an individual firm level, by integrated supervision teams. The Central Bank will have a set level of engagement with key individuals in the firm on an annual basis. Each of the firms will have direct communication from their supervision team on supervisory activities for the year ahead.

Box 2: Financial Crime - Preventing Abuse of Financial Services

Introduction

The abuse of the financial system by bad actors that leads to detriment to consumers and undermines the integrity of the system is a continued concern of the Central Bank. We are prioritising work around financial crime affecting consumers of financial services through fraud or the laundering of the proceeds of crime.

The rising scale of fraud

In respect of financial services being used to perpetrate or facilitate fraud, we have seen the value of fraud in payments in Ireland increase by a quarter in 2023 compared to 2022 – from €100m to €126m.[40] We have received reports that indicate increasing complexity and sophistication of fraud techniques used by criminals. These include fake or imitation trading platforms, clone investment firms, and impersonation via "*smishing*" or social engineering. This rise in fraud means an increase in the inherent risk of money laundering, as criminals seek to integrate proceeds of crime into the legitimate economy.

[40] See Central Bank of Ireland, Behind the Data – Insights from Irish Payment Fraud Statistics, January 2025

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The Central Bank's strategy

The Central Bank has engaged with technology firms on how best to respond to the increase in online scam activity. Through this engagement, we are requesting technology firms to verify whether services on their platforms are authorised by the Central Bank to offer such services. This should help to disrupt online fraud and protect consumers from online scams. Our Innovation Sandbox Programme's initial focus is also on developing solutions to financial crime.

We ran an awareness campaign in 2024 which built upon our previous campaigns in 2022 and 2023. The purpose of these campaigns is to increase public awareness about scams, empower individuals to avoid them, and enhance public engagement with the Central Bank.

In respect of the laundering of proceeds of crime, we identify risks on a sectoral and entity-level basis and apply a risk-based approach to supervising the sector. As Ireland is a global financial centre, there is the risk that it is used as a conduit or gateway for the flow of illicit funds. In response, in 2024 we conducted thematic supervision across several sectors to assess firms' ML/TF risk arising from international money flows and the effectiveness of their control frameworks in managing and mitigating these risks.

As part of wider changes we are making to our supervisory approach, we are revising how we identify and supervise financial crime risks. It will ensure we adopt an enhanced approach and view the risks more holistically (for example across money laundering, terrorist financing, fraud and sanctions evasion) and use the wide range of regulatory and supervisory tools to manage these risks.

Spotlight 3 – Geopolitical Risks: A Framework for Navigating Heightened Uncertainty

KEY TAKEAWAYS

- In an era of heightened geopolitical uncertainty, traditional approaches to quantifying risk and to stress testing have limitations as they may be too narrowly focused and not sufficiently forward-looking.
- Mapping transmission channels and scenario analysis are valuable tools for firms and supervisors to help decision making in the face of an unpredictable future.
- Many firms and regulators adopt scenario techniques as they identify opportunities and threats. The purpose of the Spotlight is to highlight the importance of this topic for regulated entities.
- The framework described in this Spotlight can be adapted to reflect the scale, complexity and risk exposure of an organisation. Supervisors would expect regulated entities to consider geopolitical risks in a way that is proportionate, whether by adopting an approach similar to that set out here or otherwise.

Introduction

The global macro environment described in Section 1 is one of increasing instability, increasing complexity and decreasing predictability. The geopolitical shifts we are seeing and the forces at play heighten the risk of sudden, unexpected and consequential changes to the operating environment for all, especially those entities with a significant international footprint or operating in, or from, a small, open economy like Ireland.

The increasing intensity of geopolitical threats calls for a clear understanding by firms and supervisors of the channels through which multi-faceted geopolitical risks can transmit to their organisations, and the consequent adaptability and resilience they need to nurture so they can respond to, and withstand, unexpected events. The unpredictably of when, where and how geopolitically-driven risks might materialise, and the uncertain knock on financial and operational consequences, call for a forward-looking approach to preparedness.

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A geopolitical risk assessment framework

A framework for considering geopolitical risks at a sector or entity level could encompass four main elements:[41]

A. **Risk characteristics:** Understanding the characteristics of the risk(s) under consideration (taking into account the interconnections between risks) supported by relevant horizon-scanning intelligence and the design and monitoring of chosen key risk indicators.

B. **Transmission channels:** Mapping the transmission channels to the "traditional" categories of risk firms and supervisors typically consider.

C. **Scenario analysis:** Building on traditional stress-testing methods, including reverse stress test and crisis simulation exercises, to assess how alternative possible future events or conditions could impact firms, sectors or the wider financial system.

D. **Resilience and preparedness:** Testing and calibrating the optimal levels of financial and operational resilience, including buffers and redundancy, and ex ante recovery plans should adverse events or conditions arise.

A. Risk characteristics

A first step is to be clear on the scope of "geopolitical risk" to be considered and how the level of risk is to be assessed. Each organisation should have a definition and scope that is appropriate for the context and the focus of their business model, complexity and size of their operations. They should ensure that they have identified a suite of suitable and relevant horizon scanning intelligence and key risk indicators - both quantitative and qualitative - and include in-house and external information sources capturing the risks to their business model and operations.

Geopolitical risks can manifest in many financial and non-financial ways when they crystallise, including armed conflicts and cyberattacks targeting infrastructure, financial systems or critical industries. It can also include economic actions such as tariffs, trade

[41] The framework can equally apply to other very high impact risks, such as physical climate risk or pandemic risks – or a combination - and at a macro-prudential financial stability level rather than micro-sector or firm level.

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restrictions or sanctions. Each such event may occur suddenly or build up gradually over time, with any consequent impacts, such as supply disruptions in key resources like oil, gas and rare minerals, feeding through to impacts on people's lives, the real economy and financial markets. Geopolitical risks, of course, have multi-dimensional cause-and-effect interconnections with a range of other risks, including international cohesion, climate-related and societal.

B. Transmission channels

The next stage is to map the transmission channels of geopolitical risks to, and through, the financial system. Figure 8 builds on recent work by colleagues at the European Central Bank (ECB).[42] The stylised diagram illustrates that the channels are numerous and complex. There are other examples of such mapping, for example the recent paper from the Financial Stability Board (FSB) exploring climate-related vulnerabilities.[43]

Of necessity, and given the complexity of the real world, such mapping presents a partial and simplified view. However, it can help provide a clarity of thought for firms and supervisors alike as they think about how to deal, ex ante, with high degrees of uncertainty. The mapping is only of value, though, if it supports understanding, communication and decision-making. The next steps seek to start addressing possible actions to be taken in the event of such shocks.

[42] See speech by Claudia Buch, Chair of the Supervisory Board of the ECB, September 2024, Global rifts and financial shifts: supervising banks in an era of geopolitical instability
[43] See page 7 of FSB's paper Climate-related Vulnerabilities: Analytical framework and toolkit, January 2025

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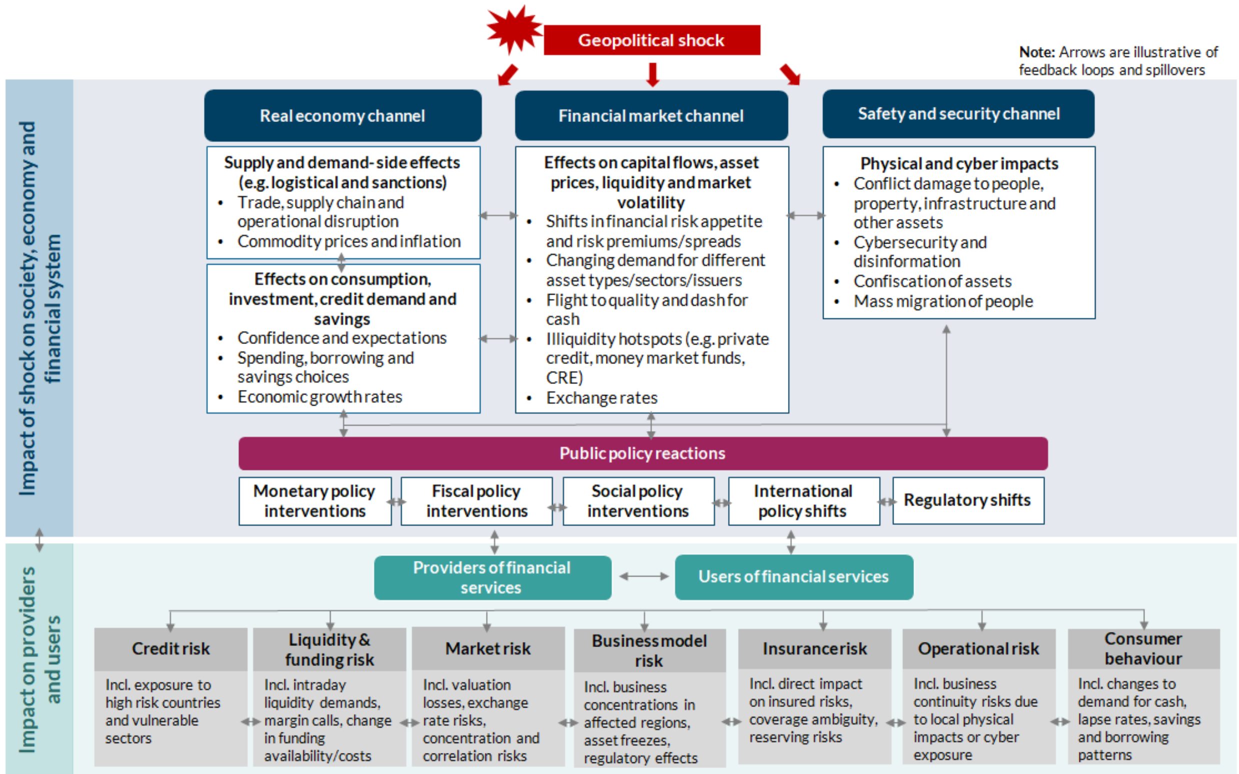
Figure 8 – Geopolitical shocks: Transmission channels to regulated entities and consumers



C. Scenario analysis

In times of high uncertainty and unpredictability, scenario analysis is an increasingly useful tool. Scenario analysis is where several alternative possible future events or different futures are considered and "what if" questions asked. Scenario analysis complements and builds on traditional stress-testing methods and crisis simulation exercises that are routinely used by firms and by supervisory authorities to test both financial and operational resilience and to identify vulnerabilities.

Whereas traditional stress testing tends to focus on the financial impact of sudden defined financial market and economic shocks, or the organisational impact of an operational incident (for example a cyberattack), scenario analysis can support a richer and broader discussion about the consequences different geopolitical triggers might have. Considering the combined effects of each scenario can allow for the identification of transmission channels, interconnections, dependencies and the full range of operational and financial vulnerabilities that might be exposed. Discussions can focus on those scenarios and sequence of events that are judged to pose the most significant and pressing threats to the financial and operational resilience of regulated entities, or to the interests of consumers or to the wider financial system.

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Firms and supervisors can plan the range of actions they would expect to take in each of those scenarios. They can then monitor external and internal events – periodically updating the scenarios they have considered - and so be prepared if a specific scenario begins to materialise. Through this exercise, they would also consider the impacts of how other actors might behave – or how critical financial and national infrastructure might fail - during periods of stress, which may amplify the impact of a shock. The outcomes of such analysis would feed into a firm's risk management through their risk identification and monitoring frameworks. They would inform their management of limits, the business strategy, including capital planning and stress testing frameworks, as well as considering the implications for a firm's wind-down process and/or recovery and resolution plans (if applicable).

D. Resilience and preparedness

The primary mitigant against the impact on a firm, or the wider financial system, of adverse exogenous or endogenous shocks, or to a rapid deterioration in the operating environment, is financial and operational resilience. Maintaining robust capital and liquidity buffers, enhancing IT infrastructure and maintaining effective business continuity plans, and leadership and workforce alignment and flexibility, all play their part in supporting adaptability and resilience. Scenarios and stress-testing help quantify the amount of additional resources and actions needed to ensure a firm's resilience. They also help with the enhancement of the suite of management and recovery options available to an institution to ensure they remain effective and feasible.

Section 4 – A Sectoral Focus

Introduction

In this section, trends, risks and vulnerabilities are considered from a sectoral perspective. As noted earlier in the report, there are a number of common cross-cutting risk themes, but each financial sector has its own specific dynamic. As a result, the Central Bank's supervisory strategy, focus and key supervisory activities for 2025/26 reflect the particular circumstances of the sector.

Approach

For each sector covered in this Section, a Key Risk Overview is provided, which describes the risk topics the Central Bank considers to be most material from a supervisory perspective. They are risks to the achievement of the Central Bank's supervisory objectives and which, if unmanaged, could give rise to widespread consumer or investor harm or could undermine the safety and soundness of firms, financial stability or the integrity of the financial system.

A risk outlook is given based on our overall assessment of the environment considering a two year horizon. The risk outlook (as defined in Table 3) denotes whether the risks identified are, in our view, increasing, reducing, or stable relative to the preceding period. The key risks identified and the outlook provided are informed by the Central Bank's market monitoring and horizon scanning, the risk assessment work undertaken by ECB Banking Supervision and the European Supervisory Authorities and feedback from the Central Bank's supervisors and other stakeholders such as the Consumer Advisory Group. They are not exhaustive lists and the outlook is for indicative purposes only.

Table 3: Risk outlook

➡ Stable	↗ Increasing	↘ Reducing

Note: "Reducing risk" means the risk level is expected to reduce albeit remaining at an elevated level.

The key supervisory activities set out for each sector are also a non-exhaustive list. Their aim is to highlight the key focus areas.

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Banking & Payments

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BANKING SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Financial risks and resilience	Adverse developments in the unpredictable geopolitical and macro environment could result in reduced profitability and a heightening of credit, market, liquidity and other inherent risks which could weaken the financial resilience of a bank. There is an increased use of significant risk transfer (SRT) tools such as synthetic securitisations. In times of stress, these might put additional pressure on a bank's capital position due to the crystallisation of additional credit risk losses on the securitised pool due to flow back risk.	Geopolitical and macroeconomic conditions.
Data, AI and modelling capabilities	Deficiencies in its data capabilities regarding aggregation, reporting and modelling could be undermining a bank's understanding of its risk exposures. Use of models/automation across the financial system is increasing. Albeit still in its infancy with limited use, AI-driven tools present a "black box" opacity risk.	Available structured and unstructured data. Data management and modelling effectiveness, including the impact of AI deployment.
Culture, governance and risk management	Shortcomings in the "tone from the top" and weak governance culture, can give rise to deficiencies in a board and management body's strategic and operational effectiveness, banks risk management and resilience, and may lead to an inadequate focus on the customer.	Organisational culture and individual behaviours, and any misalignment of incentives.
Business model and strategic risks	Potential deficiencies in "traditional" incumbent banks' ability to adapt to the changing competitive landscape, including non-bank financial institutions (NBFIs) and digital-only new entrants. The level of investment to deliver necessary change may heighten existing cost pressures. It may be badly managed resulting in poor outcomes for consumers, including IT outages and service disruption.	Entry of alternative providers of banking-type services. Consumers' requirements and expectations.
Operational risks and resilience	Increasing reliance on critical third party service providers, with some having a dominant global position creating concentration vulnerabilities. Deficiencies in operational resilience frameworks and practices.	Constraints of legacy platforms and increased operational complexity. Geopolitical tensions and rising cyber threats

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Financial crime	Banking is an attractive access point for those intent on money laundering, terrorist financing and fraudulent activities, and thereby a vehicle for illegal activities or the causing of consumer harm.	Volume of cross-border financial transactions and expanding use of digital payments.	
Climate change and other environmental related risks	Physical and transition risks can impact on the credit worthiness of borrowers and other counterparties, collateral and asset values and a bank's own level of operational risk. The purchasers of financial products from banks labelled as sustainable or as meeting certain ESG standards, face the risk of misrepresentation if the reality is not the same as that claimed.	The increasing frequency and severity of extreme weather events and the transition to net zero. Litigation risk where banks have provided finance to firms known to have significant emissions or cause environmental harms. Inadequate provision of finance for the transition to a low carbon economy.	

Banking Sector

KEY TAKEAWAYS

- The banking sector has demonstrated resilience in the face of the adverse shocks of recent years. Maintaining financial resilience is paramount as firms navigate through change and as interest rates trend down.
- Banks face challenges from fintech competitors, shifting customer expectations and growing competition from non-bank financial institutions.
- Proactive leadership and strategic management of the opportunities, risks and challenges relating to the evolving environment and shifting sectoral dynamics are critical.
- This coupled with timely and well executed investment in systems and enhancements to digital capabilities will deliver benefits to firms, consumers and society overall.
- Although progress has been made with fostering a consumer-focused culture across the sector, further work is required to improve consumer risk frameworks.

Sector profile

- Globally-oriented sector, with approximately 60% of industry assets held by internationally-facing banks.
- Internationally-facing banks focus on capital markets-based activities. Assets of c€445bn at end 2024 (up 7% on end 2023).
- Domestic retail banks serve Irish households and businesses, with some significant exposures also to the UK market. Assets of c€307bn at end 2024 (up 2% on end 2023).
- A number of banks offering savings, loans and payment services operate in Ireland from another EEA jurisdiction. They are regulated by the Central Bank for conduct of business.
- Digitalisation and the entry of non-traditional players has increased the online provision of banking services, rather than through a branch network.

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Assessment of sectoral trends and risks

Financial risks and resilience

The geopolitical outlook is rapidly changing and the ongoing uncertainty in economic growth and financial markets brings heightened risks. The increasing level of geopolitical threats calls for heightened awareness by banks of the channels through which these multi-faceted risks can impact on the sector. Banks with significant exposures to sectors or geographies most vulnerable to changes in the external environment should carefully examine their potential vulnerabilities, assess the appropriateness of risk limits in place and develop resilience to extreme but possible shocks.

