# The Lending and Secured Finance Review

Fourth Edition

**Editor**
Azadeh Nassiri

The Law Reviews

# THE LENDING AND SECURED FINANCE REVIEW

FOURTH EDITION

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This article was first published in August 2018
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THE LAWREVIEWS

**Chapter 12**

# IRELAND

*John Breslin and David Burke*[1]

## I OVERVIEW

The corporate lending market in Ireland continues to be particularly active in the real estate (investment and development), pharma and technological sectors – all of these being significant drivers of the Irish economy. Much of the lending in terms of volume tends to be to the small to medium-sized enterprise (SME) sector.

Currently market conditions are positive, albeit that the impending departure of the United Kingdom from the European Union (Brexit) has created a great deal of uncertainty in the economy. As with a number of other EU Member States, there is an oversupply of credit to meet available demand. In addition to banks, there are a number of venture capital and private equity credit providers. There are also a number of bespoke lenders providing SME finance in the property development sector. The recently enhanced competition in the Irish lending market has contributed to a 'covenant-lite' environment and somewhat increased bargaining power for borrowers. Therefore, if a credit proposition is favourable, there is a very healthy market for debt finance. However, the challenge at the moment is matching the amount of available credit to sound investment opportunities.

Currently deal activity is most active in the real estate sector. Regulated financial institutions have, since the financial crisis, sold large loan portfolios in response to regulatory requirements to consolidate their balance sheets. The number of portfolio sales by Irish licensed banks has greatly increased recently (including non-performing loans (NPLs). Over time, portfolio sales have introduced to the Irish debt market a large number of US and UK private equity funds that have since established a very significant presence. There has been, therefore, a good supply of substantial property-based financings (including bank and mezzanine financing of property development groups). There is also a steady flow of aircraft finance work in Ireland, with a number of leading global aircraft leasing firms headquartered in Ireland.

Syndicated lending occurs in Ireland, but this tends to be in deals towards the larger end of the corporate spectrum and is the exception rather than the rule. For large financings, structures commonly used involve senior and mezzanine finance models (often with a regulated institution providing senior finance and private equity the mezzanine piece), or fund structures. These include investment companies, and Irish collective asset-management vehicles – a bespoke statutory corporate fund tailor-made for tax-transparent fund strategies.

Loan Market Association (LMA) documentation is commonly used in large to medium-sized transactions. Irish law firms that are players in the commercial loan space are

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used to adapting the LMA to Irish requirements. Ireland is a common law jurisdiction with a long and close common history with the United Kingdom, and, therefore, the LMA is easily adapted to meet particular Irish law requirements.

Irish and EU banks continue to be the main players in all sectors, but increasingly, alternative finance providers such as private equity houses, fund lending structures and asset managers play an ever more significant role. Specialist lending vehicles structured as qualifying investor alternative investment funds (QIAIFs) regulated by the Central Bank of Ireland are becoming more commonly used. EU-sourced funding plays a significant role too, in particular the Irish Structural Investment Fund (ISIF), often partnering with other credit providers in projects that are suitable for ISIF's portfolio. There is a limited peer-to-peer and crowdfunding market in Ireland. This is an area that will likely be subject to regulation quite soon.

Notable recent deals include the acquisition by Avolon (a major Irish-based aircraft lessor) of CIT Group's aircraft leasing business. This US$10.38 billion deal was one of the largest transactions of its kind during 2017 and involved a syndicated term loan, intergroup financing and equity investment, and a US$3 billion private placement.

Overall trends include increasing competition on the lender side with more alternative lenders entering the market to fund large and medium-sized deals. This is has led to a covenant-lite environment. Real estate still leads the way, in particular, with development deals to provide office space and housing in large urban centres.

## II LEGAL AND REGULATORY DEVELOPMENTS

The key legal and regulatory development in the area of secured lending has been as the coming into effect, in June 2015, of the Companies Act 2014 (CA 2014). This substantially removed from security registration requirements many types of financial asset (such as bank accounts and units in collective investment schemes). This is to reflect the intent of the EU financial collateral regime. However, CA 2014 requires urgent amendment to bring charges over shares in non-Irish companies outside the scope of the registration regime. This issue has now been addressed in amending legislation affecting a number of 'running repairs' to CA 2014. It also changed procedures for registering security introducing a one and two-stage process and electronic filing. CA 2014 also ironed out some difficulties in predecessor legislation dealing with the whitewash of financial assistance transactions and connected party security.

## III TAX CONSIDERATIONS

There is a general trend internationally and in the Irish market in which investors are allocating capital to the origination of loans as an asset class. The structures being utilised in an Irish context typically involve the use of an Irish investment vehicle such as the Irish 'Section 110 company' (that is a company that meets the conditions set out in the Section 110 Taxes Consolidation Act 1997 for the tax treatment therein) and QIAIFs. The Central Bank of Ireland recently relaxed the rules on loan origination by QIAIFs. The borrowers are typically based in Ireland, Europe and the United States, and investors include EU and US investment firms and sovereign wealth funds.

