Coimisiún um Iomaíocht agus Cosaint Tomhaltóirí
Competition and Consumer Protection Commission

# Central Bank (Variable Rate Mortgages) Bill 2016

# [Private Members Bill]

**Observations of the Competition and Consumer Protection Commission to the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach**

## General Observations

1. The Competition and Consumer Protection Commission (CCPC) welcomes the opportunity to comment on the Central Bank (Variable Rate Mortgages) Bill 2016 ('the Bill'). It is understood that the Bill was prompted by a desire to address current concerns over the difficulties faced by many consumers in meeting mortgage repayments and a belief that some mortgage holders in Ireland appear to be paying higher rates when compared to those in other EU Member States.

2. The CCPC, however, has serious concerns about the proposal and believes that, if enacted, the Bill would likely limit competition in the market for principal dwelling house mortgage loans, thereby acting to the detriment of the very consumers that it wishes to protect.

3. Supplanting the decision making ability of banks on their lending rates with that of the Central Bank would likely increase both pricing and strategic uncertainty among existing mortgage providers and most likely render the market less attractive to new entrants. The risks are that caps become targets and low caps restrict credit availability to all but those representing the very lowest risks to the lender. Such uncertainty would result in less competition, higher costs and increased market exclusion for those on lower incomes and with less favourable credit scores overall.

4. The CCPC also has concerns around the fundamental premise of the Bill, which is that the Central Bank should act as a price regulator in the market for principal dwelling house mortgage loans, rather than in its current capacity as a prudential and consumer protection supervisor.

5. Rather than seeking to cap mortgage interest rates, the CCPC believes that the focus should be on introducing measures which will encourage greater competition in the sector over the medium term. This would not only facilitate downward pressure on interest rates but could provide consumers with greater access to finance, a wider choice of products, and improved service delivery. The discipline of a strong, competitive market would prove far more effective in meeting the long term needs of consumers than a move to cap mortgage interest rates.

6. The CCPC has noted the concerns regarding the Bill expressed by other key stakeholders including the European Central Bank[1], the European Commission[2] and the Central Bank of Ireland[3]. The CCPC also notes the concerns expressed by the Minister for Finance about many aspects of the Bill and his view that, rather than the proposed approach set out in the Bill, '*competition represents the most favourable method of driving down interest rates in a sustainable way without giving rise to possible unintended consequences'*.[4]

7. There are a number of initiatives underway or forthcoming that have relevance to the issues which prompted the introduction of the Private Members Bill :

    a. The Macro-prudential measures implemented by the Central Bank have led to a situation where, rather than competition on the amount of the loans provided, mortgage providers must now compete on price. This Bill undermines the potential for this situation to feed back into the system and work for the benefit of consumers.
    b. In addition, enhanced consumer protection measures for variable rate mortgage holders came into effect from 1 February 2017, with the introduction by the Central Bank of an Addendum to the Consumer Protection Code. The impact of these should be assessed before further regime changes are implemented.
    c. The EU has on 23 March 2017, published a Consumer Financial Services Action Plan[5], the aim of which is to enhance and move towards a single market for financial services, including loans. The implementation of measures in this plan has the potential, over time, to open up the mortgage market beyond the domestic suppliers, thereby giving consumers more choice and competition.

[1] CON/2016/54, Opinion of The European Central Bank, 17 November 2016
[2] Statement by EU Commission and ECB staff following the conclusion of the sixth post-programme surveillance mission to Ireland, 12 Dec 2016
[3] Introductory statement by Ed Sibley, Director of Credit Institutions Supervision, before the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, 8 December 2016
[4] Statement by Minister for Finance, Central Bank (Variable Rate Mortgages) Bill 2016, 20 October 2016.
[5] https://ec.europa.eu/info/publications/consumer-financial-services-action-plan_en

8. Furthermore, in accordance with a provision in the Programme for a Partnership Government[6], the CCPC is currently undertaking work in this area and is examining the market structure, legislation and regulation of the mortgage market in Ireland with a view to outlining options for Government on how Ireland can develop a better-functioning, more sustainable mortgage market. In recent months, the CCPC has undertaken interviews and discussions with a wide range of stakeholders, including industry experts, existing mortgage providers, lenders in external markets and potential new entrants into the Irish market. The CCPC has also met with consumer representatives; conducted focus groups with consumers; consulted with researchers and academics and has recently undertaken a public consultation exercise. It is anticipated that this work will be completed and a final report produced by May 2017.

