Trends and Developments

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Maples Group

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Overview

To date, 2023 has been a year that has brought about significant challenges as well as substantial changes to the Irish banking market – challenges and changes that will shape the market's path going forward.

In 2022, we saw Ulster Bank Ireland DAC ("Ulster") and KBC Bank Ireland (KBC) continue to sell off their loan book and wind down operations in Ireland with its final conclusion of operations this year. We also saw the impact of war on the global economy by the Russian invasion of Ukraine and this in turn kick-started an unrelenting period of inflation and high interest rates which has continued through to this year.

With the shadow of the macroeconomic factors being cast over much of this year, it has prompted a moment of reflection by borrowers and lenders alike.

Given this current backdrop, what follows is an overview of the trends and developments in the banking and finance market in Ireland for 2023.

Irish Economic Trends and Developments

Following the announcement in 2021 of the exit of Ulster and KBC from the Irish market, on 3 February 2023, the legal ownership of KBC mortgages, deposits, credit card and business and personal loan accounts transferred to Bank of Ireland. Ulster officially closed for business on 21 April 2023, with Permanent TSB and AIB acquiring the majority of its loans and assets. This has significantly altered the Irish banking landscape, with the market now reduced to three domestic Irish banks.

These departures from the Irish market have nevertheless not deterred the remaining pillar banks of AIB, Bank of Ireland and Permanent TSB from investing back into the market by coming together for a joint venture in developing "Synch", an instant payment platform for Irish consumers and businesses to rival and compete with the existing neo-banks such as Revolut. This will be achieved through the development of a mobile application known as "Yippay" to facilitate instant payments between customers through the use of a phone number alone. Initially, it will provide a peer-to-peer service for retail and business customers, and eventually broaden to person-to-merchant payments. Once established, it is intended that Synch's services will expand to the merchant acquirer sector to provide an alternative to in-store and online merchant card acceptance. Synch received clearance from the Irish Competition and Consumer Protection Commission in June 2022 and intends to launch in 2024 pending authorisation from the Central Bank of Ireland (CBI).

Non-Bank Lenders

The withdrawal of Ulster and KBC from the Irish market could have the potential to reduce competition but has in fact created more opportunities for non-bank lenders (NBLs). NBLs have featured in the Irish market for over a decade and are a key source of funding for Irish property and small and medium-sized enterprises (SMEs) while also being a catalyst for competition. The emergence of more alternative lenders, which includes the likes of Wayflyer, BlueBay Asset Management and Novellus, and their significant growth over the recent years is evidence of an exciting diversification in the Irish market.

While NBLs may be more exposed to the unstable global financial conditions in the market, the Central Bank's Financial Stability Review 2023 reports that NBLs have proven resilient to the rising interest rates showing a greater risk appetite and flexibility by offering multi-currency revolving facilities as well as term loan single currency facilities.

It is clear that the dynamic of the Irish banking sector is changing with NBLs expected to continue the evolution in the lending landscape in Ireland and indeed carve out their own lending ecosystem.

Interest Rates

Over the last year, we have seen the Irish market follow the global trends of high inflation rates alongside increasing interest rates. At the time of writing, interest rates have surpassed 4% and are at their highest rate in over 20 years, with nine consecutive increases in a twelve month period by the ECB. In turn, the Irish pillar banks have increased their interest rates on variable and fixed-mortgages. The immediate effect of this is the increased cost of funds for borrowers resulting in a significant reduction in lending activity in Ireland this year, particularly in the real estate sector. However, the banks have yet to pass on these interest rate increases to their savings customers and deposit holders, and have recently been criticised by government for failing to do so, with the Minister for Public Expenditure advising Irish savings account holders to deposit their savings with other European banks in order to benefit from much higher interest rates than those available in Ireland. This provides another opportunity for non-Irish banks in the Irish banking market.