The key Irish tax considerations that impact loan transactions principally relate to the following.

### i Deductibility of interest

Interest payable by an Irish corporate borrower is deductible as a trading expense, as a charge on income or as a deduction against rental income for a property rental business. While there is generally no relief for interest on money used to acquire general investments (apart from certain shares and realty) a deduction is given for interest payable by a Section 110 company provided that, where the interest is profit dependent, it is paid to an Irish-resident lender or is subject to tax in an EU or treaty state or is paid on a quoted Eurobond. Special rules apply to related party debt. Recent changes to the Section 110 company regime have restricted deductibility where a company holds assets that derive their value from Irish land unless they are held as part of a CLO, CMBS/RMBS or loan origination transaction and certain conditions are met.

### ii Withholding taxes

Irish-source interest on loans of more than one year is subject to withholding at a rate of 20 per cent unless an exemption applies. Perhaps the most common exemptions in the secured lending context are for payments to the following types of lender: Irish banks and Irish branches of EU-regulated banks, companies resident in an EU or treaty state and Irish Section 110 companies. LMA standard loan documentation includes 'qualifying lender' provisions. The effect of these provisions is that, if withholding tax applies to any interest payments, the borrower does not have to compensate the lender by increasing those payments ('gross up') unless the lender is a 'qualifying lender', as defined, on the date they became a party to the loan agreement. The definition of 'qualifying lender' is drafted to reflect the conditions for the many exemptions from Irish withholding tax in the Irish tax legislation. As a result, the day-one risk of withholding is placed on the lender whereas any change of law risk is taken by the borrower.

### iii Stamp duty

There is typically no stamp duty on the making of a loan or on any security for the loan. Stamp duty can apply on the transfer of the loan where it contains certain equity-like features (e.g., convertible into Irish shares), but if the loan is sold in the ordinary course of business of either the vendor or the purchaser, then no stamp duty should apply.

### iv Foreign Account Tax Compliance Act and Common Reporting Standard

FATCA and CRS have been implemented in Ireland by regulations. Both require reporting of investors by Irish 'financial institutions' (which generally includes funds and investment vehicles) unless the investors are themselves financial institutions in participating states. In our experience, the impact of Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) on the structuring of secured lending transactions has been limited. There are typically mutual obligations to provide information to enable the parties to comply with their FATCA and CRS reporting obligations, if any.

## IV CREDIT SUPPORT AND SUBORDINATION

### i Security

The following are the principal methods of taking security under Irish law and the types of asset to which they principally relate.

*a* Mortgage: this is the transfer of the legal interest in the asset subject to the borrower's right to have the legal interest conveyed back when the loan is paid off (the equity of redemption). A mortgage is most commonly used for real estate, ships and aircraft.

As regards real estate, a prescribed form of security instrument is required to create security over land the title to which is registered in the Property Registration Authority. A mortgage of registered land is referred to in the relevant statutes as a 'legal charge'.

*b* Charge: this is a proprietary security interest comprising the chargor's agreement that the creditor on a default has the right to appropriate and realise the charged asset to pay off the underlying debt and for any net surplus to be returned to the borrower.

The charge is the most common form of security interest under Irish law because of its flexibility. It is principally used for shares, bank accounts and other receivables, and intellectual property.

*c* Floating charge: this is a form of charge suitable only for assets being turned over in a business (e.g., stock in trade) that are also intended to be security for a loan. It enables the chargor company to sell the assets without the need for creditor consent and without triggering a default. However, a charge created as a floating charge ranks behind certain preferential creditors under Irish law (e.g., the Revenue Commissioners, employees in respect of salaries and other payments, and local authorities to whom local taxes are owed). Under Irish law, except for statutory floating charges over agricultural produce, it is not possible for an individual or a partnership to create a floating charge.

*d* Pledge: this is essentially the same as a charge (albeit that there is no such concept in Irish law as a floating pledge).

*e* Lien: this is the right to retain possession of an asset while the underlying debt remains undischarged but does not normally carry with it the right to sell the asset. A lien can arise as a matter of contract and also by operation of the common law (e.g., a mechanic's or a shipyard's lien to retain the vehicle or vessel until work is paid for).

A 'bankers' lien' is more correctly described as a right of set-off.

*f* Legal assignment: this is the same as a mortgage. It is commonly used for creating security over receivables. The debtor transfers ownership of the receivable as security for the debt: the creditor gives notice to the third party obliged to pay the receivable. Therefore the third party must pay the receivable to the creditor, at which point the third party discharges its obligations.