**The Current Necessity for Regulation**

9. The CCPC notes the Central Bank's recent commentary, before the Joint Committee[7], regarding the perils of oversimplifying comparison with Eurozone rates given the different characteristics of housing and mortgage markets in different Member States, including home ownership, the history of default and the balance between fixed and variable rate mortgages.

10. Among the factors cited by the Central Bank as impacting on variable rate mortgage pricing is that mortgages are higher risk in Ireland: EBA stress testing shows that Ireland's mortgage default rate is more than 10 times higher than many other Eurozone and EU countries. These stress tests also show the necessity for banks operating in Ireland to hold significantly greater capital reserves, with associated higher costs, including mortgage rates.

11. Being mindful of the principles of better regulation that any proposed regulatory intervention should be both necessary and proportional, the CCPC does not consider that the case has been sufficiently made to justify the proposed price-capping mechanism.

[6] http://www.taoiseach.gov.ie/eng/Work_Of_The_Department/Programme_for_Government/A_Programme_for_a_Partnership_Government.pdf

[7] Introductory statement by Ed Sibley, Director of Credit Institutions Supervision, before the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, 8 December 2016

**Some Specific Concerns regarding the provisions of the Bill**

***Mortgage Interest Rate Caps***

12. Section 5 of the Bill - 'Power to issue direction to lender' - specifies that where the Central Bank concludes, on the basis of criteria set down in Section 4 of the Bill, that a market failure exists, it may issue directions to a lender – or to lenders in general - regarding the maximum variable interest rate that may be charged in respect of principal dwelling house mortgage loans.[8]

13. There is considerable international evidence that capping interest rates in this way leads to less competition and ultimately harms the very consumers it is designed to protect[9]. Banks typically react to rate caps by withdrawing cheaper products aimed at winning new customers, and focusing instead on extracting higher charges from existing customers by raising non-interest fees and commissions to maintain profits. As cheaper products disappear and competition weakens further, the caps become a price target for banks to charge customers rather than an upper limit. As the threat of competition recedes, there is less incentive for existing lenders to undercut their rivals, leaving consumers to pay higher prices and suffer poorer service. The people worst affected by rate caps tend to be those on the economic margins who can least afford an increase in the cost of credit.

14. As noted, lenders may attempt to counteract the effect of reduced interest rates by increasing the prices for other products and services. Where such options are not available, some lenders may find themselves in financial difficulty, which would limit their ability to compete or influence decisions to exit from certain lines of business, weakening competition further.

15. Furthermore, banks might also modify their credit standards to mitigate fully the risk of default to ensure sustainable profitability. This could result in banks favouring less risky business and only dealing with new borrowers that exhibit a very low risk profile, a view echoed by the Central Bank. This could effectively ration variable interest rate mortgages in the Irish market only to those customers who meet stringent credit standards or who have very large deposits (and low LTV – perhaps even lower than the current Central Bank macro-prudential measures limits), thereby making access to mortgages even more difficult for many, especially first time buyers..

---

[8] This may take the form of a set rate or margin, or a rate or margin linked to European Central Bank and/or comparable market rates, as specified in S.5 of the Bill.

[9] World Bank (2014), Interest rate caps around the World, still popular, but a blunt instrument, Samuel Munzele Maimbo Claudia Alejandra Henriquez Gallegos, Policy Research Working Paper 70/70.

16. The possibility of restrictions being imposed on the maximum rate that banks would be allowed to charge for variable interest rate mortgages could therefore reduce both pricing and strategic certainty and could render the market less attractive, thereby discouraging new entrants or potentially leading to the withdrawal of some existing operators from certain lines of business. It could also increase the riskiness of operating in the Irish market which would have implications for the wider financial system.

