Chambers
Global Practice
Guides

Definitive global law guides offering
comparative analysis from top-ranked lawyers

Banking Regulation 2022

Ireland: Trends & Developments

Joe Beashel and Niamh Mulholland
Matheson

practiceguides.chambers.com

Trends and Developments

Contributed by:
Joe Beashel and Niamh Mulholland
Matheson ***see p.8***

Introduction

In many ways, 2021 has been one of the most significant years of change in the Irish banking sector since the banking crisis in 2008. Both the retail and commercial sectors have seen significant structural shifts as banks exit the market and fintechs rapidly increase their customer bases and variety of offerings, and Brexit continues to see an augmentation in personnel and expertise moving to Dublin from London.

Retail Banking

The retail banking sector has seen a significant shift in the last year, with a number of long-established banks leaving the Irish market. Meanwhile, the remaining banks continue to pivot their business models towards "online-first", to compete with rising competition from fintechs.

In February 2021, Natwest-owned Ulster Bank confirmed that it would exit the Irish market after more than 160 years. Only a short number of weeks later, in April 2021, KBC announced that it also planned to exit the market.

The decisions of Ulster Bank and KBC appear to be motivated by difficulties in achieving profitability at the same level as banks in other jurisdictions. On average, Irish banks are required to hold about three times the amount of capital as their European counterparts, according to a study by the Banking Payments Federation Ireland. These high capital requirements combined with a prolonged period of low interest rates appear to have made achieving a targeted return on investment more challenging for Irish banks.

AIB, Bank of Ireland and Permanent TSB remain as the domestically licensed retail banks in the Irish market. The loan books of Ulster Bank and KBC look set to be absorbed by the two largest remaining banks, AIB and Bank of Ireland, effecting a somewhat inevitable consolidation in the market.

Each of the remaining banks is still partially owned by the Irish State, a hangover from the 2008 banking crisis. However, in 2021, the Irish government made its first moves to gradually divest from Bank of Ireland, with the State reportedly reducing its stake from 13.9% to 11.87% between June and October 2021. The government appears to be taking a more cautious approach to divesting its respective 71% and 75% stakes in AIB and Permanent TSB.

2021 also saw an unprecedented number of bank branch closures in Ireland: Bank of Ireland closed 88 of its 257 branches in 2021, and AIB announced that it would close 15 of its branches, leaving it with a total of 170 branches across the country. Bank of Ireland stated that its decision was due to a "tipping point" being reached between online and offline business. AIB gave similar reasons for the closures and also noted that negative interest rates and competition from non-traditional lenders played a role in the decision. The closures are emblematic of the increased moves towards the provision of financial services by means of digital platforms, but they have proven somewhat politically unpopular, particularly in rural areas. Given that the two banks are operating in the same environment, the difference in scales of the closures is notable.

Fintechs

In contrast to the consolidation occurring in the traditional retail banking sector, there is considerable growth and competition coming from fintechs entering the market. Revolut now boasts more than 1.5 million Irish customers and N26, another digital-first bank, almost doubled its Irish customer base in just 18 months, adding roughly 100,000 new Irish customers between 2020 and mid-2021. UK-based Starling Bank raised GBP272 million in funding in 2021, and is reportedly seeking a banking licence from the Central Bank of Ireland (CBI). Such an authorisation would bring, inter alia, the ability to utilise the EU passport for the provision of financial services under CRD/CRR. Klarna, Flexifi, Avantcard and Finance Ireland are also amongst this growing suite of firms operating in areas that were previously dominated by the traditional banks.

In addition, new models for lending and raising capital are gaining traction. Peer-to-peer lending firm Linked Finance surpassed EUR150 million in loans provided to Irish small and medium-sized businesses in 2021 and became the first non-bank lender to offer loans through the government's COVID-19 Credit Guarantee Scheme. Crowdfunding platform Spark Crowdfunding saw the number of investors on the platform grow by more than 140% in the first six months of the year.

Regulation in this area is continuing to progress through the legislative process through to implementation and application. For example, crowdfunding, which was previously unregulated, will now be subject to the Regulation on European Crowdfunding Service Providers. Crowdfunding service providers provide an online platform that connects potential investors with businesses in search of funding. The introduction of this EU legislation brings the benefit of allowing crowdfunding service providers to "passport" their authorisation to provide their services into other EU countries on a cross-border basis. This should be a simpler process than trying to navigate the fragmented domestic legislation that previously applied to crowdfunding activities in the EU.

