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Securitisation

Ireland

Trends & Developments

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practiceguides.chambers.com

2021

Trends and Developments

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Introduction

The year 2020 was anticipated to be another record-setting one for Irish securitisation and structured finance products. As the full implications of the pandemic became apparent, attention quickly turned to whether the pandemic would trigger a global financial crisis in the securitisation market similar to 2008/2009. Thus far this does not appear to have materialised and the pandemic has demonstrated that, despite the scale of the crisis, experienced structures are performing as intended by allocating risk across the capital stack. Although overall issuance volume has fallen, issuers are still coming to the market and investor demand for securitisation paper has remained robust throughout the year. We would be optimistic for this trend continuing into 2021, despite the continued dual headwinds of the pandemic and the potential implications of Brexit.

Brexit

At the date of writing (December 2020), the deadline for the European Union and the United Kingdom to reach an agreement before the Brexit transition period comes to an end, on 31 December 2020, is fast approaching. While Brexit poses a significant risk for many parts of the domestic Irish economy it marks a moment of opportunity for the Irish financial services industry.

Migration of banking functions to Ireland

As the largest common law, English speaking member state in the EU, Ireland has proven very attractive to financial institutions that require a new EU base for regulatory purposes. Since the passing of the Brexit referendum in 2016, many have migrated payment processing capability to Ireland and Irish entities are increasingly being used to house account bank and agency functions. Furthermore, investment banks are implementing contingency plans to allow Irish entities to act as placement agent/arranger for securities issuances. Ireland now also houses a number of CRA 3 (Credit Rating Agencies Regulation) approved ratings agencies, and its growth as a lending hub for investment funds and management continues at pace.

MiFID II implementation

While negotiations are ongoing the full effect of Brexit on the Irish securitisation market remains uncertain and we are continuing to assist clients with Brexit planning and contingency arrangements. For entities providing financial services from the City of London, regulated under the Markets in Financial

Instruments Directive (MiFID II), their principal concern is that it appears increasingly unlikely that they will continue to enjoy “passport” rights in respect of their authorisations throughout the EU. While the answer to this question depends on the outcome of negotiations, the Irish MiFID II implementation may prove to be a useful tool for the Irish and other European securitisation markets prior to ESMA’s third country MiFID II passport regime applying. This exemption allows non-EU authorised entities to provide investment services to professional clients or eligible counterparties in Ireland in particular circumstances without the requirement to be authorised under MiFID II.

Toward ever closer financial union

In a twist of irony one of the consequences of Brexit may be an intensification of efforts towards further European integration through the European Capital Markets Union (the CMU). In recent months, European authorities and regulators have adopted a number of CMU “quick fixes” to reduce the regulatory burden associated with securitisations. These include the extension of the STS framework (further described below) to on-balance sheet synthetic securitisations and a relaxing of the regulatory framework for the securitisation of non-performing exposures. This type of flexibility of approach by regulatory bodies is a trend we expect to continue into 2021 and Ireland is likely to be a net beneficiary of any further CMU initiatives/integration given the open nature of its economy.

Coronavirus

Impact on RMBS and other Irish securitisation assets

As the effect of the pandemic first became clear in Ireland in March 2020, the CBI and members of the Banking and Payments Federation of Ireland (the BPF), which includes all Irish retail banks, retail credit firms and major credit servicing firms, responded quickly. They announced payment extensions of up to six months, along with a deferral of court enforcement proceedings for consumer and retail customers who required assistance as a result of the pandemic. Shortly thereafter, the European Banking Authority (the EBA) published guidelines which gave Irish entities additional regulatory flexibility to provide customers with support while avoiding the automatic classification of exposures under the definition of “forbearance” or as “defaulted” under distressed restructuring definitions.

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While the EBA guidelines were not extended, favourable regulatory treatment will continue to apply to all payment holidays granted under eligible payment moratoria prior to 30 September 2020. The BFPI has stated that its members will offer, on a case-by-case basis, additional three month payment breaks. However, it should be noted that the BFPI has not made further statements on the temporary suspension of enforcement proceedings.