The banking sector has shown resilience in the face of the unprecedented risks posed by the macro-financial environment in recent years and the competitive environment. The elevated interest rate environment has resulted in exceptional profitability since 2023 reflecting the reliance of many banks' income on net interest income and despite increased costs. Income diversification has also somewhat improved and asset quality has remained robust. Banks continue to report high liquidity buffers and capital levels above minimum requirements.

However, excess market liquidity is reducing as quantitative tightening continues and more accommodative monetary policy results in lower interest rates. Increased competition in deposit markets and customers' search for higher interest rates are among factors that may weigh upon banks' excess liquidity and deposit pricing. Bank income is expected to normalise in response to lower interest rates, while banks' costs may not adjust proportionately. Banks need to ensure that they adopt a balanced loan pricing strategy to generate sustainable profitability while securing their customers interests.

Capital planning, stress testing and scenario analysis are central to sound risk management practices. While improvements have been seen, some deficiencies remain in the quality and reliability of capital planning and projections in some banks. A number of findings from Internal Capital Adequacy Assessment Process (ICAAP) reviews highlighted that banks' risk identification and quantification methodologies are not always appropriately calibrated or sufficiently risk sensitive, while adverse scenarios tend to be too optimistic. It is expected that the implementation of Capital Requirements

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Regulation (CRR) III and Capital Requirements Directive (CRD) VI for some banks not impacted by the application of the Fundamental Review of the Trading Book (FRTB) aspects will see some improvements in capital ratios due to lower capital requirements.

Banks continue to have high liquidity buffers and mature liquidity management practices. However, in light of the changing liquidity environment and the possibility for quicker erosion of liquidity in periods of negative market sentiment due to customers' ability to withdraw deposits speedily, and in particular given the high proportion of sight deposits in some banks, banks need to remain vigilant to and plan for changes in liquidity and funding trends. Additionally, concerns remain around the non-linear impact of potential shocks when it comes to leverage, with high levels of leverage potentially amplifying liquidity issues.

Domestically, banks' lending portfolios have performed well, with several credit indicators improving in 2024, some of which was supported by the strong Irish economy. However, there are vulnerabilities in certain portfolios, notably non-residential commercial real estate (CRE), leveraged finance and the accommodation and food service activities sector. Banks should continue to ensure that borrowers in or facing financial difficulties are supported. The findings of the Central Bank's cross-sectoral thematic review on early mortgage arrears, as set out in our 2024 Dear CEO Letter, showed that customer service and supports for borrowers facing early arrears need to be improved. [44]

CRE continues to be an area of focus, and while market conditions have shown emerging signs of stabilisation, the full scale of the downturn, particularly in the office market, is still uncertain and conditions could deteriorate further.[45] The Central Bank has observed proactive strategies undertaken by banks which have mitigated refinancing risk in the short term. However, this exposure class should remain subject to rigorous assessment and monitoring, with appropriate proactive provisioning by banks.

Interest rate risk management strategies have evolved appropriately as the interest rate environment has changed. In some instances, further work is needed to ensure that adequate systems are maintained to support risk management practices in line

[44] See Thematic Review on Early Mortgage Arrears Dear CEO letter, April 2024
[45] See the Central Bank's Financial Stability Review 2024 II, December 2024.

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with EBA Interest Rate Risk in the Banking Book (IRRBB) and Credit Spread Risk in the Banking Book (CSRBB) Guidelines.

Aggregate market risk is primarily driven by a small number of the international banks based in Ireland. That said, the wider sector remains vulnerable to sudden shifts in market sentiment accompanied by episodes of volatile asset prices. This volatility and asset price fundamentals could be triggered by negative surprises about the growth outlook, geopolitical shocks, or firm-specific or sector-wide events. Global geopolitical uncertainties, allied to concerns over the fiscal situation in some countries and the structural economic challenges they face, have turned the spotlight back on sovereign risks, causing potential sovereign vulnerabilities to rise.

"Significant risk transfer" (SRT) is a tool used by banks to optimise capital by transferring credit risk to third-party investors such as insurance companies, hedge funds and private credit funds. This is mostly carried out via synthetic securitisations aimed at freeing up balance sheet capacity, for example, to reduce concentrations or the level of non-performing loans held. The inter-sectoral linkages that stem from these transfers of credit risk out of the banking system can result in the potential build-up of systemic risk and possible negative feedback loops during times of stress. These might put additional pressure on a bank's capital position due to the crystallisation of additional credit risk losses on the securitised pool. The risk is heightened by the asymmetry of information on the asset quality of the securitised assets between investors and banks. In light of this, it is important that institutions assess and monitor the impact of individual securitisation both under the baseline scenario as part of their capital planning as well as understand what vulnerabilities they are exposed to under stress conditions. They should also embed SRT within their risk appetite and risk management frameworks.

Enhancing leadership, governance and risk management

Outstanding deficiencies in governance and risk management practices are being accentuated by a lack of strategic action by some management bodies. This can affect the operational soundness of firms and increase the likelihood of customer detriment. These weaknesses can drive inappropriate risk-taking, and can hinder the ability of management bodies to effectively tackle emerging challenges and risks and make appropriate risk-based decisions. A particular areas of supervisory focus is on banks' ability to aggregate

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data and report timely and accurate information to manage their business and support their decision making. In respect of the international banking sector, the Central Bank's expectation remains that banks are adequately resourced and are capable of identifying, managing, measuring and mitigating material risks at local entity level. The Individual Accountability Framework, implemented effectively, should support improvements in these areas.

Gaps still remain in relation to customer-centric decision making and strategy formulation and execution within banks. Although progress has been made with fostering a consumer-focused culture across the sector, further work is required to improve consumer risk management frameworks and embed this within all three lines of defence. As outlined in our 2024 Dear CEO letter which set out the findings of our thematic review on credit card lending, firms need to take action to improve in a number of areas.[46] This includes the support they provide for customers facing cost-of-living challenges, their customer service levels and the disclosure to consumers regarding how interest is calculated on their outstanding balances.

Operational risks and resilience

The cyber-threat landscape has escalated such that the banking sector was among the most targeted for "distributed denial-of-service" (DDoS) attacks during 2024. The risk of state and non-state sponsored cyberattacks has risen given the geopolitical environment and prevalence of bad actors. In recent years, there have also been increasing numbers of operational incidents, with IT outages becoming more common in the retail banking sector. The impact of such outages is made greater by the importance of online, app-based banking channels to deliver services to customers. It is vital that banks build and maintain adequate levels of operational resilience and robust pre-tested contingency plans, to reduce possible impacts on access to banking and payment services.

Weaknesses in the quality of oversight of the increasingly complex networks of outsourcing, partnership and intra-group arrangements across the sector is contributing to the number of incidents. This may be coupled with constraints and vulnerabilities some banks face due to legacy systems and resource challenges, including a shortage of qualified staff in specialist areas. Outsourcing of direct customer facing services is an increasing trend that requires

[46] See Thematic Review on Customer Supports for Credit Card Lending Dear CEO Letter, December 2024

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effective monitoring and management to ensure banks can deliver positive consumer outcomes. While banks can outsource functions and activities, they cannot outsource their responsibility and they remain accountable to comply with their obligations, including to customers.

Concentration and interconnection risks relating to third party cloud service providers are growing in significance. These risks will be subject to a greater degree of focus by supervisors and institutions alike with the establishment of the critical third party oversight regime under DORA.

Financial crime

Retail banking continues to be one of the main access points to the financial system. This renders those banks operating in this area of the market particularly attractive for money laundering (ML) and terrorist financing (TF) as it provides the mechanism for the placement, transfer of funds and withdrawals. While anti-money laundering (AML) and counter terrorist financing (CTF) control frameworks are in general mature and embedded across the banking sector, it is imperative that firms' control frameworks continue to evolve in line with rising risk levels. In particular, more effective use of technology is needed to ensure appropriate and ongoing mitigation of ML, TF, fraud and broader financial crime risks.

Climate change and other environmental risks

The increasing frequency and severity of extreme weather and natural catastrophes brings heightened physical risks for the sector. Further work is required by banks to better understand their capacity to mitigate transition risks through appropriate financing of the transition to a low carbon economy. Additionally, the impact of the revised Energy Performance of Buildings Directive (EPBD) and extreme weather events affecting particular locations, could lead to increased uncertainty around future property valuations and consequent collateral values.

Some banks have yet to demonstrate that they have fully integrated climate-related and environmental risks into their risk management frameworks, with significant remediation efforts underway. Banks are expected to give climate risk the requisite focus within their organisations. This includes the effective monitoring, measurement and management of climate risk exposure

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within their risk and capital frameworks and the enhancement of climate-related data availability, reporting and disclosure. While the transition to a net zero economy may provide new commercial opportunities, it is imperative that banks have the governance, risk management and operational and financial capacity to deliver them safely and sustainably.

Key supervisory activities 2025/26

- Continued focus on the strategic oversight from boards of culture, governance and risk management practices. This includes challenges arising from the lack of local board autonomy, digital transformation, the green transition, and data aggregation.
- Continued engagement to ensure sufficient remediation actions to address gaps in meeting the ECB supervisory expectations on climate and environmental risks.
- Assessment of the adequacy and effectiveness of AML/CFT risk management frameworks.
- Assessment of the level of customer service provided by firms, including the complaints handling process across relevant channels.
- Financial resilience assessments, including the 2025 EU stress test, capital and liquidity management, and recovery planning.[47]
- Assessments of banks' ability to identify and manage new and emerging risks to the sustainability of their business models, incorporating consideration of consumers' interests, and where material, the inclusion in their risk management frameworks.
- Credit risk management and loan origination reviews, with an emphasis on vulnerable portfolios and long term mortgage arrears. Reviewing how firms are continuing to meet Central Bank expectations in resolving distressed debt. This will include how firms are meeting the Central Bank's expectations regarding the appropriate and sustainable nature of Alternative Repayment Arrangements (ARAs).[48]

[47] Including but not limited to as part of the supervisory review and evaluation process (SREP)
[48] See Thematic Review on Early Mortgage Arrears Dear CEO letter, April 2024

- Assessment of banks' proactivity in identifying and assessing transmission channels, cross-cutting risks, and cross sectoral interlinkages arising from macroeconomic and geopolitical risks.

- Implementation and development of incoming regulations and initiatives focused on improving operational resilience as well as customer functionality and safety in the payments space. These include DORA, the third proposed Payment Services Directive (PSD3) and Payment Services Regulation and Instant Payments.

Our supervisory activities are conducted as part of the ECB's Single Supervisory Mechanism.

PAYMENT AND E-MONEY SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Safeguarding of user funds	Weaknesses continue to be observed in safeguarding arrangements across the sector, which heightens the risk that users' funds are not appropriately identified, managed and protected on a day-to-day basis.	Ineffective control frameworks including in board oversight of safeguarding of user funds. Concentration risk in where safeguarded funds are held.
Culture, governance and risk management	Poor business practices and weak processes, in addition to a lack of an embedded consumer-focussed culture, giving rise to deficiencies in a firm's strategic and operational effectiveness leading to the risk of consumer detriment.	Growth outpacing operational, governance, compliance and risk management capabilities. Inadequate authority and independence at a local level in group situations.
Financial risks and resilience	Some firms are facing viability and funding availability challenges, due to firm-specific factors and the operating environment.	Macroeconomic conditions, including reducing interest rates, affecting revenue generation and cost base and tighter external funding market.
Financial crime	There is evidence that some firms' understanding of financial crime risk, including money laundering and terrorist financing risk, and the robustness of their controls, is not commensurate with the higher inherent risk exposure of this sector.	Lack of the necessary expertise, experience or focus. Ineffective risk-based financial crime frameworks.
Operational risks and resilience	The number of major incidents and service outages experienced across the sector are at an elevated level. Many are a result of outsourced service provider failure, coupled with weaknesses in monitoring and oversight. These factors result in increased risk of operational disruption and of harm to customers. A concentration of dependency across outsourced service providers has been observed.	Growth outpacing operational infrastructure and controls. Significant reliance on third party providers, including intra group, with weak controls and oversight arrangements.

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Payment and E-Money Sector

KEY TAKEAWAYS

- The sector provides a range of innovative and valued services to consumers in Ireland and across Europe, and continues to see strong growth and new players entering the market.
- To underpin that growth and innovation, it is critical that a firm's business ambitions do not outpace the strength of their governance, risk management and internal control arrangements. In particular, it is a fundamental responsibility of firms to safeguard the user funds that have been entrusted to them, both to protect their customers and to retain the public's trust in the sector.
- Given the nature, volume and international reach of the payment and e-money services being provided, the sector faces an inherently higher risk of being exploited for money laundering, terrorism financing and financial crime purposes. This requires firms to have strong systems and processes in place to manage these risks.
- The nature of the services provided by the sector is such that operational resilience is critical to ensure service reliability, availability, security and recoverability.

Sector profile

- Diverse range of business models providing services including merchant acquiring, money remittance, and e-money issuance. Firms operate in Ireland and across a range of other European countries.
- 56 authorised firms at end 2024 up from 51 at end 2023.
- Value of safeguarded funds stood at €10.2bn at end 2024 (up 26% on end 2023)
- Value of payment transactions in 2024 was €613bn (up 17% on 2023).
- Firms range from standalone businesses to complex group entities with large networks of branches, agents and distributors across Europe.

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- Services provided by the sector are increasingly serving as an alternative offering to those of traditional banks.

- The sector plays an increasingly important role in the European payments systems architecture, which will increase further through initiatives such as instant payments and open banking.

Assessment of sectoral trends and risks

Safeguarding users' funds

Funds held by firms in this sector are not covered by a deposit guarantee scheme, unlike deposits with Irish banks and credit unions. However, under the Payment Services Regulations (PSR) and the E-Money Regulations (EMR), such funds are required to be safeguarded.[49] This is of paramount importance in order to protect customers and to retain the public's trust in the services being provided.

While the Central Bank has identified some improvements in firms safeguarding frameworks and practices following supervisory interventions, deficiencies and breaches continue to be identified across the sector. Shortcomings primarily relate to governance and internal control gaps, including deficiencies in system configuration, account designation, and account reconciliation processes, as well as instances of co-mingling of funds. These are contributing to elevated risks that users' funds are not always being appropriately identified, measured, managed, monitored, reconciled and protected on an ongoing basis.

The sector as a whole needs to proactively enhance and embed its safeguarding arrangements and practices. This includes complying with PSR and EMR requirements, and the expectations the Central Bank has set out on a number of occasions. This includes that firms hold people's money securely, facilitate customers intended transactions securely and reliably, and have credible wind-up plans in place to fully return users' funds in an efficient and timely manner in an exit or wind up situation.

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[49] Safeguarding means that funds received and held by institutions for the provision of payment services and issuance of e-money should be protected in such a way that an insolvency of a payment or e-money institution would not result in losses for their customers. There must always be clear segregation, designation and reconciliation of any users' funds held.

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The Central Bank has no tolerance for weaknesses in safeguarding arrangements. It is a fundamental responsibility of firms to safeguard users' funds that have been entrusted to them when a customer avails of their services. (See Box 3.) Firms must hold these funds securely in segregated bank accounts established for the sole purpose of holding users' funds or have an insurance policy or comparable guarantee in place for an amount equal to the value of users' funds held. Our supervisory activities have highlighted that concentration risk is elevated, as safeguarded accounts are held by firms with a limited number of banks including, in some instances, with unrated banks.

Box 3: Safeguarding Enforcement Action

In November 2024, the Central Bank fined a regulated entity €324,240 for breaching safeguarding requirements of the PSR. The firm failed to deposit customer funds in a designated safeguarding account, co-mingled customer funds with other funds, and delayed informing the Central Bank once it became aware it was not following the safeguarding procedures set out in its application for authorisation.

Complying with such safeguarding requirements is fundamental for payment and e-money institutions. This case highlights that the Central Bank has no tolerance for weaknesses in safeguarding arrangements and furthermore highlights the necessity for firms to inform the Central Bank and take necessary remedial action if information provided at authorisation is no longer accurate.

Culture, governance and risk management practices

Across the sector, a culture is not yet evident whereby governance, risk management and compliance are given the focus they warrant, with an immature approach to regulatory compliance being seen in a number of firms. Supervisory activity has identified instances of firms' business ambitions outpacing their internal control arrangements, as well as their operational and financial capacity. We expect firms not only to be well run and properly resourced, but to have an organisational culture that seeks to do right by their customers. The absence of a culture that is appropriate to a regulated firm providing critical financial services, remains a root cause of many of the deficiencies we see in areas such as safeguarding as noted above, financial and operational resilience, and prevention of financial crime. Until this is addressed supervisory

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intervention and escalating supervisory measures, up to and including, enforcement action, will continue to be seen.

Firms in the sector generally operate as part of international financial or non-financial groups, and while this can be of great benefit to the entity based in Ireland, it does not reduce the obligations and responsibilities of the boards and key function holders in Ireland. We continue to see situations where the influence and role of the parent group is such that decision making is not properly exercised in Ireland and an insufficiently substantive local presence is maintained. This leads to some authorised firms having strategies that are not appropriate for the local entity, with the operational or financial capacity in place being insufficient to allow them to manage their business safely and sustainably, with customer interests secured.

Instances of firms not demonstrating a consumer-oriented culture continue to be observed, with insufficient focus on conduct and consumer protection risks at board level and the lack of a consumer-centric approach towards complaints handling and customer disclosure. The continued offering of both regulated and unregulated services by certain firms leads to a risk that consumers conflate these services and are unaware of the risks of unregulated services, for example, instances where payment or e-money institutions or their groups also provide crypto services.

