Bank of Ireland Submission

Re: Public Consultation Document on the Irish Mortgage Market

March 2017

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1. EXECUTIVE SUMMARY

Bank of Ireland ("BOI") welcomes the opportunity to make this submission to the CCPC.

Having reviewed the CCPC consultation document of February 2017, BOI are of a view that the following factors and options need to be taken under consideration as part of the review:

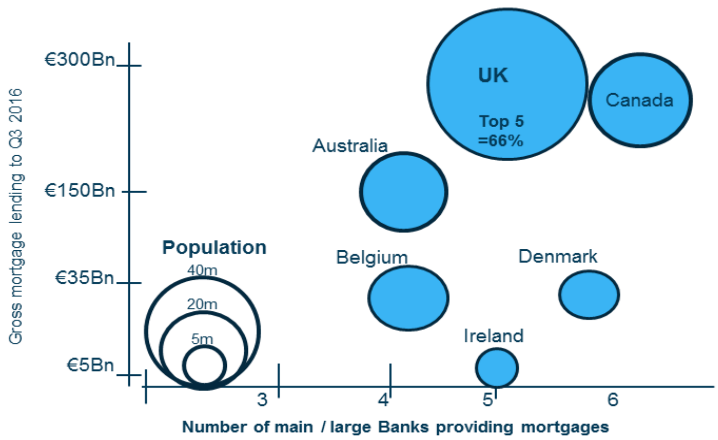
Ireland has a competitive and resilient mortgage market

BOI does not concur with the statements in the consultation document in Section 1.15 that "*Currently, by any measure, the structure of the market for mortgage lending in Ireland is highly concentrated, i.e. there is a limited amount of competition and this may be leading to poor outcomes for consumers*."

This perceived level of concentration in the mortgage market is transitory and is not a deterrent to entry, noting that 2 additional institutions have commenced operations in the past 12 months, namely Pepper and Dilosk. Furthermore, those entities as set out below competing in the market today provide a broad range of choice to consumers, with a variety of competitors undertaking different pricing strategies, origination channels and areas of focus. There is limited evidence that a concentrated market is a barrier to entry to entrants who believe they have a sustainable compelling customer proposition to offer in an open market.

Section 6 sets out some comparative examples including Australia, where in December 2014 a Financial System Inquiry into the Australian banking market concluded that "the Banking sector is competitive, albeit concentrated" across 4 pillar banks.[1] In effect, a simple concentration assessment may not give a complete picture. BOI would also note that Australia comprises a population of c. 25 million versus Ireland with a population of 4.75m million. Five main providers compares well with markets of similar scale such as Denmark and Belgium.

Figure 1.1: MORTGAGE MARKET SIZE, POPULATION & MAIN PROVIDERS (REF: SECTION 8.1)



[1] http://fsi.gov.au/publications/interim-report/02-competition/banking-sector/

There are currently five main mortgage providers in Ireland, namely AIB (including EBS & Haven), Bank of Ireland, Ulster Bank, PTSB and KBC, with new entrants Pepper Money and Dilosk. Other potential entrants such as Credit Unions and Frank Money are believed to be waiting approval from the Central Bank of Ireland. As the market recovers, more may join.

BOI is of a view that the mortgage market operates within the context of the recovering housing environment– and is very dependent on this environment working well - since recovering from its low point in 2011 of €2.5 billion, the mortgage market has increased to €5.7 billion in 2016, with future growth of >10% anticipated in 2017. New entrants have come into the market and market shares of incumbents have fluctuated substantially in this period. Figure 3.1 shows the movement in market share across the providers over time. Estimated point in time market share for 2016 are AIB Group (incl. EBS and Haven) 36%; BOI 25%; Ulster Bank 18%; KBC 11% and PTSB 10%. Additionally, it is noted that AIB Group highlighted market share of 38.6% of new mortgages in the final quarter of 2016.

Looking beyond headline point in time figures, Irish mortgage rates are in line with EU rates

BOI notes the comments of Daniele Nouy, Chairperson of the Supervisory Board, ECB, stated in her letter of 2 June 2016, that "All mortgage borrowers considered, the average interest rate paid in Ireland as at February 2016 is 2.63%, according to data published by the Central Bank of Ireland. This rate is very close to the euro area median".[2]

Variable rates in Ireland are higher than in some cases across Europe but there are explanations for the differences and it is also clear that comparisons published in the media are not on a like-for-like basis. These differences are primarily due to (i) upfront fee income in other countries which are not a feature of the sector in Ireland; (ii) the higher cost of capital and risk and (iii) tax payer supported / subsidised funding structures. It is important for the long term health of the Irish economy that lending generates adequate return on the capital employed.

In short, quoting point in time Standard Variable Rates ("SVR") does not reflect that the Irish mortgage market is a function of the broader housing and banking markets in which it operates. For example, there are specific difficulties with recovering security in Ireland. The resolution process can be much shorter in those markets with lower rates than in Ireland. Research has shown that 80 per cent of listings relate to cases seen multiple times and under 5 per cent of listings were granted possession orders.[3] BOI continues to focus on the resolution of Irish mortgage arrears by agreeing suitable and sustainable solutions with the legal process always seen as a last and imperfect resort. More than 9 out of 10 of BOI's challenged owner occupier Irish mortgage customers with restructuring arrangements continue to meet the agreed repayments.

BOI does not see a case for intervention in the mortgage market to address mortgage pricing as the Irish market is currently undergoing a recovery to growth from a severe crisis.

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[2] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/160602letter_hayes.en.pdf

[3] Coffey, S. Mortgage Repossession Hearings before the Cork County Registrar: Myth versus Reality, Department of Economics, University College Cork, 2015.

BOI recommends and would support market enhancements to facilitate securitisation and other funding mechanisms as are available in different EU countries in addition to enhancements to the resolution process.

There is significant price, service and product innovation in the Irish market

As sustainable economic recovery has been evidenced in Ireland, the Irish mortgage market has seen the arrival of new entrants, expansion of the mortgage activities of incumbent banks, growth of the intermediary channel and ongoing product and service innovation. Irish households are now benefiting from strong competitive pressures in the mortgage market as the variety of mortgage propositions increases.

BOI maintains a mortgage pricing strategy led by providing competitive short and mid-term fixed rates. These fixed rates are available to all customers, i.e. both new and any existing customers of the Bank on Variable rates. In a market that is facing into a rising interest rate environment for Europe and beyond, customers have a variety of options that provide value, certainty and stability. For example, the BOI 3 year fixed rate of 3.10%[4] provides certainty of repayments at a rate that is below the SVR charged by market competitors, on a stand-alone basis. This is before taking into account the very competitive BOI 3% cashback offer available to mortgage customers. BOI introduced 1% Cashback in 2014, 2% Cashback in 2015 and Cashback Plus in 2016.

The mortgage market itself is increasingly active across the suppliers providing mortgage finance. "Pepper Money" is now available to consumers and is offering €1,500 towards legal fees on Switcher and Buy to Let mortgages. PTSB have extended their 3 in 1 mortgage offer, whilst EBS (AIB) and Ulster Bank have also extended their cashback offers. KBC has confirmed its long term commitment to banking in Ireland in February 2017, with RBS/Ulster Bank having done so earlier in 2016.

Advertising spend continues to grow with providers competing across a range of channels to attract new mortgage business including print, broadcast and social media. The chart in section 3.2 shows the increase in estimated marketing spend per mortgage application and the growth trajectory since 2013 to date. All of the providers have launched and amended different promotional campaigns in the past 12 months.

BOI has to date continued to maintain its countrywide footprint of branches open, while many of our competitors are closing their branches. This strategic focus on and investment in our branch network ensures that we are the prominent provider of financial services embedded in local communities in over 250 urban and rural communities throughout the Republic of Ireland, complemented by the major investments we are also making in our payment systems, online and mobile banking services. This has been achieved notwithstanding the changes in mortgage origination profile as customers become increasingly comfortable using alternative phone and online services for mortgage funding.

BOI harbours concerns that an unintended consequence of interventions in the mortgage market could potentially restrict the ability of customers to benefit from BOI's national presence, by causing a retrenchment of this physical channel from local communities.

