



## August 2014

# Public Consultation – Consumer Protection on the Sale of Loan Books

### Introduction

The Department of Finance (the “**Department**”) has published a consultation paper (the “**Paper**”) to discuss proposed draft legislation, known as the “*Consumer Protection on the Sale of Loan Books Bill 2014*” (the “**Bill**”), which is aimed at ensuring that natural persons whose loans are sold to unregulated purchasers will retain the regulatory safeguards that they enjoyed prior to the sale.

The Paper proposes that this will be achieved by making the owning of Irish retail credit an activity which is required to be regulated by the Central Bank of Ireland (the “**CBI**”). Retail credit involves providing cash loans to natural persons resident in Ireland. The legislation in relation to retail credit<sup>1</sup>, in its current form, provides an exemption for entities that purchase loans that have been originated by another party. Under the current legislation, unless such a purchaser subsequently provides credit to natural persons resident in Ireland, they do not need to be authorised as a retail credit firm.

### Background

The background to the consultation process is the on-going deleveraging, including the sale of portfolios of loans to unregulated entities, by certain Irish regulated financial institutions. On 15<sup>th</sup> January, 2014, the Irish government announced that it intended, in 2015, to legislate in order “*to cater for the sale of loan books by regulated financial institutions to unregulated financial institutions*”. The reason for this drive to legislate is that currently, unregulated

<sup>1</sup> The Central Bank Act 1997 (as amended)

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entities are not obliged to comply with relevant CBI codes, such as the Code of Conduct on Mortgage Arrears, the Consumer Protection Code, and the Code of Conduct for Business Lending to Small and Medium Enterprises (the “**Codes**”), and consequently, individuals whose loans are transferred to such entities can no longer avail of the protections afforded by the Codes. In addition, borrowers cannot make complaints to the Financial Services Ombudsman (the “**FSO**”) in relation to the conduct of such unregulated entities.

Recently, certain unregulated purchasers of loan books have provided assurances that they would apply the provisions of the Codes where they had acquired loans from regulated entities; however, as these purchasers are unregulated, and not legally obliged to comply with the Codes, those assurances are not thought by the Department to be sufficient, in circumstances where there is no regulatory oversight or power of enforcement by the CBI.

### Proposed Solution

The Bill, in its current form, would require all purchasers, both Irish and non-Irish, of Irish retail credit loans to become authorised as retail credit firms in Ireland. Presently, as mentioned above, only the originators (with a few exceptions)<sup>2</sup> of such credit need to be authorised. The Paper proposes that existing owners of retail credit debt will be deemed to be authorised once they apply for authorisation within three months of the enactment of the Bill, making such entities subject to CBI oversight with effect from that date.

The Bill does provide an exception from the requirement to be regulated for “*securitisation special purpose vehicles*” (“**SSPVs**”) (which would include “Section 110” vehicles<sup>3</sup>), where the SSPV is not carrying on “*loan book servicing activities*”. However, the definition of “*loan book servicing activities*” in the Bill is quite broad, and is such that it would operate to catch activities that purchasers themselves would normally carry out, such as communicating with borrowers (e.g. communication would be on the purchaser’s letterhead), making strategic decisions in relation to the loans and the steps involved in relation to enforcement (it would be the purchaser, as the owner of the loans, that would be named in any legal proceedings). It is likely that the implications of the foregoing for purchasers of Irish retail credit loans will attract particular focus during the consultation process.

### Regulatory Burden

The Bill in its current form creates difficulties for both existing and prospective purchasers of Irish retail credit loans. Broadly speaking, the purchasers of such debt are special purpose vehicles (“**SPVs**”), and are not set up in a way that makes them suitable for regulation. Regulation would necessitate compliance with various regulatory obligations such as fitness and probity requirements, as well as the possibility of increased costs due to the imposition of levies by the CBI

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<sup>2</sup> The current legislation does not apply where the relevant individual is a “professional client” for the purposes of MiFID or is a regulated financial services provider.