Financial risks and resilience

The uncertain macroeconomic environment has continued to impact the sector. To date, the interest rate environment has had a positive impact on a number of firms who have benefitted from higher net interest income. Given reducing interest rates, interest income generation is likely to decrease, albeit above levels experienced when rates were very low to negative. Additionally, external funding conditions remain tight for some firms and indeed their parent entities, resulting in these firms being challenged by their ability to secure the external funding required to grow their business sustainably. Firms in this sector may also be particularly exposed to adverse geopolitical events.

The success of many firms in the sector continues to be inextricably linked to the successes of their parent group, often with a reliance and linkage from a funding, income and operational support perspective. The failure of a shared, intragroup technology platform,

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for example, will impact the firm's ability to maintain operational continuity, even if the firm has sufficient financial resources.

Financial crime

Given the high volume of transactions and international reach of the sector, and complex operating models, the sector has an inherently higher risk that it is used as a vehicle for money laundering, terrorist financing and financial crime. The Central Bank continues to identify shortcomings in the understanding of ML and TF and broader financial crime risk amongst firms, with controls not as robust as they should be and not commensurate with the level of risk exposure.

Similarly, anti-financial crime (AFC) controls are not as robust as they should be and not commensurate with the level of risk exposure. The Central Bank believes that some firms are failing to adequately focus on, and invest in, their risk mitigation and compliance capabilities. Their commitment and approach in these areas are not commensurate with the investment we see and priority given to growing and developing their technology. The AFC control weaknesses identified by the Central Bank are often symptomatic of the broader cultural, governance and risk management deficiencies within firms highlighted above.

Operational risks and resilience

The nature of the services provided by payment and e-money firms is such that operational resilience is critical in terms of ensuring service reliability, availability, security and recoverability. Technology is at the core of the operations of firms in the sector. Trust in payment service providers is based on the continuity and predictability of payment services provision.

Outsourcing of services to third parties, including intra-group providers, remains a key risk given the sector's reliance on such arrangements. We continue to identify deficiencies in the governance, management and oversight of outsourcing arrangements of firms, which evidence a lack of ownership at a local entity level and an absence of rigorous contingency and exit planning. Firms in the sector are still at a relatively early stage in their journey towards being operationally resilient.

We have also observed increased incidents of outages across multiple firms in the sector and regulated financial service

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providers operating in other sectors. This is the result of over-reliance on a limited number of outsource service providers, indicating elevated concentration risks across the European financial sector as a whole. We also note that risks to international communications infrastructure and the cyber threat landscape is escalating, with an increased risk of state-sponsored cyberattacks.

Key supervisory activities 2025/26

- Continuing supervisory focus on safeguarding, with the completion of a sectoral thematic inspection on safeguarding arrangements, review of board attestations on safeguarded funds and completion of 2023 audit remediation actions and industry communications on sectoral findings.
- Focus on board and executive accountability that ensures that firms:
  - Have a well thought through strategy and business plan.
  - Demonstrate they have appropriate governance, risk management and internal controls, as well as the operational and financial capacity to deliver their strategy.
  - Have a continued focus on financial and operational resilience.
- Focus on the implementation and development of incoming regulations and initiatives. These include DORA, the third proposed Payment Services Directive (PSD3) and Payment Services Regulation and Instant Payments.
- Continue to proactively engage with firms in the sector to assess the adequacy and effectiveness of their AML/CFT risk management frameworks, through supervisory engagements.
- Supervisory intervention where elevated risks or breaches of regulatory requirements are identified, including financial crime risk, using our full suite of supervisory powers where required.

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CREDIT UNION SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Business model and strategic risks	The sector is at risk of not keeping pace with digitalisation and members' needs and expectations, nor taking advantage of the opportunities provided through legislative and regulatory changes. Longer term sustainability challenges remain, in particular continuing low loan to asset ratios.	Digitalisation and entry to the market of alternative providers of banking-type services. New credit union legislation and regulations. Member demand for products. →
Financial risks and resilience	While credit unions maintain strong reserves, falling interest rates and adverse developments in the macro environment could adversely impact on surpluses, and credit, market and liquidity risks, which in turn could weaken financial resilience.	Geopolitical and macroeconomic conditions. →
Culture, governance and risk management	Weaknesses in some credit unions' board oversight, their consideration of the impact of risks, and deficiencies in the effectiveness of risk management frameworks and practices, could threaten their members' interests if risks were to crystallise.	Board and management maturity and effectiveness. →
Operational risks and resilience including cyber-related	Operational risk arises from the sector's dependence on a limited number of critical third party outsourced service providers, particularly for, but not limited to, technology and payment services. There has been an upward trend in reported IT and cybersecurity incidents.	Reliance on a limited number of third party service providers. Credit unions are exempt from DORA until 2028. ↗
Climate change and other environmental-related risks	Credit unions are still at an early stage of understanding how climate related physical and transition risks impact on the sector overall and their credit union specifically and the required plans/ risk mitigants.	Physical risks and transition risks associated with climate change. A lack of data reporting, disclosure and assessment standards. →

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Credit Union Sector

KEY TAKEAWAYS

- The credit union sector continued to grow during 2024 with total assets of €21.7bn, with strong reserves maintained and positive growth trends in lending. Credit unions are highly trusted, with community and/or industrial based common bonds providing a range of savings and lending products/services to their members.
- There is growing concentration in the use of third parties for outsourcing, which increases operational risk.
- Expanded digital offerings and the increased uptake by members, while a positive development, require increased focus on strengthening operational resilience and disruption preparedness.
- While there are some signs of progress in collaboration between credit unions, for example in the payments area, this has yet to focus on strategic transformation for the sector.

Sector profile

- 181 active credit unions in Ireland, a decrease of over 80 from seven years ago. Key metrics (end 2024):
  - 3.7m members (2023: 3.6m)
  - €18.1bn savings (2023: €17.5bn)
  - €7.1bn gross loans (2023: €6.4bn)
  - €13.7bn investments (2023: €13.7bn)
- Significant changes have taken place in the sector, supported by an updated legislative and regulatory framework, with continuing sector consolidation. A wider range of products and services are now available to members, including digital services.

Assessment of sectoral trends and risks

Adapting to the changing market

The structural changes in the broader financial services landscape, including new providers introducing new services and others

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withdrawing from the market, present both opportunities and challenges for credit unions. Credit unions have the regulatory scope to provide a broad range of products and services to meet their members' needs, including current accounts, and home and business loans.

2024 saw the commencement of certain provisions of the Credit Union (Amendment) Act 2023, which introduced a number of changes to the Credit Union Act, 1997. These changes included provision for credit unions to participate in new business activities, such as the referral of a member to another credit union for the provision of a service, and the ability to undertake loan participation and syndication. However, with some exceptions, credit unions have yet to show the necessary focus on a strategic transition, aligned with risk appetite. This could inhibit their ability to provide a range of products and services to credit union members into the future.

Financial risks and resilience

Despite some positive trends being seen in the reported 2024 financial data, including overall capital levels maintaining a buffer over minimum requirements, strategic challenges remain due to a number of structural issues. These include a continued lending and savings imbalance. The consequence of this imbalance is that outstanding loans still account for a low percentage of total assets, increasing modestly from 31% to 33% between December 2023 and December 2024. The low level of loans reduces interest income earnings potential. This, together with low returns on investments over recent years, resulted in credit unions' total return on assets (RoA) averaging c. 0.6% p.a. over the last five years. The move to a higher interest rate environment since 2023 has presented some opportunities to increase these returns. The average RoA for 2024 rose to c. 1.0%, albeit interest rates more recently have been reducing.

Credit unions have a large proportion of total assets in investments, the majority of which is invested in deposits with authorised credit institutions. There are some large and concentrated exposures at individual credit unions and across the sector to certain investment counterparties. While these exposures are subject to overall regulatory counterparty limits, there is a risk of broad sectoral impacts if one or more of these counterparties were to experience material financial difficulties. This reinforces the need for credit unions to maintain prudent capital reserves including buffers. In the

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event of a widely-used investment counterparty failure, there could potentially be a significant impact on the reserve base of those individual credit unions holding investments with such a counterparty.

Proactive asset-liability management plays a crucial role in the safe management of credit unions as with other credit institutions. Credit unions need to be cognisant of – and manage - the maturity and liquidity profile of the assets they hold relative to the short term nature of their member savings liabilities. Such asset and liability management should seek to mitigate interest rate risks and ensure that sufficient liquid assets are available to meet anticipated liquidity requirements, including in stress situations.

Risk management effectiveness

The Central Bank continues to have concerns about governance effectiveness in some credit unions and that risk management practices are not fully embedded. Boards and management have responsibilities for establishing and ensuring good governance and an effective internal control framework to evaluate whether risks are being properly identified, assessed and controlled. Credit unions are expected to continue to enhance their risk management as they expand their product and service offerings and to embed a strong risk management culture throughout their entire organisation. Expansion into new areas of activity needs to be done carefully, having regard to underlying risks to minimise the potential for adverse outcomes for members.

The requirements of the Individual Accountability Framework (IAF) will assist in the strengthening of governance effectiveness. The IAF seeks to underpin sound governance across the financial sector by setting out clearly what is expected of well-run firms. The Minimum Competency Code has been extended to bring credit unions within scope and should build on the existing knowledge and expertise available across the credit unions sector.

The current inherent risk of money laundering and terrorist financing in the sector remains at a medium-low level. However, as credit unions expand their product and service offerings, this may expose them to an increase in ML, TF and financial crime risk. Credit unions need to enhance their capacity to assess and mitigate the additional risks that may arise from business development initiatives.

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Operational risks and resilience

Credit unions' operational resilience and disruption preparedness requires further attention taking into account the impact of digitalisation of products and services. Credit unions have continued to become ever more reliant on third-party outsourcing for IT systems and other services, which in some cases is limited to a relatively small number of third-party service providers. This increases outsourcing concentration risk for the sector and, along with expanding branch networks for some credit unions, is increasing the operational risk profile of many credit unions. The overall control frameworks of credit unions need to fully identify, address, mitigate and monitor information and communications technology outsourcing and cybersecurity risks.

Climate change and sustainability

Credit union boards and management teams have begun to consider their potential climate-related risks exposures, taking into account their business model and specific member base. However, credit unions will need to take further actions to integrate climate and environmental-related risks into their business strategy, governance and risk management frameworks. Credit unions are expected to have realistic plans in place to address the risks they face, with appropriate board and management ownership and accountability to drive the monitoring, measurement and management of those risks. This includes the physical and transition risks associated with climate change.

Key supervisory activities 2025/26

- Proactively engaging with credit unions considering voluntary restructuring through transfers of engagement.

- Continuing the sectoral supervisory focus on financial and operational resilience. Concluding the thematic review of IT risk and the engagement with credit unions and other sector stakeholders on required actions to mitigate risk.

- Evolving the regulatory framework in a tailored, proportionate and prudentially responsible manner to support and enable the commencement of remaining provisions of the Credit Union (Amendment) Act 2023.

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- Updating the Prudential Return for credit unions to support the increasingly data-driven approach to supervision.

- Publishing a Feedback Statement on the proposed changes to credit union lending regulations following Consultation Paper 159. Amending regulations are planned to take effect in Q3 2025.

- Considering the full application of the revised Consumer Protection Code to credit unions to ensure that their members are afforded the same protections as other consumers of financial services, particularly as the range of products and services offered increase.

- Commencing the implementation of recommendations included in the Peer Review Report by the International Credit Union Regulators' Network into the Central Bank's performance of its regulatory functions in relation to credit unions published in 2023.[50]

[50] See International Credit Union Regulators' Network, Peer Review Report: Central Bank of Ireland's Performance of its Regulatory Functions in Relation to Credit Unions, November 2023

RETAIL CREDIT SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Culture, governance and risk management	There is a heightened risk that firms' culture and incentives lead to an inadequate focus on the interests of consumers.	Organisational culture, collective and individual behaviours, incentives and board effectiveness.
Operational risks and resilience	Systematic and individual errors that are occurring in day-to-day operations, are leading to an increased risk of customer detriment, which is linked to cultural issues at firms. The increasing complexity of operating models, with greater reliance on third parties and intra-group service providers, is increasing operational risk. This could be due to deficiencies in operational resilience frameworks covering IT outsourcing and IT security and cyber risks.	Skills and experience gaps. Constraints, deficiencies and vulnerabilities of IT systems and controls, including legacy systems. Growing complexity, concentration and interconnectedness amongst firms within the sector.
Borrowers in arrears or risk of arrears	The risk of ineffective engagement between the lender and the borrower in relation to financial distress from: • Firms failing to engage effectively with customers (including SMEs) at risk of arrears/in arrears, or • Borrowers failing to engage effectively with the firm in relation to their financial situation.	Lack of consideration of end-to-end customer journeys. Operational constraints within firms limiting their capacity to engage with borrowers, or affected borrowers themselves being reluctant to engage.
Over-indebtedness	For short-term credit, for example Buy Now Pay Later arrangements, there is a particular risk of over-indebtedness and poor consumer understanding of risk. Multiple small borrowed amounts can build up to an unaffordable larger debt.	Easier access to short term credit. Ineffective disclosure of loan terms and costs, with limitations in some borrowers' understanding of credit. Macroeconomic conditions and the potential for deterioration.

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Retail Credit Sector

KEY TAKEAWAYS

- As the sector continues to evolve through the provision of new product offerings and outsourcing activities on behalf of the wider banking system, firms' strategic objectives need to be underpinned by governance and risk management frameworks which ensure that customer interests are placed at the heart of decision making.
- Consideration of the end-to-end customer journey - from product inception to product maturity - needs to be embedded as part of the risk management and customer service framework to drive a more consumer-focused culture and improve the overall customer experience.
- The identification, mitigation and monitoring of IT outsourcing and cybersecurity issues and risks as part of firms' risk control frameworks are imperative to ensure the effective functioning and integrity of the wider banking system given their role in managing large portfolios of distressed debt.

Sector profile

- Diverse business models ranging from non-lending firms managing large portfolios of distressed loans sold by the domestic retail banks to non-bank entities, handling restructuring, collections and enforcement actions to lending firms offering mortgages, personal loans, including Buy Now Pay Later and Personal Contract Plans, and small and medium enterprise loans.
- Total assets under management of c€49bn at end June 2024 (up c€300mn from end 2023).
- 56 authorised firms at end 2024, down from 62 at end 2023.
- Non-lending firms and lending firms each have c300,000 accounts across all customers. Retail credit firms have c470,000 customers and credit servicing firms, c140,000.
- A small number of credit servicers are authorised and prudentially supervised in other EEA member states, operating in Ireland on a freedom of services basis. They are regulated by the Central Bank for conduct of business rules.

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Assessment of sectoral trends and risks

Leadership, culture and governance

While some firms are governed effectively and endeavour to take account of consumer interests in their decision making, deficiencies are still identified across the sector. Most recently, for example, as part of the thematic reviews on early mortgage arrears[51] and credit card lending,[52] we have seen evidence of positive customer practices and decision making. However, sustained improvements are needed to ensure that the sector as a whole is effectively governed and puts the interests of their consumers at the heart of all their decision making. While every employee within a firm has a role to play to protect consumers, it is the responsibility of those individuals holding senior positions to continuously drive and support positive consumer-focused experiences and outcomes in all cases.

While being part of larger group entities can bring about a number of synergies for firms, there is evidence of over-reliance on group structures and decision making powers. From a strategic point of view in particular, it is not always clear how the group strategy translates to the Irish entity and if effective local governance and risk management frameworks are in place to deliver on the strategy. While the changing operating environment continues to be a challenge for firms, boards are ultimately responsible for implementing adequate governance arrangements. Appropriate cultures are needed which ensure effective risk management and control arrangements are in place to deliver on the agreed strategy and to address emerging risks. Boards are expected to ensure they have a substantive presence in Ireland and executives must take greater responsibility for the strategy, governance and risk management of their firms.

Operational risks and resilience

Retail credit and credit servicing firms operate in an increasingly complex and interconnected environment, facilitating the provision of services across the wider credit sector, including to banks and credit unions. The adequacy of firms' investment in their technology platforms - and their deployment of enhancements - has consequences for firms' operational resilience and the quality of their

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[51] See Thematic Review on Early Mortgage Arrears Dear CEO letter, April 2024
[52] See Thematic Review on Customer Supports for Credit Card Lending Dear CEO Letter, December 2024

dealings with their customers. In many cases, firms rely on outsourced service providers to support their operations. Poor oversight and governance of these outsourced arrangements by some firms has led to risks to consumers. This has resulted in, for example, errors being made by firms. Firms' overall control frameworks need to be able to fully identify, address, mitigate and monitor IT outsourcing, operational and cybersecurity issues and risks.

There is a risk of customer harm as a result of systematic and individual errors arising because of increased pressure on existing systems, resources and processes. As business models have diversified, this has created complexities in the management of critical business processes and systems. A lack of system automation and manual intervention has become a common feature of firms' operations which has increased the likelihood of a material error, breach or operational incident occurring.

Engagement with borrowers in or at risk of arrears

Approximately 23% of the borrowers whose loans are serviced by credit servicing firms are in various stages of default, which compares to 3% across the Irish domestic retail banks.[53] It is, therefore, important that firms adopt a consumer focused approach that will deliver positive outcomes for borrowers in vulnerable circumstances, with sufficient customer service capacity and standards to manage such cases in a timely and responsible way. Evidence of poor customer service identified in supervisory thematic reviews conducted last year indicated that some firms in the sector need to strengthen their governance, and improve their operational capacity and the accuracy of their work to be able to appropriately respond to borrowers in, or at risk of, arrears.