[4] Available to all borrowers where the loan to value on the property is less than 80%

Mortgage switching continues to increase as the market returns to growth

Industry data for the start of 2017 has seen a strong start to the year relative to the same period in 2016. BOI believes that this return to growth in the market is the key driver of competition. Mortgage switching has increased 65 per cent year-on-year and represented 9 per cent of all mortgage drawdowns in 2016. By way of comparison the level of switching in 2012 was 2 per cent. Additional factors such as the high proportion of existing mortgage stock on Tracker mortgages and the estimated c. 100,000 mortgages with some element of negative equity should also be considered by the CCPC as inhibiting factors to the desire or ability to switch providers.

Consumers have access to a substantial and increasing level of commentary and information on mortgages (e.g., comparison websites and commentary by journalists). This has been helped by the availability of information via mobile and internet search, which have both helped to reduce search costs and improve competition. Separately, the European Commission mandated competition related measures (as part of the Irish banking State aid decisions), which have been implemented by BOI, AIB and PTSB in recent years.

Disclosures re mortgage brokers

The purpose of an intermediary or mortgage broker should be that a consumer receives an objective view of the mortgage most appropriate for their needs. As the CCPC document notes mortgages tend to be the biggest financial commitment made by individuals. Borrowers should know if their broker is owned by a product provider or only providing products on which they can earn a commission. BOI were precluded between 2012 and 2016 from originating via the broker market, and were regulated to sell its ICS brand together with a book of performing mortgages in 2014.

BOI recommend that the CCPC consider undertaking customer research in line with the Financial Regulator intermediary market review in 2008[5] to determine whether most consumers believe a "mortgage broker" offers

- total market coverage across all providers by way of being independent and transparent,
- are clear as to whether payment of a fee is the total remuneration due to a broker
- are clear as to the responsibilities of the broker and whether products from providers that do not pay a commission are actively considered in all recommendations and if not, how this constitutes identifying the most suitable product available

BOI recommend that standard qualification, transparency and disclosure rules be introduced as per the UK market, to ensure consumers understand the level of independence of mortgage brokers and to be comfortable that they have the appropriate qualifications to give the best, informal advice.

State Intervention as a legacy of the housing and banking crises

Over the period 2009-2013 the State invested c. €20Bn into AIB and c. €0.8Bn into EBS bringing them into State ownership. The State then subsequently subsumed EBS into AIB Group. As a consequence, the combined AIB Group share of mortgage stock has increased from pre-crises levels of c. 18% to c. 31% of mortgage stock. AIB has advised that it had c. 36% of new market

[5] *www.centralbank.ie/publications/.../Review%20of%20Intermediary%20Market.pdf*

lending in 2016 under three separate brands, namely AIB, EBS and Haven. Potential confusion over ownership may be reinforced by the usage of different branding.

Structure of the Submission

BOI has identified the themes in the consultation paper and structured its submission so as to respond to the themes and questions in the following way.

Section 2 outlines the structure of the Irish mortgage market with a review of the pre- and post-crisis period, ongoing legacy issues and the current situation in the Irish housing market – all of which have an impact on the level of competition in the mortgage market. It is impossible to understand fully the current mortgage sector in Ireland without paying attention to the period 2000-2013 and its effects.

Section 3 details the current level of competition in the Irish mortgage market. In particular, this Section comments on the level of market concentration and perceived operational barriers.

Section 4 outlines the scale of the opportunity for new entrants to the market as well as the current regulatory practices and policies introduced subsequent to the financial crisis and their implications for new entrants to the market.

Section 5 provides a commentary on the standard variable rates in Ireland versus those reported in some parts of the rest of Europe. The impact of customer switching, variable rate caps and product innovations on standard variable rates are discussed in some detail.

Finally, *Section 6* provides an overview of a number of international mortgage markets with which the Irish market can be compared to some extent – in terms of the level of concentration, competition and market interventions.

The following table provides a cross reference of the issues raised in this submission with the CCPC public consultation questions.

Table 1.1: CROSS REFERENCE TO CCPC CONSULTATION QUESTIONS

Topic	Question	Refer to the following Section
Current Level of Competition	2.1 (a)	Sections 1, 3 and 6
	2.1 (b)	Sections 1 and 3
	2.1 (c)	Sections 1 and 3
	2.1 (d)	Sections 1 and 3
	2.1 (e)	Section 3.8 p15
	2.1 (f)	Section 3, p8
Standard Variable Rate	2.2-2-5	Section 5.1, p21
Operational Barriers to Entry	2.6 (a)	Section 3.3
	2.6 (b)	Section 3
Other Potential Barriers to Entry- AIB and PTSB	2.7 (a)	Section 3.7, p16
	2.7 (b)	Section 3.9, p16
Default, Credit Risk and Repossessions	2.8 (a)	Section 4.1, p17
	2.8 (b)	Section 4.1, p17
	2.8 (c)	Section 4.2
	2.9 (a)	Section 4.1, p17
	2.9 (b)	Section 4.2
Legislative Options	2.10 (a)	Section 5.3, p23
	2.10 (b)	Section 5.3, p23
Regulatory Environment	2.11 (c)	Section 3.2, p10
	2.11 (d)	Section 3.2, p10
	2.11 (e)	Section 4.2, p18
Scale of Opportunity in Irish Mortgage lending	2.13 (a)	Sections 2 and 4
Lending Criteria	2.14 (a)	
Information Available to Lenders	2.15 (a)	Section 3.4, p13
Mortgage Switching	2.17	Section 5.2, p22
	2.18	Section 3.5
Independent Financial Advisors	2.20 (a)	Section 3.6, p14-15
	2.21 (a)	Section 3.6, p14-15
	2.21 (b)	Section 5.2, p22
	2.21 (c)	Section 3.6, p15
Product Innovation/Alternative Mortgage Lending Models	2.23 (a)	Sections 5.1 & 5.4
	2.24 (a)	Section 5.4
	2.24 (b)	Section 5.4
	2.24 (c)	Section 5.4
Other views	2.27	Section 2
	2.28	Section 2

2. STRUCTURAL AND LEGACY ISSUES IN THE IRISH MORTGAGE MARKET

The financial and economic crisis has shaped to a very large extent the level of competition in the mortgage market at the present time. The CCPC review needs to be cognisant of the major transition which is still underway in the banking sector from the unprecedented crisis situation to the restoration of financial and economic stability and the continuing return to growth in the Irish mortgage market. Material progress has already been achieved.

2.1 Background to this Review

Ireland enjoyed significant economic growth starting in the 1990s and continuing well into the first decade of the new millennium. This economic growth was fuelled by macroeconomic policy as well as a related credit and property market boom. The onset of the international financial crisis in 2008, which significantly impacted the euro area, eroded the levels of credit flowing to domestic Irish banks, and led to a sharp decline in property prices. The scale of the property crash was probably the most intense in Ireland's case compared to other countries in terms of its scale, which resulted in significant negative equity for mortgage borrowers and had severe knock on effects on the banking system.

The unprecedented economic and financial crisis and subsequent adverse consequences for the banking system has been well documented[6]. These measures led to an economic adjustment which saw Ireland's GDP fall by almost 12 per cent between 2007 and 2012.

The "boom to bust" development in the Irish housing market was very significant. Mortgage residential lending collapsed to just €2.5 billion in 2011, 6 per cent of peak lending (2006), while property prices fell by half between 2007 and 2013.

