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Central Bank of Ireland

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Abstract

In this *Note* we focus on non-banks lending to small and medium-sized enterprises (SMEs). Understanding how non-bank lenders (NBLs) to SMEs fund themselves and the interconnections they have with other entities helps us to assess the lenders’ resilience and how their activities may impact the real economy. We find they have significant interconnections with European banks and other international financial entities, as well as with European parent non-financial companies (NFCs). We also present an activity-based taxonomy of NBLs to SMEs containing three main categories. *Asset Finance Providers* mainly receive funding through their (European) parent companies. *Specialist Property* and *General Lenders* rely on a mix of market-based sources of funding and the banking sector, and often borrow through variable rate loans. We suggest that *Specialist Property Lenders* are the most important category from a financial stability perspective as they are lending to a systemically important sector of the Irish economy, are specialist lenders (increasing concentration risk) and appear to be more sensitive to current financial conditions.

1 Introduction

Non-bank lenders can provide benefits to the real economy by widening and deepening the availability of credit. They can widen choice for borrowers by increasing the number of lenders available, which increases competition. In addition, as demonstrated by Gaffney & McGeever (2022), access to credit can grow as borrowers that may not have been able to access credit through the banking system can avail of financing through non-banks. These entities may also introduce innovations through new product offerings and funding models. Non-bank lenders can facilitate diversification of risk sharing across the domestic and international financial system via the use of different (often international) funding sources rather than traditional retail banks (whose main source of financing in Ireland is generally domestic deposits).²

However, as with all forms of credit, non-banks can also increase risk in the system depending on the characteristics of their lending and funding profiles. Potential sources of additional financial vulnerabilities include high leverage, liquidity mismatches, and/or interconnectedness with other parts of the financial system. Because of these vulnerabilities, Fleckenstein et al. (2020) find that non-bank lending in the US is more than twice as cyclical as bank lending, while non-bank funding is also strongly cyclical. Previous Central Bank of Ireland analysis has also shown that lending from certain cohorts of non-bank lenders has co-moved more strongly with financial conditions than

¹ International Finance Division. paul.reddan@centralbank.ie. Thanks to Peter Dunne, Cian Murphy, Fergal McCann, Kevin Farrell, Naoise Metadger, Brian Golden, Mark Cassidy, and Vasileios Madouros. All views expressed in this Note are those of the authors alone and do not represent the views of the Central Bank of Ireland.

² [Financial Stability Review 2023 H1](#) (page 21).

others (for example, non-bank lenders to real estate SMEs appear particularly sensitive).³ In times of stress, the presence of financial vulnerabilities can mean that non-bank lenders are more likely to amplify shocks, with potential adverse implications for other parts of the financial system or the broader real economy.

Access to credit for businesses is important for the real economy, in particular for SMEs as they play an important role in the Irish economy.⁴ Lack of availability of credit to this sector could have knock-on effects for growth and innovation, as well as investment and employment. The importance of direct lending from non-banks to Irish SMEs has grown over the past decade meaning the question of how non-bank entities fund themselves has also grown in importance, both from an economic and financial stability perspective (Heffernan et al. 2021).

The non-bank sector includes a variety of entities that have significant differences across a number of factors, including business model and funding sources. While it is useful to analytically separate non-banks from the banking sector given their differences, it is also useful for the purposes of financial stability assessment to further separate non-banks into different categories depending on their entity type or their (lending) activity. Entity-based monitoring alone may not capture risks which arise in specific sectors or from particular activities, as detailed by the Financial Stability Board (2022) and the European Systemic Risk Board (2022). We therefore develop an activity-based framework for assessing non-bank lenders based on their lending activity. An activity-based framework assesses the *economic function*, rather than the legal or regulatory form of non-bank lenders' activities and is a more holistic framework for assessing financial stability risks to the real economy. Borio et al. (2022) advocates for a combination of entity-based and activity-based regulation. Activity-based regulation strengthens the resilience of a systematically important activity directly by placing restrictions on how entities perform that activity, e.g., the Central Bank of Ireland's [macroprudential mortgage measures](#). Meanwhile, entity-level regulation imposes restrictions at the entity level, for example minimum capital and liquidity requirements, which aim to enhance the prudential health of individual entities and protect against market disruptions due to their failure.

The purpose of this Note is to analyse the funding structures of non-bank lenders to SMEs in Ireland in order to assess the resilience of these non-bank lenders to shocks to the financial system.⁵ This lending is separate to the investment in Irish commercial real estate by Irish property funds, which is a separate (but also important) example of non-banks financing the Irish economy.⁶ Primarily, we wish to present a *taxonomy* of non-bank lenders to SMEs to facilitate over time the financial stability monitoring and assessment of this growing sector.

2 Methodology and Data

A number of different types of non-bank lenders provide credit to SMEs in Ireland. Data from the Central Credit Register (CCR) allows an identification of these lenders.⁷ This Note focuses on new lending agreements provided by non-banks to Irish SMEs over the 2019-2022 period. Non-bank

³ [Financial Stability Review, 2022 II](#), chart 94.