17. Separately, due to the significant and real-time information at the disposal of lenders, they are better placed than the Central Bank to formulate informed pricing strategies appropriate for their individual institutions, a view shared by the ECB. Transferring price setting responsibility to the Central Bank could therefore lead to significant mispricing with potential consequences for the financial stability of lenders with the corresponding impact on their customers (including depositors) and the wider system.

18. As noted earlier, due to the rationing of credit to those customers exhibiting a very low risk profile, as choice diminishes an increasing number of those on the economic margins could find themselves excluded from access to mainstream financial services including housing loans.

19. Direct price regulation of the type envisaged in the Bill would likely significantly reduce Ireland's attractiveness in the eyes of any potential entrant who might be considering setting up in Ireland. It would restrict their ability to direct their own commercial operations and develop their own individual pricing strategies. New entrants – or a realistic prospect of new entrants – impose an important constraint on the behaviour of existing mortgage providers. They provide essential safeguards for consumers, who otherwise run the risk of being left at the mercy of a small number of established operators. The prospect of regulatory intervention in the market, as envisaged in the Bill, would give rise to uncertainty, the possibility of further intervention at a future date and therefore might be seen to make Ireland a more risky location in which to do business. Any new entrants to the market might then seek to factor such risks into their pricing decisions.

20. It is also to be expected that any price setting role for the Central Bank is likely to give rise to significant lobbying by the financial services industry, with the cost of such activity being ultimately borne by customers.

***Non-discrimination***

21. Section 7 of the Bill prohibits discrimination against existing customers. Commentary by Deputy McGrath during passage of the Bill[10] claims that customers with high loan-to-value mortgages, those in negative equity, those in arrears, those who have restructured their mortgage or those whose financial situation has worsened often find it impossible to switch in order to avail of the new, better rates.

22. By imposing a prohibition on price discrimination, institutions may be deterred from offering a full variety of financial products across the customer spectrum. This applies in particular to introductory offers that could help to promote switching; assist first time buyers who are under more cash flow pressure than those switching or moving home, and encourage overall price competition. This measure could stifle product innovation, reduce competition and ultimately act to the detriment of consumers.

***Lack of an appeals mechanism***

23. Section 6 provides that a direction issued by the Central Bank pursuant to Section 5 of the Bill may be for an indefinite period and there appears to be no appeals process in place. In fact, Section 11 of the Bill specifically states that no appeal shall lie to the Irish Financial Services Appeals Tribunal or the High Court in respect of a Section 2 assessment or a direction pursuant to Section 5. This would grant the Central Bank seemingly unchecked latitude to make significant market interventions which have immediate and substantial implications for the profitability of the lending institutions affected. The combined effect of direct pricing intervention and the absence of any form of an appeals mechanism could create significant regulatory moral hazard leading to substantial strategic uncertainty for banks, which in turn would likely deter entry into the market by new lenders, limit expansion by existing operators, preserve the significant positions of the two big banks and further weaken competition in the sector.

***Privity of Contract***

24. By allowing the Central Bank to intervene to set interest rates, the Bill would undermine the principle of privity of contract. If an element of the income streams of banks was made subject to third party adjustment through the suspension of the privity principle, this would increase materially the risks to potential and actual market participants, and further impede competition.

[10] Central Bank (Variable Rate Mortgages) Bill 2016: Second Stage [Private Members], Tuesday, 17 May 2016

Existing banks would likely be required to mitigate this risk by increasing capital reserves, which would in turn reduce the available lending capacity, thereby reducing credit availability and competition further.

**Concluding Comments**

25. While the motivation behind the Bill is understood, the CCPC is of the view that, if enacted, the Bill might well prove counterproductive as it would likely limit competition in the market for principal dwelling house mortgage loans.

26. As a general principle, regulation – particularly direct retail price regulation – should only be introduced where there is clear evidence of market failure in a particular sector; where this market failure has been shown to be incapable of being addressed by normal competitive processes and where it can be demonstrated that the proposed regulatory intervention is proportionate, effective and imposes the least possible restriction on competition. The CCPC is of the view that the proposed Bill does not adequately meet these conditions.

27. Competition policy has an important role to play in promoting consumer welfare. The best way of securing sustainable reductions in mortgage interest rates for consumers is through policy measures which increase competition in the banking sector.

**…. ENDS ….**