2.2 Legacy Issues

The Irish economy is estimated to have grown by 5.2 per cent in real GDP terms in 2016 and is projected to continue to grow in the coming years. Employment is rising and unemployment has fallen to an eight year low of 6.6 per cent. However in 2017 crisis legacy issues are still unwinding. These include the following:

- Negative equity is still a concern for many households. The ESRI estimate that at the end of 2015, just under 100,000 mortgages were still in some element of negative equity (down

[6] A series of high profile commissioned reports by the Minister for Finance from Regling & Watson (2010), Honohan (2010), Nyberg (2011) and the subsequent Banking Inquiry report (2016) highlighted the confluence of factors – external and domestic, macroeconomic and structural – which interacted to cause the crisis. Reports available at following links:
http://www.bankinginquiry.gov.ie/Preliminary%20Report%20into%20Ireland%27s%20Banking%20Crisis%2031%20May%202010.pdf
http://www.bankinginquiry.gov.ie/The%20Irish%20Banking%20Crisis%20Regulatory%20and%20Financial%20Stability%20Policy%202003-2008.pdf
http://www.bankinginquiry.gov.ie/Documents/Misjuding%20Risk%20-%20Causes%20of%20the%20Systemic%20Banking%20Crisis%20in%20Ireland.pdf
https://inquiries.oireachtas.ie/banking/

from over 300,000 in 2012) and that if prices grew by 6 per cent p.a. the vast majority of mortgages would clear negative equity by 2019.[7]

- Cash buyers are a significant part of the housing market with circa half of residential purchases in the past five years are being funded by mortgage loans.
- There are five main mortgage banks in Ireland; Bank of Ireland, AIB (including EBS and Haven), Ulster Bank, PTSB and KBC, with new entrants Pepper and Dilosk. Other potential entrants such as Credit Unions and Frank Money are believed to be awaiting approval from the Central Bank of Ireland.

2.3 Developments in The Housing Market

There are many complex factors at play in the housing market at present. The market has been recovering in recent years, with the debate now firmly focused on the shortage of housing supply. There are potential buyers who were not accommodated during the boom years due to affordability problems, while others would have postponed property purchases during the recession years. Thus there is likely to be considerable pent up demand in the market over the medium-term, over and above trends which annual average household formation projections suggest. The presence of pent up demand is a positive driver for the mortgage market over the coming years as a normal housing market returns. Currently the turnover in the housing stock is around 2 per cent compared with 3.5 to 4 per cent in the UK.

An increased presence of large institutional landlords/REITs in the private rented market may impact the number of small investors who traditionally purchase stand alone properties and individually raise a mortgage for that property. REITs tend to purchase and manage developments as a single block. These emerging trends are likely to impact the size and profitability of the mortgage market.

[7] ESRI, "Quarterly Economic Commentary – Spring 2016", March 2016.

3. COMPETITION IN THE MORTGAGE SECTOR

3.1 CURRENT STRUCTURE OF THE MORTGAGE MARKET

The past decade has seen dramatic changes in the Irish mortgage market with a number of leavers, new entrants and expansions of existing operations. In 2007, the six main participants in the Irish mortgage market were Bank of Ireland (BOI; ICS Building Society (ICS)), Allied Irish Banks (AIB; Haven), Ulster Bank, Irish Life & Permanent, KBC Bank, and Educational Building Society (EBS), whom together accounted for 89 per cent of the market. Other participants in the market at the time included Irish Nationwide Building Society, Danske Bank Ireland, BOSI (owed by Lloyds) and ACC (owed by Rabobank).

Over the period 2009-2013 Irish Nationwide merged with Anglo into IBRC and went into liquidation while ACC, Danske and BOSI announced their exit from the Irish mortgage market. Irish Life & Permanent (IL&P) was brought into state ownership in 2011 and Irish Life sold on. Permanent TSB as a mortgage focused bank was floated on the stock market in 2015 with 25% purchased by private sector investors.

Over the period 2009-2013 the State invested c. €20Bn into AIB and c. €0.8Bn into EBS bringing them into State ownership. The State then subsequently subsumed EBS into AIB Group. As a consequence, the combined AIB Group share of mortgage stock has increased from pre-crises levels of c. 18% to c. 31% of mortgage stock. AIB Group has advised that it had c. 36% of new market lending in 2016 under three separate brands, namely AIB, EBS and Haven. Potential confusion over ownership may be reinforced by the usage of different branding.

In 2010, BOI was required by the European Commission to exit the broker intermediary market until 2017 and to sell its broker intermediary subsidiary ICS.

KBC has confirmed its long term commitment to banking in Ireland in February 2017, with RBS/Ulster Bank having done so earlier in 2016. Both entities compete through a variety of channel with Branch networks, Hub structures, direct and broker intermediary origination.

Dilosk entered the market as a new provider in 2014. Pepper, an Australian owned non-bank lender, began selling mortgages directly to Irish customers in November 2016.[8] It has been reported that Irish pension funds may, for the first time, move into mortgage lending this year, as media reports suggest Frank Money has raised €200m from several of the country's pension funds and may enter the market once it has raised €250m and secured regulatory approval .[9] The current lenders in the market are Bank of Ireland, KBC Bank, Permanent TSB, AIB (including EBS and Haven), Ulster Bank, Dilosk and Pepper.

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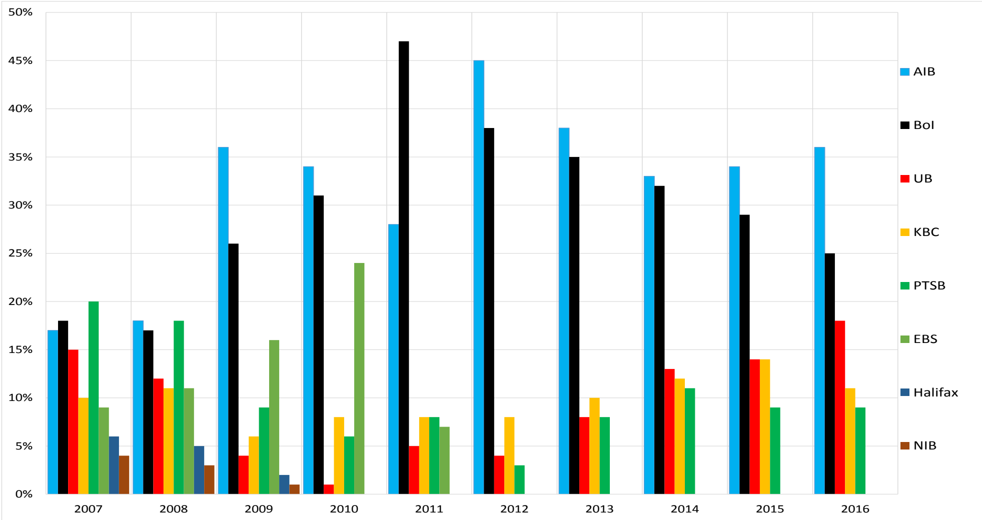
[8] http://www.independent.ie/business/new-entrant-to-the-mortgage-market-to-begin-selling-directly-to-irish-consumers-35194053.html

[9] https://www.ft.com/content/4786cdca-0335-11e7-aa5b-6bb07f5c8e12

Figure 3.1: SHARE OF NEW MORTGAGE LENDING 2007-2016



Source: Bank of Ireland internal estimates *Note that EBS and AIB merged in July 2011.

It is possible for new entrants to enter the Irish mortgage market as barriers to entry are low. This extends to the full range of support structures available in the Irish market e.g. there are a number of mortgage servicing platforms to support business origination and management, access to capital markets and securitisations, distribution via access to intermediaries, and there is no requirement for a full banking licence.

New entry on a more significant scale may take some time to occur, given that the sector is returning to growth and is still in a transitioning phase. However, it is evident from Figure 3.1 that competition is returning to the Irish mortgage market. During the height of the financial crisis BOI and AIB held the majority of new mortgage lending between them. This has clearly subsided in recent years with the share of new lending by Ulster Bank, KBC and PTSB, for example, all increasing relative to their 2011/2012 shares. Market share has fluctuated across the main players in the market on the back of clearly differing pricing strategies (e.g. fixed rates, SVRs and cashback offers), alternative origination models and channels (e.g. branch, broker etc.), the expansion of mortgage lending in incumbents and new entrants.