*g* Equitable assignment: this is the same as a charge. Like a legal assignment, it is commonly used for creating security over receivables. In this instance, however, notice of the assignment is not given to the third party obliged to pay the receivable. Therefore it is a weaker security than the legal assignment because the third party could pay the receivable (thereby defeasing the asset) without the knowledge of the creditor. However, it is more popular because it is less disruptive to the debtor's business than a legal assignment. The debtor's customers are not given conflicting instructions as to whom payment of their debt should be directed. It is very commonly used in the context of creating security over bank accounts.

The most common means of taking all-asset security from a company is by way of a debenture, which is essentially a deed that can create all of the different types of security interest over the assets that are relevant to the transaction. Under CA 2014 it is possible for a creditor that can identify at an early stage the precise assets over which it is proposed to receive security to obtain enhanced priority by engaging in the two-stage security registration process. However, this process has not been utilised in practice to the extent originally anticipated. This is probably because secured assets are not identified with sufficient precision early enough to make the process worthwhile.

In spite of CA 2014, there are still some particular issues to do with corporate security that need to be addressed in Irish law. Practitioner treatment of the effect of the Financial Collateral Regulations can differ among Irish commercial lawyers, some of whom take an unduly conservative approach and continue to recommend that the creation of collateral over financial instruments should still be registered under CA 2014, which goes against the spirit of the EU financial collateral regime. A more robust legislative statement would be welcome.

### ii Guarantees and other forms of credit support

The principal forms of credit support used in secured lending are guarantees and indemnities. Since the onset of the financial crisis in 2008, personal guarantees by business sponsors are less favourably viewed by lenders. This partly arises from occasionally zealous protection of personal guarantors in the Irish courts. Guarantees and indemnities therefore tend to be given by other companies in the borrower group.

Negative pledges still feature in corporate security, particularly all-asset debentures. Since CA 2014, the practice of including reference to a negative pledge in security registration has fallen away because CA 2014 provides that including a reference to a negative pledge in registered particulars has no statutory effect. Set-off provisions are also standard in most loan or security deals and cash-pooling arrangements within groups are also commonly encountered.

### iii Priorities and subordination

Debt subordination is typically effected on a contractual or on a structural basis. A debt subordination or priorities agreement is effective under Irish law for the parties to regulate their rights to receive payments from an obligor. Structural subordination is achieved through creditors advancing credit at different levels of a group structure – normally the senior creditor will feature at the level of principal trading company with junior creditors having claims against a holding company. This means that the junior creditor claim is dependent on the subsidiary discharging the senior debt and declaring a dividend to the holding company. Contractual subordination enjoys statutory recognition under CA 2014.

## V LEGAL RESERVATIONS AND OPINIONS PRACTICE

Ireland enjoys a common law tradition and therefore in general, aside from consumer credit transactions, the principle of freedom of contract prevails. To date, the principal basis upon which Irish courts have intervened is where creditors look to impose direct or indirect impediments to a borrower repaying or refinancing its loan. In general, Irish courts are astute to protect the borrower's equity of redemption. Recent case law has shown that attempts to impede a borrower from repaying a loan (e.g., by invoking 'penalty' default rates) will not be permitted.

CA 2014 has minimised the impact of the *ultra vires* rule for company outsiders. It remains important, however, to show that a transaction is for the benefit of a corporate obligor. This tends to feature where a company is providing security for the obligations of other companies in its group.

CA 2014 provides for prohibitions on financial assistance for the purpose of the acquisition of shares in the obligor company or its holding company. The prohibition is subject to limited exemptions. It is possible for such a transaction to be pre-approved by way of the Summary Approval Procedure under CA 2014 (SAP). The SAP is not available to public limited companies. The SAP is not available either to a subsidiary of a public company for the purpose of the acquisition of shares in the public company. The test for determining whether a transaction amounts to financial assistance has been helpfully narrowed by CA 2014.

CA 2014 also provides for prohibitions on a company providing a loan or security for a loan to a director of the company, a director of certain group companies and persons closely connected to such directors (Connected Party Transactions). CA 2014 provides that the SAP can apply to pre-approve a Connected Party Transaction provided that it can be shown that the company will not be rendered insolvent as a result of the transaction.

Security granted in the onset of insolvency is vulnerable under CA 2014:

*a* any security that is intended to prefer one creditor over another is voidable by the company or its liquidator if it is entered into within one year of insolvency (or three years where the preferred person is connected to the company);

*b* a floating charge over a company's assets will be void if it has not been granted in consideration of new lending and has been created within 12 months of the date of insolvency (or three years if the floating charge is granted in favour of a person connected to the company); and

*c* any transaction that amounts to the improper or fraudulent disposition of property can be set aside in the winding-up of the company. There is no statutory time limit applicable.