According to a “Payment Breaks Update” released by the BFPI, over 149,000 accounts took advantage of these payment breaks at their peak. More than 74,000 of these were principal dwelling house mortgage accounts, with some 35,000 consumer credit accounts and 31,000 SME loan accounts. It should be noted that over 105,000 of these payment breaks had expired by 2 October 2020. While lockdown measures continue to have an impact, in positive news, the book value of accounts on payments breaks fell by EUR4.7 billion to EUR4.4 billion in the four weeks to 30 October 2020, therefore matters are stabilising. As a consequence, we have seen an increase in RMBS activity in recent months and we expect that loan portfolio sale activity will recommence next year.

Legislative protections for tenants

On the legislative front, the Irish government introduced the Residential Tenancies and Valuation Act 2020 to increase protections for tenants who lost their employment, had their wages reduced or are in receipt of the unemployment pandemic payment. These protections include a rent freeze as well as a ban on evictions up to 10 January 2021. As Ireland continues to experience lockdowns on an ongoing basis, it is likely that these measures will be extended for the duration of the pandemic.

Government stimulus package

As the scale of the pandemic became apparent, the Irish government announced the most significant stimulus package in the history of the state. It comprises relief programmes, COVID-19 loans and a range of other initiatives to assist SME businesses. The overall objective of these measures is to ensure that financial providers have the necessary support to continue to provide liquidity to Irish businesses.

One of the most significant of these was the introduction of the largest ever state-backed loan guarantee in Ireland. The EUR2 billion Credit Guarantee Scheme provides a partial 80% state-backed guarantee to participating finance providers lending to eligible SMEs, small mid-caps and primary producers. In addition, other state bodies – including the Irish Strategic Investment Fund (the ISIF), the Strategic Banking Corporation of Ireland, Enterprise Ireland and Microfinance Ireland – announced support for struggling businesses with loans available from EUR10,000 to EUR1.5 million plus. In the case of ISIF,

it also made a EUR2 billion Pandemic Stabilisation and Recovery Fund available to support medium and large enterprises.

Anti-money Laundering Registration Requirements for Irish SPVs

The law in Ireland on anti-money laundering and the countering of the financing of terrorism is governed by the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (as amended). This Act introduced what has become known as the Schedule 2 regime, which requires otherwise unregulated firms that fall within its scope due to their business activity to conduct AML and otherwise comply with the Irish AML regime. This regime has been the subject of renewed focus since late 2018 when a registration regime for such Schedule 2 Firms was introduced to Ireland.

While SPVs have not traditionally been viewed as in the scope of AML, this question has recently been subject to renewed debate amongst market participants in respect of these Schedule 2 firms. Schedule 2 activity includes lending and financial leasing, but, in the absence of Central Bank of Ireland (CBI) guidance, advisors continue to apply their interpretations to the scope and nature of activity required of an SPV to fall within its scope (for example, RMBS, non-performing loan (NPL) portfolio owning SPVs, collateralised loan obligations, loan funds, treasury options and other inter-group arrangements, alternative lenders and retained forms of asset finance). In 2021, we expect these questions of law to further consolidate around accepted market practice and perhaps to be shaped further by express CBI guidance.

Securitisation Regulation

The introduction of the Securitisation Regulation in 2019 represented a long-awaited reform of the EU securitisation rules. It took the existing patchwork of legislation governing European securitisations and replaced them with harmonised rules on due diligence, risk retention and transparency applying to particular types of securitisations. Since its introduction we have often had to make the distinction to clients that it only regulates “securitisations” as defined in the Securitisation Regulation and that transactions that do not meet this definition are not regulated per se in Ireland.

New Transparency RTS

One provision of the Securitisation Regulation which was awaiting implementation was the development by the European Securities and Monetary Authority (the ESMA) of draft regulatory and technical standards (including detailed draft disclosure templates). These templates specify the information required to be disclosed in respect of underlying exposures and quarterly investor reports (the Transparency RTS). While they had been circulated in draft and subject to extensive industry

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scrutiny and discussion, for a considerable period of time, they were only formally published by the ESMA and became law on 23 September 2020. As a result, there has been a significant amount of activity in ensuring that in-scope securitisations (ie, those issued on or after 1 January 2019) comply with the finalised reporting requirements prior to each transaction's relevant next reporting date.