3.2 MARKET CONCENTRATION

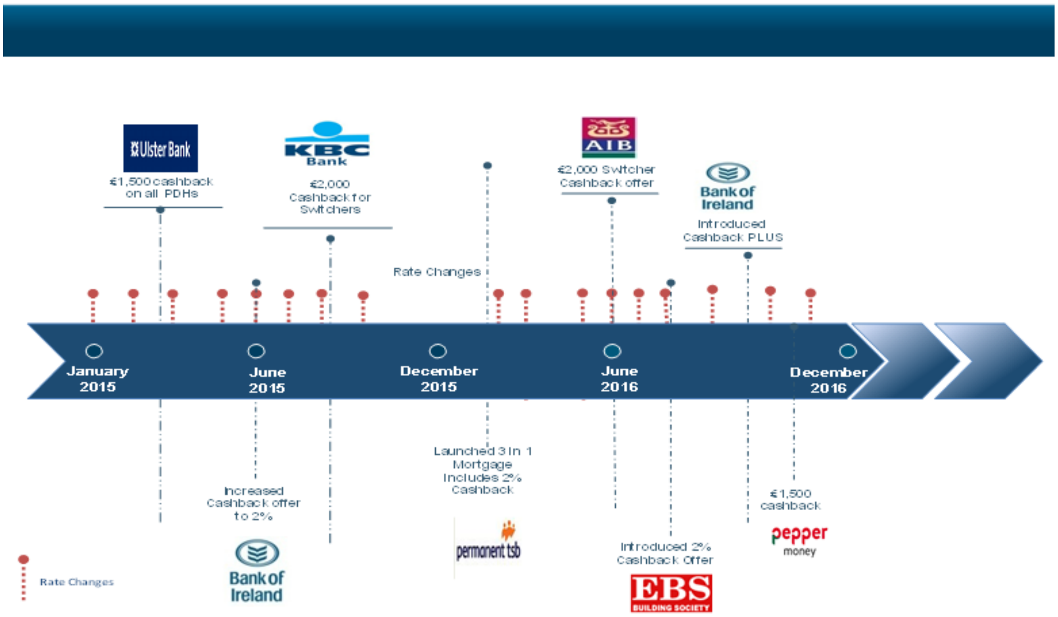
The CCPC consultation document references that the mortgage market is highly concentrated and uses the HHI as an illustration. The HHI score was consistently below 1,500 (above 1,800 signals a highly concentrated market) before the onset of the crisis but increased substantially in 2011, following market exits and mergers as outlined above, as well as loan transfers. However this increased concentration to over 2,100 at end of Q1, 2016, is a consequence of the financial crisis and the policies put in place since then to restore financial stability.

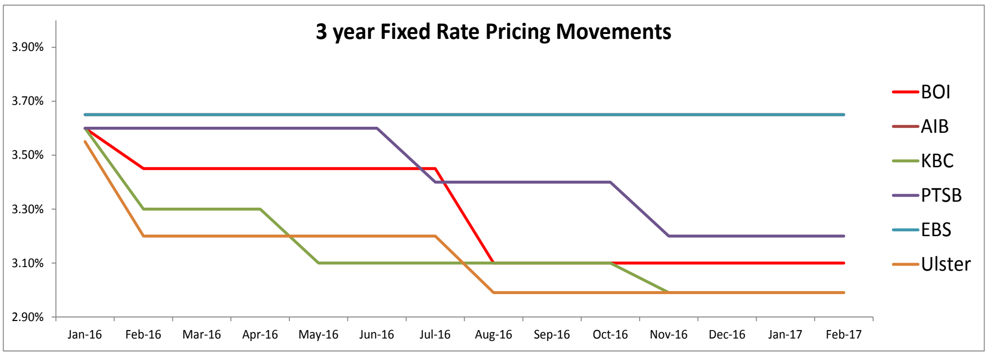
Concentration is just one indicator of competition in a market. With seven players currently in the mortgage lending market, it is evident that competition in the market is already increasing in line with the recovering economy, the improvement in job creation and the pick-up in mortgage lending since 2013. The entry to the market of Dilosk in 2014, Pepper in 2016 and potentially Frank Money and/or the Credit Unions would further increase the number of participants. If AIB were to divest of its subsidiary, EBS, to a new entrant, for example, this would also increase the number of providers in the market.

The return of the switching market between mortgage providers is an important indicator of recovery. Having declined to just 2 per cent in 2012, the switching segment has grown significantly since then, from 6 per cent in 2015, up to 9 per cent in 2016. Switcher growth is driven by (i) increased competition; (ii) increase in the number of customers available to switch as property price growth reduces negative equity in the market, thereby increasing the number of mortgage holders which have switching options available to them and (iii) divergent mortgage options and incentives for consumers e.g. cashback offers.

The perceived level of concentration in the mortgage market is transitory and is not a deterrent to entry, noting that 2 additional institutions have commenced operations in the past 12 months, namely Pepper and Dilosk. Furthermore, those entities competing in the market today provide a broad range of choice to consumers, with a variety of competitors undertaking different pricing strategies, origination channels and promotional areas of focus. This is illustrated in the examples below which show the breadth of rate and promotional offers in the last two years.

Figure 3.2: MARKET TIMELINE SINCE 2015 OF SAMPLE RATE AND PROMOTION OFFERS IN MORTGAGE MARKET





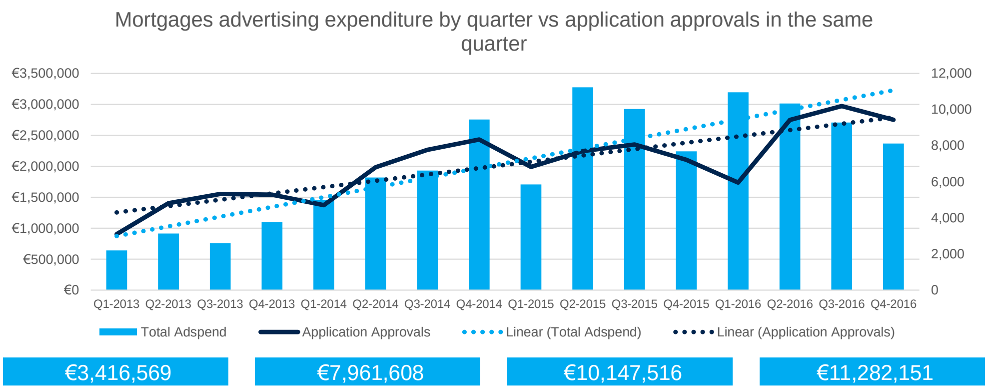
In addition, Section 3.6 sets out the diversity of channels through which mortgages are offered and the increasing level of independent financial advisors / brokers.

Broker share of the market peaked in 2007/08 when it accounted for 46 per cent of the market. In recent years, the market has begun to recover in tandem with the expansion in mortgage activity. Broker or intermediary origination of mortgages accounted for c. 17 per cent of the First Time Buyer and Mover mortgage market in 2015 and stood at c. 20 per cent for 2016.

All lenders in the market (excluding BOI) operate in the broker market either under their own brand (KBC, Ulster, PTSB) or a separate brand (AIB under EBS/Haven), with Pepper now also operating via the broker market.

Advertising spend continues to grow with providers competing across a range of channels to attract new mortgage business including print, broadcast and social media. The chart below shows the increase in estimated marketing spend per mortgage application and the growth trajectory since 2013 to date. All of the providers have launched and amended different promotional campaigns in the past 12 months.

Figure 3.3: MORTGAGE ADVERTISING EXPENDITURE INCREASES OVER TIME



Source: *BPFI Mortgage Applications Report / Nielsen Media Research Ad spend 2013-2016 for AIB, EBS, PTSB, Ulster Bank, BOI and EBS. (Paid Search and Social Media investments are not included for any advertisers as these investments are not monitored by Nielsen).*

3.3 OPERATIONAL BARRIERS TO ENTRY

As a small and open economy, the Irish economy tends to be subject to more volatility than other larger European economies (i.e. in terms of the volatility of GDP growth). Research by the Central Bank of Ireland concluded that new loan pricing by existing banks was impacted by losses on the back book of mortgages (i.e. due to trackers and non-performing loan).[10] New entrants could charge lower rates as they did not carry the burden of a loss making back book. The lack of new entrants is potentially:

"thought to reflect the lasting impact of the wider crisis across European banks, as well as an understandable apprehension of entering a market experiencing such a high level of non-performing existing loans."

The research also noted that the arrival of entrants '*can be expected to happen'* presumably as the recovery takes hold and the level of non-performing loans at an industry level continues to improve.

However, by international comparison, the mortgage market in Ireland is small and all things being equal, is capable of sustaining only a smaller number of players at efficient scale (see Table 8.1 in Appendix 2). Section 6 contains a review of comparative markets.