It has been 13 years since a person (or persons) using the name Satoshi Nakamoto invented Bitcoin and sowed the seeds of the cryptocurrency boom of the last decade. The original goal of cryptocurrency was to create a peer-to-peer payment system that disposed of the need for regulated "trusted third parties" to act as intermediaries for payments. The reality has transpired to be somewhat different.

Cryptocurrency exchanges have performed strongly, acting as intermediaries for cryptocurrency payments. Furthermore, on the theme of new and enhanced regulation, cryptocurrency service providers and issuers will be closely watching the development of the proposed new EU regulatory and supervisory regime for markets in crypto-assets ("MiCA"). The core objective of MiCA is to establish a new legal framework for crypto-assets that are not already covered by existing EU regulations. In particular, specific rules will be introduced for stablecoins. As part of the ordinary legislative procedure, the European Parliament's Economic and Monetary Affairs Committee published its draft report on MiCA in 2021, detailing some suggested amendments to the draft legislation, as proposed by the European Commission. The European Central Bank (ECB) also published an opinion on the proposal, which also proposed that certain adjustments should be made.

Banking clients have noted that the pandemic has accelerated the move by businesses away from cash, creating an increased focus on the ability to process payments as efficiently as possible.

*Contributed by: Joe Beashel and Niamh Mulholland, **Matheson***

Commercial Banking

On the wholesale banking side, Brexit caused significant changes to the structure of the domestic market. Although no new banking authorisations have been sought from the CBI as a direct result of Brexit, there has been an expansion in the amount of assets held and products offered by banks in Ireland. Barclays Bank has dramatically increased its presence and is now the largest bank in Ireland by balance sheet. Citibank and Wells Fargo have also notably increased their Irish footprint.

Expansions into Ireland were made by many banks under the considerable pressure and uncertainty of Brexit. Now that Brexit is more settled, banks are beginning to look past the immediate regulatory necessities to maintain their presence in the EU and towards a more long-term EU strategy. While there may be an impression that Brexit is now over in the banking sector, clients report that the impact is still very much being felt. Firms continue to reassess their Brexit models and operating structure in a very dynamic environment.

A noted trend is the expansion of product offerings in Dublin. Historically, the range of products offered out of Dublin was much narrower than in London. That dynamic appears to be changing as banks add more specialised product expertise in Dublin. The CBI appears to have anticipated this growth in the wholesale market, having established a dedicated Wholesale Market Conduct Team in 2018.

The shift of further staff and business from London to Dublin, and the rest of the EU, seems inevitable. The ECB has reportedly been pushing UK banks to significantly increase their staff numbers and the level of capital in their EU operations. While UK-based banks may have availed of a reasonable level of substance required in the EU as an initial consideration of authorisation of post-Brexit EU operations, it appears that this situation will be short-lived. Clients confirm that they have received representations to move more resources to the EU. In particular, senior management (known as pre-approval controlled functions or "PCFs") are usually expected to be located in the EU. The ECB has been highlighting shortcomings in "desk-mapping" reviews of EU offices and, with the end of temporary pandemic-related reprieves, it is likely that pressure will only increase until EU bank offices are capable of carrying on EU business with little assistance from London.

International clients have noted an increase in the sophistication of the CBI's market capability in recent years. This is undoubtedly linked to the increasing amount of diversity of the types of products offered in the Irish banking sector and a massive increase in headcount at the CBI over the past ten years. The CBI was previously seen as following the lead of UK regulators on new developments, but has more recently been seen as taking the lead on certain issues.

IFD/IFR

The EU's Investment Firms Directive (IFD) and Investment Firms Regulation (IFR) are primarily aimed at creating a new prudential framework for investment firms authorised in the European Union. However, the legislation may lead to an increase in the number of authorised credit institutions in Ireland.

The legislation divides investment firms into a number of different classifications and applies proportional regulation based on the firm's business activity, risk profile and structure. Investment firms that fall into the "Class 1" category will be subject to the same prudential requirements that are applied to banks. "Class 1" firms are defined as being systemically important firms that deal on own account and/or underwrite or place financial instruments on a firm

commitment basis. They also must have average monthly total assets of above EUR30 billion or be part of a group in which the total value of the consolidated assets of all undertakings in the group exceeds EUR30 billion.