Legal opinions practice in Ireland closely mirrors that carried on in the United Kingdom. In Ireland, creditor and debtor counsel can provide opinions in respect of transactions. It is normal, however, for creditor counsel to provide an opinion that the transaction documents create legally binding and valid obligations under local law and for debtor counsel to opine that the transaction is within the capacity of the obligor and has been duly authorised on behalf of the obligor. Such opinions are usually addressed to the creditor.

The Rome I and Rome II Regulations apply in Ireland. An Irish court will uphold parties' choice of law subject to the very limited public policy exceptions provided for in Rome I Regulation. Again, subject to very limited public policy exceptions, a court judgment obtained in another EU or EEA member state can easily be enforced in Ireland. Judgments obtained outside the EU and EEA require to be enforced by way of separate proceedings in Ireland and there are greater restrictions on the enforcement of such judgments. For example, the claimant will have to show (among other things) that the court properly assumed jurisdiction over the defendant and that the judgment does not seek to enforce a revenue debt and is otherwise consistent with Irish public policy.

## VI LOAN TRADING

Loan participations can be traded in Ireland. It is common for major corporate and real estate loans to be syndicated, although sub-participations occur also.

The most common methods of loan trading in Ireland are as follows:

*a* Loan or loan portfolio sale: in the wake of the financial crisis and steps taken by authorised banks to bolster their balance sheets in the light of regulatory capital requirements, there has been a significant amount of loan sale activity – albeit tapering off at the moment. The legal method adopted is an assignment by way of outright transfer of the loans together with an assumption by the transferee of all outstanding obligations.

*b* Syndication: the syndicated loan market is relatively buoyant in Ireland. Syndication involves syndicate banks entering into the facilities and security documentation through an agent bank.

*c* Sale of sub-participations: the sale of a sub-participation is either funded (in which case it is a *pro rata* assignment of the right to receive payments of interest or repayment of capital) or unfunded (in which case it also involves an obligation on the sub-participant to fund future advances).

*d* Novation: novation entails the creation of a new contract between the original lender, the original borrower and a new lender. Novations tend to be rare as they can be expensive and cumbersome to organise.

*e* Other: other potential methods of transferring obligations include a scheme of transfer pursuant to Part III of the Central Bank Act 1971 and a cross-border merger. A Part III transfer must be approved by the Minister for Finance, but once it is then the entire banking business (together with all loans and underlying security) transfer across to the transferee. Cross-border mergers occasionally occur albeit that the EU cross-border regime envisages the new entity having to carry out all required registrations to ensure it can enforce security: see *Kavanagh v. McLaughlin* [2015] IESC 27.

## VII OTHER ISSUES

The tide of regulation continues to flow relentlessly. In particular, one needs to be alert with regard to the following less obvious issues. First, purchasers of loans or loan portfolios from authorised banks must appoint a Central Bank of Ireland (CBI)-authorised credit servicer where the underlying loans are to individuals or SMEs. This is to comply with recent legislation designed to ensure that borrowers who enjoyed regulatory protection continue to enjoy it even where an unregulated entity purchases the loan. There is an initiative at EU level to introduce a system of authorisation and passporting for credit servicers: this is in order to improve the tradeability of NPLs. Draft Irish domestic legislation currently before the Irish parliament which looks to establish an authorisation regime for loan owners looks to be in conflict with the EU initiative on NPLs.

Second, a detailed credit reporting regime has just recently gone live. The purpose of this statutory regime is to ensure that the CBI can access a wide range of credit information for statistical purposes. The duty to report statistical loan data to the CBI's central register applies to licensed and unlicensed lenders and the definition of in-scope credit is very broad.

Thirdly, market participants and their advisers are closely following potential developments in the regulation of the non-bank lending sector together with EU moves to provide a uniform regime for SME credit. Finally, as noted above, the Irish government is likely to introduce regulation for crowdfunding.

## VIII OUTLOOK AND CONCLUSIONS

General economic growth in Ireland looks relatively positive at the time of writing, albeit that concerns arising from the terms for Brexit, together with the implications for the land border with Northern Ireland, mean that one must be cautious about the short to mid-term economic outlook.

**Appendix 1**

# ABOUT THE AUTHORS

**JOHN BRESLIN**

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John is a partner in the finance department of Maples and Calder, Dublin. John is the author of *Banking Law* – the first ever text on the subject in Ireland. It continues to be the leading text in the area and is now going into its fourth edition. John advises banks and other financial institutions on transactional and regulatory issues. John has acted for banks in leading funds-based financings, and advises clients on all aspects of banking and insolvency law. John is also the head of Maples' advocacy group.

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ISBN 978-1-912228-44-7