⁴ See [Business in Ireland 2020](#), Central Statistics Office. Small and medium enterprises (SMEs) are defined as enterprises with less than 250 persons engaged.

⁵ Some of the lenders also provide credit to households and larger NFCs. However lending to these parts of the economy are not the focus of this note but may be explored further in future research.

⁶ The Central Bank of Ireland recently introduced macroprudential policy measures for Irish property funds, see [here](#) for further detail.

⁷ The CCR contains records on loans granted over €500, where the borrower is an Irish resident at the time of applying for the loan and/or the loan is governed by Irish law.

lenders are defined as loan-originating entities that are not banks, credit unions (as they are already contained within existing credit institution statistics), or government-sponsored entities.^{8,9} The credit provided by these lenders is in the sphere of *private credit*, defined by the International Monetary Fund (IMF) as ‘the provision of credit by Non-Bank Financial Intermediaries to often small borrowers through direct lending and other structures.’¹⁰ The transaction level data from the CCR gives us the overall sample of lenders in Ireland to be analysed and recent activity data, but it does not give us balance sheet data for these entities.

To understand the funding sources of the non-bank lenders identified through the CCR, we assess the companies’ balance sheets. We turn to Dun & Bradstreet data and the non-banks’ annual, publicly-available, financial statements from the Company Registration Office.¹¹ In addition, the Central Bank of Ireland collects quarterly balance sheet data for special purpose entities (SPEs), a subset of the overall group of non-bank lenders. Although financial statements can be informative regarding assets/liabilities of these entities, and can provide information on counterparties, the structure of financial statements is not uniform across the sample which, at times, makes comparisons more challenging and therefore data gaps remain.

3 Results

In 2021 Q3, non-bank lenders made up 37 per cent of total bank and non-bank lending to SMEs. This share of total lending decreased by 13 percentage points in 2022 (Figure 1) to 24 per cent at end-year. Non-bank lending to SMEs varies significantly by sector in Ireland.¹² Within this, SMEs in the real estate sector (engaged in both construction and real estate activities including investment) receive the largest amount and highest share of new lending to SMEs from non-banks (compared to banks).¹³ Although lending to this sector has reduced over the past year or so (Figure 1, Figure 2).

Non-bank lending for real estate activities of SMEs has been volatile in recent years in comparison to other sectors. This has implications for the real economy. While the real estate sector is important to the economy in terms of employment and gross-value added, it is also of great macro-financial significance. Real estate loans and assets are the largest balance sheet items for banks and households in particular. Due to the importance of these assets as collateral for household and business borrowing, as well as through effects on wider sentiment, the impact of fluctuations in commercial and residential property prices can be felt throughout the economy.

Within the real estate sector, the vast majority of firms are SMEs (as opposed to larger companies), with SMEs accounting for over 99 per cent of active enterprises. SMEs are also the largest employers in the real estate sector accounting for 90 per cent of persons engaged (employees plus proprietors) with the remainder working in larger firms.¹⁴ Ireland has historically had a more

⁸ Credit institutions, which includes banks and credit unions, are undertakings whose business is to receive deposits or other repayable funds from the public and to grant credits for their own account and/or issue means of payment in the form of electronic money.

⁹ NAMA, local authorities, and vehicles that are solely involved in the purchase of loans from other lenders are excluded.

¹⁰ See [Chapter 2: Nonbank Financial Intermediaries: Vulnerabilities amid Tighter Financial Conditions](#) from the IMF Global Financial Stability Report, April 2023.

¹¹ Annual financial statements were analysed up to end-2021.

¹² The information on borrowers provided in the CCR is enhanced by other data sources including the Irish input into the Register of Affiliates and Assets Database and the Company Registration Office (CRO), which allow categorisation of borrowing firms as SMEs or larger firms. Further details on classification of borrowers available in [Behind the Data – The role of non-bank lenders in financing Irish SMEs](#), (2019).

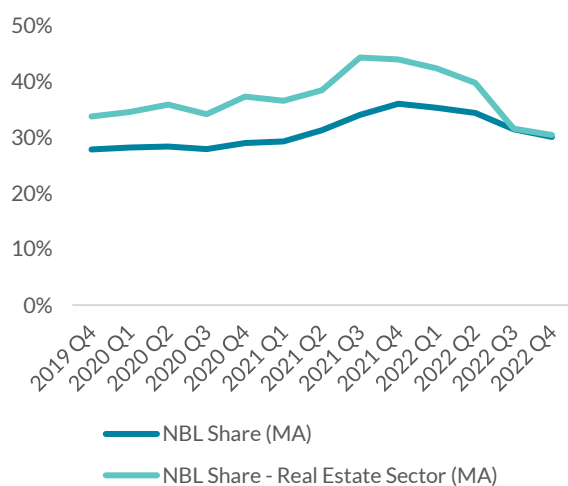
¹³ Real Estate activities include the Construction Sector ([NACE Code F](#)), which includes the construction of buildings and civil engineering works (motorways etc.) and the Real Estate Activities Sector ([NACE Code L](#)), which includes investing in real estate, renting real estate as well as real estate agencies.