3.4 INFORMATION AVAILABLE TO LENDERS

The CCPC notes in its consultation paper that information on a customer's income and credit history can assist a lender to extend credit to that customer. The introduction of the Central Credit Register (CCR) in 2018, as a national mandatory database of credit intelligence, to be maintained by the Central Bank of Ireland, will significantly enhance transparency in the market and be fully accessible to all lenders including new entrants. The regulations governing the operation of the CCR set out the legal obligations on lenders to supply information to the Register and to access the Register when considering loan applications. This will be a further regulatory step in the move to improve financial stability and consumer protection.

The introduction of the revised Payments Services Directive (PSD2) by the European Union, which must be adopted by all Member States by January 2018, is another significant development.[11] Innovation in payment services has boosted transparency, innovation and security in the single market and the revised PSD2 will bring these types of payments within the scope of the regime. The purpose is to provide lenders with significantly enhanced credit relevant customer information with which to make robust credit and risk assessments. The new regime will allow banks and their customers to obtain a consolidated view of their bank accounts, including the access in order to enable, for example, an affordability check to be carried out when applying for a mortgage or loan.

Payments UK, the trade association for the UK payments industry has stated that PSD2 will substantially benefit and protect customers.[12] In addition, they anticipate that these changes will result in the development of products and services that allow customers to optimise the use

[10] Central Bank of Ireland, "Influences on Standard Variable Mortgage Pricing in Ireland", May 2015.
[11] http://europa.eu/rapid/press-release_MEMO-15-5793_en.htm?locale=en
[12] The Second Payment Services Directive (PSD2): A Briefing from Payments UK, July 2016, available at https://www.paymentsuk.org.uk/sites/default/files/PSD2%20report%20June%202016.pdf

of their account and transaction data. PSD2 could help open up new markets and encourage new market entrants, some of whom will offer services that will assist people who are currently financially excluded. These are all developments which will benefit consumers.

The introduction of the Payment Services Directive from 2018 will consolidate financial information held by banks so as to enhance competition between incumbents and potential entrants. The measures will provide incentives for potential entrants to the market as it will reduce the cost of gathering proprietary information on clients.

3.5 DISTRIBUTION CHANNELS

The range of distribution channels used for mortgages is evolving rapidly. The impact of the internet and digital technology has seen the proportion of the total mortgage business coming through the traditional branch network decline over the past decade. Many financial institutions have rationalised their branch network accordingly.

The mortgage market is rapidly evolving to accommodate changing customer behaviours For example; BOI now provides a mortgage application service by phone or online, in addition to holding mortgage meetings over Skype or Facetime.

Some competitors are relying less on the branch network, competing via hub structures, intermediaries or directly. BOI are always innovating to make banking easier for customers, while providing practical assistance so that they can make the most of digital options. The combination of digital channels, phone channels, mobile mortgage managers and local presence means BOI can be more responsive and flexible to meet our customer needs.

In response to the increased levels of competition in the market in recent years, BOI has introduced a number of new measures to meet customers changing requirements. 2016 saw the introduction of MortgageSaver, which helps customers saving for their new home. BOI increased the number of mobile mortgage managers across Ireland to ensure availablity to customers at times that suit them. We have enhanced our 2 per cent cashback offering so that our qualifying mortgage customers receive an additional 1 per cent cashback after five years.

BOI has to date continued to maintain its countrywide footprint of branches open, while many of our competitors are closing their branches. This strategic focus on and investment in our branch network ensures that we are the prominent provider of financial services embedded in local communities in over 250 urban and rural communities throughout the Republic of Ireland, complemented by the major investments we are also making in our payment systems, online and mobile banking services. This has been achieved notwithstanding the changes in mortgage origination profile as customers become increasingly comfortable using alternative phone and online services for mortgage funding.

3.6 BROKER INTERMEDIARIES

There is a large network of financial brokers operating in the Irish market providing consumers with advice on mortgage products and financial planning.[13] Mortgage brokers or intermediaries are authorised to provide advisory services by the Central Bank of Ireland. The extent of mortgage information available in Ireland and across all media is extensive.

BOI exited the broker market in 2013 under the EU revised restructuring plan which required the bank to cease the origination of new mortgages through its intermediary channel, including the sale (or retirement) of the ICS Building Society's distribution platform, as a market opening measure. Consequently in 2014, Bank of Ireland sold the ICS Distribution Platform, together with a number of performing mortgages to Dilosk Limited ("Dilosk"). The restriction on origination of mortgages via intermediaries expired on 31 December 2016.

Key concerns with respect to broker compensation in Ireland are (i) absolute levels of compensation which have increased significantly over the last number of years; and (ii) significant divergence in the market. Both of these factors could create incentives for a broker to recommend the mortgage product which offers the highest commission rather than one which best meets the needs of the customer.

It is noted that commission levels in Ireland are significantly higher than in the UK where commission must be disclosed to consumers (at 30-40bps) and where the requirements to qualify as a mortgage broker are more rigorous and extensive than in Ireland.. Any proposed change to the current commission remuneration model should promote and encourage a level playing field and full information disclosure on commissions for consumers.

A key function of a broker is to offer the product to the customer which best meets their needs. Some brokers are tied to selling the products of a few lenders and therefore may be unable to provide the best advice or most competitive products to customers. Since BOI do not currently utilise the Broker channel, the full range of available propositions may not be included in the recommendations that a broker makes to their customers.

BOI recommend that the CCPC consider undertaking customer research to determine whether most consumers believe a "mortgage broker" offers

- total market coverage across all providers by way of being independent and transparent,
- are clear as to whether payment of a fee is the total remuneration due to a broker
- are clear as to the responsibilities of the broker and whether products from providers that do not pay a commission are actively considered in all recommendations and if not, how this constitutes identifying the most suitable product available

BOI recommend that standard qualification, transparency and disclosure rules be introduced as per the UK market, to ensure consumers understand the level of independence of mortgage brokers and to be comfortable that they have the appropriate qualifications to give the best, informal advice. Recent research carried out by Millward Brown on behalf of BOI reinforced concerns mentioned above.

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[13] Register of Mortgage Intermediaries, available at http://registers.centralbank.ie/DownloadsPage.aspx

‘Our mortgage broker told us that they (i.e. BOI) ***weren't worthwhile approaching****. ‘– ‘the broker said that there were* ***only two banks worthwhile approaching*** *and it was a waste of time speaking to the other banks as we* ***wouldn't get a mortgage from them****.’ (First Time Buyer).*

‘I knew the broker wouldn’t include BOI as an option*. I did ask him to let us know what they were offering though as I had seen the ad on TV for their money back offering.’ (First Time Buyer)*

4. REGULATORY PRACTICE AND POLICIES

4.1 MANAGEMENT OF ARREARS

The existence of mortgages in arrears in a market will reduce the capacity of existing borrowers to switch their mortgage or move house. They also slow the economic recovery, which will be less than it might otherwise be, as households in arrears are having to divert any surplus income to mortgage repayments. For a potential new entrant, the existence of mortgage arrears could comprise a barrier as they reduce the potential market size. However, the potential risks for a new entrant are more likely to comprise macroeconomic risks and risks specifically associated with the housing market (e.g. falling house prices, an interest rate shock). Potential new entrants would also end up with a lower risk mortgage book, given the stage in which the housing cycle is at present. This would place them at an advantage relative to incumbents.

The extent of arrears and repossessions are legacies of the economic crisis and has been acknowledged by the ESRI (Summer Quarterly Economic Commentary 2016) as a contributor to the high level of variable rates in the Irish mortgage market.[14] In a study which compared mortgage interest rates in Ireland with those in Spain, Germany, Greece and the Euro zone average, the ESRI concluded that the low level of repossessions in Ireland was impacting on the variable rate that banks were able to offer customers.

In Ireland, as long as the rate of repossessions remains low, banks will inevitably need to factor this additional risk into their variable rates – regardless of the level of competition in the market. It is likely that the length of time associated with the Court approval of a repossession of a principal private dwelling house may act as a barrier to entry in the mortgage market. All principal private dwelling repossessions are deferred at first hearing by the courts. This timeline in Ireland is materially longer and more uncertain when compared to the UK.[15]

The management and resolution of mortgage arrears is a key priority for the Bank of Ireland Group and the Bank continues to make very significant progress, with a lower number of accounts in arrears and default than the industry averages. The Bank's focus remains on supporting customers with financial challenges by providing a comprehensive range of sustainable restructuring solutions – legal action is a last resort.

