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Banking Regulation 2023

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Ireland: Trends & Developments

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Trends and Developments

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Retail Banking Sector

The Irish retail banking sector continued to trend towards consolidating the sector into fewer providers in 2022. The industry is also experiencing increasing challenges from new entrants from outside the traditional banking sector.

Departing banks

Two of the five high street banks in the State – Ulster Bank and KBC Bank – are progressing their plans to shut down their Irish operations.

Ulster Bank announced that it was exiting the Irish market in February 2021, leaving behind a 160-year legacy as one of the State's best-known high street banks. Shortly thereafter, KBC Bank announced it was leaving Ireland after 49 years in the market. Both banks are overseas-parented, with NatWest owning Ulster Bank, and KBC Bank being part of the Belgian KBC Group.

Each bank is in the advanced stages of planning its exit, but slow progress has been made on migrating existing Ulster Bank and KBC customers to alternative banking partners.

The Banking & Payments Federation Ireland found that although more than 600,000 new bank accounts were opened in Ireland's remaining retail banks in 2022, few of those customers leaving Ulster Bank or KBC Bank have updated their direct debit originator with these new account details. Figures published at the end of September 2022 show that around 854,000 accounts remain open in Ulster Bank and KBC Bank, amounting to around three quarters of the total number of accounts that were open at the start of the year.

This will be cause for nervousness within the departing banks and indeed within the Central Bank of Ireland (the "Central Bank"), which has been closely monitoring their withdrawal. Migrating existing customer accounts and direct debits to alternative banking providers before the banks fully withdraw remains a Herculean task.

Reduced State ownership

The government has signalled its intention to reduce the stake it acquired in the remaining Irish retail banks as a result of the 2009–2011 bank bailout. Bank of Ireland became the first Irish lender to return to full private ownership when, in September 2022, the government confirmed it had sold the remainder of the 13.9% shareholding it had acquired in the bailout.

The other two high street banks – AIB and Permanent TSB – remain largely State-owned; a legacy of the 2008 financial crisis. In September 2022, the Minister of Finance, Paschal Donohoe, confirmed that the State had reduced its shareholding in AIB from 71.2% to 63.5%, and in Permanent TSB from 75% to 62.4%. Minister Donohoe confirmed to the Parliamentary Finance Committee that the State will continue to gradually release AIB shares back into the private market.

Branch closures

Following the announcement of the closure of 88 Bank of Ireland and 15 AIB branches in late 2021, 2022 saw the continued decline of local branch banking across the country as banks increasingly restructured in favour of online banking services. In July 2022, AIB reversed its decision to make 70 of its 170 branches cashless after the intervention of Minister Donohoe following a political furore.

The reduction in in-person services among the retail banks has pushed customers towards alternative providers, notably An Post and credit unions, which both have extensive branch networks nationwide. An Post has partnered with Bank of Ireland (in March 2021) and AIB (in July 2022) to launch the Everyday Banking service, whereby customers in each of these banks are able to carry out their normal banking services at An Post offices. In this way, An Post looks to be stepping into the space vacated by a retail banking sector as it seeks to reduce its physical branch network.

New entrants

Retail banks are experiencing increasing challenges to their market dominance from non-traditional providers. Digital-only payment institutions and e-money institutions such as Revolut are disrupting the sector, providing app-based services without the costs associated with operating a branch infrastructure.

Likewise, non-bank lenders have continued to increase their market share. As of March 2022, non-bank lenders held 13% of all principal dwelling house mortgages, and close to 30% of new lending in the buy-to-let and refinancing markets. Non-bank lenders have also increasingly participated in the SME lending market, accounting for around 37% of all new SME loans.

Mortgage income rules to ease

In October 2022, the Central Bank announced a relaxation of its long-standing Loan-to-Income limit, to allow households to borrow up to four times their income for a mortgage. This is the first such change to the limits since 2015, when the Central Bank restricted lenders to offering loans of only up to 3.5% of the household income.

The Central Bank had previously indicated in May 2022 that it was to carry out a major mid-year review of its macro-prudential mortgage rules, as an additional measure to their annual assessment.

Tracker Mortgage Fines

On 29 September 2022, the Central Bank reprimanded and fined the Governor and Company of Bank of Ireland EUR100.5 million for regulatory breaches affecting its tracker mortgage customers. Bank of Ireland was the last of six retail banks to be fined by the Central Bank for their involvement in the tracker mortgage scandal. The Central Bank fined the banks a combined EUR278.8 million under their Administrative Sanctions Procedure (the ASP), as prescribed by the Central Bank Act 1942.

The interest rate of tracker mortgages should track the interest rate set by the European Central Bank (the ECB). After the 2008/09 financial crisis, the ECB reduced interest rates dramatically, meaning that tracker mortgages became unprofitable for lenders. Many banks sought to move their existing tracker mortgage customers to more expensive variable rate mortgages. The Central Bank determined that this resulted in customers being overcharged for their monthly mortgage repayments and led to the loss of homes and property. Just over 40,000 customers were affected.