In the lead-up to the entry into application date of 26 June 2021, most investment firms across all IFR/IFD designations committed time and resources in order to best prepare for the changes proposed by the prudential regime dedicated to investment firms.

In order to achieve its objective of ensuring the safe functioning of investment firms and the proper management of customer and market risk, IFR/IFD have instigated a number of changes, enhancements and augmentations to the prudential regulation of investment firms.

Key changes effected by IFR/IFD include an amended consolidation regime and revised prudential requirements applied on a differentiated classification scale to investment firms based on the nature, scale and complexity of their business and their regulatory permissions.

There are also considerable remuneration and governance changes that firms will have to effect across 2022, according to the recently finalised EBA Guidelines on Remuneration Policy and Internal Governance.

By the time of entry into application, most investment firms had identified which of the prudential classifications was most pertinent to them. However, in a number of instances, particularly for investment firms of third-country groups, some ambiguity remained as to whether such firms would need to seek authorisation as credit institutions.

As the relevant delegated legislation that will determine the methodology for the calculation of the relevant thresholds set out in Article 8a(1) had not been adopted at the time of the entry into application of IFR/IFD, the EBA issued an Opinion providing direction to firms on navigating their way through the application of Article 8a of Directive 2013/36/EU, and guiding that competent authorities should not prioritise any supervisory or enforcement action in relation to the requirements in said Article until six months after the final methodology is in place.

Depending on the outcome of the consultations and deliberations with respect to the regulatory technical standards on the threshold calculation methodology, a number of MiFID firms that may have originally determined that re-authorisation as a credit institution did not apply on the application of the prudential classifications may now find that such an application for authorisation is needed on the basis of their membership of a global group whose assets will surpass the threshold delineated for Class 1 firms. In practical terms, this could see a number of significant investment firms seeking authorisation as credit institutions across 2022.

Accountability

The CBI has long planned the introduction of a Senior Executive Accountability Regime (SEAR), which it is expected will share similarities with the UK's Senior Managers and Certification Regime. Following a number of delays, the General Scheme of the Central Bank (Individual Accountability Framework) Bill (IAF), which introduces SEAR, was published in July 2021.

The Bill is currently going through pre-legislative scrutiny and, at the Oireachtas Parliamentary Committee hearing on 10 November, the Minister for Finance Paschal Donohue expressed the hope that the IAF would be operational in the early part of 2023. While this indicative commencement date takes cognisance of the legislative timeline, many financial services firms are

currently considering the potential impacts of the provisions in the IAF.

The General Scheme proposes amendments in relation to conduct standards, changes to the Fitness and Probity (F&P) regime, detailed governance requirements and changes to enforcement. Under the General Scheme, the CBI will be able to directly enforce against senior individuals for prescribed contraventions without needing to first prove a prescribed contravention against the firm itself.

Broadly speaking, the General Scheme reflects what was broadly expected by the sector on the basis of the Banking Culture Report and various other CBI publications and speeches on IAF and accountability more generally.

The proposed IAF will be founded on four main pillars:

- conduct standards will apply to individuals in all Regulated Financial Services Providers;
- the SEAR will apply only to a limited sub-set of the industry at first – ie, credit institutions, insurance undertakings, some investment firms and third-country branches of those firms;
- the F&P regime will be enhanced – there will be a certification requirement and other reforms; and
- the Central Bank's enforcement process will be unified and a major hurdle for enforcing against individuals will be removed.

Combined, the SEAR, the F&P regime and the conduct standards are intended to support the Central Bank's objective of individual accountability – which it has stated as being necessary "to embed a culture of ethical compliance in regulated firms".

The conduct standards will apply to all regulated financial services providers. In summary, this aspect of the IAF will delineate:

- common conduct standards to apply to all persons in controlled function roles;
- additional conduct standards for individuals in senior positions; and
- business conduct standards for all regulated firms in the financial sectors.

As noted above, enhancements are also proposed to the existing F&P regime, including the introduction of a certification regime and the enhancement of the CBI's regulation-making powers, such that it will be empowered under the IAF to specify what policies and procedures firms need, what sort of due diligence they must carry out and what reporting to the CBI is required.