The recovering economy and the increase in employment will have improved the repayment capacity of those borrowers in arrears, but the improvement can also be somewhat attributed to the Mortgage Arrears Resolution Process which became effective from 1st July 2013. This process led to more engagement between both borrowers and lenders on alternative repayment arrangements that were affordable in the long-term.

The resolution process, however, can be a lengthy one. It takes at least eight months from the date arrears arise before legal proceedings can commence. The court process is also a lengthy one as cases tend to be adjourned on their first hearing for between three and six

[14] http://www.esri.ie/pubs/QEC2016SUM.pdf

[15] Based on 2012 data from the Central Bank of Ireland, CMI and Moody's there were approximately 160,000 accounts in arrears with c. 40,000 repossessions in the UK. This compares to 120,000 accounts in arrears in Ireland in the same year with no repossessions.

months. At the second court date, the case can often be adjourned for another six months. An order for possession, if one arises, may not be given until the third or fourth hearing. Research has shown that 80 per cent of listings relate to cases seen multiple times and under 5 per cent of listings were granted possession orders.[16] When an order is granted a stay is usually imposed meaning that the order cannot be executed until the period of the stay, usually six to eight months, has elapsed. But often from the last repayment on a mortgage, it can take around five years to secure repossession.

Research was undertaken by the Expert Group on Repossessions, established in September 2013 in response to a commitment to the Troika, to examine the court repossession system in Ireland and compare it with other jurisdictions.[17] The timeline set out above for Ireland is longer than compared to the UK.

Having repossession policies and practices in place to deal with arrears is good regulatory practice. For new entrants, however, the likelihood is that if the system in Ireland is perceived to be weaker or take longer than in other jurisdictions, this may constitute a barrier to entry.

4.2 Regulatory Practice and Policies

In the context of the Irish mortgage market the most notable of the macro-prudential suite of policies has been the introduction of caps on the Loan-to-Income (LTI) and Loan-to-Value (LTV) ratios and the Countercyclical Capital Buffer. The Bank is supportive of the principal objectives of the macro prudential policy.

The Countercyclical Capital Buffer (CCB) is a macro-prudential instrument designed to make the financial system more resilient and less pro-cyclical.[18] As indicated in the Macro-Prudential Policy Framework for Ireland[19] the CCB helps authorities meet one of the intermediate objectives of macro-prudential policy, namely mitigating and preventing excessive credit growth and leverage. Currently, the CCB rate on Irish exposures is set at 0 per cent based on the credit gap (which is currently below a threshold of 2 per cent) and a suite of other indicators.[20]

Higher capital requirements, as introduced during the recession on a European level, will have deterred expansionary plans amongst European banks in the same period. These banks may have been more likely to remain in their existing markets than expand into other markets given the greater capital requirements.

Coffey, S. Mortgage Repossession Hearings before the Cork County Registrar: Myth versus Reality, Department of Economics, University College Cork, 2015.
[17] Findings of this expert group available at http://www.justice.ie/en/JELR/ExpGroupReportFinal.pdf/Files/ExpGroupReportFinal.pdf.
[18] Creedon, C. & O'Brien, E. (2016). Indicators for Setting the Countercyclical Capital Buffer, Central bank of Ireland, Economic Letter Series, Vol. 2016, No. 2.
[19] http://www.centralbank.ie/stability/Documents/FINAL-for%20publication-macro-prudential%20framework.pdf.
[20] For example, measure of the potential overvaluation of property prices, external imbalances, strength of bank balance sheets etc.

4.2.1 Other Policies and Practices

Help-to-Buy Initiative

More recently, Government has introduced a Help-to-Buy scheme which it is hoped will assist FTBs in obtaining the deposit required to purchase or self-build a new home. Since its introduction, the Government has commissioned an independent impact assessment of the scheme due to be completed in time for Budget 2018. In the meantime, and notwithstanding the issues with new housing supply, it is anticipated that the scheme will further increase the scale of market opportunities for new and existing banks.

5. STANDARD VARIABLE MORTGAGE RATES AND OTHER ISSUES

The CCPC wishes to understand the recent divergence between the cost of funds and the cost of standard variable rate mortgages (SVRs) in Ireland compared to other jurisdictions and asks if the comparison with other jurisdictions is valid, given different incentives offered across markets.

5.1 WHY SVRS DIFFER IN THE REPUBLIC OF IRELAND

The differences between rates in Ireland and some other Eurozone rates are largely explained by structural factors such as higher relative funding, operating credit and capital costs, limited fee income and introductory teaser rates in other countries. However, the bank's difficulty in realising collateral at default remains an expensive and lengthy process and is still a somewhat uncertain process.[21]

In front book variable rates, the differences primarily include (i) higher fee income in other countries resulting in a smaller all-in cost differential than on interest rates; and (ii) higher risk weightings for Irish Mortgage providers driving higher capital requirements, and (iii) tax payer supported / subsidised funding structures. It is important for the long term health of the Irish economy that lending generates adequate return on the capital employed.

A recent study by the Central Bank of Ireland[22] examined the drivers of mortgage interest rate pricing in the Irish market. It identified key issues within the Irish banking system and the associated structural differences with other European markets in the context of variable rate pricing.

The cost of risk and capital has increased with a significant premium for Irish lenders when compared to our European counterparts, while economies of scale are much lower for lenders operating in Ireland compared to those in larger markets which afford the ability to have fixed costs allocated across higher loan volumes.

Goodbody published comments in relation to SVRs on the 19th October 2016;
"We acknowledge that variable rates in Ireland are amongst the highest in Europe, but so also are mortgage risk weights, a key input for pricing by the banks. Irish mortgage risk weights (under IRB) range from 27-43 per cent for the main domestic banks. This compares to c.15 per cent in the UK, c.10 per cent in Scandinavia and c.20 per cent in Spain. Also, collateral access for the banks in repossession typically takes longer than in other jurisdictions and Irish term funding costs are higher (lower ratings). As such, rates in Ireland should be structurally higher than peers."

It is worth reiterating that the scale of the recession together with legacy issues are driving the regulatory capital demands in the Irish market. As a consequence the capital demand in Ireland is significantly higher than in other countries. To sustain that level, banks need to be able to

[21] Banks, Davy Research Note, 9th June 2016.
[22] Influences on Standard Variable Mortgage Pricing in Ireland, Central Bank of Ireland, May 2015.

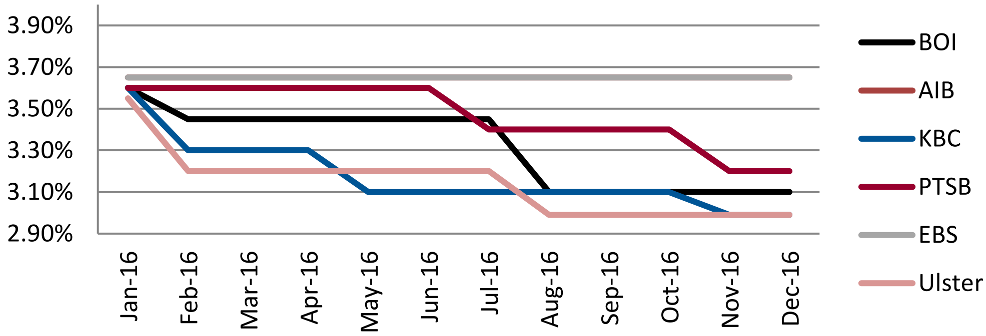
generate and reward the capital and liquidity necessary to lend into the mortgage market and hence, this much higher level of capital must be paid for.

Mortgage markets differ in structure and features across all EU member states thereby preventing an accurate and transparent comparison. The statistics published on same by the Central Bank of Ireland relate to interest rates on new loan agreements to households for house purchase, with either a floating rate or initial rate fixation of up to one year, thereby excluding longer term fixed products and potentially including products with an initial discount period which are a feature of some markets.

