Trends and Developments

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Trends and Development 2022

2021 was a year of growth and optimism following on from the uncertainty of 2020. The year began with a collective sense of enthusiasm as the country returned to ‘business as usual’ and looked towards the future. This being said, there were a number of new challenges which caused a pause for thought this year and the outlook for the remainder of the year and beyond.

In 2021, two of Ireland’s most well-known banks, Ulster Bank Ireland DAC (“Ulster”) and KBC Bank Ireland (KBC), announced their exit from the Irish market further narrowing the choice of lenders in this jurisdiction, leaving just Allied Irish Banks, p.l.c. (AIB), Bank of Ireland (BOI), Permanent TSB (PTSB) and Barclays Bank Ireland plc as the main players.

Moreover, Russia’s surprise invasion of the Ukraine has cast a long shadow over 2022. With such resultant uncertainly, it has already had a substantial impact on global markets and life more generally as have the sustained levels of inflation and interest rate hikes that have been populating our headlines this year. Compounding this is the risk of a global economic downturn, a change to the US tax code to entice American multinational companies to return to the United States and the implementation of the latest OECD global tax agreement which will increase Ireland’s tax rate to 15%.

Given the current backdrop what follows is an overview of the trends and development in the banking and finance market in Ireland for 2022.

Irish Economic Trends and Developments

In early 2021, Ulster Bank and KBC announced they were to cease all operations in Ireland. In the following July, PTSB announced that they had entered into a non-binding agreement that would see them acquire €6.8 billion of Ulster’s loans (mostly personal mortgages and small business loans) and 25 of its branches. This was approved by the Competition and Consumer Protection Commission (CPCC) in July 2022.

In June 2021, AIB agreed to purchase €4.2 billion of corporate and commercial loans from Ulster which received clearance from the CPCC a year later in April 2022. In June 2022, AIB entered into a binding agreement to purchase Ulster’s €6 billion tracker mortgage portfolio which at the time of publication still awaits CPCC clearance. Like the PTSB acquisition, the AIB acquisition awaits ministerial approval with there being no indication of when this will occur.

In October 2021, KBC entered into a legally binding agreement with BOI to acquire its performing loan assets (including mortgages, commercial and consumer loans), deposits and a small number of non-performing mortgages to the tune of €8.8 billion. This binding agreement received approval from the CPCC in May 2022, subject to a number of legally binding commitments, though remains subject to ministerial approval.

Ulster’s parent NatWest cited an inability to generate sustainable long-term returns as the deciding factor for exiting the Irish market while KBC referenced the challenging operational context for European banks for its departure.

These reasons have not put off new entrants however, with the likes of Dutch neobank 'Bunq' launching its new Irish lending platform following its acquisition of alternative lender Capitalfow in late 2021. Bunq has ambitious plans to advance over €1.2 billion in new lending to Irish SMEs and property investors over the next three years. Recently, UK-based digital lender, Starling Bank ("Starling") advised that they are focusing on rolling out a cloud banking platform, Engine, into the Irish market which will allow third parties to leverage its technology and provide a platform to develop tools and apps for individual financial service providers. The cloud banking platform is certainly an interesting area of growth for consumers as it incorporates non-banking businesses with regulated financial infrastructures whilst at the same time providing an opportunity for new entrants to get ahead in the Irish banking market.

Alternate Lenders

The CBI's Financial Stability Review 2022 shows that Ireland, in line with global trends, is seeing non-bank lenders (NBLs) growing in numbers domestically and playing an increasing role in lending markets of all types with NBLs accounting for an estimated 37% of the value of total lending for SME's in Ireland. NBLs include investment firms such as Bain, Earlsfort, Garrison and Activate and are spread across all sectors and are filling gaps, creating niches and offering a tempting alternative to the incumbent Irish pillar banks.

