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A New Regulatory Framework for Credit Servicing Firms in Ireland

■ Background

The Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 (the “**Act**”) became law on the 8th July, 2015. The Act amends Part V of the Central Bank Act 1997 and has the effect of introducing a new regulatory framework for entities engaged in the holding or servicing of cash loans to Relevant Borrowers (as defined below).

Over the past number of years the Irish market for loan portfolio sales has been very active, with Irish financial institutions and the National Asset Management Agency engaged in on-going programmes of deleveraging of their loan books. This process has raised some concerns, as many purchasers of these portfolios have been unregulated entities, meaning that borrowers may lose the regulatory protections afforded to them, for example pursuant to the Central Bank of Ireland (the “**CBI**”) codes of conduct¹ (the “**Codes**”), when their loans are sold.

■ Introduction

The Act seeks to resolve this situation by requiring firms that are servicing loans Relevant Borrowers apply with the CBI to become authorised as credit servicing firms (“**CSFs**”) on or before 8th October, 2015 and to be regulated by the CBI. If the servicer fails to do so, then the holder of the loans (often a special purpose vehicle) would themselves have to apply for authorisation.

¹ Including the Consumer Protection Code 2012, the Code of Conduct for Business Lending to Small and Medium Enterprises 2012, the Code of Conduct on Mortgage Arrears 2013 and the Minimum Competency Code 2011.

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The effect of this is that consumers and SMEs continue to avail of statutory protections, including those afforded to them by the Codes, where their loans have been sold to unregulated entities. The Act also extends the Financial Services Ombudsman's jurisdiction to cover complaints made by borrowers whose loans are being serviced by CSFs.

There is no minimum threshold for authorisation, either by reference to the value or the number of the loans being serviced. In addition, the CBI does not have any discretion to grant an exemption from the terms of the legislation to any party that falls within its scope.

It should be noted however that SME loans that were originated by lenders that are not the subject of CBI regulation do not fall within the scope of the Act. This is a welcome clarification and is in accordance with the stated aim of the Act; to ensure the continuation of statutory protections for borrowers whose loans are sold from regulated to unregulated entities, while at the same time ensuring that the market in Ireland for the provision of alternative credit is not subject to unnecessary regulatory burdens.

What is Credit Servicing?

Credit Servicing is described as “*managing and administering a credit agreement*” and is stated to include the following activities:

- notifying the borrower of changes in interest rates or in payments due under the credit agreement or other matters that the relevant borrower is to be notified further to the terms of the credit agreement, and
- taking any necessary steps for the purposes of collecting or recovering payments due under the credit agreement from the borrower, managing or administering repayments under the credit agreement and any charges imposed under the credit agreement, dealing with errors made in respect of the credit agreement or complaints made by the borrower, addressing financial difficulties, alternative repayment arrangements, restructuring, assessing the borrower's ability to repay and communicating with the borrower in respect of any of the foregoing.

The owners of affected portfolios will also need to check the contractual terms of their loan documentation to ensure that any activities being undertaken by third parties other than the loan servicer do not fall within the quite broad definition of “*credit servicing*” as it is possible that such parties may also be the subject of the terms of the Act.

What is a Credit Agreement?

A “*credit agreement*” is an agreement whereby a person grants or promises to grant credit (being a cash loan) to a “*relevant borrower*”.

Who is a Relevant Borrower?

The Act provides that a relevant borrower is as follows:

- (i) any individual person (excluding professional clients for the purposes of MiFID and persons who are regulated service providers) situated in Ireland; or
- (ii) any SME (i.e. an entity that employs fewer than 250 persons and has an annual turnover of not more than €50 million and/or an annual balance sheet total of not more than €43 million).

The definition of SME is that contained in EU Commission Recommendation 2003/361/EC of 6th May 2003. This definition is broad and includes companies, partnerships and sole traders. The Act does not appear to restrict its purview to SMEs located in Ireland, but it is assumed that this is unintentional and that it is not intended to apply to SMEs located elsewhere.

What Does Not Constitute Credit Servicing?

As outlined above, the definition of “*credit servicing*” is quite broad; however, certain activities are expressly excluded from its scope. Provided that an unregulated loan owning entity is restricted to taking the high level decisions in relation to a loan portfolio, it will not need to become authorised as a CSF, so long as the day to day servicing and administration is undertaken by a regulated CSF.

In this regard, the following activities fall outside the remit of the legislation:

- determining the overall strategy for the management and administration of the loan portfolio and maintaining the control over key decisions relating to same;
- taking such steps as may be necessary for the purposes of allowing another person to undertake credit servicing;
- enforcing a credit agreement; or
- taking such steps as are required to appoint a receiver.

The rationale for the foregoing exemptions seems to be to ensure that where an entity has purchased a loan book and it seeks to outsource the servicing of same to a CSF that the holder of the loans is not brought within the scope of the regulatory regime by virtue of it undertaking one of the above activities.

However, the Act provides that the holder of the loans must not undertake these exempt actions in a manner which if taken by a regulated entity would amount to a breach of Irish financial services law. This is quite a notable provision of the Act, as it effectively seeks to impose regulatory obligations on unregulated loan holding entities.

Persons Deemed to be authorised

The following persons are excluded from the requirement to become authorised under the Act:

- those holders of credit whose credit is being serviced by a CSF;
- the National Asset Management Agency; and
- entities providing credit servicing to regulated financial services providers (**RFSPs**) where the RFSPs are authorised to provide credit in Ireland.