STS securitisations

One of the key innovations of the Securitisation Regulation was the creation of a framework for "simple, transparent and standardised" securitisations which have become known in the market as STS securitisations. They have proven attractive as they allow certain institutional investors to potentially benefit from more favourable regulatory capital treatment for STS exposures. One of the requirements for a transaction to qualify as an STS securitisation is that the originator, sponsor and securitisation special purpose entity (SSPE) must be established in the European Union. This further enhances the attractiveness of Ireland as a post-Brexit location for securitisations. It is therefore unsurprising that a number of STS transactions came to market in 2020 and we expect this number to increase in 2021.

CBI oversight powers

The Securitisation Regulation gave the CBI, as competent authority, significant powers to supervise and enforce compliance with its provisions. Over the course of the last year, the CBI has taken steps to exercise these powers and has communicated with the market to detail the way in which it should be notified of securitisations that fall within the scope of the Securitisation Regulation. In addition, during the summer of 2020 the CBI issued a questionnaire to Irish originators to survey Securitisation Regulation compliance. We understand that respondents have yet to receive feedback from the CBI on their submissions to date but it is likely that the data set gathered will form the basis of future CBI action on guidance in the area (for example, in respect of required policies and procedures under Article 30 (Powers of the competent authorities) of the Securitisation Regulation).

Summary

The Securitisation Regulation was introduced to revive EU securitisation activity so as to better diversify funding sources, unlock capital and create one of the building blocks for the EU's capital market. As we approach the two-year mark since its introduction, we believe that it is contributing to the accomplishment of these goals and is a net positive for securitisation participants across Europe.

Credit Servicing

There is significant political and public interest in the question of credit servicing in Ireland, particularly with respect to

Irish RMBS. As a consequence, the Irish Consumer Protection (Regulation of Credit Servicing Firms) Act was introduced in January 2019. It radically altered the operation of the secondary acquisition, ownership and servicing of performing and non-performing Irish consumer loans, and certain small and medium enterprise (SME) loans, by extending the scope of regulated activities to include legal title holding in, as well as management and control of, such assets.

Increased focus on the legal title holder

The foregoing act resulted in a large number of SPVs holding Irish loan portfolios applying for credit servicing licences, with many of these applications still being actively scrutinised by the CBI. While the NPL primary and secondary market was largely put on hold this year due to the pandemic, the market had largely digested the new regime with the existing, traditional credit servicers expanding their service lines to include these two new regulated activity headings. Nonetheless, for those existing fund and bank participants who have obtained transitional or full licences, this may offer some competitive advantages as and when the market restarts.

European NPL law developments

There are questions as to whether this legislation conflicts with the EU's proposed directive on credit servicers, credit purchasers and the recovery of collateral (the NPL Directive), the text of which was first published in March 2018. The draft NPL Directive largely reflects the position in Ireland before the introduction of the 2019 Irish credit servicing regime as it provides for the regulation of credit servicers – but not credit purchasers. In addition, the draft NPL Directive makes it clear that there is no justification for requiring investors on secondary markets to apply for authorisation, or to set special conditions when investors are buying existing credit at their own risk and do not cause prudential concerns.

The NPL Directive is still under discussion and at first reading stage by the EU Council. However, it is listed in the European Commission 2021 work programme as a proposal which requires swift progression. It is therefore likely that the NPL Directive will be implemented later in 2021 or 2022. When this occurs, the current Irish regime will need to adapt and so we expect that there will be further developments in this area in the coming year.

LIBOR Benchmark Reform

The year 2020 was a critical one for firms preparing for LIBOR transition. The deliberations and decisions published by the UK Working Group on Sterling Risk-Free Reference Rates have been closely followed by Irish financial institutions and funds to ensure that they are prepared for LIBOR cessation by the end of 2021.

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The CBI has focused on ensuring that its supervisory expectations with respect to the LIBOR transition have been made clear to regulated entities. On 28 February 2020, the CBI circulated a letter to the industry reminding the boards of fund management companies that they are responsible for ensuring that preparations for the impact of the benchmark reforms are in place for each fund they manage.