NBLs play a vital role in driving competition in the market as they are not subject to the same stringent capital requirements of retail banks and have a greater risk appetite driven by increasing returns for their investors. It is a double edged sword as NBLs are more exposed to global financial conditions given they do not have a stable deposit base, but since the 2008 financial crisis, when traditional lenders were unable or unwilling to lend, NBLs have been very successful in increasing their market share in this jurisdiction.

The Deloitte Alternative Lender Deal Tracker Spring 20221 showed that despite concerns over the economic recovery in Ireland post Covid-19 and the interest rate hikes that were expected for 2022, 2021 was a stellar year for lending in all sectors by NBLs, boosted by deployment of 'dry powder' amassed by venture capital and private equity firms in 2020 and 2021. This increase in NBL lending reflected the trend seen across the wider EU.

Undoubtedly borrowers, both consumer and commercial, are benefiting from this diversification and given the reduction in the number of retail banks it will be interesting to see if alternative lenders can further consolidate the gains they've been making over the last number of years.

Russia Ukraine Conflict

Russia's surprise invasion of Ukraine in February 2022 has led to a period of huge uncertainty as governments, professionals and consumers distanced themselves from Russia, its regime and its businesses. This uncertainty still persists as Russia continues to show its complete disregard for the rule of law and eschews international norms of expected behaviour.

Though Ireland's exposure to the conflict is relatively minor compared to some of our EU neighbours, we have seen direct and tangible examples of the impact it has had in this jurisdiction. Ireland's primary exposures relate to aircraft leasing, pharmaceutical products and imports of petroleum and fertilisers.

As Irish aircraft leasing firms severed ties with Russia, the Kremlin, in response to EU sanctions directed at its aviation sector, passed a law allowing foreign aircrafts to be added to the Russian registers ignoring the European Parliament's demand that these aircrafts be returned to lessors, leaving up to 513 aircrafts worth circa $10 billion leased from non-Russian lessors stranded in Russia

The long-term effects of the war in Ukraine and its upward pressure on the price of commodities, fuel and raw materials generally will have unwelcomed trickle-down consequences that will leave no sector of the Irish financial market unaffected. While the initial sentiment of the CBI for 2022 was that of an improving economy, given these developments they have now signalled that there is "considerable uncertainty" for the Irish economy going forward.

Interest Rates

Over the course of 2022, we have seen central banks around the world moving to increase interest rates to tackle the growing cost of living. While we have seen these hikes before, it does not mean this is an easy task for global economic regulators as they attempt to find the right balance for economic growth while cooling potential overheating in the markets.

In response to the recent ECB interest rate hikes, Irish pillar banks, AIB, PTSB and BOI have raised their tracker mortgage rate by 0.5% in line with the ECB however, at the time of publication, they have for now at least, maintained their variable or fixed mortgage rates. The impending September interest rate hikes from the ECB have marked a return of the Irish government to the bonds market in an attempt to spending down cash reserves prior to the expected base rate increase by the ECB with rumours circulating that as much as a further 0.75% interest rate hike could be in the pipeline.

Similarly, the Bank of England has enacted a 15 per cent base rate rise in its attempt to stem inflation. In doing so, they have predicted a 15 month recession with the UK now projected to enter into a recession from Q4 of this year with real household post-tax income projected to fall sharply in 2022 and 2023. We wait, cautiously, to see how the CBI will respond.

The markets are watching eagerly as to how the effects of the end of ECB sub-zero rates and winding down of quantitative easing will play out. The appetite for debt is expected to slow down with the ECB's second-quarter bank lending survey showing that loan credit standards tightened considerably for consumers in Ireland, especially on residential mortgages, while access for wholesale bank funding also deteriorated.

As a result, we are seeing an increased level of apprehension in the market as funding costs rise and lenders are now questioning if their yield is still as prosperous as it has been over the last number of years. The macroeconomic factors combined with the increased cost of lending is leading to speculation in the Irish financial market that the pipeline of debt supply for the end of 2022 will not be as prevalent as it was for 2021.