¹⁴ For greater detail, see [Business in Ireland 2020](#), from the Central Statistics Office. Persons engaged include employees, proprietors and family members. Persons engaged are the sum of Employees plus Working Proprietors.

volatile real estate cycle than in many other countries, owing primarily to the experience around the Global Financial Crisis (O'Brien et al., 2018).

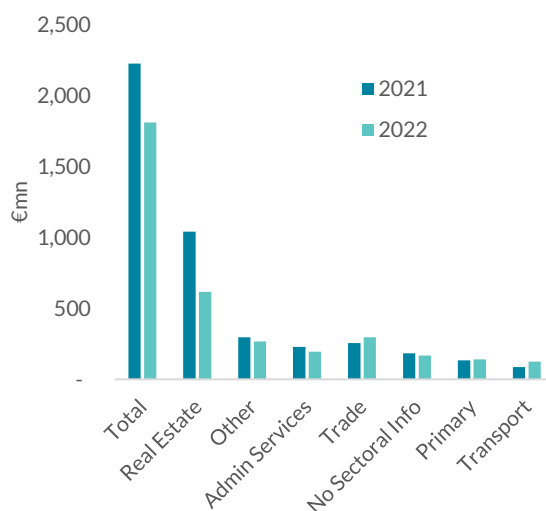
Any amplification of volatility in Irish real estate through vulnerabilities in non-bank lenders could have implications for Irish financial stability, firstly through direct effects on the real economy and secondly, indirectly through potential interconnections with other parts of the financial system. For example, if a downturn in the real estate market was to be amplified by a reduction in lending from non-banks, this could cause spillovers. Lack of credit could worsen the falling property values affecting collateral for the banking system (through common exposures). This would have effects both on banks through impairments and on borrowers and the wider economy through negative equity and borrowing constraints. While lending to other sectors may also have an impact on financial stability, this analysis suggests that focusing on lending to real estate SMEs may be a key first step in monitoring non-bank lending in Ireland through a financial stability lens.

Figure 1: NBLs are an important sources of finance for SMEs in Ireland



Source: CCR, Credit and Banking Statistics
 Notes: NBL Share (MA) is a four quarter moving average of the share of new lending from non-bank lenders relative to the sum of NBL and bank new lending. NBL Share - Real Estate Sector (MA) is a four quarter moving average of the share of new lending to real estate SMEs from non-bank lenders relative to the sum of NBL and bank new lending to real estate SMEs. Real estate-SMEs include SMEs in Real Estate Activities and Construction. Last observation 2022 Q4.

Figure 2: SMEs in the real estate sector receive the largest amount of funding from NBLs



Source: CCR
 Notes: Non-bank lending based on NACE sectoral classification of SMEs is depicted in millions of euro as columns against the left axis. Real estate-SMEs include SMEs in Real Estate Activities and Construction.

We identify 77 non-bank lenders actively lending to SMEs in Ireland over the 2019-2022 period, with over €7bn euro in credit provided through over 100,000 individual loans.¹⁵ There is significant variation in the business models of the NBLs actively lending to SMEs in Ireland. This provides a key challenge when attempting to develop a taxonomy for non-bank lenders to SMEs evaluating financial stability risks. Lending may not always fall clearly along entity lines. The main entity types lending to SMEs are Retail Credit Firms (which require authorisation from the Central Bank of Ireland), Asset Finance Firms, SPEs, high cost credit providers and social and community lenders.^{16,17} These categories are informative, particularly to understand whether certain entities

¹⁵ €7bn has been provided cumulatively in new loans over the 2019-2022 period. At end-2022, the outstanding stock of credit owed by Irish SMEs to NBLs in Ireland was €4.5bn, see [Financial Stability Review 2023 H1](#) (page 40).

¹⁶ More information on Retail Credit Firms and high cost credit providers can be found [here](#) or [here](#) on the Central Bank of Ireland website. Social & Community lenders provide finance to support social goals and some are non-profit organisations.

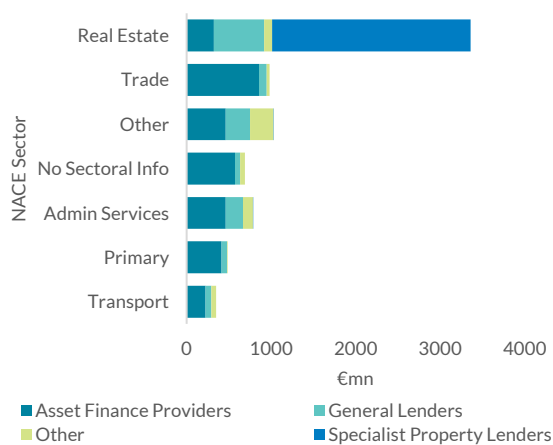
¹⁷ Asset Finance firms provide credit in the form of products such as hire-purchase agreements, personal contract plans, leasing contract, or loans with assets as collateral. Asset finance allows businesses to access equipment without capital expenditure, or to release value

are subject to entity-based regulation, but they do not reflect the activities of the entities or the financial stability risk.¹⁸ To do this, we examine the non-bank lenders in terms of activities as well as entities and develop a new *taxonomy*.