A poor understanding of the full borrower journey exacerbates the risk that firms do not engage effectively with customers in, or facing, arrears. While significant progress has been made by firms in the sector to reduce long term mortgage arrears, a lack of understanding of the full customer journey can result in errors, misinformed decision making and poor customer service. Firms are, therefore, reminded of the importance of meeting the Central Bank's expectations in respect of sales, securitisations, purchases and transfers of residential mortgage loans set out in 2019.[54] Of

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[53] See Central Bank of Ireland Mortgage Arrears statistics
[54] See the Director of Consumer Protection's letter to chairpersons, August 2019.

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particular importance is the administration of the mortgage in line with the terms and conditions and any specific commitments made to consumers, to avoid any potential customer detriment.

The Central Bank will continue to engage with firms on risks to consumers as a result of a changing economic environment. The emphasis is on regulated firms supporting consumers in their navigation of an economic environment that is still challenging for many. Our expectations were set out in 2022's Dear CEO letter regarding protecting consumers in a changing economic landscape.[55] This includes sufficient planning, resourcing and training by firms to ensure there is capacity to deal with consumers' needs in a timely and appropriate manner and that products and service offerings continue to be fit for purpose. In the area of credit, in particular, proactive support to borrowers in or facing arrears is called for.

Risk of customer over-indebtedness

A number of firms in the sector provide Buy Now Pay Later (BNPL) arrangements and Personal Contract Plans (PCPs) which were brought into the regulatory perimeter in 2023. While these convenient and flexible payment options appeal to many consumers, they carry risks that can lead to financial difficulty if not managed responsibly. Over-indebtedness can arise where there are ineffective disclosures as part of the customer journey and a poor understanding by consumers of the debt they are taking on. Fees and charges are applicable, including obligations and additional fees if payments are missed, which can lead to financial difficulty. Product information should be easy to understand and in plain language. It should explain the product clearly, both in terms of its benefits and costs. Failure to highlight key information succinctly and in a way that informs the customer effectively, can lead to poor consumer outcomes.

Key supervisory activities 2025/26

- Continuing the sectoral supervision focus on:
  - Firms' operational capacity as part of loan sales/transfers
  - How boards are ensuring they are meeting the expectations set out in the Central Bank's November 2022 Dear CEO letter

[55] See Central Bank of Ireland, Protecting consumers in a Changing Economic Landscape Dear CEO Letter, November 2022

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and April 2023 publication Protecting consumers in a changing economic landscape[56]

- o Engagement with in scope firms of both the thematic review on early arrears and credit cards

- Reviewing how some firms are continuing to meet Central Bank expectations in resolving distressed debt, and the appropriate and sustainable nature of Alternative Repayment Arrangements (ARAs).[57]

- Reviewing some firms' overall operational resilience.

- Commencing a targeted review of some firms' governance structures with a focus on boards' strategic oversight, independence and accountability.

- Enhancing regulatory returns to support the increasingly data-driven approach to supervision.

[56] See Central Bank of Ireland Publication, Protecting consumers in a changing economic landscape, April 2023
[57] See Thematic Review on Early Mortgage Arrears Dear CEO letter, April 2024

HIGH COST CREDIT PROVIDER SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Excessive lending	Consumers may be granted excessive credit due to the lending practices of some firms, which may not be in customers' best interests. Examples of such practices include: • Creditworthiness assessments that are not sufficiently robust to assess the suitability or affordability of loans, and • Remuneration models for collection agents that are linked to consumers' weekly repayments, which in turn could drive agents to issue loans that are not suitable in order to increase weekly collections. This risk is particularly relevant in the cash loans segment of the market.	Inadequate creditworthiness assessments. Inappropriate remuneration incentives linked to the agency distribution model.
Short term credit used to meet long term needs	The use of short term loans on a continuous basis to meet customers' longer term credit needs increases the risk that consumers fall into a cycle of high cost debt. This risk of consumer harm exists even when credit is being provided responsibly by a firm. This is because, in some cases, while the consumer can afford the repayments, better alternatives may be available.	Cost of living pressures in the current economic environment. Borrower habit and familiarity leading to alternative types of credit arrangements not being sought.
Structural changes in the sector	Changes in the regulatory framework covering the provision of high cost credit introduced in 2022 (which included a cap on the interest rate that can be charged) sought to protect consumers by limiting the interest they will pay. The introduction of the cap has impacted the viability of some business models. Market exits mean that consumers have less choice of regulated credit providers and potentially expose consumers in vulnerable circumstances to illegal moneylenders or to falling prey to online scam websites when seeking a new lender.	Legislative changes. The activities of illegal moneylenders and scam websites. Macroeconomic conditions.

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High Cost Credit Provider Sector

KEY TAKEAWAYS

- High cost credit providers (HCCPs) play an important role in society providing certain benefits for customers who may have limited access to mainstream financial services, offering an alternative to illegal lenders.
- However, firms must balance this role by lending responsibly. The use of short-term credit on a continuous basis poses the risk of consumers falling into a debt cycle.
- Interest rate caps apply under the terms of the Consumer Credit (Amendment) Act 2022. Their aim is to protect borrowers from excessive borrowing costs. The Central Bank will provide a report on the impact of the caps on the sector to the Minister for Finance in 2025. Consumers may have less access to regulated products if the high cost credit sector is rendered non-viable.

Sector profile

- The products offered in the high cost credit sector include cash loans, premium finance and credit for goods from online retailers.
- Approximately 280,000 consumers had loans outstanding amounting to €108m at end 2023. Premium finance and online retailers made up just under 90% of the total.
- The number of providers continues to decline, with 28 firms authorised at end 2024 compared to 38 five years earlier.
- An interest rate cap was introduced by the Irish government in the Consumer Credit (Amendment) Act 2022 with the objective of protecting consumers from excessive borrowing costs. A cap of 1% per week up to a maximum of 48% applies on fixed rate loans. The cap is 2.83% nominal interest on the outstanding balance per month on running accounts.

Assessment of sectoral trends and risks

Responsible lending

HCCPs play an important role in providing credit to consumers who may have limited alternatives. Some of the borrowers may be in vulnerable circumstances when availing of the credit, and they may

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not use – or may not have access to - other regulated credit products. As such, lending of this type comes with a duty to lend responsibly.

Consumers may be granted excessive credit due to the lending practices of some firms. This may not be in the consumers' best interests and could pose a risk of harm. This risk is particularly relevant in the cash loans segment of the sector. Drivers of this risk include inadequate creditworthiness assessments that are not sufficiently robust to assess the suitability and affordability of loans and inappropriate remuneration incentives linked to agency models employed by firms, whereby agents' income is directly linked to amounts lent or collected.

The use of short term loans on a continuous basis to meet longer term credit needs poses the risk of consumers falling into a cycle of high cost debt. This risk remains even when credit is being provided responsibly by a firm because, in many cases, the consumer can afford the repayments. However, cheaper alternatives may be available. Cost of living pressures in the current macroeconomic environment accentuates this risk.

The financial viability of firms

There is a risk to consumers from further firms withdrawing from the market, particularly in the cash loan segment. While the introduction of an interest rate cap gives extra protection to consumers by reducing the total cost of credit they will pay, firms' margins are squeezed by a combination of the cap and other increased operating costs. As a result, some HCCPs may not be viable in the medium term. Further, there has been no new cash loan entrants to the market in recent years.

As a result of these dynamics, consumers that tend to utilise these firms may have less access to credit from regulated credit providers. This, in turn, could lead to unintended consequences, such as having to resort to illegal moneylenders or falling prey to online fraudulent websites when seeking a new lender.

Key supervisory activities 2025/26

- Continuing to engage with industry following the onsite inspections undertaken in 2024 which focused on the adequacy of firms' complaints handling procedures.

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- Reviewing the impact of the interest rate cap and providing a report to the Minister for Finance.

- Using enhanced supervisory data to monitor the sector, in particular the outcome of the onsite inspections in 2024 which focused on ensuring that firms have policies and procedures in place to encourage responsible lending, robust affordability assessments take place and records are maintained.

Insurers & Reinsurers

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INSURANCE AND REINSURANCE SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6	
Financial risks and resilience	The sector has proved resilient through recent crises, with solvency coverage remaining well above minimum requirements. Solvency and liquidity risks are driven by factors including the adequacy of pricing and reserving assumptions, investment allocations, asset-liability matching and liquidity management. Changes in the economic and geopolitical environment also impact the sector. In group situations which dominate the sector, parental support may not always be available in times of stress.	Macroeconomic and financial market uncertainty and volatility. Pricing, reserving and capital adequacy, and ALM effectiveness.	→
Culture, governance and risk management	Risks of poor or unfair outcomes for consumers arise where their best interests are not central to decision making throughout the product lifecycle, or where product benefits, costs, risks and suitability are not be fully explained and understood.	Lack of consumer orientation in governance, strategy and decision making.	→
Business model and strategic risks	Risks to entity safety and soundness or consumer interests can arise if rapid growth and expansion into new product areas or geographies is not underpinned by strong technical, operational and risk management capabilities. In group situations, there is a need for an adequate substantive local presence and board oversight.	Governance, risk management and change management effectiveness.	↗
Operational risks and resilience	Risks to operational continuity can arise from multiple sources, including factors such as cyber threats or the interruption of services provided by an outsourced service provider, including data and technology related. Some operational activities may rely on legacy systems or semi-automated processes. Risks are being exacerbated as operating models and processes get more complex involving multiple parties, particularly if oversight and controls are not adequate.	Ineffective controls, board and operational oversight and risk management practices. Legacy IT constraints in some firms and prevalence of semi-automated processes.	→
Climate change and other environmental risks	(Re)insurers have direct exposure to the physical, transition and litigation risks associated with climate change, varying according to the types of risk they cover and geographical footprint. Changes in reinsurance capacity, terms and pricing affect the terms primary insurers can offer.	The increasing frequency and severity of extreme weather events, and transition to net zero. The increasing prevalence of environmental-driven litigation.	↗

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Insurance and Reinsurance Sector

KEY TAKEAWAYS

- The (re)insurance sector has proved to be financially resilient in the face of the various crises and headwinds of recent years.
- Pricing and underwriting discipline, reserving and capital adequacy, effective model risk management, and operational resilience are fundamental to the sector's continued resilience and the formation of fair and reasonable prices for consumers.
- Firms need to effectively navigate the multi-dimensional and highly connected operational and financial risks arising from the increasingly volatile and unpredictable geopolitical environment, economic uncertainty and more complex business structures.
- Firms need to effectively incorporate the interests of consumers into their strategy, business model and decision-making process, reflecting their overall obligation to act in the best interests of their customers.

Sector profile

- Ireland is the home to the fourth-largest life and non-life insurance industry in the EU measured by gross written premium.[58]
- Insurers serve in excess of 20m customers. Domestically, there are c2.5m private car insurance policies, c2.7m life insurance and pension policies and c2.5m people with health insurance cover.
- 182 firms, including life insurers which are predominantly focused on unit linked investment and pensions saving products, and protection, with non-life insurers and reinsurers offering cover ranging from personal motor, household and health insurance to specialty lines of business such as cyber and marine.
- The majority are subsidiaries of large international groups, including captives which provide non-life insurance solely to the group to which they belong.

[58] See EIOPA European Insurance Overview 2024

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- Very internationally oriented, with approximately 70% of the €105bn received in gross premiums in the 12 months to end September 2024 coming from over 70 countries.

Assessment of sectoral trends and risks

Financial risks and resilience

The aggregate solvency position of the Irish insurance sector has remained stable despite the headwinds experienced in recent years. More than 99% of the sector's liabilities are held by firms with solvency coverage ratios above 130%.[59]

With more than half of (re)insurers' non-linked assets in bonds and market pricing of credit risk appearing to be compressed, the sector is exposed to a widening of corporate and sovereign credit spreads. However, the relatively strong credit quality of Irish (re)insurers' holdings would contribute to resilience against a credit spread shock. Direct exposure to private debt and equity type investments is limited among Irish firms, while property exposures continue to be small.[60] A small number of domestic life insurers continue to apply deferral periods on withdrawals from unit-linked property funds,[61] though the liquidity positions of these funds has been improving.

Inflation risk remains a continuing challenge for (re)insurers and consumers may unwittingly be underinsuring. Although levels of inflation globally have been on a downward path many insurance claims costs are influenced by specific price factors which can be volatile and poorly correlated with general inflation. This includes the cost of parts and labour for motor and property damage repairs[62], medical cost inflation, and the cost of settling personal injury claims. In turn, consumers who are not regularly reviewing their sums insured, for example on home or life insurance policies, may find that

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[59] Solvency coverage is measured as each firm's available capital (known as "own funds" under Solvency II) as a percentage of its Solvency Capital Requirement.
[60] Property related investments include: directly owned property; investments in real estate funds; equity of real estate related corporations; mortgages; real estate based collateralised securities; and, structured notes on real estate risk
[61] As at 2024Q2 the value of direct investments in Irish property by unit-linked funds was approximately €2.3bn. This represents just 9% of the total value of Irish property held by Irish investment funds at 2023Q4.
[62] The latest National Claims Information Database report for private motor insurance noted claim costs had increased 5% in 2023. See Central Bank of Ireland Private Motor Insurance Report, October 2024

inflation has eroded the real value of the level of protection they have so that it no longer is sufficient for their needs.

The rapidly evolving geopolitical environment is a key driver of several risks that particularly impact non-life (re)insurers with an international footprint and writing specialty lines of business. Alongside the crystallisation and elevated level of economic, financial market and operational risks that are faced by all firms in all sectors, Russia's war in Ukraine demonstrated how conflict can give rise to idiosyncratic risks for some (re)insurers due to their particular mix of business and territories. These could be, for example, creditor, aviation, marine and cyber-related. The ongoing legal disputes between certain aircraft leasing companies and their insurers in respect of aircraft stranded in Russia are high profile examples of claims cost uncertainties.

The insurance fundamentals of pricing and underwriting discipline and reserving and capital adequacy, underpin the resilience of (re)insurers, plus the formation of fair and reasonable prices for consumers. Sustaining a disciplined approach through the insurance cycle[63] - and in the face of increasingly erratic climate-related and geopolitical-driven losses – is necessary to deliver long term sustainability. Reliable input data and effective model risk management are the foundations upon which sound insurance practices have always been built. The increasing deployment of AI tools – which is being seen particularly in the non-life sector - may serve to exacerbate risks in these areas, for example, as a result of data and algorithmic bias or lack of model transparency. As noted in *Spotlight 2*, without strong control frameworks around data governance and AI usage itself, flawed output and decision making can result.

Governance oversight

Irish (re)insurers typically form part of larger international groups which can be advantageous, but requires effective local governance and risk management oversight. Whilst intra group relationships can offer significant operational synergies and capital support to Irish firms to fund growth or in adverse situations, this should be

[63] Insurance underwriting cycles have historically been divided into "hard market" periods, in which insurance rates are at levels that correspond to a return on capital that equals or exceeds the cost of capital, and "soft market" periods, in which underwriting returns are low or even negative

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complemented by robust local governance oversight and substantive local presence so control is effectively driven from the Irish firm.

Culture and trust in the sector

Households in Ireland and across the world are facing a growing array of risks that could jeopardise their property, their income in retirement, and their wealth and health, with businesses being equally exposed. Insurers, given their deep risk expertise and as providers of a range of retail investment and pensions products, are uniquely placed to help society address these daunting and complex challenges. However, the industry as a whole needs to continue to work to enhance levels of trust with the public[64] and invest further in innovation. This includes, for example, the pace at which digitalisation and technology are being exploited to keep insurance products and services relevant to the changing needs of consumers and to meet their rising expectations. A failure to build trust and invest further in innovation may hamper the societal contribution insurers can, and aspire to, make and their longer term profitability, with "Big Tech" companies and other new players seeking to disrupt the market.

Clarity, certainty of coverage and fairness are critical features of a stable and trusted insurance sector and in insurers' own commercial long term interests. Insurance operates on a promise. Risks to consumers can crystallise if their best interests are not central considerations through the life and non-life product lifecycle. Recent years have seen many instances where regulators in Ireland and overseas have had to step in to achieve the fair treatment of customers. In the domestic non-life sector the new National Claims Insurance Database (NCID) report produced by the Central Bank is contributing to an overall improvement in the transparency of the sector. The NCID provides analysis of the cost of claims, the cost of premiums, how claims are settled, how settlement costs vary

[64] The Central Bank of Ireland's Consumer Research Report, March 2024, undertaken as part of the review of the Consumer Protection Code included the results of a survey which sought to identify consumers' views on trust in the overall financial system and in specific sectors in Ireland. Respondents were asked to evaluate their level of trust in the financial system, banking, insurance, payment services, credit unions, other financial service providers and trust in the Central Bank on a scale of 1 to 10, where 1 meant "I do not trust them at all" and 10 meant "I trust them completely". 50% of respondents gave a score of between 7 and 10 in respect of the financial sector as a whole, while for the insurance sector in general the proportion was 42%. Credit unions' proportion was 78%.

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depending on how claims are settled, and an analysis of the various types of cost that make up settlements.

Business model and strategy

Ambitious strategic plans that are delivering rapid growth or introducing material additional complexity need to be underpinned with strong governance, sufficient resources and technical expertise. In the past, the Central Bank has seen situations where significant changes in product offerings and geographical footprints, or the implementation of more complex organisational models or financial constructs, were not supported by sufficiently strong governance arrangements. One growth area at present is specialty lines of non-life business. These depend heavily on specialist underwriting and pricing expertise that may not be readily available, and may be subject to greater claims and reserve volatility and uncertainty than firms have historically encountered. In particular, we have noted how concentrations of cyber insurance, where relevant experience data and expertise is scarce, must be carefully managed within a firm's overall risk appetite.

