Legal 500 – Focus On… Finance Law in Ireland and the Outlook for 2022

2021 was a year of optimism for lawyers and other financial professionals, with Covid-19 and Brexit somewhat 'in the rear view mirror'. There was a collective sense of enthusiasm as the country returned to 'business as usual' and looked towards the future.

That is not to say that 2021 was all plain sailing, as 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 and with such resultant uncertainly, has already had a substantial impact on global markets and life more generally.

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

Irish Economic Outlook

In February 2021, Ulster announced that they were to cease all operations after 186 years of business in Ireland. 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 agreement became binding in December 2021 subject to final approval by Competition and Consumer Protection Commission ("**CPCC**") which is still awaited. Approval of the Minister for Finance is also required for a merger or acquisition involving a credit institution where the transaction is necessary to maintain the stability of the financial system in the state

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 €6b 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 April 2021, KBC signalled that they too were leaving the Irish market after over 40 years on the island, with CarVal Investors, acquiring its €1.1b non-performing loan book. On 22 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 €8.8b. This binding agreement received approval from the CPCC on 23 May 2022, 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 with plans to plans to advance over €1.2b in new lending to Irish SMEs and property investors over the next three years.

Alternate Lenders

The Central Bank of Ireland's ("**CBI**") latest Financial Stability Note shows that Ireland, in line with global trends, is seeing non-bank lenders ("**NBLs"**) play an increasing role in lending markets of all types. NBLs are spread across all sectors and are filling gaps, creating niches and offering a tempting alternative to the incumbents. NBLs operating in Ireland include investment firms such as Bain, Earlsfort, Garrison and Activate.

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 2022[1] shows that despite concerns over the economic recovery in Ireland post Covid-19 and the prospect of interest rate hikes in 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 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 and pharmaceutical products and imports of petroleum and fertilisers.

As aircraft leasing firms severed ties with Russia, the Kremlin passed a law allowing foreign aircrafts to be added to the Russian registers ignoring the European Parliament's demand that these aircraft be returned to lessors, leaving up to 513 aircraft worth circa $10b 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 economy unaffected. This negative sentiment is borne out by the **CBI** who have signalled that there is "considerable uncertainty" for the Irish economy going forward as a result of the Ukrainian conflict.

An a result, the CBI put on hold its plans to gradually reinstate its counter-cyclical capital buffer ("**CCyB**") which was reduced to 0% in March 2020 to counteract the effects of the Covid-19 pandemic. The CCyB aims to promote the sustainable provision of credit by increasing capital requirements of banks in the upward phase of a given cycle and decreasing them during a downturn and is a key tool used by the CBI to address risk in the Irish market.

Nevertheless, in June 2022, the CBI announced the gradual reintroduction of the CCyB to 0.5% with a plan to move to 1.5% over the following 12 months signalling the CBI's view of an improving economy but with the consequence that this will eat into bank profits with the potential knock on effect of reducing the amount which banks are willing to lend.

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 will finally conclude 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

[1] https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-aldt-spring-2022.pdf

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 such as the Revenue debt warehousing scheme ("**Warehousing Scheme**") are phased out, the expectation is that there will be a wave of corporate insolvencies in the Irish market. Approximately €3b is tied up in the Warehousing Scheme which will become payable from 1 January 2023, subject to any individual arrangements that Revenue reach with participants. This coupled with the planned ECB interest rate hikes and the rising energy costs faced by business as a result of the Russia/Ukraine conflict could see 2022 reversing the trend and breaking new records for all the wrong reasons. Indeed the number of business failures in Q1 2022 is some 19% higher than the same period in 2021.

Brexit

Britain's losses continue to be Ireland's gains as the country moves forward and looks to consolidate gains achieved in the post-Brexit shake up. A recent report published by the Baking and Payments Federation of Ireland in conjunction with the Federation of International Banks Ireland ("**FIBI**") has shown that large international banks operating in Ireland including AIB, BOI, Barclays, Bank of America, Citibank and others have boosted their balance sheets by as much as €200b since the Brexit referendum, second only to Germany in terms of the value of assets that were moved from UK to EU banks post-Brexit.

This increase has led to Ireland being the eight largest international banking sector in the EU and the 17th largest worldwide in 2020, up from ninth and 19th in the previous year, with Ireland ranking as the fifth largest exporter of financial services in Europe and the eighth largest worldwide.

The FIBI report suggests that this growth can be attributed in part to major growth of significant financial institutions (those supervised directly by the ECB) that use Ireland as their base to service the EU and global financial markets.

Sustainable Finance

As 2021 drew to a close, sustainable finance was high on the agenda at the 26th UN Climate Change Conference of the Parties (**COP26)** being touted as a crucial and necessary part of the global strategy to counteract climate change. In the weeks before the conference, Sustainable Finance Ireland ("**SFI**"), a public-private partnership, published its National Sustainable Finance Roadmap ("**Roadmap**") and set out its plans to make Ireland a leading sustainable finance centre by 2025. The Maples Group was part of the oversight committee for the development of the Roadmap.

With nearly €160b 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**"), which includes the EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment[2] (more commonly known as the Taxonomy Regulation ("**TR**")) and the Sustainable Finance Disclosures Regulation ("**SDFR**")[3], 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

[2] Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

[3] Regulation (EU) 2019/2088 on Sustainability-Related Disclosures in the Financial Services Sector

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 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 continuing rise in green bonds was another feature of 2021 with, AIB, BOI and the Irish Electricity Supply Board ("**ESB**") making green bond announcements. The ESB launched its second green bond offering of €500m to raise funds for green energy projects including renewable energy generation and green infrastructure. AIB and BOI both launched their green bond frameworks following on from inaugural €1b and €750m bond issuances in 2020 and 2021 respectively. AIB has gone on to raise a further € 750m in its second green bond issuance in 2021 and €1b from its first social bond in 2022.

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

Furthermore Euronext Dublin has become a leading stock exchange for green bonds and a centre of excellence for debt listings with 420 ESG bonds listed from 150 issuers globally, including government-backed entities, financial institutions and corporates.

Given the EUs strong leadership role in the continuing development and promotion of sustainable finance the future is bright for Ireland's finance sector as we are undoubtedly well positioned to help businesses and customer's transition to a low carbon economy. When it comes to sustainable finance, Ireland is practicing what it preaches to ensure it meets it climate targets and that there can be no accusations of 'greenwashing' on the Emerald Isle.

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, i.e. 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 'Focus On' 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 18. Though not a seismic shift, this nonetheless represents a 200% 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 hand at the Maples Group having just recently launched our second ILP and with more ILPs already in the pipeline for remainder of 2022.

Outlook for 2022 and Beyond

If the last three years have taught us anything, it's that nobody knows what is around the corner. How 2022 will unfold is anybody's guess, but all the signs look positive. What is certain is that Ireland, and the Maples Group, are well placed to capitalise as markets improve and adapt as necessary to whatever lies ahead.