In other European countries mortgage fees and charges, such as arrangement fees, means comparing the interest rate alone does not provide a direct comparison as there are no arrangement fees currently on mortgages versus UK and European norms. Bearing this in mind, Daniele Nouy, Chairperson of the Supervisory Board, ECB, stated in her letter on 2nd June 2016, that "*all mortgage borrowers considered, the average interest rate paid in Ireland as at February 2016* [was] *2.63 per cent, according to data published by the Central Bank of Ireland. This rate is very close to the euro area median*".[23]

Longer term, it is probably desirable as a matter of economic and social policy to hedge as many mortgage holders as possible, from fluctuations in interest rates, through the greater use of fixed interest rate mortgages. BOI continues to focus on a fixed rate led pricing strategy with a range of attractive one, two, three, five and ten-year fixed rate options starting from 3.1 per cent. Fixed rates provide certainty, value and stability to the customer at a time when interest rates are at historic lows. Indeed, fixed rates accounted for c. 76 per cent of new lending in 2016 at BOI.

Figure 5.1: Three-Year Fixed Rate Pricing Movements



Source: BOI

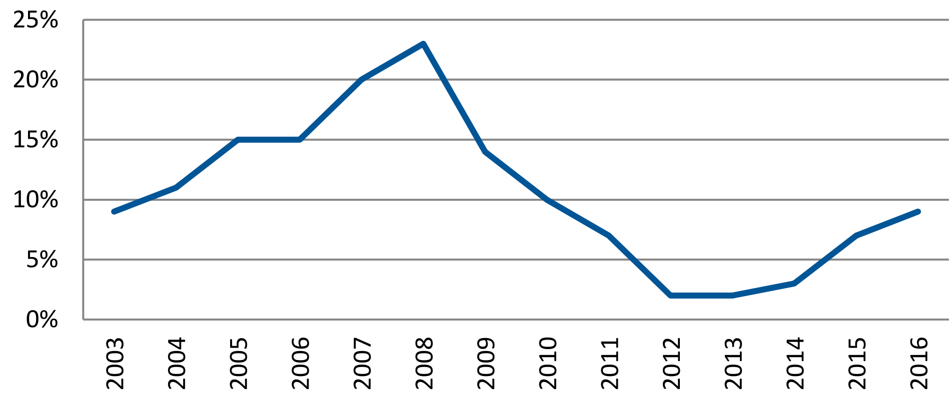
5.2 Customer Switching

The switcher market was significantly impacted by the financial crisis due primarily to massive economic uncertainty. In 2006, the switcher market accounted for 15 per cent of overall new lending, but by 2012, it had dropped to just 2 per cent of new lending (see Figure 5.1). As the Irish mortgage market has stabilised and started its journey to normalisation, the market is

[23] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/160602letter_hayes.en.pdf

seeing an increase in switching. In 2016 switching accounted for 9 per cent of new mortgage lending.

Figure 5.2: Switcher Mortgage Market Activity 2003 – 2016



Source: BPFI

In a recent Economic Letter[24] the Central Bank of Ireland examined the opportunities that exist for mortgage holders to switch between lenders. The report found that of half a million PDH mortgages held by three Irish headquartered financial institutions some 21 per cent of borrowers could save by switching.

While the Central Bank of Ireland has pointed to a lower level of switching in the Irish market, it is not considered a barrier to entry. Additional factors such as the high proportion of existing mortgage stock on Tracker mortgages and the estimated c. 100,000 mortgages with some element of negative equity should also be considered as inhibiting factors to the desire or ability to switch providers. The primary cost to consumers for switching are legal and valuation fees, many of which are now covered in full either directly or indirectly by way of cashback offers and are not considered a barrier. BOI believes that in the recent past customers would have demonstrated inertia to switching to providers not seen as committed to the market, but that as switching returns they are more likely to be attracted to new propositions. As some mortgage providers have re-affirmed their commitment to remain in the market then it is quite possible that consumers might be more willing to switch to them – consumers were acting rationally at not switching to providers who may not remain in the market but this risk is diminishing all the time.

An EU mandated measure imposed on AIB Group, BOI and PTSB lead to the new website www.switchyourbank.ie. The website provides a single source where consumers can access useful facts about switching, including a straightforward step-by-step guide, links to CCPC comparison tools and helpful information to support their decision-making. Bank of Ireland has a dedicated page on our group mortgage website on switching and advises customers of the steps involved.

[24] https://www.centralbank.ie/publications/Documents/EL_2015_8.pdf

5.3 CONTROLS ON VARIABLE MORTGAGE RATES

The Variable Rate Mortgage Bill 2016 seeks to provide the CBI with powers to review the mortgage market on a quarterly basis and cap variable mortgage interest rates. Both the Central Bank of Ireland and the ECB has highlighted the risks of interest rate controls in recent months. On November 17th 2016 the ECB provided an opinion signed by Mario Draghi highlighting:

> *"the possibility of restrictions on the maximum rate that banks are allowed to charge for variable interest rate mortgages could potentially render the market less attractive and discourage new entrants. This would lead instead to lower competition in financial services in Ireland, effectively defeating the purpose of the draft law".*

And:

> *"The ECB would like to emphasise that extreme caution should be exercised when transferring the power to take commercial decisions from market actors to public authorities."*

Similarly, speaking conference in Dublin on 19th May 2016, the Minister for Finance and the Governor of the Central Bank of Ireland reiterated their views that legislation to control variable interest mortgage pricing would be harmful for competition.

In the Irish market, it is worth noting that both the cost of risk and cost of funding are elevated compared to other countries, as these metrics are influenced by recent trends in the respective mortgage market. In addition, the Irish market focuses on the lending rate for income, with relatively low volumes of commission income generated.

The introduction of interest rate controls would be detrimental not just to competition, but could also negatively impact demand and valuations of Irish bank debt and equity instruments while also threatening financial stability – the banks are still in the process of rebuilding their balance sheets and financial stability remains a key policy imperative for the Central Bank and the government.

5.4 PRODUCT INNOVATION/ALTERNATIVE LENDING MODELS

Product innovation can take many forms, from moving away from the traditional variable rate lending model to longer term fixed rate mortgages, peer to peer lending, or to innovative offers by various lenders.

Within Ireland lenders have generally offered short-term fixed mortgage rates due to the fact that Irish mortgage lending relies heavily on deposit and wholesale funding. Longer-term fixed rates, facilitated by tax payer supported long-term funding instruments, are well established in a number of counties particularly Belgium, Denmark and Germany.

As sustainable economic recovery has been evidenced in Ireland, the Irish mortgage market has seen the arrival of new entrants, expansion of the mortgage activities of incumbent banks, growth of the intermediary channel and ongoing product and service innovation. Irish households are now benefiting from strong competitive pressures in the mortgage market as the variety of mortgage propositions increases.

BOI maintains a mortgage pricing strategy led by providing competitive short and mid-term fixed rates. These fixed rates are available to all customers, i.e. both new and any existing customers of the Bank on variable rates. In a market that is facing into a rising interest rate environment for Europe and beyond, customers have a variety of options that provide value, certainty and stability.

The mortgage market itself is increasingly active across the suppliers providing mortgage finance and advertising spend continues to grow with providers competing across a range of channels to attract new mortgage business including print, broadcast and social media.

In consideration of alternative mortgage lending model, Peer to Peer (P2P) lending is emerging internationally, however this type of lending would need to be carefully regulated. P2P lending is more established in the UK and America. In the UK alone last year, cumulative P2P lending for 2016 hit £3.2 billion versus £381 million in 2012.[25] Ireland currently has two P2P lenders - Linked finance and Initiative Ireland, who only offer loans to businesses. These models need to be considered in the context of their risk management and regulation, with the objective being to protect borrowers and promote competition. To date, they are an untested form of financing in the context of mortgage loans, which are complex products.

[25] https://www.bondmason.com/

6. INTERNATIONAL COMPARISONS

This section examines mortgage market competition in other jurisdictions and is generally relevant to the point that high concentration does not necessarily mean limited competition. Table 8.1 in Appendix 2 summarises a range of key indicators in the respective mortgage markets.

It must be noted that a detailed empirical analysis/regulatory impact analysis would be required prior to any such interventions being introduced to the Irish market.

6.1 OVERVIEW AND CASE STUDIES

A number of international mortgage markets with which the Irish market can be compared are profiled. Discussions on their characteristics and suitability as comparators are included in Appendix 2.