At the time of writing, the rate of inflation in Ireland is 4.8% compared to an average 5.5% inflation rate across the Euro area. As we look to the remainder of 2023, the outlook for the Irish banking market will depend on the ECB's decision making – whether it will continue to pursue the aggressive target of a 2% inflation rate over the medium term, or whether there will be an acceptance that inflation and interest rates have reached a standing position whereby the market will find a new level in order to encourage lending activity again.

Sustainable Finance

Notwithstanding the challenges that increased inflation and interest rates bring to bear, Ireland has continued its progress towards establishing itself as a sustainable finance centre in line with the Sustainable Finance Roadmap (the "Roadmap") published by Sustainable Finance Ireland in 2021. In February 2023, the International Sustainable Finance Centre of Excellence (ISFCOE) hosted its first Communities of Practice meetings which brought together ISFCOE members and sustainable finance professionals to collaborate as a community. Members of the ISFCOE, which comprises of a mix of public/private participants including IDA Ireland, AIB, Bank of Ireland, other financial institutions and professional services including the Maples Group, are working together to drive Ireland forward in becoming a leading sustainable finance centre.

The Department of Finance in the meantime launched its 2023 Action Plan to reflect its update to the Ireland for Finance Strategy, which was originally published in 2019 (the "Action Plan"). The Action Plan sets out key measures to be taken to support the further development of the international financial services sector in Ireland. The sustainable finance theme of the Action Plan sets out two key deliverables. Firstly, the Roadmap will be updated to reflect developments in sustainable finance with particular focus on the net-zero transition, biodiversity finance and the implementation of the sustainable finance fintech strategy. The second deliverable will see IDA Ireland, in collaboration with stakeholders Financial Services Ireland, ISFCOE and the Department of Finance, develop an updated Sustainable Finance Proposition to promote the potential for further investment in sustainable finance and develop the value proposition for foreign direct investment into Irish sustainable finance activities by targeting investors.

EU Framework

The 2023 Action Plan and the Roadmap are bolstered by the EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment (more commonly known as the Taxonomy Regulation (TR)) and the Sustainable Finance Disclosure Regulation (SFDR), both adopted in June 2020. The TR and SFDR have been subject to important developments in recent months.

In June 2023, the European Commission adopted the Environmental Delegated Act to the TR setting out the screening criteria for its remaining environmental objectives taking effect on 1 January 2024. This offers clarity to the entities subject to the TR by setting out the non-climate environmental objectives under the TR such as pollution prevention, biodiversity protection and specifying criteria to determine whether economic activities, including finance related activities, cause significant harm to any of these objectives.

The major development in the SFDR, which requires financial service providers to disclose environmental, social, and governance (ESG) considerations publicly, is that it has now entered its phase 2. This will mean that the reporting obligations will now be fully applicable to financial market participants with over 500 employees and will certainly require companies fitting the criteria to review their ESG policy and their broader responsibilities with regard to ESG in conducting their business.

In addition to these EU regulations, the Corporate Sustainability Reporting Directive ("CSRD") entered into force in January 2023 in Ireland replacing the Non-Financial Regulation Directive which applied only to large public interest entities. The CSRD requires entities to report on a double materiality basis meaning that companies will have to disclose the risks they face from climate change and other ESG matters (financial materiality) as well as the impact they themselves will have on the climate and society (impact materiality). The reporting obligations under the regulations will begin to apply from January 2024 to public interest entities with over 500 employees. Public interest companies include those that are:

- listed on a regulated EU stock market;
- financial services companies; or
- companies specifically designated a public interest entity by their country of incorporation.

The reporting obligations for large entities with over 250 employees apply from 1 January 2025 with listed SMEs from January 2026. This does however include an "opt-out" possible until 2028. While non-listed Irish SMEs are not in scope of CSRD, these entities may need to provide information to larger companies if they form part of the value chain. With these additional reporting requirements, we have seen an uplift in Irish companies beginning to inform and equip themselves in anticipation of this potentially challenging change of landscape.