Operational risks and cyber threats

Operational risks remain at a heightened level, with vulnerabilities arising from the broadening use of outsourcing and other partnerships, the continuing impact of legacy systems, ever-growing and increasingly sophisticated cyber threats, and skill gaps. The implementation of DORA brings together provisions addressing digital operational risk in a single legislative act and provides an opportunity for firms to enhance the management of their operational risk. Recruitment and retention of skilled staff across business areas, including technical areas such as risk management and compliance, IT and cyber security, and customer service and claims, present challenges for some firms. Where there is a lack of consumer focus and insufficient experienced staff, poor outcomes for consumers can result, which in some firms is manifesting itself in very poor service quality and rising complaints.

In supervisory engagements with the sector, cyber security emerges as a paramount challenge. The digital transformation opens up new avenues for cyber threats, demanding robust defence mechanisms to ensure data security and customer trust. Data and privacy management emerges as another significant hurdle. As the digital landscape expands, effective management of data and

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adherence to privacy regulations become imperative to protect consumer information and maintain regulatory compliance.

Life assurance products can be used as a vehicle for money laundering/terrorist financing. It is important that firms mitigate the risks of money laundering/terrorist financing through appropriate systems and controls which are informed by business-wide and customer ML/TF risk assessments.

Climate change and other environmental risks

Insurers and reinsurers may be exposed to climate change through both the increased frequency and severity of weather related events, nature-related risks and the instability which may arise from a "disorderly" transition to net zero. These risks have long-term implications for the sector, and in many instances these have not yet been fully integrated into strategy and risk management frameworks. Greater urgency is needed across the financial system, and related regulatory and policy developments will focus on nature related risks, greenwashing and the credibility of sustainability claims.

Key supervisory activities 2025/26

- Supporting EIOPA's 2025 Union-wide strategic supervisory priorities, we will be completing work in relation to risk transfers and value for money, and reviews of pricing discipline, adequacy of reserves and capital.

- Sectoral supervision focusing on the monitoring of the potential impacts of changes in financial markets and macroeconomic environment on the insurance sector and its consumers. Additional specific engagement will vary by insurance sector:

    - For firms with business models and strategies exhibiting significant growth or high degrees of complexity this will mean focusing on the governance and practices in place to undertake this business.

    - For life firms' capital optimisation strategies, this will mean focusing on future needs, risks and recovery options.

    - Broader work will look at manual processes in life reserving and pricing in the domestic non-life sector, and disclosure of commission arrangements with intermediaries.

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- Assessing firms' reliance on parent groups for services and capital support.
- Assessing the level of customer service provided by firms, including the complaints handling process across relevant channels.
- Assessing the embedding of DORA requirements and adherence to the Central Bank's Cross Industry Guidance on Operational Resilience.
- Monitoring firms' climate risk exposures and integration within governance and risk management frameworks.
- Reviewing the use of AI in pricing and underwriting processes.
- Solvency II review: Industry participants will be asked to engage on an assessment of the expected impacts in terms of quantitative elements (e.g. solvency coverage) and also qualitative elements (e.g. take-up of proportionality measures).

Capital Markets & Funds

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FUNDS SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Liquidity and leverage risks	Leverage and liquidity are "evergreen" sectoral risks which require on-going monitoring and mitigation. Liquidity issues can restrict a fund's ability to meet redemption requests upon demand. Instances in which leverage and liquidity issues arise together require particular focus, e.g. high levels of leverage in some fund cohorts can amplify liquidity issues within such funds.	Deficiencies in fund and Fund Service Provider (FSP) liquidity risk management frameworks. Funds with less liquid assets. Highly leveraged funds. Interconnectedness between the non-banking financial institutions (NBFI) and traditional financial sectors.
Asset valuation and market risks	The response of the financial system to the external environment and moves towards more private assets increase valuation risks in the sector, with harder to value asset types or those with greater inherent market risk are increasingly proposed within fund structures.	Volatile geopolitical environment and changing investor preferences. Asset valuation challenges at asset class level.
Operational risks and resilience	The increase in digitalisation of fund operations, as well as the interconnectedness of the funds industry, exacerbates the potential impact of a successful cyberattack and operational disruptions. The risk that outsourcing frameworks of funds and fund management companies (FMCs) do not adequately mitigate third party risks. Money laundering and terrorist financing risks is driven by the often complex legal structures of funds, which can create a lack of transparency in relation to the ownership and control of these structures which can be further compounded where the bank and custodian accounts of a fund are held in offshore jurisdictions, particularly those jurisdictions with bank secrecy laws.	Increasing deployment of technology and digitalisation. Geopolitically-driven threats. High levels of delegation and outsourcing in the funds sector. Growth of white label/third party management companies.
Sustainable finance	The funds sector fails to support or encourage the transition to a sustainable economy. Risks related to non-compliance with relevant Sustainable Finance Disclosure Regulation (SFDR) rules which may divert investments from their intended use, i.e. greenwashing.	Shifting investor demand for "green" products and the promotional advantages of "sustainable" or "ESG" labels Global climate targets not being met.

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Data, AI and modelling risks	Increasing use of AI tools could potentially have regulatory and investor protection consequences if not governed properly.	Increasing deployment of generative AI tools.
	Inaccurate and/or incomplete fund returns submitted to the Central Bank raise questions about data governance procedures and effectiveness.	Poor governance of data completeness and accuracy by funds and FSPs.
Strategic risk and adapting to structural change	Retail investors are unable to participate in financial markets sufficiently to support the achievement of better returns for themselves (subject to their risk appetite and tolerance).	Lack of confidence, opportunity and/or incentives for citizens in Ireland and some other EU countries to participate in the funds market.
	Funds are unable to support the funding of innovation and the scaling of Irish and other EU companies.	Embedded culture of bank-financing in the EU.
	Risks arising from the growth in complex investment strategies in growing new market segments.	Growth in demand for new types of potentially more complex and higher risks investments.

Funds Sector

KEY TAKEAWAYS

- The globally significant scale and nature of the funds sector in Ireland means that fund liquidity, leverage and financial system-wide interconnectedness are "evergreen" risks. Funds are the subject of both macro-prudential policy and supervisory interventions by the Central Bank.
- The dynamics and risks in the external environment have the potential to create heightened volatility across asset classes, sharp revaluations and marked changes in investor preferences. This has potential knock-on consequences for fund investors – for example in terms of returns and liquidity – and promoters and fund service providers through the impact on their financial and operational performance.
- There continues to be a significant focus on sustainable finance, including the role of the sector in financing the transition to a net zero economy. The EU Sustainable Finance Disclosure Regulation (SFDR) and fund naming guidelines seek to minimise greenwashing misrepresentation that could cause investor harm.
- The Draghi report emphasised the critical role of the fund sector in bridging the EU's economic and innovation performance gap.

Sector profile

- Ireland is a significant global funds domicile. Approximately 9,000 funds are authorised in Ireland with net asset value (NAV) of almost €5.0tn at December 2024 (an increase of 22% on end 2023).
- Two main categories of funds authorised by the Central Bank are UCITS (Undertakings for Collective Investment in Transferable Securities) which mainly invest in securities such as equities and bonds, and AIFs (Alternative Investment Funds) which can invest in alternative assets such as commercial real estate.
- Ireland is also host to the largest Exchange Traded Funds (ETFs) sector in Europe with total net asset value (NAV) of over €1.5tn at end 2024, about two-thirds of the total assets of ETFs in the euro area.

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- Environmental, social and governance (ESG) funds represented 28% by fund count (2,567) and 36% by net asset value (NAV) (€1.82tn) of all Irish funds at end 2024.

- The ecosystem of regulated fund management companies (FMCs) and fund service providers (FSPs) based in Ireland manage and offer services to funds and investors globally as well as in Ireland.

Assessment of sectoral trends and risks

Liquidity and leverage risks

Leverage can amplify both the gains and losses of an investment fund, while liquidity risk arises where a fund's dealing frequency does not align with the liquidity profile of the fund's investments. This means that to satisfy redemption requests such investments may have to be sold in a disorderly manner, potentially on "fire sale" terms. Both risks are interlinked and can reinforce each other, with vulnerabilities potentially being exposed in the current highly uncertain and volatile geopolitical and macroeconomic environment.

An inability to meet redemptions to investors– or to meet collateral and margin calls from counterparties - can generate risk at the individual investor level and at a system-wide level. Highly leveraged funds that collectively have very large holdings of illiquid assets – or funds which adopt similar derivative-based investment strategies - may pose concentration risks that can adversely affect the stability and integrity of the wider financial system in times of stress. All of these risks are intensified where robust liquidity risk management practices are not in place. In recent years, the Central Bank's macro-prudential and supervisory efforts have, therefore, focused on cohorts of such funds, particularly real estate funds and liability-driven investment (LDI) funds. As a result, the Central Bank has introduced various macro-prudential measures involving maximum leverage limits and minimum liquidity requirement to address the risks posed by such funds.[65]

Funds that face heightened liquidity risk due to their asset profile, adopt various liquidity management tools (LMTs). The Central Bank has commenced a review into the LMTs used by fund management

[65] In this regard, macroprudential measures have been introduced by the Central Bank for both real estate funds and LDI Funds – see: The Central Bank's macroprudential policy framework for Irish property funds and The Central Bank's macroprudential policy framework for Irish-authorised GBP-denominated LDI funds

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companies to assess their adequacy considering the liquidity profile of the relevant funds. Further engagement can be expected with FMCs where vulnerabilities are identified.

Asset valuation and market risks

While interest rates and inflation rates have both reduced in recent times, the external environment for funds remains challenging due to high macroeconomic uncertainty and elevated geopolitical risk. Such factors have the potential to impact funds, their investors and FSPs, including contributing to spikes in market volatility and giving rise to material asset revaluation risk, in particular given some funds' high concentration in equity holdings, including the so-called "Magnificent 7" stocks.[66] As well as affecting FSPs' revenue and overall financial performance, such impacts could exacerbate leverage and liquidity risks within the funds as described above.

The accurate and timely valuation of commercial real estate assets, which are vulnerable to market conditions, may have implications for funds exposed to such assets.[67] In light of this, funds and FMCs should pay close attention to the findings of the ESMA Common Supervisory Action (CSA) on asset valuation and ensure their compliance with supervisory expectations.[68]

Operational risks and resilience

Given the increase in digitalisation and the interconnectedness of firms within the funds sector internationally, cyberattacks – in particular to key global FSPs – can have wide-ranging disruptive impacts. Such attacks and related incidents continue to occur both in Ireland and internationally, with heighted risk due to the geopolitical context. While to date there have no significant periods of interrupted operations in firms based in Ireland or loss of data, the growing sophistication of attacks and the perpetrators' enhanced ability to penetrate defences, highlight the need for continuing vigilance, enhancement of barriers and adequate stress testing and refreshing of contingency and recovery plans.

[66] See the November 2024 edition of the ECB's Financial Stability Review
[67] See Central Bank of Ireland FSR Special Feature Commercial Real Estate: A Macro-Financial Assessment June 2024
[68] See Central Bank of Ireland letter to chairs 2022 ESMA Common Supervisory Action on Asset Valuation December 2023

Fund management company governance continues to be a key area of focus for the Central Bank. Responsibility for any activities delegated and outsourced ultimately rests with the regulated fund and FSP outsourcing the activity. In particular, the outsourcing risks associated with White Label Fund Management Companies[69]/Third Party Management Companies remain a supervisory focus, given the growth of this business model in recent years.

The AML National Risk Assessment, published by the Department of Finance, assesses the money laundering and terrorist financing risks of the funds sector as medium high. This assessment is driven by the often complex legal structures of funds, which can create a lack of transparency in relation to the ownership and control of these structures. These concerns can be further compounded where the bank and custodian accounts of a fund are held in offshore jurisdictions, particularly those jurisdictions with bank secrecy laws. The rating highlights the need for all firms to ensure that they fully understand the risks to which their individual firm is exposed and to have in place the appropriate controls, procedures and processes to manage these risks. When using group or third party developed controls and procedures, firms must take the responsibility to ensure that these are appropriate for the firm's specific ML/TF risks.

In the course of the Central Bank's AML/CFT supervisory engagements with funds and fund service providers, the Central Bank has identified AML control deficiencies in the areas of AML/CFT risk assessments, governance and oversight, customer due diligence processes and suspicious transaction reporting process and procedures. These areas will continue be a focus of the Central Bank and firms will be subject to on-going scrutiny and assessment of the robustness of these controls.

Climate and other environmental-related risks

The fund sector can play a key role in financing the European transition to a sustainable economy through its channelling of investable funds. To complement regulatory transparency initiatives such as SFDR, the sector has the expertise, insights and engagement with investee firms – for example, as lender or equity stakeholder - to influence and, where appropriate, prioritise and finance sustainable initiatives on behalf of fund investors. Such investments can support

[69] White Label Fund Management Company business models set up funds on behalf of clients and then typically delegate investment management to those clients.

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existing and new investee companies' transition to a lower carbon, more climate resilient future, and help address the EU's climate policy objectives as set out, for example, in the EU's "Fit for 55" programme. Increasing the range and quantum of funds that focus on sustainability will increase the options available to institutional and retail investors to manage their own exposure to climate transition risk.

Diverging interpretations of regulatory requirements and shortcomings linked to the consistency, availability and transparency of ESG-related data increases the risk that investment do not in reality meet the ESG criteria. This raises the risk of greenwashing, whereby investors believe they are being sold a product that supports sustainable investment, but it does not fulfil that expectation.

The Central Bank has noted a slight downward trend in the number of the most sustainable cohort funds ("Article 9") seeking authorisation since the end of 2022, and an upward trend in the number of funds seeking authorisation under the less onerous Article 8.[70] More broadly, we also note the emergence of so-called "greenhushing" internationally, the phenomenon whereby funds seek to downplay, or draw less attention to, their ESG credentials, which can be attributed to the political and geopolitical environment. With both of these trends in mind, the Central Bank will continue to monitor SFDR compliance, including investigating suspected instances of greenwashing. In August 2024, ESMA published its guidelines on funds using ESG or sustainability-related terms in their names.[71] As set out by the Central Bank in October 2024, full compliance with these Guidelines is expected. [72]

Data, AI and modelling risks

While some improvements have been noted recently, data quality deficiencies continue to persist, particularly with AIFMD data sets and Fund Profile Returns submitted to the Central Bank. Incomplete data sets and errors in data can potentially misdirect the

[70] Under the EU SFDR, Article 8 ("Light Green") Funds promote environmental or social characteristics but do not have a strict sustainability objective, while Article 9 ("Dark Green") Funds have sustainability at their core.
[71] See ESMA, Guidelines on funds' names using ESG or sustainability-related terms, August 2024
[72] See Central Bank of Ireland, Notice of intention in relation to the application of the ESMA Guidelines on funds' names using ESG or sustainability-related terms, October 2024

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decisions of funds and FSPs, as well as the supervisory activities of the Central Bank. As such, the data which funds and FSPs supply to both the market and to the Central Bank remains a key focus, with the underlying root causes generally being inadequate data governance practices. The data reported by funds is assessed to ensure compliance with relevant fund legislation. Incorrect data submitted will lead to increased supervisory attention and the escalating use of our supervisory toolkit as appropriate.

The use of AI for portfolio management techniques has the potential to significantly enhance the efficiency of fund portfolio managers. While many FSPs intend to use AI in the future, the application of AI systems within the funds sector has been relatively limited to date. Nonetheless, the alignment and oversight of such systems remain key considerations. The potential use of outputs from AI-based tools in fund management decision-making processes – for example, stock selection or for the application of portfolio diversification rules under the UCITS Directive - can lead to unwanted bias and poor investment decisions which could harm both investors and firms. Human oversight of AI systems will remain crucial given the risk of such scenarios occurring.

Box 4: AIFM Regulation Enforcement Action

In November 2024, the Central Bank fined a regulated entity €393,512 for breaching requirements of the European Union (Alternative Investment Fund Managers) Regulations 2013 (the AIFM Regulations) between May 2018 and August 2020.

Compliance with the AIFM Regulations is critical in enabling regulated entities to effectively safeguard investors' interests. The regulated entity in this case failed to conduct adequate due diligence, identify conflicts of interest and conduct effective oversight of its delegated functions. In addition, it failed to put in place adequate risk management structures and appropriate fund valuation procedures. These failures exposed investors in a fund to significant risks, which in this case crystallised in a loss.

This enforcement action reflects the continued focus of the Central Bank on regulated entities compliance with investor protection requirements.

Strategic risks and adapting to structural change

The Central Bank has noted increased engagement by funds and FSPs in relation to proposals for investment in alternative assets, such as crypto-assets, private debt and collateralised loan

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obligations (CLOs). It is important that funds and FSPs adequately consider the potential risks arising from such instruments, their unique features, their transparency, and their suitability for the fund's target market. With these sort of underlying instruments, there is a greater potential that retail investors may not fully understand product features, characteristics and associated risk profiles. We will continue to constructively engage with industry in relation to the potential to establish funds that give exposure to instruments which have previously been considered as presenting comparatively higher risk. This allows the Central Bank to consider the appropriateness of different types of instruments in portfolios targeting different segments of the market.

The fund sector has a potentially important role to play in bridging the EU's economic and innovation performance gap. Retail investors do not currently participate in financial markets sufficiently to support the achievement of better returns for themselves (subject to their risk appetite and tolerance) or help address the structural gap in EU economic performance. This status quo manifests as a gap in the funding of innovation and the scaling of domestic and other EU companies.

