Regulating Loan Owners: Proposed Amendments to the Credit Servicing Regulatory Regime

29 November 2018

The sale of non-performing loan ("NPL") books by Irish banks has been the subject of intense political and media scrutiny for a number of years due to the perceived impact of the sales of such loan books on underlying borrowers, particularly consumer and small and medium enterprise ("SME") borrowers.

Recent political debate and discussion on the topic has resulted in the proposal of an amendment to the "credit servicing" regime introduced in 2015 pursuant to the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 (the "2015 Act") to expand the scope of the "credit servicing" regime to also include, amongst other things, the legal holder of title to loans.

During a recent Dáil debate on the relevant amending legislation, the Consumer Protection (Regulation of Credit Servicing Firms) Amendment Bill 2018 (the "Bill"), it was stated by the Minister of Finance that the Government now intends to pass the Bill into law before Christmas/year end. Although the Bill has yet to go to the Seanad (the upper house of the Irish parliament) it now seems unlikely that the content of the Bill will change materially prior to enactment.

Credit servicing under the 2015 Act - the current regime

The 2015 Act introduced regulatory protections for consumers and SMEs whose loans were purchased by entities that were otherwise unregulated by the Central Bank of Ireland (the "CBI"). The 2015 Act accomplished this by requiring the day-to-day servicing, management and administration of loans to "relevant borrowers" - i.e. loans to:

- natural persons within Ireland; and/or
- loans to SMEs, but only where those loans were first originated by a regulated financial service provider,

be undertaken by regulated 'credit servicing firms' on behalf of the owners of that credit.

In practice, this meant that, during the recent loan sales of both performing and NPL books undertaken by the Irish banks and onward secondary sales by loan purchasers, in-scope borrowers would always have found themselves:

- continuing to deal with a regulated financial service provider (a credit servicing firm); and
- receiving the benefit of key CBI consumer and SME protections and codes, such as the Consumer Protection Code, the Code of Conduct on Mortgage Arrears and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015.

However, a key point to note regarding the 2015 Act is that the obligation to obtain authorisation from the CBI did not necessarily fall on the legal owner of the credit, unless they failed to appoint an authorised credit servicing firm.

New regime - amendments being introduced by the Bill

The principal amendment proposed by the Bill expands the current definition of credit servicing in Irish law. In practice, it now appears that a number of unregulated entities that hold title to Irish loans (e.g. special purpose vehicles) and/or control the overall strategy or key decisions relating to the credit, may find themselves subject to regulation.

Credit servicing is defined in the Bill as including:

a. holding the legal title to credit granted under the credit agreement;

b. managing or administering the credit agreement including managing or administering repayments, charges, complaints, and addressing borrowers' financial difficulties under or in relation to the credit agreement;

c. determining the overall strategy for the management and administration of a portfolio of credit agreements; or

d. the maintenance of control over key decisions relating to such portfolio.

This amendment will have the effect of introducing a new, additional 'credit servicing firm' authorisation requirement on, amongst others, the legal owners of loans to "relevant borrowers" (as defined above).

Securisation carve-out

In one important piece of helpful news, the Bill contains a carve-out from the new authorisation requirements for securitisation special purpose vehicles, meaning standard securitisations should not come within the scope of the Bill.

Will the Bill improve consumer and SME protection?

It is debatable whether the Bill will actually achieve its stated 'consumer protection' goal given that it is unlikely to provide any additional regulatory protections to borrowers compared to the current regime. This Bill may instead have the unhelpful effect of further delaying the resolution of the (still substantial) NPL books of regulated Irish lenders, which can only lead to higher costs of credit/financial services for Irish customers.

In progressing the Bill, the Government appear to have ignored the proposals for an EU-level framework for authorising/licencing credit servicers as set out in a draft directive recently proposed by the European Commission as part of an EU-wide package of measures to target NPLs. This draft directive may require yet further amendments to (including potentially rolling back elements of) the Irish credit servicing regime being proposed by the Bill.

In addition, the CBI has raised a number of concerns throughout the Bill's progression through the legislative process, including specifically making a submission on an earlier draft of the Bill (available here) where the CBI reiterated its concerns in relation to the expanded scope of credit servicing.

Finally, an opinion dated 5 July 2018 from the European Central Bank strongly queried the approach noting the approach raised in the draft Bill "*may raise issues of legal certainty*", that "*the impact of the draft law, and the role of the CBI, are not clear*" and that "*the draft law is being introduced without the benefit of a thorough impact assessment*".

Consequences and next steps for current loan owners

Holders of legal title to in-scope Irish loans and those who control the overall strategy or key decisions relating to such loans should review the provisions of the Bill and determine if they will be in scope of the amended definition of credit servicing.

The Bill does not provide for grandfathering, but instead provides for a limited transitional period for those entities that will come within the expanded definition of "credit servicing firm". In summary, where an entity is deemed to be "credit servicing" as a result of the expanded provisions of the Bill, that entity will be "taken to be authorised" provided that entity:

a. applies to the CBI for authorisation within three months of the commencement of the Bill; and

b. currently has a regulated credit servicing firm appointed.

A lot of practical questions remain including whether a bespoke authorisation process will be put in place and/or how SPVs will satisfy the substance requirements associated with becoming a regulated financial service provider. Consequently, we will be keeping developments in this area under close review.

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Contacts

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