3.1 Classifying Non-Bank Lenders to SMEs

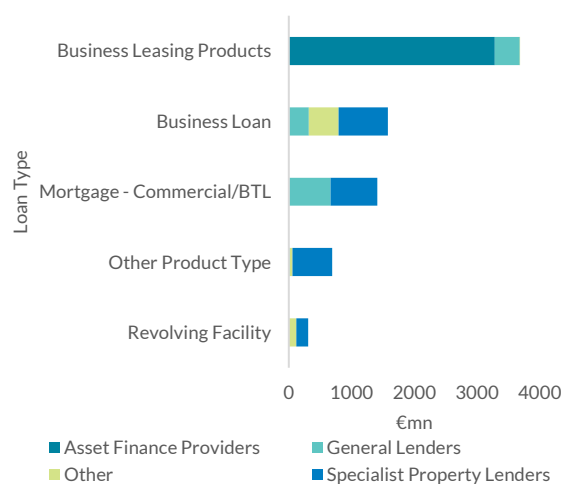
We use granular CCR data to examine the lending activity of the NBLs on two key measures. Firstly, we analyse whether NBLs have a high sectoral concentration of lending, specifically whether NBLs provide 80 per cent or greater of their lending to any one specific sector. Secondly, we analyse whether NBLs have a high concentration in the product types they offer, specifically whether NBLs provide 80 per cent or greater of their lending through a specific type of loan product. Using these measures as a guide, we categorise the NBLs using an activity-based approach and under four headings. We provide summary statistics for each lender type (Table 1).¹⁹

Figure 3: NBLs are active across the wider economy, except for Specialist Property Lenders



Source: CCR
Notes: Chart outlines new lending from 2019-2022 by lender type identified in Table 1 and by the sector of the borrowing SME.

Figure 4: Asset Finance Providers mainly offer business leasing products



Source: CCR
Notes: Chart outlines new lending from 2019-2022 by lender type identified in Table 1 and by contract types offered to borrowers. Business Leasing Products include business hire purchase, business leasing, stocking finance, hire purchase (excluding personal contract plan), leasing, and personal contract plans.

The first category consists of *Specialist Property Lenders*. The key measure under which we categorise *Specialist Property Lenders* is sectoral concentration. As illustrated in Figure 3, there is a high concentration of credit provided by these lenders to SMEs in the real estate sector (both construction and real estate activities including investment). The other lender categories we outline below do not have similar levels of concentration to any one sector. Regarding the loan products offered, *Specialist Property Lenders* provide credit through a number of different product types, including business loans and commercial mortgages. *Specialist Property Lenders* provide credit through a relatively small number of large loans to a limited number of counterparties in comparison to other lender types and overall are the second biggest provider of credit (Table 1).

The second category are *Asset Finance Providers*. The key measure under which we categorise these lenders is concentration in a specific type of loan product – business leasing products (see Figure 3).

from assets they already own. These entities can also be referred to as Leasing and *Asset Finance Providers*, we refer to them as *Asset Finance Providers* throughout this note for simplicity.

¹⁸ Some of these lenders are subject to regulation depending on their activities and may require authorisation to register as financial services providers with the Central Bank of Ireland.

¹⁹ These categorisations are similar to those outlined in a previous Central Bank of Ireland publication using the initial Central Credit Register data available in 2019. [Behind the Data - The role of non-bank lenders in financing Irish SMEs](#), (2019).

Asset Finance Providers specialise in these products (including leasing, hire purchase and other asset finance products), which allow businesses to access equipment without capital expenditure, or to release value from assets they already own. For example, one major activity for *Asset Finance Providers* is the provision of vehicle/equipment leases to SMEs. *Asset Finance Providers* lend to a wide variety of sectors (Figure 4) and lend to a high number of (unique) counterparties (Table 1).

Table 1: A taxonomy of Non-Bank Lenders to SMEs

Lender Category	No. Lenders	Avg. Loan	Total Loans	No. Loans	No. Counterparties
Asset Finance Providers	25	€35,777	€3.3bn	92,637	18,522
Specialist Property Lenders	33	€3,430,088	€2.4bn	686	498
General Lenders	6	€91,612	€1.4bn	15,008	6,350
Other	13	€25,376	€0.6bn	25,318	16,195
Overall	77	€57,449	€7.7bn	133,649	34,257

Source: Central Credit Register

Notes: Other includes a variety of lenders including high cost credit providers, lenders linked to social and community funding activities and some miscellaneous general lenders. Table outlines new lending in the 2019-2022 period by lender category.