Key supervisory activities 2025/26

The Central Bank's remit is wide ranging and of global significance. Working with the relevant European and global regulatory bodies such as ESMA and IOSCO,[73] priority activities include:

- Risk-based review of applications regarding funds and FSPs.
- Sectoral and thematic assessments, including the completion of the ESMA Common Supervisory Action on compliance and internal audit functions.
- Continuing the focus on delegation and outsourcing arrangements in FMCs.
- Focusing on FSPs' implementation of the requirements of DORA.
- Continuing to enhance and use fund data and risk models to deliver a data-led, agile and risk-based approach to the effective and efficient oversight of the sector.

[73] European Securities and Market Authority (ESMA) and International Organization of Securities Commissions (IOSCO)

SECURITIES MARKETS SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Asset valuation and market risks	Risks emanating from the external environment may heighten the volatility and level of asset values and commodity prices, with the risks of sudden spikes and material revaluations.	The macroeconomic and geopolitical environment.
Operational risks and resilience	Cyberattacks and related incidents have the potential to severely affect the operation of securities markets. Outsourcing risks arising from the growing reliance on third party or group service providers for key activities. Risks are heightened in the absence of the effective oversight and control of outsourced activities and deficiencies in IT governance and IT risk controls, including data management and cybersecurity.	Poor cybersecurity risk management frameworks. Widespread reliance on IT systems in securities markets. Geopolitical and macroeconomic environment. Delegation and outsourcing of critical functions.
Sustainable finance	The impact of non-compliance with relevant sustainable finance rules. For example, the miscategorisation or misselling of "green" bond products issued or traded may divert investments from their intended use, i.e. greenwashing.	Strong investor demand for green products.
Market integrity	The risk that abusive practices in financial markets undermine trust in such markets and contribute to the detriment of market participants including investors.	Shortcomings in the governance of algorithmic trading activities. Cross-venue and cross-product market manipulation which is exacerbated by the fragmentation of trading across a very large number of trading venues and bilateral trading systems. Use of social media to spread inaccurate information and complications with obtaining information from such entities to support market abuse investigations.

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Strategic risks and adapting to structural change	Crypto assets as a relatively new and developing asset class which pose various risks, including to investor interests, market integrity and financial crime. This can be compounded by possible limited awareness of risks by potential investors. Crypto-assets not backed by other assets may be particularly subject to volatile price movements. Lack of transparency can increase money laundering and terrorist financing risks.	New market participants may be challenged by the application of regulation to a previously unregulated sector. Geopolitics leading to fragmented regulatory regimes
Culture, governance and risk management	Failure of boards to demonstrate proactive ownership and challenge of key risks, in particular wholesale market conduct risk matters. On-going issues have been noted with firms' wholesale conduct frameworks.	Ineffective board knowledge, challenge and governance failures. Insufficient awareness and management of potential conflicts of interest. Control weakness and deficiencies in trading systems.
Data, AI and modelling risks	The risk that the lack of, or inaccuracy in, data leads to incorrect decisions being made by firms and market participants, including supervisors. The risk that AI systems, particularly generative AI, are not appropriately aligned and governed. AI systems could potentially amplify numerous other risks to securities markets.	Increasing reliance being placed on data as volumes of data increase. Errors in data provided by firms. Increasing levels of sophistication and opacity in AI systems, with escalating use of AI in the future.

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Securities Markets Sector

KEY TAKEAWAYS

- Securities markets are exposed to the uncertainty and level of risk in the global macro environment leading to potential volatility in trading patterns, asset values and commodity prices.
- The delegation and outsourcing of functions to third parties continues to be prevalent, sometimes with inadequate oversight and controls in place, heightening operational risk.
- Cyber-incidents have the potential to create significant disruptions to securities markets which could permeate across the wider financial system.
- While AI has the potential to enhance all areas of securities markets, the use of AI technologies could increase market volatility, facilitate market abuse, introduce systemic risk, increase cybersecurity exposure, and reduce market transparency.

Sector profile

- Diverse sector with entities ranging from entities operating trading venues across multiple asset classes, including crypto-assets, and entities which are significant liquidity providers to securities markets and algorithmic and high-frequency trading firms.[74]
- There is a growing concentration of some of the most significant market makers operating from Dublin, e.g. five trading venue operators and four of the most significant market makers in the EU.
- There is a breadth to these trading venue operators, providing infrastructure in equity, fixed income, foreign exchange and commodity trading.
- There are over 56,000 bonds listed in Ireland and the Central Bank approved 735 prospectuses in 2023 and 758 in 2024.

[74] The entities which participate in wholesale financial markets are subject to a range of regulatory obligations, including under the Market Abuse Regulation (MAR), Investment Firms Regulation (IFR), as well as significant requirements under the Market in Financial Instruments Directive II (MiFID II).

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- Over 1bn MiFIR transactions were reported to the Central Bank in both 2023 and 2024.

Assessment of sectoral trends and risks

This section covers a suite of sector specific risks to capital market activities and associated risks related to trading and issuance of securities (market abuse, transparency, listing, prospectuses), while risks to investors, including retail investors, are presented in the MiFID Investment Firms section.

Asset valuation and market risks

The volatile financial, economic and geopolitical environment can have a significant effect on securities markets participants, their operating and risk management models, and their investors. Potential impacts include amplified movements in market volatility, transaction volumes, asset valuations and commodity prices. Exposures to assets which may be particularly impacted by geopolitical events, such as commodities, require appropriate management and mitigation of risk from both market-making and collateral management perspectives.

Operational risks and resilience

Cyberattacks, in particular to key market infrastructure providers, can have significant disruptive impacts on securities markets and consequently the wider financial system. Domestic and international cyberattacks and related incidents continue to occur and risks remain elevated due to the geopolitical environment. These can have a profound impact on securities markets, including outages and potential second round effects. For example, cyberattack breaches to firms' IT infrastructures may result in wider contagion effects, an inability to execute orders with no access to trading platforms, a lack of accurate pricing data, loss of investor confidence and reduction in liquidity. This is particularly so given the reliance on IT systems in marketplaces and their potential international interconnectedness across the system.

Through its supervisory work, the Central Bank has seen deficiencies in cyber risk management frameworks within firms, including frameworks not being reviewed and updated regularly. Vulnerabilities will be found and exploited by bad actors unless there is a consistent focus by firms on the enhancement of cyber-

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protection barriers. There needs to be adequate stress testing, robust outsourcing and IT risk management frameworks, regular IT reporting to the board, and the maintenance of up to date contingency and recovery plans.

The delegation and outsourcing of functions to third parties continues to be prevalent in the sector. We have noted recently instances of smaller firms outsourcing more of their critical functions. In these cases, the oversight of such arrangements takes on even greater significance, as the impact on the firm and investors can be magnified in case of deficiencies given smaller entities may be less resilient with fewer recovery options available. Such arrangements require careful oversight in order to mitigate investor protection risks.

Climate and other environmental-related risks

There is a continuing risk of mislabelling investment products as sustainable even when they do not meet all the relevant criteria. The concerns relate to the potential for greenwashing or green-bleaching, as well as a lack of accurate information around product characteristics. This can result in the financing being channelled into the transition to a net zero economy being constrained, despite investors' original intentions being to support sustainability-related investments. As Ireland is home to a significant level of debt capital markets activity, the topic of sustainable finance disclosures in prospectuses is a key focus of the Central Bank.

Although the EU Green Bond (EUGB) Regulation came into force in December 2024, the standard is not mandatory. Where issuers choose, they can use the "European Green Bond" or "EUGB" label to identify and promote green bonds. This labelling should enhance the degree of transparency regarding sustainable finance in bond markets, which could act as a catalyst for its growth.

Technology and market integrity

The increase in digitalisation can lead to a rise in abusive market practices, while poor surveillance can create risks to the integrity and fairness of securities markets. Specifically, concerns relate to the oversight and control of high frequency and algorithmic trading activity, and risk of market manipulation, including cross-venue and via social media.

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The conduct of participants in capital markets can have wide-ranging implications, not only on counterparties and investors who may suffer direct detriment, but also on the reputation and functioning of markets and more broadly on the reputation of Ireland as a place to do business. This is particularly so as technological advancements continue to have significant impacts on the organisation and operation of capital markets. The risks involved in algorithmic trading linked to "flash crashes" in financial markets, that is unexpectedly sharp moves in asset prices, can lead to financial loss for investors and have wider effects on sectors and markets.[75]

Robust controls of algorithmic trading systems, including appropriately calibrated "kill switches", can assist in mitigating such risks. Additionally market manipulation via trading on rumours or inaccurate information, has the potential to mislead market participants and generate financial and reputational losses. The risks associated with activities of this nature could be amplified by the growing use of AI.

Box 5: Trade Surveillance Enforcement Action

In February 2024, the Central Bank fined a stockbroking firm €1,225,000 for breaching trade surveillance obligations under Market Abuse Regulations (MAR). The firm failed to put in place an effective trade surveillance framework to monitor, detect and report suspicious orders and transactions for over five years.

Such trade surveillance frameworks allow suspicious orders and transactions to be identified and reported on a timely basis to the Central Bank, which assists in the combatting of potential market abuse. This case highlights the importance the Central Bank places on firm frameworks to monitor, detect and report suspected market abuse.

Strategic risks and adapting to structural change

Activity in crypto markets has increased over the last year, with some major coin prices reaching historical highs. The activities of participants in crypto markets have largely been unregulated since the advent of crypto-assets. Box 6 provides further background on

[75] In May 2022, the Swedish OMXS30 Index decline by up to 8% in a matter of minutes before quickly recovering. The Finish OMXH25 Index, the Danish OMXC25 Index and the Norwegian OBX Index were all impacted in a similar, albeit less severe, manner.

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the Markets in Crypto-Assets Regulation (MiCAR). Additionally, crypto-assets are subject to various specific risks including:

- **Potential lack of consumer awareness of risks as crypto-assets possess characteristics which are different to more traditional financial assets:** This can be linked to the opacity of their valuation in that there may be no expected future cash flows upon which such valuations can be based. This can lead to significant fluctuations and volatility in their prices, and contribute to the possibility of incurring large losses. As with other assets, liquidity risk may also arise where crypto-assets cannot be readily converted into cash. For example, where trading is concentrated on large exchanges or where there is a mismatch in stablecoin reserves.

- **Heightened risk of market abuse due to a lack of transparency in crypto markets:** MiCAR places responsibility on Crypto-Asset Service Providers (CASPs) to meet certain obligations in relation to disclosures in circumstances where they propose to admit a crypto-asset to trading.[76] Many major unbacked crypto-assets, for example Bitcoin (which accounted for over half the value of all crypto-assets as at August 2024)[77] are not subject to MiCAR.

- **Risk of financial crime:** A lack of transparency in the crypto asset sector, including ownership, may attract more users with illicit intentions than other asset classes where ownership is more transparent. This could cover money laundering, the financing of terrorism and as a ransom payment for cyberattacks. Some firms lack strong controls and understanding of the risks. Weaknesses include ineffective customer on-boarding and monitoring systems, and insufficient processes to identify high risk factors. This exposes firms to being used as the vehicles for fraud and compromises the integrity of the financial system.

- **Crypto-assets are often commented upon by "finfluencers" via social media**: As with recommendations regarding all financial products, investment suggestions which do not comply with the Investment Recommendations regime of MAR may not be as reliable as investment recommendations provided within that regime.

[76] CASPs are entities which provide certain services in relation to crypto-assets. For example, custodial/administration services, operating a trading platform for crypto-assets and the exchange of crypto-assets for certain other assets.
[77] See ESMA, TRV Risk Monitor No.2, 2024, August 2024

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Box 6: The New Regulatory Framework for Crypto-Assets

Markets in Crypto-Assets Regulation (MiCAR)

MiCAR has introduced a new regulatory framework for crypto-assets. For the first time, the EU has a harmonised regulatory framework for this sector that introduces prudential and conduct obligations for issuers of e-money tokens (EMTs), asset-referenced tokens (ARTs), and for crypto-asset service providers (CASPs). MiCAR does not cover all crypto-assets, for example, Bitcoin and Ether are not within the scope of these provisions. Nevertheless, MiCAR is a very important step forward in the regulation of crypto activities in Europe.

The Central Bank is the National Competent Authority (NCA) for the authorisation and supervision of entities in Ireland subject to MiCAR. At a high level, CASPs authorised under MiCAR are subject to anti-money laundering, prudential and conduct requirements. Over recent years, the Central Bank, other NCAs and the European Supervisory Authorities (ESAs) have worked together to deliver the effective and harmonised application of MiCAR and convergent supervisory practices throughout the EU. This includes sharing of information relating to applicant firms in order to identify instances where these firms could be seeking regulatory and supervisory arbitrage opportunities.

Implementation of MiCAR

The Central Bank's authorisation process is based on clarity, transparency, and predictability for firms seeking authorisation. We are committed to achieving the benefits of the new EU regulatory framework for crypto assets while ensuring the risks are well managed. We are engaging extensively with those firms that wish to enter the authorisation process, details of which can be found on the Central Bank website.[78]

We have put in place a well-resourced and expert team to deal with the authorisation process in a high quality and timely way. This is designed to ensure a good implementation of the new MiCAR regime in Ireland in line with the 12 month transition period.

Of course, the role and approach of applicant firms is also key in this regard. Our assessments of MiCAR authorisation applications will be guided through many perspectives including the use case and utility, suitability, and the risks associated with a crypto product or service. The importance of good culture and conduct risk management in delivering on new obligations under MiCAR cannot be overstated.

[78] More detail on the CASP authorisation process and the Central Bank's expectations with regard to MiCAR authorisation can be found on the Central Bank's website: https://www.centralbank.ie/regulation/markets-in-crypto-assets-regulation

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The stronger their risk management, the better position firms are in to understand, calculate and mitigate risks, therefore strengthening their business model, and their relationship with their customers.

Regardless of the services, the target customer base, or whether the business is retail focused or aimed at institutional clients, governance and safeguarding of client assets are critical considerations for the Central Bank.

Risks associated with crypto-assets

Risks to consumers and investors are inherently high in some crypto and related services. MiCAR is a welcome step forward, however, it will not provide the same levels of protection as exists for traditional financial investment products, nor will it enable mitigation of all the significant risks linked to crypto-assets. The volatility in valuation of crypto-assets means that consumers could quickly lose their money, and there are no safeguards like those in place for traditional financial products such as investor compensation schemes.

Therefore, we are keen to ensure consumers have clarity around risks when they make financial decisions. With this in mind, our *5 things you need to know about buying crypto* campaign launched in 2024 aimed to create an understanding amongst the public about the risks of buying crypto.[79] Additionally, both the Central Bank and the ESAs have issued warnings to consumers that crypto products can be highly risky, speculative and are not suited for most retail consumers. Where we see higher inherent conduct and consumer protection risks in products, we will have higher expectations of firms to adhere to high standards.

Culture, governance and risk management

Given their scale in Ireland, wholesale financial markets, and the conduct of participants within such markets, are important matters for the Central Bank. Key to overseeing conduct in such markets are the risk and governance frameworks used by firms to identify and mitigate corresponding risks. The Central Bank continues to observe deficiencies in such frameworks, in particular regarding:

- **Controls around conflicts of interest:** Firms participating in wholesale financial markets, particularly those offering a wide range of services, can be subject to conflicts between their own interests and the interests of third parties including their clients. We have observed instances of firms failing to take a broad view

[79] See Central Bank of Ireland, 5 things you need to know about buying crypto

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of all potential conflicts of interest they are exposed to, and hence struggling to mitigate such conflicts of interest accordingly. For example, firms being unable to demonstrate sufficient awareness of the potential conflicts arising in their business models and unable to map associated mitigating controls to such conflicts.

- **Trading and pre-trade controls:** The controls around the trading of financial instruments, pre-trade controls and the oversight of such controls are a key focus for the Central Bank. We have noted deficiencies in this area for various reasons including the outsourcing of critical functions, and ineffective detection and prevention tools.

Data, AI and modelling risks

A lack of data or inaccuracies in data can lead to market participants making misinformed decisions. Data quality deficiencies continue to be an issue, particularly in data sets relating to reporting under the Markets in Financial Instruments Regulation (MiFIR) and European Market Infrastructure Regulation (EMIR). We acknowledge that recent initiatives, such as the EMIR Refit, should contribute to enhancing data quality in the longer term. However, the data which firms supply to both the market and to the Central Bank remains a key focus. Data provided to the market can contribute to investor decisions, while data provided to the Central Bank helps to inform and direct our supervisory activities.

Box 7: Data Quality Enforcement Action

In November 2023, the Central Bank fined a regulated entity €192,500 for breaching reporting obligations under EMIR. The entity failed to report to a trade repository within the required timeframe over 200,000 derivate trades entered into over a period of over two years by one of its sub-entities.

Such reporting enables the Central Bank to obtain full visibility of each entity’s operations, understand the risks facing securities markets firms, and to consider corresponding systemic risk. This case highlights the importance that the Central Bank places on complete, accurate and timely data quality.

While AI has the potential to affect almost all areas of securities markets, the use of AI technologies in trading operations and algorithms can lead to the creation of possible new risks in terms of impacts on market functioning. These could include automated

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trading evolving autonomously to different trading strategies, hindering understanding of trading and monitoring of price fairness or market dislocations. Opacity of AI systems could lead to the decision-making methodologies not being fully understood, and it is possible that there is an increased risk of abusive practices in this area as a result. For example, AI systems could be solely focused on investment outcomes from trading activities, potentially ignoring behaviours, investor welfare, good governance and compliance with relevant financial regulation, such as the correct application of market abuse related rules. Appropriate calibration and alignment of AI systems will be key in such scenarios.