<sup>3</sup> These are Irish special purchase vehicles that are “qualifying companies” under Section 110 of the Taxes Consolidation Act, 1997.

and the FSO. Purchasers may also be subject to the CBI's administrative sanctions regime in circumstances where they are in breach of their regulatory obligations.

The application process for a retail credit firm licence and the internal systems required to ensure ongoing regulatory compliance would create a disproportionate administrative burden on SPVs, which are not set up with adequate personnel and support functions to effectively comply with such obligations.

#### **Presence in Ireland**

The Paper seems to suggest that purchasers would also need to have a “*presence*” in Ireland. The level of connection to the jurisdiction that would be necessary is unclear, but if it is the case that non-Irish purchasers cannot obtain a licence, this would not only have implications for prospective foreign purchasers of Irish retail credit debt, but also for existing structures where a non-Irish entity has been used as an acquisition vehicle for a loan portfolio which includes retail credit debt.

#### **Small and Medium Enterprises**

The Paper also envisages that SME loans would be captured pursuant to the provisions of the Bill. However, it is assumed that SME loans would only be caught insofar as those loans are to natural persons resident in Ireland (i.e. sole traders and partnerships), and that it is not the intention of the Department that the legislation would extend to other SMEs, such as companies.

#### **Narrowing of exemption for Regulated Financial Service Providers**

The current retail credit firm legislation provides an exemption from the requirement to be regulated as a retail credit firm for “*regulated financial service providers*”. This exemption has been considerably tightened by the Bill, such that if the Bill were enacted in its current form, regulated financial services providers would have to be authorised by either the CBI or another EEA authority “*to provide or own credit*” (otherwise than pursuant to the terms of the Bill). The upshot of this is that entities that are providing credit and availing of the exemption in the current legislation (because they hold an authorisation unrelated to the provision of credit) would no longer be entitled to do so and would be required to be regulated specifically “*to provide or own credit*” either under the retail credit firm legislation or otherwise.

#### **Difficulties**

Although it is appreciated that the Bill is an effort to ensure adequate consumer protection, if enacted in its current form, it would also most likely have the effect of slowing down activity in the market, with increased costs, structuring headaches and a considerable regulatory burden for purchasers of loan portfolios which include Irish retail credit debt.

The provisions of the Bill would also create problems, where, as is often the case, the portfolio that is being acquired contains loans to natural persons resident in Ireland, together with loans to various other borrowers, such as corporates. The retail credit loans would presumably need to be split from the non-retail credit loans in the portfolio and acquired by a separate entity; otherwise the entire portfolio would be subject to any applicable provisions of the Codes, and the purchaser would be subject to all of the other obligations that result from regulation.

In addition, in what is presumably an unintended consequence, the Bill, if enacted, would result in multiple SPVs, which hitherto were not permitted to lend money to natural persons, now being authorised to do so.

### **An Alternative Approach**

The Paper discusses a number of options that were considered in order to legislate for consumer protection in this area. One route that was considered but then discounted is that of regulating loan servicers. This has been the approach taken in other jurisdictions, including in the United Kingdom. We would argue that there is no reason why the same approach would not work here.

This would not involve the creation of an entirely new regulatory regime; the activity of loan servicing could for example be regulated pursuant to the existing retail credit firm legislation. Then, insofar as a purchaser of retail credit debt does not outsource their loan servicing to a regulated loan servicer, that purchaser itself would be caught by the legislation. Industry participants should be well equipped to comply with this model of regulation, given that it is already in use in other jurisdictions.

This alternative approach would result in consumers maintaining adequate regulatory protection, and avoid the imposition of an unduly onerous regulatory burden on the purchasers of Irish retail credit loans.

### **Engagement in the Consultation Process**

Dillon Eustace is actively engaging in the consultation process with a view to representing the views of our clients, and in this regard we would encourage our clients to contact us with any views or concerns that they have in relation to the Bill and the Paper.

The closing date for submissions to the Department is **22<sup>nd</sup> August, 2014** and a copy of the Paper and the Bill are available at the following link:

<http://www.finance.gov.ie/news-centre/press-releases/public-consultation-consumer-protection-sale-loan-books>

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