The third category are *General Lenders*. These lenders do not exhibit high sectoral concentration and are also not specialised in any particular product type (Figure 3, Figure 4). These NBLs do provide a significant share of their overall lending for real estate activities but are not fully specialised to the degree of *Specialist Property Lenders*.²⁰ The average loan provided by *General Lenders* is also much less than for *Specialist Property Lenders*, while they also provide credit to a much larger number of counterparties (Table 1). Some of the entities in this category also provide residential mortgages, which are outside the scope of this Note.

The entities classified as *Other* include lenders with specific business models that differ from the lender types outlined above. These are high-cost credit providers and some other entities that provide finance to support social goals (and who may be non-profit organisations). *Other* also contains a residual of smaller firms who have provided a limited number of loans over the period.

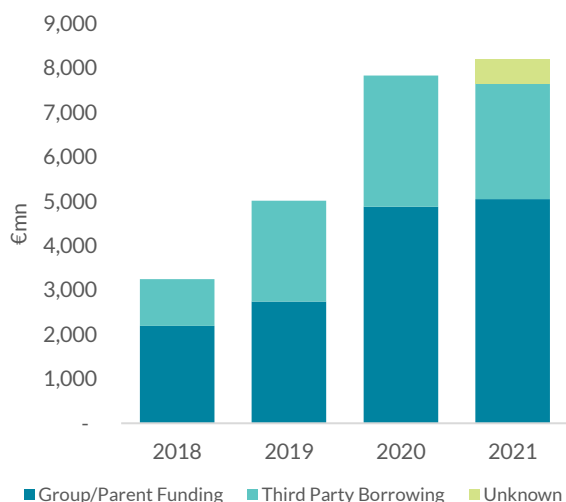
3.2 Funding Profiles of Non-Bank Lenders to SMEs

Having categorised the NBLs based on their lending activity, we next explore how these entities fund themselves. As an overall sector, NBLs receive funding from a variety of sources, including parent companies, banks, and various market-based and other non-bank sources (Figure 5). However, as with their lending behaviour, the sources of funding for the particular non-bank lender types varies significantly. *Specialist Property* and *General Lenders* rely on market-based sources of funding and the banking sector, taking on leverage in the process (Figure 6). *Asset Finance Providers* mainly receive funding through their parent companies (generally a vehicle/equipment leasing non-bank will receive funding from the parent that is manufacturing the vehicle/equipment). The main geographical source of funding for NBLs is European (excluding the UK), with more limited links to Ireland and the rest of the world (Figure 7). However, some funding is directly received from other financial intermediaries based in Europe but the funding may ultimately come from non-European

²⁰ *General Lenders* have more varied business models than both *Specialist Property Lenders* and *Asset Finance Providers*, and as a result do not fit in either category, but overlap with both in their lending behaviour to some extent.

countries such as the US, something we are unable to identify with the data to hand. Funding with no known direct counterparty is mainly made up of listed debt securities. There is limited information on their counterparties (Figure 9).

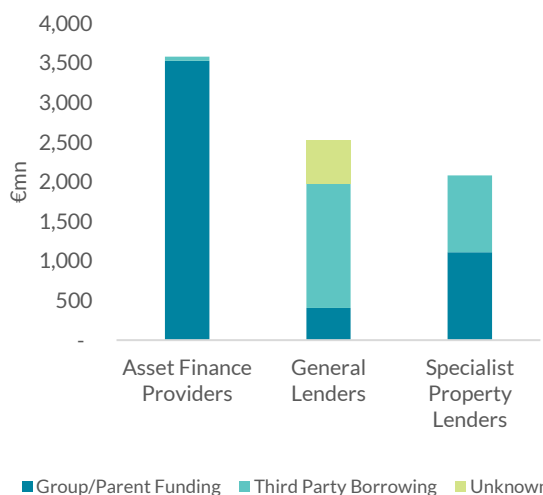
Figure 5: NBLs rely on group/parent funding but also have significant levels of third party borrowing



Source: CRO, Central Bank of Ireland, Dun & Bradstreet, Authors' calculations.

Notes: Chart outlines funding sources for NBLs 2019-2021. Group/Parent funding is provided by either parents or entities in an overall group structure. Third Party Borrowing refers to funding provided by third parties in both the bank and non-bank sector. This funding consists of market-based products (i.e. debt securities) and loans. Unknown refers to lack of transparency in the financial statements.

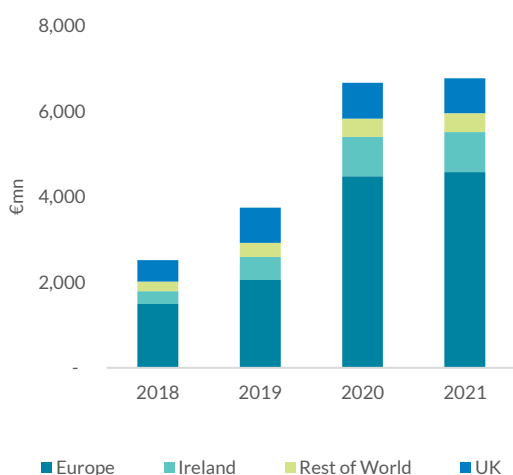
Figure 6: Non-bank lenders' funding sources vary by lender type



Source: CRO, Central Bank of Ireland, Dun & Bradstreet, Authors' calculations.