Sustainable Finance

Sustainable finance was noted as an important aspect of the global commitment to aid in combatting climate change at the 26th UN Climate Change Conference. Prior to the conference, Sustainable Finance Ireland published a Sustainable Finance Roadmap ("Roadmap"), which sets out an action plan for Ireland to develop into an established sustainable finance centre by the year 2025. The Maples Group is one of the working group members of this Roadmap along with, amongst others, AIB, BOI and PTSB which shows the commitment to sustainable finance across the financial market in Ireland.

With nearly €160 billion sustainable-related assets managed or listed in Ireland, Ireland already has strong green sustainable credentials but the Roadmap sets out a plan to build on this reputation. Key to this is the establishment of an international sustainable finance centre of excellence in partnership with which is among 18 actions contained in the Roadmap.

In tandem with the development of the Roadmap, Ireland's finance industry has been getting to grips with the implementation of the EU's Sustainable Finance Action Plan (the "Action Plan"). This includes 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 Disclosures Regulation ("SDFR") both adopted in June 2020.

The TR sets out an EU-wide classification system and provides a common method for investors to identify environmentally sustainable economic activities and encourage private investment in those activities. The SFDR requires financial market participants to publish information on how, and to what extent, their activities align with those considered environmentally sustainable in the TR, with a core objective to mitigate 'greenwashing'. In order for an economic activity to qualify as environmentally sustainable, it has to substantively contribute to at least one of the six environmental objectives set out in the TR.

The majority of the Level 1 measures under SFDR have applied in Ireland and across Europe from 10 March 2021 and the first two of the objectives under the TR - "climate change mitigation" and "climate change adaptation – have applied since January 2022. The remaining four objectives under the TR and the implementation of the Level 2 measures under SDFR will apply from 1 January 2023.

The issuance of green bonds has been gaining momentum since 2021. Through the issuance of green bonds, companies and banks are in a position to contribute to green initiatives as the proceeds of green bonds may be used for projects to aid in combatting climate change. Through two successful green bond issuances, AIB and BOI both launched their green bond frameworks following on from inaugural €1 billion and €750 million bond issuances in 2020 and 2021 respectively. AIB has gone on to raise a further €750 million in its second green bond issuance in 2021 and €1 billion from its first social bond in 2022.

Green lending is also a recent emerging trend with AIB having stated an intention for green lending to account for 70% of all new lending by the year 2030. Alongside green bonds, blue bonds, which are a subset of green bonds targeted at raising funds for sustainable marine and ocean related projects, have also made an emergence into Irelands finance sector, as reported in the Irish Sustainable Finance Roadmap. Notably, we are seeing more ESG type covenants being included in facilities on a more regular basis in order to qualify them as green loans which reflects a real shift in the market.

ESB have likewise made green commitments in January 2022 as they issued their second green bond for the value of €500m in order to fund projects related to renewable energy generation and also energy efficiency. The company was oversubscribed receiving over €2 billion in orders across Europe showing the confidence the wider financial markets have in the sustainable finance sector in Ireland along with an appetite for what ESB are doing.

It's not only corporates following this trend. Since its launch in 2018, the National Treasury Management Agency has raised €6 billion through its Irish sovereign green bond with all issuances oversubscribed highlighting the demand in the financial market for green bonds.

Given the EU's strong leadership role in the continuing development and promotion of sustainable finance, the future for sustainable finance is bright for Ireland's finance sector as we are undoubtedly well positioned to help businesses and customers transition to a low carbon economy and ensure that Ireland meets it climate targets.

Funds Financing

The Irish funds industry has proven very adept at managing the shift toward sustainable finance and has been a key driver in promoting the sustainable finance agenda in Ireland. Figures from an Irish Funds survey of its members showed that, as of August 2021, approximately 17% of all Irish domiciled funds could be classified as either Light Green ie, within scope of Article 8 of SDFR and promoting environmental or social characteristics or Dark Green, within scope of Article 9 of SDFR that is, funds with a sustainable investment objective.