In December 2015, the Central Bank commenced an industry-wide review of tracker mortgage accounts, called the Tracker Mortgage Examination (the TME). The TME required all lenders to examine the extent to which they were meeting their contractual obligations to their customers, and to provide redress and compensation where applicable.

According to the most recent figures published by the Central Bank, the total amount paid to affected customers under the compensation and redress scheme was around EUR638 million as of May 2019.

In addition to the TME, the Central Bank also conducted statutory investigations into the lenders. The most common regulatory breaches found across the enforcement actions in relation to the TME included providing unclear contractual information to customers, failure to warn customers about the consequences of decisions relating to their mortgage, failure to handle customer complaints in a fair and consistent manner, and failure to properly implement the TME's Stop the Harm principles. Larger fines correlated to the number of regulatory breaches, the number of customers affected and the loss of properties (with emphasis on the loss of family homes).

The largest fine from the TME was issued to Bank of Ireland (EUR143.6 million) for a series of significant and long-running failings in respect of almost 16,000 tracker mortgage customers, resulting in the loss of 50 properties, 25 of which were family homes. This is the largest fine ever imposed by the Central Bank. Bank of Ireland admitted to 81 separate regulatory breaches and had its fine reduced by 30% to EUR100.5 million under the Central Bank's settlement discount scheme.

The second largest fine was issued to Allied Irish Banks (AIB), which was reprimanded and fined EUR83.3 million. AIB had just over 10,000 affected customer accounts, resulting in the loss of 53 properties, 13 of which were family homes. AIB had admitted to 57 separate regulatory breaches; its four previous Central Bank enforcement actions were an aggravating factor in this circumstance.

Many other Irish mortgage providers have faced fines as a result of the TME, albeit not to the same quantum as AIB and Bank of Ireland. In March 2021, Ulster Bank was fined EUR37.8 million, and KBC Bank was fined EUR18.3 million in September 2021. Permanent TSB was fine EUR21 million in 2019, in addition to the earlier EUR4.5 million fine against its subsidiary, Springboard Mortgage, in 2016.

Whilst the Central Bank has confirmed the conclusion of its statutory investigation into the lenders, Derville Rowland (Deputy Governor (Consumer and Investor Protection) of the Central Bank) has provided that it will continue to look at "individual accountability" in relation to its investigation. The Central Bank currently possesses statutory power to hold inquiries into the conduct of persons involved in the management of a regulated financial service provider. This reinforces the Irish legislature's trend of extending the Central Bank's ASP powers and serves to further embed compliance culture and individual accountability in the financial services sector.

Senior Executive Accountability Regime

Following the 2008/09 financial crisis, the Central Bank sought additional powers from the government in order to regulate key individuals within regulated entities, rather than merely the entity itself. The first generation of these new powers was the Fitness & Probity Regime, whereby appointments to key positions would be conditional on Central Bank approval.

Following the example of the UK's Senior Manager and Certification Regime, the Central Bank now seeks to enhance its existing powers to regulate individual officeholders within regulated entities. The Senior Executive Accountability Regime (SEAR) is designed to deliver these further powers.

The SEAR will require certain firms and senior individuals within them to establish a framework clearly setting out the structure of responsibility and decision-making. This will be a significant project for many firms, which will need to review their internal compliance structure and document where responsibility for compliance with individual regulations lies.

The SEAR forms part of the Central Bank (Individual Accountability Framework) Bill 2022 (the "Bill") introduced by Finance Minister Pascal Donohoe to Dáil Éireann (the Irish Parliament) on 28 July 2022, alongside an Explanatory Memorandum (the "Memo").

The Bill is expected to make its way through the Houses of the Oireachtas and be enacted early in 2023. However, this Bill has been subject to a number of delays and it is difficult to estimate how long discussions on the more controversial points will take.

Once the Bill is enacted, the Central Bank will open a public consultation, which will be followed by guidance for firms that are affected by the new rules. The Central Bank has advised that it will move quickly to engage with stakeholders, and has urged companies to use this time to reflect on their governance structures, culture, education and training in order to meet the new expectations under the SEAR. The Central Bank envisages that approximately 150 firms will be captured under the SEAR initially, including credit institutions, certain insurance undertakings and investment firms.

The Bill remains in draft format and it is not possible to predict the final wording or the related Central Bank guidance. However, as initiated, the Bill envisages that the Central Bank will have the power to make regulations for senior executive responsibilities. The Memo anticipates that senior executives will be aligned with Pre-Approved Controlled Function (PCF) roles. These responsibilities can be inherent to or allocated to senior executives. The Memo also advises that this will require documentation at an individual level via a "statement of responsibilities" and at a macro level through a "management responsibility map".