Notes: Chart outlines funding sources by type of lender. Group/Parent funding is provided by either parents or entities in an overall group structure. Third Party Borrowing refers to funding provided by third parties in both the bank and non-bank sector. This funding consists of market-based products (i.e. debt securities) and loans. Data covers funding for most recent observation, 2021. Other lenders are not included due to data gaps.

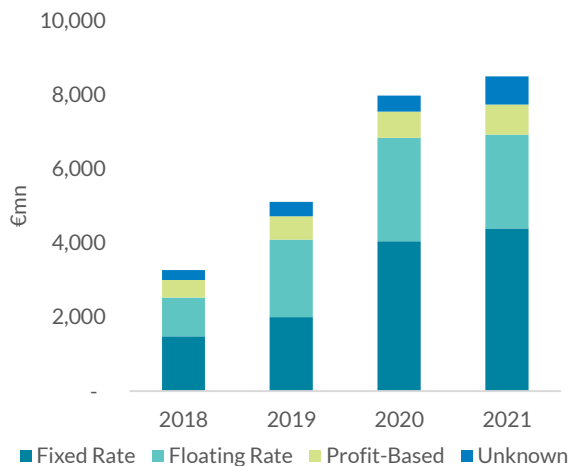
Figure 7: The majority of Non-bank lenders' funding comes from outside of Ireland



Source: CRO, Central Bank of Ireland, Dun & Bradstreet, Authors' calculations.

Notes: Chart outlines funding sources for NBLs from 2018-2021 by region. European funding sources include Austria, France, Germany, Luxembourg, Malta, the Netherlands and Sweden. Rest of World includes Japan, Australia, the United States of America, the Cayman Islands, the Isle of Man and some smaller jurisdictions. Counterparty is unknown mainly for funding received through issued debt securities, which may be listed meaning ascertaining ownership can be difficult.

Figure 8: Loan terms are split mainly between fixed and floating rates



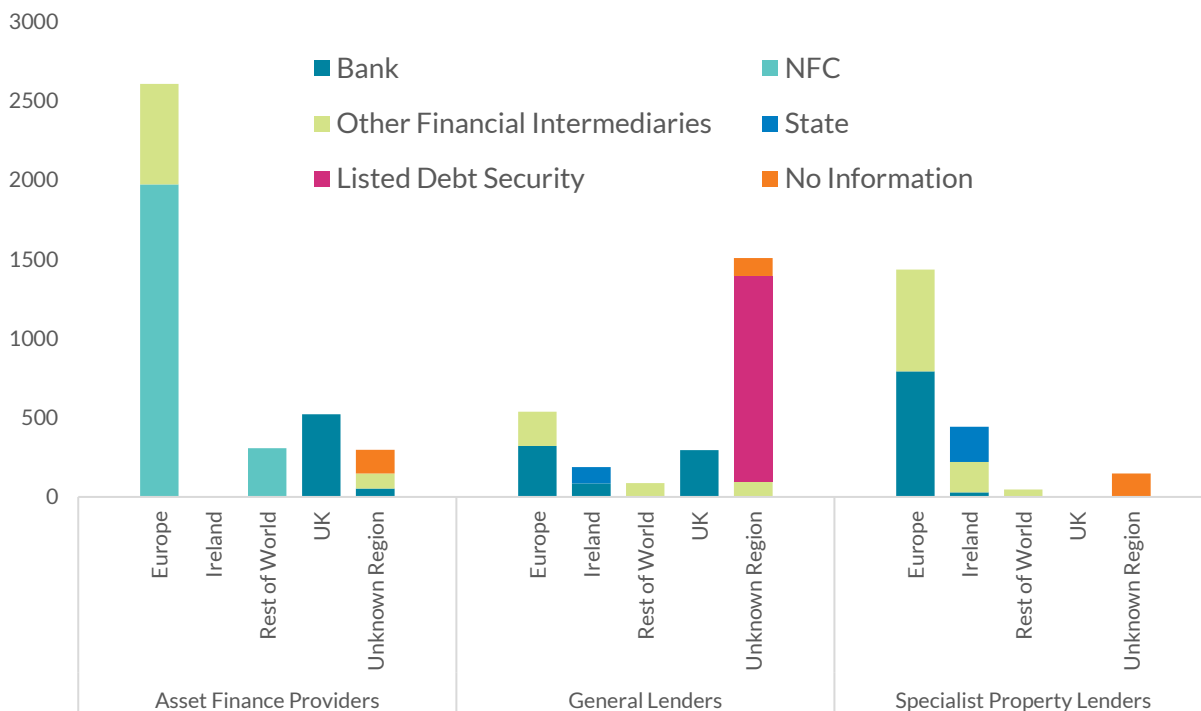
Source: CRO, Central Bank of Ireland, Dun & Bradstreet, Authors' calculations.