The scope of the F&P regime will also be extended, with the result that financial holding companies and insurance holding companies established in Ireland will be captured for the first time. In addition to this extension, another commonly raised question was whether or not the SEAR pillar will be applicable to all regulated financial service providers.

The General Scheme has been consistent with expectations from previous publications in providing that the SEAR will apply to those in management roles within the following entities:

- credit institutions (excluding credit unions);
- insurance undertakings (excluding reinsurance undertakings, captive (re)insurance undertakings and Insurance Special Purpose Vehicles);
- investment firms that have MiFID licences (ie, that underwrite on a firm commitment basis and/or deal on own account and/or are authorised to hold client monies/assets); and

- third-country branches of these types of firms.

The General Scheme of the IAF also outlines that the new "Senior Executives Functions" (SEFs) will align with the existing pre-approval controlled functions (PCFs). This was expected. However, it also seems that the definition of a SEF will include non-executive directors (NEDs) where they are performing PCF roles.

That NEDs would be captured within the scope of the SEF definition was not clear from the Culture Report, and this is something that is likely to be clarified further during the future consultation process.

Furthermore, while there is no express carve-out in the General Scheme for the role of Head of Legal, as they are not PCF they will not automatically constitute a SEF. Again, further clarification on this position is expected in due course.

The extension of the CBI's regulation-making powers is not the only facet of the CBI's powers that the IAF is seeking to address: enforcement powers are also being enhanced and augmented.

The key proposal is the removal of what has become known as the "participation link" in the CBI's administrative sanctions regime. The current situation is that the Central Bank has to prove a prescribed contravention against a firm before it can impose an administrative sanction on an individual who participated in the management of such firm. The CBI sees this as a significant gap in its toolbox; accordingly, the published General Scheme has removed the proof requirement related to the participation link.

The second key enforcement change proposes the direct enforceability by the CBI of the aforementioned conduct standards against individuals. Furthermore, evidence obtained in the course of investigating a failure to meet a particular conduct standard may be used as potential evidence of an F&P failing.

Matheson was established in 1825 in Dublin, Ireland and now has offices in Cork, London, New York, Palo Alto and San Francisco. More than 720 people work across Matheson's six offices, including 97 partners and tax principals and over 520 legal, tax and digital services professionals. Matheson services the legal needs of internationally focused companies and financial institutions doing business in and from Ireland. Its expertise is spread across more than 30 practice groups, including finance and capital markets, corporate, international business, M&A, technology and innovation, intellectual property, insolvency and corporate restructuring, EU and competition, asset management and investment funds, employment, pensions and benefits, commercial real estate, litigation and dispute resolution, healthcare, insurance, tax, private client, energy and infrastructure, fintech and life sciences. The firm works collaboratively across all areas, reinforcing a client-first ethos, and its broad spread of industry expertise enables it to provide the full range of legal advice and services to clients.

AUTHORS

Joe Beashel is a partner in the financial institutions group at Matheson, and head of the regulatory risk management and compliance team. He assists clients with the authorisation of new entities by the Central Bank of Ireland, including banks, MiFID/investment firms, fund services providers, alternative investment fund managers, payment institutions and retail credit firms. He also assists in expanding the regulatory authorisations of existing entities. Drawing on his extensive industry experience, Joe provides practical advice and assistance to boards of directors, senior management, in-house counsel and compliance officers in relation to the impact of new regulation.

Niamh Mulholland is a consultant in the financial institutions group at Matheson. Her primary focus is on providing advice to Irish and international investment banking, investment firm and investment fund clients, through authorisation, regulatory change projects, supervisory engagements, Risk Mitigation Programmes and Skilled Person Independent Reviews. She has advised clients on "own initiative" reviews and change programmes. As a former regulator, Niamh has also advised on supervisory inspections and enforcement actions. She has extensive experience in advising clients on the assessment and implications of AIFMD, UCITS, AML/CTF legislation, MiFID II/MiFIR, CRD/CRR, IFR/IFD and BRRD.

Matheson

70 Sir John Rogerson's Quay
Dublin 2
Ireland

Tel: +353 86 102 8773
Email: niamh.mulholland@matheson.com
Web: www.matheson.com