Ireland's Green Financing Trends

In 2023, we have seen green bonds continue to grow in popularity as investment vehicles for sustainability. The AIB and BOI green bond issuances have continued to increase under their green bond frameworks. So far this year, BOI has issued EUR1.5 billion green bonds, bringing its total issuance to date to circa EUR4 billion with AIB's 2023 half-yearly green finance performance showing issuances of EUR1.1 billion and over EUR3 billion green bonds now in issuance.

The National Treasury Management Agency has also raised EUR3.5 billion through the syndicated sale of a 20 year Irish Sovereign Green Bond (ISGB) maturing in 2043, the second ISGB since inaugural issue in 2018. The money raised will be used under the terms of the Irish Sovereign Green Bond framework. This Government-approved framework lists six eligible categories of green projects supporting the pillars and actions set out in the 2023 Action Plan and demonstrates the government-wide support for sustainable finance in Ireland in the long term.

NBLs and other alternate lenders are also driving a shift towards green financing with the Irish-based Capitalflow Group securing EUR10 million from the low-cost Energy Efficiency Loan Scheme (EELS) launched in 2022 by the Strategic Banking Corporation of Ireland. This is a state-owned lending institution aimed at ensuring access to funding for Irish SMEs. Some other on-lenders of the EELS include AIB, BOI, Fexco Assets Finance and Finance Ireland. Loans of up to EUR150,000 can be applied for under the scheme which will see the positive effects of green financing in the form of energy-efficient products financed at a fixed rate.

ESG in Practice

With ESG issues continuing to be a focus for not only Irish financial institutions but their borrowers too, there has been a steady increase in the inclusion of ESG related covenants in Irish law loan agreements in order to qualify them as sustainability-linked loans. Significantly, the Loan Market Association (LMA) published draft provisions for sustainability-linked loans in May 2023, the first form of prescribed drafting since the initial publication of the sustainability-linked loans principles in 2019 and guidance in 2020. Given that such provisions act as a framework only, we are starting to see the likes of the Irish pillar banks and NBLs producing their own working template. The setting out of a clear basic format and terminology represents a positive shift towards standardised drafting in documenting sustainability-linked loans and provides a good starting point for negotiation given the increased investor interest and demand.

Fund Financing

ICAV & ILP update and the use of cascading pledges

Over the last number of years, the Irish Collective Asset-management Vehicle (ICAV) has established itself as the most commonplace structure in the Irish fund financing space. The ICAV is a bespoke corporate structure with its own legislative framework regulated by the CBI with a unique feature of the ICAV being that it cannot provide third-party credit support for any third party by way of guarantee. In practice, this means that where an ICAV forms part of a master-feeder structure in a subscription line financing, the lender cannot take direct security from the ICAV feeder fund over its uncalled capital commitments and capital call rights.

The use of cascading security structures to overcome this restriction is not a new feature of the fund financing market, but it is a recent growing trend when an ICAV forms part of the borrowing structure. In short, the "cascading pledge" means the ICAV creates security over its uncalled capital commitments in favour of its master fund, which then assigns this security interest on to the lender.

Key considerations when implementing the cascading structure include:

- whether the ICAV's offering documents permit the granting of security over its capital call rights and uncalled capital commitments;
- the requirement for side letters with the alternative investment fund manager (AIFM), administrator and investment manager (as applicable) in order to document who has authority to make the capital calls and enforce the capital call rights; and
- the terms of acknowledgement from the ICAV as the feeder fund with regard to the borrower financing and the cascading pledge arrangement bearing in mind the guarantee restriction.

It is also important that the feeder fund ICAV is not party to the subscription line facility agreement lest it trip itself up when it comes to the guarantee restriction but equally it is fundamental that the events of default are drafted to include default on the part of the ICAV feeder fund under the cascading security documentation. This alternative approach to the guarantee is now a widely accepted practice in subscription line financing involving ICAVs.