Accelerated and more complex trading strategies make monitoring and supervision more difficult. As AI is an area of increasing supervisory focus, firms should be aware of the scale of AI in their operations and apply appropriate governance structures reflecting new ways of working. We expect firms to be aware of different use cases of AI, for example whether such usage is implicit or explicit, as the level of human decision-making may differ depending on such use cases.

Key supervisory activities 2025/26

- Continuing the risk-based reviews of applications regarding prospectuses and new trading venues.
- Implementing an authorisation process for CASPs based on clarity, transparency and predictability for firms seeking authorisation. A commitment to achieve the benefits of the new EU regulatory framework for crypto assets while ensuring the risks are well managed.
- Continuing data analysis, engagements with securities markets firms, thematic reviews and other supervisory risk assessments, including a focus on:
    - Securities markets firms' implementation of the requirements of MiCAR and DORA.
    - Identifying weaknesses and vulnerabilities in relation to operational resilience and governance frameworks. Seeking remediation through robust control frameworks and strong financial positions.

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  - Undertaking assessments of the most significant firms to identify weaknesses and seek remediation in their Wholesale Market Conduct Frameworks.

- Implementing a new social media monitoring tool in conjunction with the Scila surveillance system, to further enhance our supervisory capabilities.

- Developing a supervisory approach to EUGB and environmental, social and governance (ESG) bonds in line with ESMA supervisory expectations and the recommendations of the ESMA Greenwashing Report.[80]

[80] See ESMA, Final report on greenwashing, June 2024

MiFID INVESTMENT FIRMS SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6	
Conflicts of interest and inadequate disclosures	Inducement and remuneration structures may include an inherent conflict of interest between revenue generation and acting in the best interests of investors. Risk that investors are not effectively informed of key information and the level of risk associated with a product or service which can lead to poor investor outcomes. This includes disclosures in the context of the Sustainable Finance Disclosure Regulation (SFDR), where relevant.	Poor practices regarding inducement and remuneration structures. Inadequate disclosures regarding products and services.	↗
Operational risks and resilience	Outsourcing risks arising from a reliance by some investment firms on third party or group service providers for key activities. Risks are heightened where there is ineffective oversight and control of outsourced activities or deficiencies in IT governance and IT risk controls, including data management and cybersecurity.	Reliance on external and intra-group outsourcing. IT and cybersecurity vulnerabilities. Growth outpacing operational infrastructure and controls.	↗
Culture, governance and risk management	Risk that firms do not have robust and fit for purpose governance structures, risk management frameworks and systems of control to adequately mitigate risks. Risk of investor detriment as a result of deficient investor protection and client asset frameworks, poor business processes and a lack of an embedded investor protection focused culture. Risk that investors' interests are not sufficiently protected if firms are not putting investors' interests at the heart of their business alongside those of other stakeholders.	Poor governance structures and business practices, and weak controls and business processes. Growth outpacing operational, governance, compliance and risk management capabilities. Organisational culture, collective and individual behaviors and board and executive team effectiveness.	→
Strategic risks and adapting to structural change	The evolving macroeconomic, geopolitical and operational landscape continues to impact the investment firm sector and investors through market volatility, movements in assets values and commodity prices giving rise to opportunities and risks for the sector and investors more broadly.	Macroeconomic conditions and geopolitical risk. Digitalisation of financial services. Potential for escalating use of AI systems in the future.	→
Financial risks and resilience	Risks to solvency and liquidity due to the evolving economic and financial market outlook, including changes in the inflation and interest rate environment impacting on firms' financial resilience.	Macroeconomic conditions and geopolitical risk. Financial market volatility.	→

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MiFID Investment Firms Sector

KEY TAKEAWAYS

- Many investment firms operate across Europe and deal with a significant number of retail investors. As such, the Central Bank works closely with other European regulators and supports ESMA's supervisory convergence work.
- According to our consumer research, retail investors still find it difficult to engage with the sector in some instances, with disclosure and the provision of information being cited as particular challenges.
- Firms must embed robust governance, risk management and internal control frameworks to promote an investor protection focused culture, and to safeguard financial and operational resilience in the face of the evolving operating environment.
- Firms must have sufficient customer service capacity and capability to be able to appropriately respond to investors' needs, and enhance their trust and confidence in engaging with the sector.

Sector profile

- 79 firms are authorised in Ireland, with 11 firms authorised in another EU member state and offering investment services on a freedom of establishment basis via a branch or a tied agent located in Ireland.
- The sector encompasses a heterogeneous range of businesses of varying size and complexity, providing investment products and services to retail and professional investors.
- Products and services range from those provided by wealth and portfolio managers and online broker platforms, through to firms providing pension-related services and engaging in capital markets activity.

Assessment of sectoral trends and risks

This section covers sector-specific risks relating to activities such as wealth and portfolio management, online brokerage and pension related servicing. For institutions engaging in capital market activities and associated risks related to trading and issuance of securities (market abuse, transparency, listing, prospectuses) please refer to the Securities Markets section.

Conflicts of interest and inadequate disclosures

Inducement and remuneration structures can lead to an inherent conflict of interest between revenue generation and acting in the best interests of investors. Some firms continue to demonstrate a lack of understanding of these conflicts of interest, and the implications in terms of value-for-money for investors. Furthermore, poor practices continue to be observed around the implementation of the Capital Requirements Regulation (CRR) and Investment Firms Regulation (IFR) remuneration regimes, including deficiencies in the application of performance management frameworks, particularly when assessing conduct-related criteria prior to awarding variable remuneration.

Variances are observed in the standard of firms' disclosure, including in respect of sustainable products and compliance with Sustainable Finance Disclosure Regulation (SFDR) expectations. This can lead to poor investor decisions as the characteristics of products or services and the associated level of risk might not be fully made available. Whilst examples of fair, clear and effective disclosures have been evident, there have been cases where investors were not adequately informed of key information and the level of risk associated with a product or service. This can lead to poor investor outcomes.

The complexity of sustainability concepts and sustainability-related regulatory requirements are creating challenges for some firms and investors. This covers, for example, obligations regarding suitability, product governance and disclosure under SFDR. There is also a risk that retail investors may not fully understand some of the new sustainability terms and concepts and therefore may not be in a position to fully articulate their sustainability preferences. Some firms may position themselves or their products as "green" or "sustainable" but do not meet the requirements of the SFDR or other sustainability criteria. These factors, coupled with some advisors' limited understanding of this product area and potentially misaligned sales incentives, could lead the level of investments into sustainable products being less than it might otherwise have been, or a lack of suitable product options being made available to meet customers' sustainability preferences.

Operational risks and resilience

Over-reliance on external and intra-group outsourcing arrangements makes it harder for the board and management of the Irish regulated entity to effectively oversee, monitor and challenge the level of service provided. This could lead to potential conflicts of interest, a lack of sufficient and adequate controls, or concentration across service providers. The materiality of these issues will vary between firms depending on the nature, extent and location of the outsourced activities and the scale, size and nature of the Irish regulated entity. It is imperative that firms have suitable internal controls in place and can demonstrate to the board that the risks are understood and appropriate mitigants are in place. The oversight of outsourced services should comply with the Central Bank's Cross-Industry Guidance on Outsourcing.[81]

Deficiencies continue to be frequently identified by supervisors in the areas of IT governance and IT risk controls, including data management and cybersecurity. These gaps can lead to material risks for firms and ultimately lead to poor outcomes for investors, which can manifest as systems failures, outages, unavailable services, or loss of customer data.

Culture, governance and risk management

The effectiveness and maturity of governance and controls, including investor protection frameworks, varies across the sector. Where firms place an emphasis on strong governance arrangements, we have found that this results in an investor-centric approach being adopted. Conversely, the absence of sufficiently robust frameworks means that firms may fail to assess and identify the risks posed to investors by their specific business model, strategy and processes. Consequently, they may not implement the procedures, controls and oversight mechanisms required to mitigate and manage these risks, and ensure the best interests of investors are protected. It is essential that firms' growth does not outpace their governance, operational, compliance and risk management capabilities.

To ensure that products are sold to the intended target market, firms need to have effective product governance arrangements in place. Where firms develop and offer products for the retail market that are highly speculative in nature or include complicated

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[81] Central Bank of Ireland, Cross-Industry Guidance on Outsourcing, December 2021

structures and features, there is a risk that these products may not be suitable for, and may not meet the needs, circumstances and attitude to risk of, the end investor.

Holding any level of client assets gives rise to heightened risks to investors. Without robust governance and controls over client asset arrangements, there may be a risk of misappropriation of client assets or a loss of client assets in the event of firm failure. We expect firms to continually challenge the appropriateness of their client asset arrangements to ensure they remain fit for purpose, in particular where the nature, scale or complexity of their operations changes.

We continue to see an increase in the number of firms receiving complaints from investors. The absence of effective complaints handling processes can lead to investors being treated unfairly or in an untimely manner when issues arise. We expect firms to comply with complaints handling regulatory requirements and to able to demonstrate the thorough investigation of complaints. This includes root cause analysis and resolution, and taking the necessary actions to prevent re-occurrence. The adverse impact is magnified where firms are providing services to retail investors on a cross-border basis.

The introduction of measures under the Individual Accountability Framework (IAF) are intended to drive higher standards of governance including accountability for decision-making and effective corporate culture in all firms. Boards and senior executive teams must drive effective cultures and standards, and take ownership and responsibility for putting the interests of investors at the heart of their business by continuously driving and supporting positive investor-focused experiences and outcomes at all times.

Strategic risks and adapting to structural change

The ease of access to innovative products on the fringe of the regulatory perimeter or unregulated products provided by regulated firms through online platforms, coupled with increased "gamification", can make effective disclosure difficult and lead to retail investors making poor decisions.[82] Investors' ability to make

[82] Gamification is the application of typical elements of game playing (e.g. point scoring, competition with others, and rules of play) to other areas of activity, typically as an online marketing technique to encourage engagement with a product or service.

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informed decisions will be hampered if the characteristics of products and services and the associated risks are not fully understood. Given the ease and immediacy with which firms can now reach potential investors, firms must be mindful of the distribution channels and marketing techniques they are using, particularly in relation to high risk products or products with complex features. They must ensure that marketing material and advertising are fair, clear and not misleading, and presented in a way that is likely to be understood by a retail investor. The regulatory status of products and the level of protections afforded need to be clear.

The use of AI in the provision of investment services such as portfolio management or provision of investment advice may present risks to investors if not deployed in a manner that seeks to secure investors' interests. While the application of AI in the sector in Ireland has been relatively limited to date, many firms are already experimenting and more extensive deployment is likely. MiFID II requirements are technology neutral and firms remain responsible for discharging all of their obligations when relying on AI technologies in the provision of investment services.

Financial resilience and financial integrity

While firms have proven to be financially resilient through bouts of market volatility, such rapid change could adversely affect firms' profitability and financial resources. The continuing volatile and uncertain macro environment backdrop has the potential to materially disrupt financial markets, adversely affect the financial health of firms and may result in strategic decision-making that impacts the interests of investors. Disruptions in the provision of investment services can be particularly damaging where the firm holds assets that belong to retail investors.

Some services carrying elevated money laundering and terrorism financing risks such as execution-only trading, trading in complex investment products and wealth management. Furthermore, the diverse customer base exposes the sector to a higher proportion of customers who have the potential to be classified as "High Risk", such as high net worth individuals, Politically Exposed Persons (PEPs) and complex cross-jurisdictional ownerships structures. Considering the heightened ML/TF risks presented by segments of the investment firms' customer population, the Central Bank expects the firms to have robust customer due diligence and transactions monitoring controls in place. It is important to note, however, that the

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proportion of firms providing products and services carrying elevated ML/TF risks is small, and most firms' activities are deemed to be Medium-Low to Low Risk, for example, investment firms that exclusively offer clients advice and do not hold any client assets.

Investment firms often assume more than one role, potentially performing a diverse set of activities through different legal divisions or entities within the same group. These group entities may be subject to different regulatory and statutory requirements, and as a result, the firms' consideration of the Irish AML/CFT legislative requirements can at times be below the expected standard. Importantly, however, supervisors have observed a widespread desire by firms to comply with the regulations, and to ameliorate any gaps or shortcomings highlighted as part of supervisory engagements. The high volume, rapid pace of activity and technological advances within the investment firm sector give rise to changes in ML/TF risks and the continuous innovation and development of products and services necessitates continued focus and scrutiny as part of future supervisory engagements.

Key supervisory activities 2025/26

- Continuing the supervisory review and evaluation process (SREP) assessments, including reviewing firms' oversight of cross border service provision and complaints management.
- Assessing the effectiveness of safeguarding of client asset against the enhanced rules.
- Supporting ESMA's supervisory convergence work including:
    - The MiFID ESMA CSA thematic work commenced in 2024 in the area of sustainability requirements, and
    - The 2025 ESMA CSA thematic work on investor protection.
- Further enhancing regulatory returns and embedding the enhanced social media monitoring capabilities.
- Supporting the implementation and development of incoming regulations and initiatives related to the sector (including the EU Commission's Retail Investment Strategy, the EU Artificial Intelligence Act and the EU Accessibility Act etc.).

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RETAIL INTERMEDIARY SECTOR KEY RISKS OVERVIEW

Topic	Risk description	Risk drivers and risk outlook for 2025/6
Customer needs not being adequately met	Risk that firms provide negligent or poor professional advice or sell an unsuitable product that is not appropriate to the customer's needs, circumstances and attitude to risk	Lack of focus on serving consumer interests. Failure to ensure consumers' needs and interests are served on an ongoing basis, for the duration of products and services.
Commissions and ineffective disclosure	Risks to consumers associated with an incentivised remuneration model, which gives rise to potential conflicts of interest. Consumers may not be adequately informed of key information including remuneration arrangements and level of risk associated with a product or service, which can lead to poor outcomes.	Poor practices regarding commission and remuneration structures. Lack of consumer understanding of commission versus fee charging models. Disclosure information which is unclear and not easily understood by consumers.
Operational landscape	Risks to consumers arising from the changing financial services industry due to the uncertain economic environment. Firms must have robust operational resilience processes in place to ensure the provision of critical services during periods of disruption.	Macroeconomic conditions. IT and cybersecurity vulnerabilities.

Retail Intermediary Sector

KEY TAKEAWAYS

- Consumers rely on retail intermediaries to help them access the products and services that can meet their short and long term financial needs. They, therefore, need to have confidence that the firm is competent, professional and will act in their best interests.
- Clear, effective and transparent communication and disclosures are critical to ensuring consumers understand their products and services, what and how they are paying for those services, and the measures in place to protect them.

Sector profile

- c2,500 authorised retail intermediaries at end 2024, comprising insurance intermediaries, investment intermediaries, and mortgage intermediaries. Many intermediaries hold more than one licence.
- Majority of firms (c 89%) have less than 5,000 clients, while some larger and more complex firms have hundreds of thousands of clients.
- The sector also includes debt management firms and crowdfunding service providers. (See Box 8)

Assessment of sectoral trends and risks

Customer needs not being adequately met

A key risk for a customer of a retail intermediary is that the firm provides negligent or poor professional advice or sells an unsuitable product that is not appropriate to the customer's needs, circumstances and attitude to risk. The retail intermediary sector operates primarily on a commission basis, so there is an inherent need to sell products in order to remain financially viable. This can conflict with a firm's obligation to act in the best interests of the consumer. Consumers rely on firms to provide advice that is fair and unbiased.

Consumers may suffer poor outcomes when firms do not meet expected standards of professionalism, reflected in their business

practices, standards of compliance, and documentation. Consumers use retail intermediaries to access products necessary for their day-to-day lives and to support their financial well-being. Risks posed by poor or negligent practices are heightened where consumers lack financial literacy or experience. This could be exploited by firms if they do not have their customers' best interests in mind, or fail to consider customers' circumstances.

The regulatory status of products and services, and the levels of protection afforded, may not always be clear for consumers. Retail intermediary firms can offer both regulated and unregulated products and services. This means that even though the firm itself may be regulated by the Central Bank, not every product they sell may be covered by regulation. It is important that firms clearly distinguish their regulated business from any unregulated products they provide. The Central Bank has continued to remind retail intermediaries of their obligations in this regard, including through the annual Roadshows.[83]

Commissions and ineffective disclosure

The incentivised remuneration model in the retail intermediary sector presents an inherent conflict of interest that needs to be carefully managed. Conflicts can exist between the means of generating revenue for a firm, and acting in the best interests of consumers. The product that generates most commission for the firm, may not be the one that best serves the consumers interests. Where retail intermediaries receive commissions from a product provider for selling their product, they must clearly explain this arrangement to the consumer. It is also important that firms do not represent or market themselves as being "independent" when they are in receipt of commission payments.[84]

In relation to ineffective disclosures, the main risk is that the consumer is not adequately informed of key information, including remuneration arrangements and level of risk associated with a product or service. Poor information presentation can impede a consumer's ability to assess the benefits and risks of a financial product or service. This risk is heightened when the product is more complex, or where similar alternatives are available on the market.

[83] See Central Bank of Ireland Retail Intermediary Roadshow 2024 November 2024
[84] See Central Bank of Ireland Consumers to have transparency of commission arrangements between intermediaries and product producers, September 2019.

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Firms must clearly advise consumers on the fees charged and whether the firm receives commission from the product producer. It is important that consumers are presented with sufficient information in a clear, balanced and effective manner to enable them to make informed financial decisions. The Statement of Suitability is a crucial document in this regard.

Operational landscape

The financial landscape has seen rapid change, creating both opportunities and risks for consumers. The retail intermediary sector plays an important role as part of the wider insurance, pensions and investments, and mortgage sectors in supporting customers, particularly those in vulnerable circumstances. Firms are responsible for navigating change in a manner that places the best interests of consumers at the heart of their commercial decision-making.