The Bill also contemplates placing a duty on persons with SEAR inherent or allocated responsibility to take reasonable steps in the circumstances to ensure compliance with the financial services legislation relating to their area of responsibility. The Bill also provides detail on what circumstances the Central Bank may consider to be relevant in assessing this duty.

There have been some industry concerns about this additional layer of accountability, noting that this regime is unique to Ireland within the EU. However, in contrast, ECB recently released an opinion on the Bill, commenting that it "strongly welcomes the measures envisaged by the draft law". In addition, UK firms will have some familiarity with a similar scheme, known as the Senior Managers and Certification Regime (SMCR).

Intermediate Parent Undertaking

In an effort to ensure stronger resilience of EU banks and to provide stronger tools for supervisors overseeing EU banks, the EU has introduced a number of directives and regulations, together known as the EU Banking Package. The amendments to the Capital Requirements Directive introduced a new requirement to establish an Intermediate Parent Undertaking (IPU) for certain third country groups in the EU. Institutions belonging to third country groups that have at least two licensed institutions in the EU and a total value of assets in the EU greater than EUR40 billion must establish an IPU before 30 December 2023.

Traditionally, a third country banking group may have many separate subsidiary banking operations across the EU. The new structure requires an IPU (an EU parent entity) to be established as a single supervised entity for these individual subsidiaries. An IPU must be a credit institution, a financial holding company or a mixed financial holding company. Where the third country groups are investment firms, or where a second IPU must be established to comply with a mandatory separation of functions, the second IPU may be an investment firm.

Establishing an IPU allows all of the third country group's EU institutions to be consolidated under a common EU parent entity. From a supervisory perspective, this allows for a single consolidated supervision of the third country group's EU activities as opposed to individual supervision of several individual entities. This also allows the consolidated supervisor to evaluate the risks and financial safety of the entire group within the EU and to apply prudential requirements on a consolidated basis accordingly. By establishing an IPU, the EU also seeks to ensure that any third country owned operations are sufficiently capitalised so that there is sufficient capital to absorb the losses if the group fails.

In some circumstances, a second IPU may need to be established in order to comply with the separation of activities imposed by the rules. For example, if an entity offers retail banking and investment banking, two IPUs must be established to separate the activities and the different levels of risk associated with the two activities. The second IPU should be set up for the purpose of allowing the third country group to continue providing services, and should only perform services that are segregated from the activities of the first IPU.

The effect of this new requirement means that firms must quantify their EU assets on an ongoing basis and consider the optimal structure of the IPU. The third country group must also consider the potential restructuring of the group, which may require the establishment of a new parent undertaking and the notification of a change of control.

Large Investment Firms Converting to Banks

The rollout of the Investment Firms Directive (IFD) and the Investment Firms Regulation (IFR) has introduced major change to the prudential framework for investment firms in Ireland. In June 2022, the IFD and IFR were implemented in Ireland by way of amending legislation.

The IFD/IFR introduced a new prudential framework for investment firms authorised under MiFID II. The legislation categorises investment firms based on their size, complexity and risk profile, and assigns prudential regimes accordingly.

At the top level are "Class 1 Firms". These are "systemically important" investment firms that deal on their own accounts and/or underwrite or place financial instruments and either have an average monthly total of assets exceeding EUR30 billion (to be calculated over a 12-month period) or are part of a group where the total value of assets of all group undertakings exceeds EUR30 billion.

The IFD/IFR dramatically change the prudential requirements for these Class 1 Firms. Article 62(6) of the IFD requires Class 1 Firms to apply for re-authorisation as a credit institution. Class 1 Firms are supervised by the ECB under the Single Supervisory Mechanism. They will be subject to the prudential requirements of the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR). Class 1 Firms will also be subject to an initial capital requirement of EUR5 million, with the potential to also be subject to high capital requirements under the CRD/CRR, depending on the type of activities they are performing.

A slightly less vigorous prudential regime will apply to "Class 1 Minus Firms". These are systemic investment firms that deal on their own account or place financial instruments on a firm commitment basis and have an average monthly total assets exceeding EUR15 billion (to be calculated over a 12-month period) or are part of a group in which the total value of assets of all group undertakings exceeds EUR15 billion, or that have high significance in the market or pose significant risks to the wider economy in the event of their failure.

While Class 1 Minus Firms do not have to seek authorisation as a credit institution, they will be subject to additional requirements under CRD and CRR, similar to Class 1 Firms. They will also be subject to the initial capital requirement as set by the IFD for any relevant investment service they provide.

The IFD/IFR also introduce less vigorous but still substantially enhanced prudential requirements for large but not systemically important investment firms ("Class 2 Firms") and small investment firms (Class 3 Firms).

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Matheson LLP 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.

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