Environmental, Social and Governance (ESG)

Historically, the securitisation market has not focused on environmental, social and governance factors. It is easy to understand why this was the case; however, one of the key lessons of the global financial crisis was the importance of considering the ESG implications of financial products, and the necessity for investors' interests to be aligned with those of broader society. As a consequence, the EU has pushed towards creating a framework for sustainable finance as part of a roll out of its "green agenda". The onset of the pandemic, and the systemic inequalities it has exposed, has seen focus on this topic intensify and there have been a number of key developments in 2020.

The EU Regulation on the Establishment of a Framework to Facilitate Sustainable Investment (which is more commonly referred to as the Taxonomy Regulation), adopted in June 2020, 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. Currently the taxonomy is limited to environmental objectives, but the development of a social and governance-focused taxonomy is likely to be accelerated in light of the pandemic. It is expected that the regime prescribed by the Taxonomy Regulation will be established by the end of 2021 for implementation by the end of 2022.

While these measures are primarily directed towards AIFM/UCITS managers and MiFID portfolio managers or advisors they are demonstrative of a clear trend line in legal and regulatory developments. In the coming years we expect that securitisation vehicles will be increasingly structured to account for ESG requirements and market-driven demand in the area. For example, more and more European CLOs are coming to market with certain ESG labels or investment criteria. As banks and other originators create more green finance products, such as green mortgages, these will be pooled to exclusively or partially target ESG focused investors.

Green finance

By providing the investment necessary to achieve sustainability ambitions, sustainable finance has a key role to play in solving the global climate crisis. Ireland has a strong track record of adapting to changes and demands in the global financial market and therefore it is not surprising that it has established itself as a

"green" international finance hub. In November 2019, the Irish Stock Exchange (now trading as Euronext Dublin) launched the Euronext Green Bonds initiative. It is a dedicated area on the Euronext website where green bonds listed on all Euronext markets are consolidated onto one highly visible area. This offering gives investors the opportunity to discover and participate in sustainable investment opportunities across all Euronext exchanges. In order to be included in the initiative, the green bonds must be aligned with particular industry standards such as the International Capital Market Association's Green Bond Principles. International organisations have recognised Ireland's sustainable finance credentials, as was evidenced by the World Bank's decision to list its EUR1.5 billion ten-year Global Sustainable Development Bond on the Euronext Dublin in 2019.

Tax Developments

In recent years, the key changes in Irish tax law of relevance to securitisation structures have related to Ireland's implementation of international tax initiatives such as the OECD BEPS project and the EU Anti-Tax Avoidance Directives (ATAD).

In 2019, Ireland implemented ATAD anti-hybrid rules. These rules have not had a significant impact on Irish securitisation vehicles as they primarily target arrangements between associated entities. Securitisation vehicles are usually structured in a manner which means that this test of association is not met and therefore the rules do not apply. By this point, the legal analysis is relatively streamlined and rating agencies have adapted to the new opinions being provided on this technical area.

At the end of 2019, the Irish legislature also expanded the Irish transfer pricing regime such that it became applicable to non-trading entities such as securitisation vehicles. However, in expanding these rules the legislature introduced a carve-out for payments of interest made on profit participating notes (PPNs) issued by Irish securitisation companies.

The most significant change was one to Irish anti-avoidance rules aimed at structures where over 20% of the equity tranche of notes was held by a person with a significant influence over the issuer. An unintended consequence of the legislation was felt in cases where the collateral manager or an affiliate, such as a risk retention vehicle, held horizontal risk retention notes. The rules can impact the deductibility of interest paid to such noteholders. This change has led to increased analysis of risk retention structures in the course of securitisation transactions. In general, most managers have adapted to these changes although it is an area best addressed in establishing the risk retention structure.

Looking to the year ahead, it is expected that the ATAD interest limitation rule will be implemented in Ireland with effect from

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January 2022. Further analysis of the potential impact of this on securitisation vehicles may be required when draft legislation is published although, given the nature of Irish securitisation vehicles, no material impact is expected.

Overall, while changes in Irish tax law over the past couple of years have given rise to certain additional analysis and structuring discussions, they have not tended to negatively impact securitisation transactions when properly addressed.

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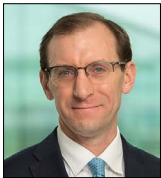
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