All intermediaries should ensure they have robust operational risk management frameworks, in particular firms with high volumes of consumers or with reliance on third party service providers. It is important that firms have procedures in place to deal with unplanned events and disruption that could result in loss of access to critical and important business services. Deficiencies in IT governance and cybersecurity controls can lead to material risks for firms and ultimately lead to poor consumer outcomes.

Box 8: Overview of Crowdfunding Service Providers

Crowdfunding services involve matching business funding interests of investors and project owners through the use of a crowdfunding platform.

Crowdfunding Service Providers (CSPs) are authorised under the European Crowdfunding Service Provider Regulations (ECSPR) since November 2023. There are currently seven CSPs authorised by the Central Bank of Ireland, five of which were authorised in 2023 and two in 2024. Crowdfunding services may also be provided in Ireland by firms authorised in other EU member states.

CSPs must ensure they have effective and prudent management in place to prevent conflicts of interest, ensure business continuity, and promote the integrity of the market and the interests of their clients. In addition, all marketing communications from CSPs are required to be fair, clear and not misleading, and advertisements must contain specific risk warnings for prospective investors.

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In 2024, CSPs were required to submit their first annual return to ESMA detailing activity on their platforms, including the amount of funding raised. This data fed into ESMA's first annual report[85] on the EU crowdfunding market. The report found that the majority of investors (87%) were retail investors, who tended to invest in smaller amounts than more sophisticated investors.

In 2025, the Central Bank will continue to embed the supervision strategy for the CSP sector, including developing our information and reporting capabilities, and through sectoral engagement and the use of thematic work, as appropriate. The cross-border nature of this sector will place a continued focus on collaboration with European authorities and other regulators to ensure harmonisation and application of best practices from around Europe.

Key supervisory activities 2025/26

- Supporting the implementation and development of new and revised regulatory requirements relevant to the sector, including the EU Commission's Retail Investment Strategy and the revised Consumer Protection Code.
- Sectoral supervision including focusing on the reviews of larger retail intermediaries owned by insurance firms and concluding the thematic inspection of fair versus limited analysis of the market.
- Continued engagement at industry level on authorisations, supervisory priorities and expectations.

[85] See ESMA Market Report, Crowdfunding the EU 2024, January 2025

APPENDICES

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Appendix A - Key Regulatory Initiatives

Initiative	Overview
Access to Cash	The Finance (Provision of Access to Cash Infrastructure) Bill 2024 aims to ensure that sufficient and effective access to cash is available in the State, and that any further evolution of the cash infrastructure will be managed in a fair, orderly, transparent and equitable manner for all stakeholders. The Bill provides for registration and ongoing oversight by the Central Bank of ATM deployers and cash-in-transit providers.
Anti – Money Laundering (AML) and Countering the Financing of Terrorism (CFT) legislative package	The AML EU Regulation, AML Directive and the establishment of EU AML supervision will make important changes to the existing AML framework. These changes include Customer Due Diligence and Beneficial Ownership rules. The impact of the AML regulation is multi-sectoral. The EU AML Authority (AMLA) will become administratively operational in 2025 and is expected to start direct supervision from 2028. All financial services sectors are within scope for AMLA either via direct or indirect supervision.
Artificial Intelligence (AI) Act	The EU Artificial Intelligence (AI) Act was endorsed by all Member States in February 2024 and entered into force in August 2024. The first provisions of the AI Act came into force on 2 February 2025; in relation to AI literacy and prohibition of certain AI practices. The other obligations under the Act will be phased in over a period of 36 months with the key obligations in place within 24 months. The Act aims to ensure that the fundamental rights, health and safety of the individual are protected, while promoting responsible innovation. It is central to ensuring that AI systems are designed, developed and deployed in an ethical and trustworthy manner.

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Initiative	Overview
Basel III Finalisation: Capital Requirements Regulation 3 (CRR3) and Capital Requirements Directive VI (CRDVI)	This aims to implement the final tranche of post-crisis reforms to the Basel III standards in the EU, notably introducing an output floor to internal model approaches and revisions to standardised approaches for credit (this includes reduced standardised approach risk weights, the removal of the IRB multiplier and reduced LGD's from 45% - 40% with a general lowering of risk weights across the board), market and operational risk. Other EU-specific amendments relate to the progressive incorporation of ESG considerations into the prudential framework, a new regime for third country branches and stronger requirements in relation to fitness and probity and supervisory independence. Most changes to CRR commenced from 1 January 2025, with some phased in over time from that date. The transposition deadline for CRD is 1 January 2026. Implementation of the Fundamental Review of the Trading Book (FRTB) has been pushed back by one year to 1 January 2026 in the EU and the European Commission is monitoring the implementation plans of other jurisdictions. The UK will not implement the FRTB before 1 January 2027.
Consumer Protection Code	The Revised Consumer Protection Code will deliver an updated and modernised Code that reflects developments of recent years and enhances clarity and predictability for firms on their consumer protection obligations, including their obligation to secure the interests of their customers. The Revised Code will take effect following a 12 month implementation period after the Code Regulations have been published. The Code Regulations are due to be published in Q1 2025. Application of the revised Code to credit unions will be considered in H2 2025 to ensure credit union members are afforded the same protections as other consumers of financial services.
Credit Union (Amendment) Act, 2023	Phases one to three commenced in 2024. Further phases to be commenced - including provisions on credit union services organisations and corporate credit unions. The Central Bank will develop regulations/guidance as appropriate to support.

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Initiative	Overview
Department of Finance's Funds Review Recommendations	In 2024, the Department of Finance published its final report following its review of the funds sector in Ireland. In total, the report makes 42 recommendations, 16 of which relate to the work of the Central Bank. The Central Bank is now working to implement these recommendations.
Digital Operational Resilience Act (DORA)	DORA has been applicable in full since 17 January 2025[86]. It aims to apply a harmonised and transparent Information and Communications Technology (ICT) risk management and governance framework to a wide range of financial entities. For the first time, DORA brings together provisions addressing digital operational risk in the financial sector in a consistent manner in one single legislative act. Regulated financial entities should recognise similarities between a number of key DORA requirements and existing Central Bank guidance in relation to Outsourcing, Operational Resilience and IT & Cybersecurity Risks, as well as in existing sectoral guidelines.
European accessibility act	The European accessibility act is a directive that aims to improve the functioning of the internal market for accessible products and services, by removing barriers created by divergent rules in Member States. It will apply from 28 June 2025.
European Single Access Point (ESAP)	The ESAP is a single point of access to public financial and non-financial information about EU companies and EU investment products. It aims to give companies more visibility towards investors and open up greater financing opportunities. While the initial focus will be on securities markets, in later phases ESAP will collect information from banks, insurers, investment firms and others. To this end, ESAP has wide-ranging and multi-sectoral impacts. While ESAP entered into force in January 2024, it is due to become applicable on a phased basis between July 2026 and 2030.

[86] Credit unions are exempt from DORA until 2028

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Initiative	Overview
Individual Accountability Framework (IAF)	The domestic IAF was signed into law in 2023 and became applicable in stages up to July 2024. It includes the following key elements: Senior Executive Accountability Regime (SEAR); Conduct Standards; Enhancements to the Fitness & Probity Regime (F&P); and Amendments to the Administrative Sanctions Procedure (ASP). SEAR for Independent Non-Executive Directors and Non-Executive Directors will be introduced on 1 July 2025 covering credit institutions (excluding credit unions), some insurance undertakings, certain investment firms and third-country branches. During 2025, the Central Bank will continue to implement the IAF in a proportionate and predictable manner.
Instant Payments Regulation	The Instant Payments Regulation was adopted by the European Parliament in March 2024, is aimed at accelerating the roll-out of instant payments in Europe and covers credit transfers denominated in euro within the European Union. It amends the SEPA Regulation and the Regulation on cross border payments. In scope payment service providers (PSPs) have until October 2025 to implement the requirements of the Regulation.
Insurance Recovery and Resolution Directive (IRRD)	The IRRD was published in the Official Journal of the EU in January 2025. This new regulatory framework is aimed at strengthening the stability and resilience of the EU insurance sector by setting harmonised recovery and resolution tools and procedures. The IRRD seeks to ensure a consistent approach across EU Member States while safeguarding policyholder interests and maintaining financial stability.
Markets in Crypto-assets Regulation (MiCAR)	MiCAR aims to provide an EU harmonised framework for the authorisation and supervision of the issuance of certain types of crypto-assets and provision of services related to crypto-assets, as well as to ensure the proper functioning of crypto-asset markets while ensuring investor protection, market integrity and financial stability. MiCAR has been fully applicable since December 2024.

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Initiative	Overview
Omnibus Directive on regulatory simplification	The Competitive Compass which is an initiative of the European Commission aiming to address competitiveness challenges outlined in the Draghi and Letta reports, is due to be published at the end of January. The proposal for the Omnibus package is due to be published on 26 February.
Payment Services Regulation (PSR) and 3rd Payment Services Directive (PSD3)	On 28 June 2023, the European Commission published its proposal to amend and modernise the current Payment Services Directive (PSD2) which will become PSD3 and establish, in addition, a Payment Services Regulation.
Retail Investment Strategy	This European Commission proposal aims to empower retail investors to make investment decisions that are aligned with their needs and preferences, ensuring that they are treated fairly and duly protected. It will make amendments to the conduct provisions in the following regulations: Markets in Financial Instruments Directive (MiFID); Insurance Distribution Directive (IDD); Packaged Retail and Insurance-based Investment Products (PRIIPs); Undertaking for Collective Investment in Transferable Securities (UCITS); and Alternative Investment Fund Managers Directive (AIFMD).
Solvency II Review	The Solvency II Review reached a significant milestone in January 2024 with the European Parliament and European Council publishing their agreed amendments to the Directive. The Level 1 text was subsequently published in January 2025 and member states have until January 2027 to make it applicable.
Sustainable Finance Disclosure Regulation (SFDR)	In October 2024, the European Supervisory Authorities (ESAs) published a Joint Report on principal adverse impacts disclosures under the Sustainable Finance Disclosure Regulation. An implementation timeline for SFDR was published by ESMA at the end of October 2024. [87]

[87] https://www.esma.europa.eu/sites/default/files/library/sustainable_finance_-_implementation_timeline.pdf

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Initiative	Overview
The Listing Act	Within the context of CMU / SIU, the Listing Act is a package of measures that aim to simplify listing rules for companies listing on public exchanges. Importantly, the Listing Act also seeks to preserve transparency, investor protection and market integrity. It will make amendments to the following existing pieces of legislation: the Market Abuse Regulation, the Prospectus Regulation, the Markets in Financial Instruments Directive (MIFID), the Markets in Financial Instruments Regulation (MIFIR) and the Multiple Voting Share Structures Directive.
Tokenisation within Investment Funds	Technologies, such as Distributed Ledger Technology (DLT), may have potential to increase the access and choice of investors and consumers in relation to financial services. Firms are increasingly exploring the potential of tokenisation, which uses DLT to represent real assets in digital form, known as tokens. The Central Bank intends to publish a Discussion Paper on the potential application of tokenisation within investment funds.
Transposition of the Alternative Investment Funds Manager Directive (AIFMD) and the Directive relating to Undertakings for Collective Investment in Transferable Securities (UCITS) Directive	Ireland has become the fourth largest global jurisdiction for investment funds with funds domiciled in Ireland serving the needs of both international and European investors. The AIFMD and UCITS are two EU Directives that form the basis of the European regulatory framework for the fund sector. The European Commission completed a review of the AIFMD in 2021 and proposed a series of amendments to the legal text. Following publication of the final legal text in the EU's Official Journal in 2024, the Funds Policy Team is currently transposing the new rules into the domestic framework, which will require extensive updating.

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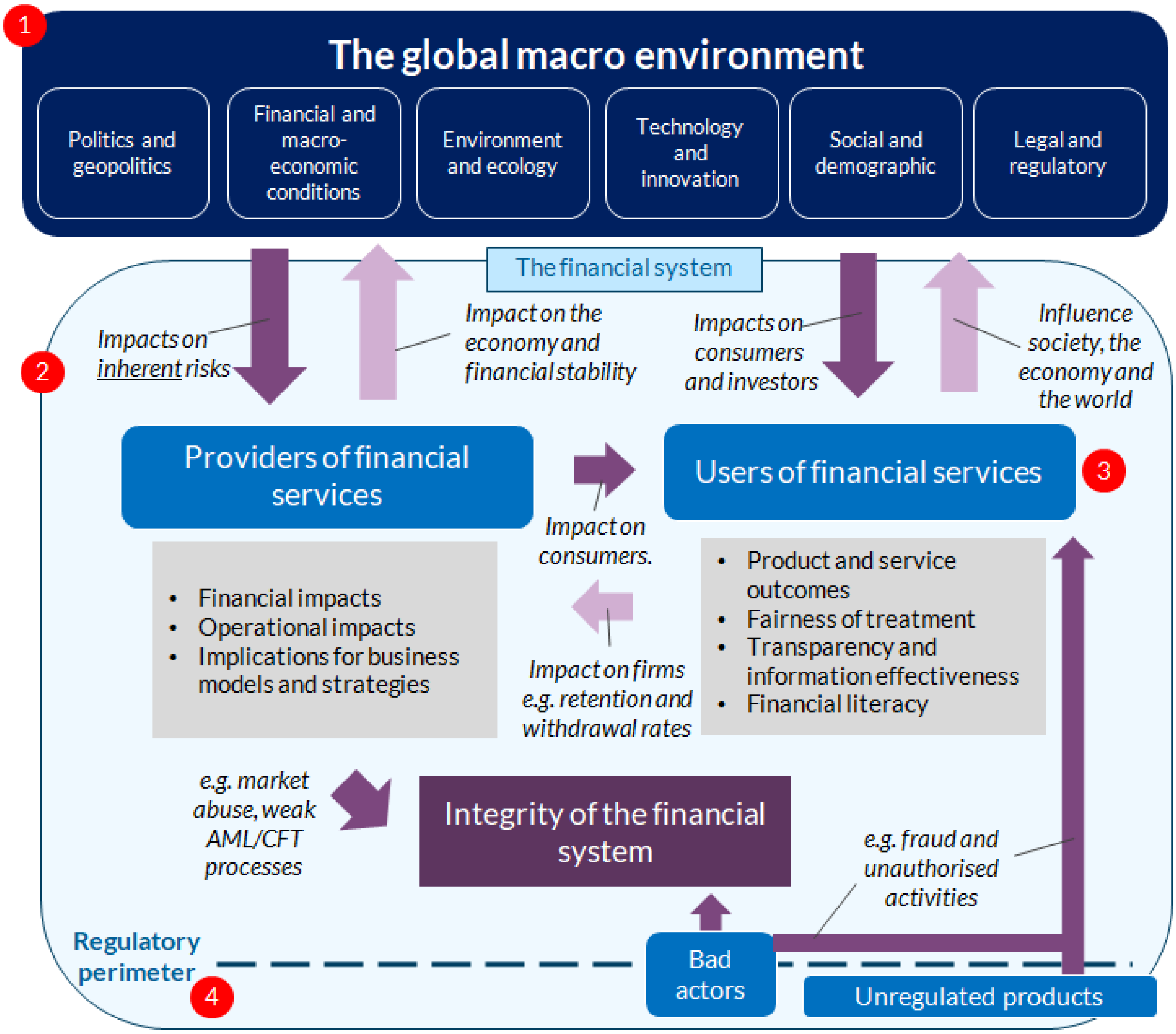
Initiative	Overview
UCITS Eligible Assets Directive (EAD) Review	UCITS are an important investment product that are intended to be readily accessible by retail investors. Investments by UCITS are subject to certain eligibility criteria set down in the UCITS EAD. In 2023, the European Commission tasked ESMA to develop technical advice on a potential update to the EAD in light of its divergent implementation across the EU. The Central Bank has engaged intensively with ESMA and the European Commission in this work given its importance for UCITS.

Appendix B – Holistic risk assessment approach

Figures 9 sets out the conceptual framework that informs how we consider the risk environment holistically. The diagram illustrates the transmission channels and feedback loops between the global macro environment, the financial system as a whole and the various actors within the regulatory perimeter and beyond.

Figure 9 – A stylised view of our holistic approach to risk assessment



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Appendix C - Description of risk ratings

For each risk category, an assessment is made of the current level of relative risk allowing for the mitigations providers and consumers of financial services generally have in place.

The assessment is judgement-based, underpinned by relevant key risk indicator data and is, of course, a blended view covering multiple sectors. The risk position of individual providers (or sub-groups), or particular cohorts of consumers, may be higher or lower. Table 4 sets out the descriptions associated with each risk rating.

Table 4: Description of risk ratings

SEVERE	SIGNIFICANT	MODERATE	LIMITED
Expert judgement and supporting key metrics suggest that conditions are already very adverse or very volatile in the risk category with potential severe adverse impacts on the providers and/or users of financial services and/or the integrity and/or functioning of the financial system – or there is a very high chance that they will become so over the next c2 years.	Conditions are deteriorating (or likely to do so) and/or volatile, going beyond the levels of downside risk seen historically in more benign times; and/or the future outlook is very difficult to assess due to macro-level events (e.g. political/ economic uncertainty); and/or there is exposure to potentially swift adverse changes in sentiment (e.g. affecting financial markets).	The level of risk is at or around what might be expected as normal given the inherent risk exposures that apply to financial services undertakings, (e.g. credit risk as it relates to banks) or risks of consumer detriment, with such risks being around long term historical levels and there is no significant adverse divergence of key risk indicator metrics from long term averages.	Judgement and the key metrics in respect of a risk category point to a benign and stable exogenous and endogenous risk environment for financial services providers and users, with no expectation of any adverse developments over the next c2 years that would affect a non-negligible proportion of providers/users in a material way.

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