Notes: Chart outlines loan terms. Profit-based refers to loans/notes where the party providing funding participates directly in the profit and losses of the entity. Thus, payments are made to the funding party if profits remain after accounting for other costs (including other interest payments). These instruments are generally profit participation loans/notes, see Golden & Hughes, (2018) for further detail.

As well as the sources of funding for NBLs, we also provide information on the terms of this funding (Figure 8). Fixed rate loans make up the largest type of loan provided to NBLs, with floating rate loans also making up a large share. Profit-based loans are important for some lender types,

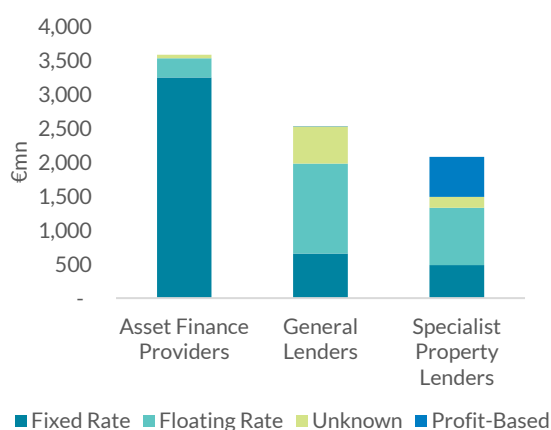
particularly *Specialist Property Lenders*. Repayments on profit-based loans are determined by the profits of the NBLs (after fixed or floating rate loan interest payments are paid). Loans terms vary across the different lender types. *General* and *Specialist Property Lenders* have a large amount of floating rate loans (Figure 10). These loans are often linked to Euribor meaning the cost of these funds would have increased through 2022. Whereas *Asset Finance Providers* mainly relying on relatively low-cost fixed rate loans (provided through their parent/group).

Figure 9: Specialist Property and General Lenders are mainly funded through financial institutions or markets



Source: CRO, Central Bank of Ireland, Dun & Bradstreet, Authors' calculations.
 Notes: Chart outlines funding sources for NBLs for 2021 by region and sector. European funding sources include Austria, France, Germany, Luxembourg, Malta, the Netherlands and Sweden. Rest of World includes Japan, Australia, the United States of America, the Cayman Islands, the Isle of Man and some smaller jurisdictions. Counterparty is unknown mainly for funding received through issued debt securities, which may be listed meaning ascertaining ownership can be difficult. State refers to funding from the Ireland Strategic Investment Fund (ISIF). The ISIF, managed and controlled by the National Treasury Management Agency (NTMA), is a sovereign development fund with a mandate to invest on a commercial basis to support economic activity and employment in Ireland. Other Financial Intermediaries are comprised of all financial institutions that are not classified as banks, insurance corporations, pension funds, public financial institutions, central banks, or financial auxiliaries (FSB, 2017, page 2), for example, investment funds, SPEs, treasury and holding companies (Lane and Moloney 2018, chart 4 page 67).

Figure 10: Specialist Property and General Lenders have a large amount of floating rate loans



Source: CRO, Central Bank of Ireland, Dun & Bradstreet, Authors' calculations.

Figure 11: Lending from both Specialist Property and General Lenders decreased markedly through 2022.



Source: CCR.
 Notes: Chart outlines change in new lending for recent quarters by NBL lender type identified in Table 1.

Notes: Chart outlines loan terms for NBLs by NBL lender type 2021. Profit-based refers to loans/notes where the party providing funding participates directly in the profit and losses of the entity. Thus, payments are made to the funding party if profits remain after accounting for other costs (including other interest payments). These instruments are generally profit participation loans/notes, see Golden & Hughes, (2018) for further detail. *Other* lenders are not included due to data gaps.

3.3 Financial Stability Assessment

Taking into account the information outlined above, we now provide a ranking of the NBLs we suggest are most important from a financial stability perspective.

We assess the most important cohort to be *Specialist Property Lenders*. Real estate markets are known to be illiquid and have been central to several financial crises (Lyons et. al, 2019). *Specialist Property Lenders* are the second largest provider of credit (after *Asset Finance Providers*). A reduction in credit supply to this sector could affect the economy directly through property markets and indirectly through spillover effects (for example through common holdings, collateral valuation effects and borrowing constraints) to other parts of the financial system. *Specialist Property Lenders* lend primarily to the property sector and are subject to concentration risk (the risk that distress in the property sector could threaten the viability of the lenders). They also rely on third-party funding to a significant degree, much of which is floating rate in nature. Thus, these entities are more sensitive to changes in interest rates than *Asset Finance Providers*. This could increase the procyclicality of the supply of credit and increase the probability of *Specialist Property Lenders* amplifying a shock to the financial system. This combination of the size of total credit provided, the macro-financial connections, importance to the financial cycle and potential that credit supply from these lenders is more sensitive to changes in financial conditions leads us to conclude *Specialist Property Lenders* are the most important from a financial stability perspective.