Though the ICAV has been the Irish fund vehicle of choice in the Irish market when it comes to fund finance, we are starting to see another Irish fund structure in the mix – the Investment Limited Partnership (ILP), particularly subscription line financing. In last year's "Funds Financing" piece, we discussed the ILP and provided on update on its progress in the Irish market. To date the total number of ILPs registered in Ireland is 36, an increase of 16 on the 20 registered at the time of last year's update. Since the introduction of the Investment Limited Partnership (Amendment) Act 2020, 31 new ILPs have been registered, approximately 30% of which have been advised by the Maples Group, with more ILPs set to launch during the remainder of 2023. Though this is not necessarily a massive uptake, it does reflect a steady stream of new registrations relative to what the rate of new registrations was prior to the legislative overhaul.

Practice Management in Finance Transactions

As a result of new Irish legislative updates and recent Irish case law, we have set out below a summary of some practical considerations for loan documentation in the Irish market.

Piercing the corporate veil

In a recent landmark decision, Powers v Greymountain Management Ltd (In Liquidation) [2022] IEHC 599, the Irish High Court held directors and shadow directors personally liable for funds misappropriated by a company as part of a fraudulent investment scheme. This is the first time that an Irish court has pierced the corporate veil to hold directors personally liable, notwithstanding the well-established principle that a company has a separate legal personality to its members and directors.

Although the court accepted that lifting the corporate veil would only arise in the most exceptional circumstances, this judgment serves as a stark warning to all directors that they must carry out their roles exercising the appropriate control and oversight.

In particular, the decision highlights that directors should never abrogate their duties to shadow directors and should always exercise caution and diligence when dealing with third parties. Furthermore, the granting of a power of attorney by a director to another individual does not discharge the director's duty to oversee actions taken on behalf of the company by that attorney. Directors must also acquaint themselves with the affairs of the company and exercise appropriate supervision and oversight at board level in respect of the discharge of delegated tasks.

As a result of this case, consideration should be given to the insertion in Irish legal opinions of an assumption that no director is disqualified from so acting or subject to any proceedings that might result in disqualification.

SCARP process advisor re solvency

A Process Advisor is an insolvency practitioner appointed to oversee the Small Company Administration Rescue Process, also known as the SCARP, which was introduced by the Companies (Rescue Process for Small and Micro Companies) Act 2021.

The standard banking searches for the purposes of giving an Irish law legal opinion, such as of the Judgment and Petitions Sections of the Central Office of the High Court, would not reveal the appointment of a Process Advisor, as the SCARP procedure was designed to avoid court involvement. The appointment would, however, appear on a Company Registration Office (CRO) Search Report, as the Process Advisor is required to file a notice with the CRO of their appointment and also to advertise a notice in Iris Oifigiúil within two days of their appointment. As a matter of practice, it is therefore advisable (especially for Irish finance lawyers) to check the CRO printout in relation to the company.

Given the current state of the economy, this could be something to watch out for and should be considered when giving legal opinions and drafting the insolvency related provisions (for example, events of default) in the loan agreement.

It was only last autumn that the numbers of SCARPs increased from a tiny handful. It seems that as of early August 2022, only three had been initiated.

Táilte Éireann

Following the Táilte Éireann Act 2022, Táilte Éireann is the new State entity undertaking the functions of the Property Registration Authority (PRA), Ordnance Survey Ireland and the Valuation Office, and was officially launched on 1 March 2023.

Conditions precedents and post-completion requirements in an Irish real-estate financing arrangements should, going forward, refer to registration with "Táilte Éireann" in place of the PRA. Some precedent documents may also require updating.

Conclusion

In the first three quarters of 2023, the Irish banking sector has undoubtedly navigated various challenges both nationally and internationally. Despite these hurdles, the outlook for the remainder of 2023 looks promising as we see the continued strength of NBLs in the market along with an embrace of innovative financial technology. The strong commitment to sustainable finance by both the traditional pillar banks, along with governmental support, shows that the Irish market continues to be adaptable to the ever-changing landscape and will be prepared for the opportunities and challenges that lie ahead.