In last years 'Trends and Developments' piece we discussed the introduction of the Investment Limited Partnership (Amendment) Act, 2020 (the "2020 Act") which aligned the Irish investment limited partnership ("ILP") more closely with the well-established limited partnership structures in other international funds domiciles such as the Cayman Islands and Luxembourg.

As we predicted, the numbers of new ILPs did not explode overnight and to date the total number of ILPs registered in Ireland to date is 20. Though not a seismic shift, this nonetheless represents a significant increase on the pre-2020 Act numbers.

This slow start was in part as a result of the spot-checking of applications by the CBI, which raised uncertainties about certain standard features of partnership funds and delayed the industry promoting the new ILP structure while that uncertainty persisted. Thankfully, these teething issues seem to have been ironed out.

Given Ireland's experienced network of service providers, law firms and other finance professionals, the ILP has the potential to become the Irish fund vehicle of choice. The creation of more ILPs in this jurisdiction will act as a proof of concept for new entrants into the Irish funds market and will force global fund managers to stop and consider Ireland and the ILP as a viable alternative to the traditional fund vehicle options.

We are seeing this shift first handat the Maples Group having just recently launched our second ILP and with more ILPs already in the pipeline for remainder of 2022.

Covid-19

The largest state-backed loan guarantee scheme in the history of the Irish state, the Covid-19

Credit Guarantee Scheme (the "Scheme"), which offers an 80% guarantee to facilitate up to €2 billion in lending to participating small and medium sized enterprises ended on 30 June 2022, having been extended on multiple occasions since its inception in September 2020.

To the end of April 2022, three retails banks, six non-bank lenders and 19 credit unions made 9,274 loans totalling €636,305,657 to SMEs and have been responsible for maintaining 75,123 Irish jobs in the process. Though this represents less than half of the Scheme's €2b limit, figures show that the Scheme and other similar supports have had the desired effect of keeping business failure rates to a record low not seen since 2005/2006. By way of example, there were 401 corporate insolvencies in 2021, a decrease of over 30% from 2020.

However, as the Scheme and other pandemic related supports are phased out, the expectation is that there will be a wave of corporate insolvencies in the Irish market. Revenue have recently announced that €26.4 million of tax liabilities has been written off because the companies involved have since been liquidated. With the conclusion of support schemes coupled with the ECB interest rate hikes and the rising energy costs, the number of business failures in 2022 is some 19% higher than the same period in 2021.

Conclusion

While the first six months of 2022 show that there are challenges ahead, both internationally and domestically for the banking and finance market, the remainder of 2022 and beyond looks to undoubtedly create opportunities for new retail banks and alternate lenders in the Irish market with the exit of Ulster Bank and KBC. As well as welcoming new entrants, Ireland is embracing new ways to provide finance with new technologies and genuine commitments to sustainable finance so the Irish banking and finance market is undeniably well placed to capitalise as it adapts, as necessary, to whatever lies ahead.

Maples Group advises global financial, institutional, business and private clients on the laws of the British Virgin Islands, the Cayman Islands, Ireland, Jersey and Luxembourg through its leading international law firm, Maples and Calder. With offices in key jurisdictions around the world, the Maples Group has specific strengths in the areas of finance and banking, corporate commercial, investment funds, litigation and trusts. The banking and finance team in the Maples Group's Dublin office has a diverse practice and comprises three partners and four associates. The team acts as lead counsel, as well as local counsel, for lenders and borrowers on a wide range of domestic and cross-border debt financings, including corporate and leveraged finance, real estate finance and funds finance, and provides commercially focused and solutions-oriented advice to clients. The firm's international perspective, working with both Irish and international financial and institutional clients, ensures best-in-class advice.

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