We judge the second most important cohort to be *General Lenders*. While these entities often provide a significant share of their overall lending to SMEs for real estate activities (approx. 40 per cent), they are not fully specialised to the degree of *Specialist Property Lenders*. Their total lending is less than the other two main categories and their spread of lending is more diversified in terms of contract type and sector (Figure 3, Figure 4). A reduction in credit supply would likely have less of a targeted effect on real estate or any one sector in particular. With respect to their funding sources, *General Lenders* rely on third party borrowing to a significant degree, employing leverage to support their lending in the Irish economy. *General Lenders* have strong interconnections with the international financial system through these funding sources (similarly to *Specialist Property Lenders*). A large portion of the funding for *General Lenders* is floating rate in nature, meaning these lenders are vulnerable to any changes in financial conditions, such as the increases in interest rates observed in 2022 and 2023. In conclusion, based on the size of the total credit supplied, their varied lending to Irish SMEs and their reliance on interest-rate sensitive third party borrowing, we suggest that this group warrants further monitoring, while remaining a lower priority than *Specialist Property Lenders* from a financial stability perspective.

While *Asset Finance Providers* are the largest cohort of lenders by total credit provided to SMEs, we suggest they are the third most important from a financial stability perspective. A reduction in the availability of credit from this cohort could have an impact on financial stability given the volume of credit provided across a variety of sectors. However, in stark contrast to *Specialist Property* and *General Lenders* who rely on third-party interest rate sensitive borrowing, the funding sources for *Asset Finance Providers* are mainly their parent companies (several of which are multinational NFCs). This access to parent funding is reflected in relatively low-cost fixed rate loans, and thus is not

interest rate sensitive. With this information in mind, we suggest *Asset Finance Providers* are a lower priority from a financial stability perspective than the cohorts outlined above, despite their importance as a funding source for a broad cross-section of SMEs across the Irish real economy.

The activity of *Other* lenders is relatively small, mainly focused on business loans but spread out in terms of sectors so less likely to have a large/collective impact.

While data on the balance sheets of NBLs lending to SMEs is available to end-2021, we can assess the lending behaviour of the NBLs throughout 2022 using the CCR database. As outlined above, *Specialist Property* and *General Lenders* were more vulnerable to increases in funding costs at end-2021, due to their reliance on funding from third parties (much of which is floating rate in nature). CCR data shows that lending from both *General* and *Specialist Property Lenders* decreased markedly through 2022 in comparison to 2021 (Figure 11). In contrast, lending from *Asset Finance Providers* remained stable throughout the year. Further research and analysis will be required to fully understand the effects of changes in financial conditions on lending from NBLs to SMEs.

4 Conclusion

The supply of credit from non-bank lenders increased significantly during the latter period of low interest rates. Recently it has shown signs of heightened sensitivity to rising interest rates. Non-bank lenders' growing presence brings both benefits and risks to the economy and financial system. In this *FS Note* we focus specifically on non-banks that lend to SMEs. This is because non-banks have become an increasingly important source of credit for SMEs in Ireland in recent years, and also because SMEs are a central contributor to growth and employment in the domestic economy. A significant reduction in credit to SMEs could impact financial stability and the real economy directly through credit market dysfunction and indirectly through other financial intermediaries with common exposures.

There are significant differences between individual lenders within the non-bank space, in terms of business model, funding sources, and type of funding. With this in mind, the main purpose of this *Note* is to present a taxonomy of non-bank lenders to SMEs that assesses cohorts of non-bank lenders in terms of their importance for financial stability. We propose a *taxonomy*, which includes four ranked cohorts: *Specialist Property Lenders*, *General Lenders*, *Asset Finance Providers* and *Other* non-bank lenders. This taxonomy approximates the importance of the cohort from a financial stability perspective. These cohorts are listed in order of importance with consideration given to the sectors they lend to (including the diversification of lending); the vulnerability of their funding sources; and the type of funding they have (i.e. fixed rate, floating rate loans etc.). This approximation is based on our current analysis of the sector and thus may be subject to change as our understanding of the sector deepens over time.

We propose that the *Specialist Property Lender* cohort is the primary cohort of importance from a financial stability perspective for a number of reasons. Firstly, because they are lending to a sector that has historically experienced significant falls in credit supply and market dysfunction leading to and/or amplifying financial instability. Secondly, because evidence shows this sector appears to be more sensitive to the current change in financial conditions than the other sectors. Also thirdly, because the source of funding is mainly from international third parties that are not linked to the NBLs (unlike a parent company would be) and thus may choose to pull back on funding and/or may be sensitive to financial conditions. Finally they may be more likely to amplify shocks because a significant portion of their funding is subject to floating interest rates (making them more sensitive to current financial conditions). Next steps in the analysis of non-bank lenders to SMEs is to focus –

for these reasons – on the *Specialist Property Lender* cohort to deepen our understanding of these vulnerabilities, while also continuing our ongoing monitoring of the sector as a whole.

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