Impact of Non-Compliance

Carrying on the activity of credit servicing without a licence is a criminal offence. It is also an offence for the holder of legal title to credit granted under a credit agreement to instruct a CSF to take or fail to take any action, if this would amount to a breach of the Act if otherwise undertaken by a CSF. Any person who commits such an offence is liable of a fine of up to €250,000 and / or imprisonment for a term of up to 5 years. Moreover, when an entity becomes a CSF it is subject to the CBI's supervisory regime, which allows the CBI to impose a range of sanctions on CSFs and individuals involved in the management of such firms for breach of regulatory their obligations.

Transitional Arrangements

The Act provides for transitional provisions for those CSFs in existence on 8th July, 2015. These firms will be deemed to be authorised to carry on the business of a CSF until the CBI has granted or refused authorisation, provided that such firms have applied for authorisation before 8th October, 2015. The application for authorisation must contain such information as the CBI has published on its website in its "*Stage 1 Application for Authorisation as a Credit Servicing Firm*".

Entities that have not been carrying on credit servicing prior to 8th July, 2015 cannot begin to provide credit servicing until they have been granted an authorisation by the CBI.

Consultation Process

The CBI has also launched a public consultation (the "**Consultation**") on authorisation requirements and standards for CSFs. The CBI has indicated that the outcome of the Consultation may result in additional authorisation requirements and standards for CSFs.

The Consultation runs until 30th September, 2015, with submissions to be made available on the CBI's website thereafter. However, the Consultation confirms that CSFs that need to be authorised in the three month transitional period from 8th July should continue to proceed with their application, regardless of the fact that separately the CBI is undertaking the Consultation.

The Consultation outlines the proposed requirements that it is envisaged an applicant seeking authorisation to carry on credit servicing will have to satisfy in order to be granted an authorisation

and which must be complied with thereafter on an on-going basis. It envisages that certain requirements and standards will be imposed on CSFs, including the following:

- **Organisation, Management and Independent Review:** that a CSF must be in a position to conduct its affairs in a manner that ensures that the best interests of its customers are protected and must have robust governance arrangements in place in respect of organisational structure, control of risks, internal control mechanisms etc. In addition, a CSF is required to have adequate staffing in place and to ensure that relevant members of staff are fit and proper and have appropriate experience and skills, including, in accordance with the Central Bank Reform Act, 2010. The CBI may require that a CSF procures a review of its operations, systems and controls by a third party of relevant expertise to provide the CBI with an assurance that the requisite operations, systems and controls are in place in the CSF and functioning as described. In addition, a CSF must structure, organise and resource its business to ensure that it is in a position to demonstrate compliance with all applicable regulatory requirements and that adequate and effective control of the CSF rests in the State.
- **Professional indemnity insurance (PII):** that a CSF will be required to have in place a policy of PII covering its activities as a CSF, with the amount insured at a minimum providing cover for €1.25 million per claim and €1.85 million in aggregate cover in a single policy period.
- **Outsourcing:** that a CSF must notify the CBI in advance where it proposes to outsource any important operational functions relating to the provision of credit servicing and where a change occurs or is due to occur to an outsourcing arrangement governing an important operational function related to the provision of credit servicing and that outsourced functions must be properly supervised and the associated risks properly managed.
- **Relationship with Loan Owners:** that a CSF must inform the holder of legal title over loans for whom it acts of its obligations under financial services legislation and the CSF must be in a position to demonstrate how the agreement that it has with the holder of the legal title of the loans allows it to comply fully with its obligations under financial services legislation.
- **Relationship with the CBI:** that the CBI must be informed before a CSF takes on a new loan portfolio or client.
- **Ownership:** that a CSF be required to notify the CBI of any proposed material change of ownership of the CSF – i.e. proposed changes in direct and indirect qualifying shareholders and in respect of the transfer / ownership of certain levels of shareholding in the CSF.
- **The CBI Codes:** consequential amendments to the Codes are also outlined in the Consultation.

Additional Provisions of the Act

As well as regulating credit servicing, the Act also brings about certain regulatory changes in respect of loans sold by credit unions and friendly societies to third parties as well as in relation to retail credit firms.

Credit Unions

Prior to the Act coming to force credit advanced by credit unions and friendly societies did not fall within the scope of either the Consumer Credit Act 1995 (as amended) (the “**CCA**”) or the Codes. However, the Act now provides that where such credit is transferred to an entity that is not a credit union or a friendly society, then the credit will become subject to the CCA and the Codes.

Retail Credit Firms

The Act also amends the current retail credit firm regime in Ireland. Prior to the entry into force of the Act RFSPs were exempt from the need to be regulated as retail credit firms. However, the definition of “*retail credit firm*” has been amended by the Act such that the exemption applies only to an RFSP authorised to provide credit in the State whether by the CBI or on a passporting basis. The net effect of this is that an RFSP that is authorised for some purpose other than to provide credit in the State will now need to be authorised as a retail credit firm if it is advancing credit to natural persons resident in the State.

Such firms are taken to be authorised with effect from 8th July, 2015, but must apply for authorisation prior to 8th October, 2015. The CBI may impose certain conditions or requirements on such entities and / or direct that they will not carry on business as a retail credit firm for a specified period not exceeding 3 months.

■ Conclusion

The Act is a much anticipated development and operates to strike an appropriate balance between ensuring the continuation of regulatory protections for affected borrowers and not disrupting the flow of alternative funding to Irish SMEs. However, loan portfolio purchasers will now need to ensure that they either become regulated as CSFs (which is unlikely where the acquirer is a special purpose vehicle without the infrastructure or staffing levels to facilitate this) or that they appoint a regulated CSF. In this regard, those loan purchasers that have already appointed CSFs will need to ensure that such servicers comply with the terms of the Act and all related regulatory obligations and that the terms of the servicing agreements that they have in place are amended as necessary to reflect the requirements and obligations set out in the Act.

We would encourage our clients to contact us with any queries that they have in respect of the Act or any views or concerns that they have in relation to the Consultation.

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