1. AUSTRALIA

The Australian mortgage market is considered concentrated[26], yet robust competition has been a hallmark for an extended period. Australia is an appropriate comparator noting regulatory responses to the global financial crisis which affected the liquidity of the Australian mortgage market[27], albeit that the four large banks (National Australia Bank, Commonwealth Bank, ANZ, and Westpac) are protected by a longstanding federal "four pillars policy".[28]

In December 2014 a Financial System Inquiry (FSI)[29] delivered its final report on competition within the Australian banking sector. The report concluded that "the banking sector is competitive, albeit concentrated". This concentration is focussed around the banks included in the "four pillars policy".

Although the market is competitive, the FSI warned against excessive exposures to mortgages and recognised that "housing is a potential source of systemic risk for the financial system and the economy". BOI would also note that Australia comprises a population of c. 25 million versus Ireland with a population of 4.75m million.

[26] http://eprints.utas.edu.au/17829/1/2014-01_Yanotti.pdf
[27] https://www.genworth.com.au/homegrownedition5/Home-grown-edition-5.pdf
[28] http://fsi.treasury.gov.au/content/PublicInformation/Pressreleases/PR090497.asp
[29] http://fsi.gov.au/publications/interim-report/02-competition/banking-sector/

2. BELGIUM

The Belgian mortgage market demonstrates how a concentrated market can also be a competitive environment which is conducive to a stable housing market. Despite this competition, mortgage arrears levels are low[30] and Belgium avoided a housing market crash around the time of the global financial crisis.

Recent interventions in the mortgage market[31]:

- In 2013, the Belgian national bank introduced a 5 percentage point add-on to internal risk weights for Belgian mortgage loans. This applies to nine institutions which account for about 90 per cent of the c. €36 billion pa Belgian residential mortgage market.
- Two other micro-prudential rules were introduced to address potential weaknesses of the risk parameters used by banks, and to require self-assessments by banks of the degree of conservatism of their credit standards for residential mortgage loans.

The Belgian National Bank reflected on the mortgage market in 2015, and stated that competition and low interest rates "induced many borrowers to refinance their mortgages in the period under review, involving only small prepayment compensations for the credit institutions, which eroded the profitability of a key balance sheet item for many Belgian banks." Although the banks compensated for this effect and indeed increased NIMs according to the National Bank, the impacts were felt on other areas of the banking market, such as deposits. The interventions outlined above were also said to have increased prudence in lending standards in a competitive mortgage market as banks "tightened some of their lending standards for mortgage loans, thus helping to maintain the high quality of Belgian mortgage loan portfolios".

Despite its robustly competitive nature, Lunde & Whitehead[32] described the Belgian mortgage market as "very traditional" and "fairly conservative in its product innovation". The inherent prudence of Belgian banks and consumers has been highlighted as a key determinant of risks relating to mortgage credit remaining low for both parties.

[30] http://www.ecbc.eu/uploads/attachements/100/65/Belgium.pdf
[31] https://ideas.repec.org/a/nbb/fsrart/v12y2014i1p113-122.html
[32] Milestones in European Housing Finance (2016).

3. CANADA

The Canadian mortgage market is notable for its high level of concentration, recent intervention by government in order to increase prudential behaviour, and for its resilient performance through the global financial crisis.

Recent interventions in the mortgage market[33,34]:

- Mortgages issued with an LTV above 80 per cent must have mortgage default insurance.
- Banks must stress test all borrowers applying for an insured mortgage at interest rates which are typically higher than market rates.
- Limits imposed on the share of borrowers' gross household income needed to pay for home-related expenses, including mortgage payments and property taxes.
- Borrowing limited to a maximum of 80 per cent of the value of homes when refinancing, down from 95 per cent.
- 20 per cent minimum down payment for non-owner occupied properties.
- Reduced maximum amortization period for a high-ratio insured mortgages to 25 years.

It is expected that these interventions will act to improve the quality of new credit issued, and somewhat dampen housing demand.[35]

Increased competition in the Canadian mortgage market has arisen since the 1990s due in large part to the emergence of Mortgage Finance Companies (MFCs) which underwrite and administer mortgages sourced through brokers. MFC lending is largely funded through securitisation or direct sales to third parties, primarily the Big Six banks active in the market. Tax Payer mortgage insurance and securitisation programs have facilitated lower interest rates and enhanced credit availability[36], while consumers have shown an increased willingness and ability to shop around.[37]

Although concentrated, the Canadian mortgage market is considered competitive between the six largest banks.

[33] http://www.theglobeandmail.com/real-estate/four-major-changes-to-canadas-housing-rules/article32223470/
[34] http://www.cba.ca/changes-to-canadas-mortgage-market
[35] http://www.bankofcanada.ca/wp-content/uploads/2016/12/fsr-december2016.pdf
[36] http://www.bankofcanada.ca/wp-content/uploads/2016/12/fsr-december2016.pdf
[37] http://www.bankofcanada.ca/wp-content/uploads/2011/02/allen.pdf

4. DENMARK

Denmark is another example of a mortgage market with perceived concentration and intense competition, though significant concerns have surrounded the sustainability of the market[38] while observers have also expressed concern that a housing bubble exists, particularly around Copenhagen.[39]

It is quite a unique market in size and structure, as a 'match-funding principle' states that there must be a complete match between mortgages and specific bonds.[40] Thus, comparing Ireland and Denmark could be problematic, especially in the context of comparing new interventions which are targeted solely at Denmark's unique matched funding system.

Competition in the Danish mortgage market has been credited to economic growth and increasing house prices. This competition has resulted in mortgage providers offering attractive terms to customers, but the Danish Central Bank has warned against any trends towards implementing more lenient credit standards so as to undercut competitors. Overall, despite tightening credit standards, competition in the mortgage market has intensified in recent years.[41]

The Danish mortgage market is characterised by three standard mortgage products which are not typically tailored for individual borrowers. The introduction of Adjustable Rate Mortgages (ARMs) in 1996 is the main example of product innovation and is evidence of competitive forces at work as its introduction by one institution prompted similar actions across the board.[42] Despite the lack of differentiation of mortgage products across providers, competition is said to have been enhanced by the transparency and comparability which these standardised mortgage products provide. Consumers are said to benefit from being able to compare products in an efficient and cheap manner.[43]

[38] http://www.economist.com/news/finance-and-economics/21600994-denmarks-property-market-built-rickety-foundations-something-rotten
[39] http://www.reuters.com/article/us-denmark-economy-houseprices-idUSKCN11K1MC
[40] https://www.realkreditraadet.dk/sites/default/files/2016/08/Realkreditraadet_engelsk_2012_skaerm.pdf
[41] https://www.nationalbanken.dk/en/publications/Documents/2016/12/Finansial_stability_2_2016.pdf
[42] http://pure.au.dk/portal-asb-student/files/81251163/The_Effect_of_Adjustable_Rate_Mortgages_on_the_Default_probability_of_Danish_Mortgage_Banks.pdf
[43] https://www.realkreditraadet.dk/en/danish_mortgage_model/main_types_mortgage_loans

5. UNITED KINGDOM

Although not covered in the above sections, the UK was also considered. Despite being Ireland's closest neighbour, the market was not deemed to be an appropriate comparator as it is considerably larger and more complex than that of Ireland. However, given its proximity it needs to be considered:

- Significantly higher standards to qualify as a mortgage broker and to maintain that qualification along with very high transparency requirements on commission payments.
- More stringent assessments of borrower mortgage serviceability which includes analyses of not only incomes, but borrower spending patterns.
- Stricter rules on issuing interest-only mortgages where a clear and detailed repayment strategy must now be provided.
- Loan-to-Income (LTI) flow limit: Mortgage lenders should not extend more than 15 per cent of their total number of new residential mortgages at loan to income ratios at or greater than 4.5.
- Affordability test: Stress testing of mortgage repayments must be conducted at interest rates which are 3 percentage points above market rates.

Despite these interventions, the Financial Conduct Authority (FCA) is concerned that consumers may not have sufficient information to choose between loans and services to access the most appropriate product. The FCA is also concerned that the structure of the market – which contains lenders and brokers – may be generating conflicts of interest. As with the other market listed above, digital innovations are being considered which would make the decision-making process for borrowers more informed and efficient.[44]

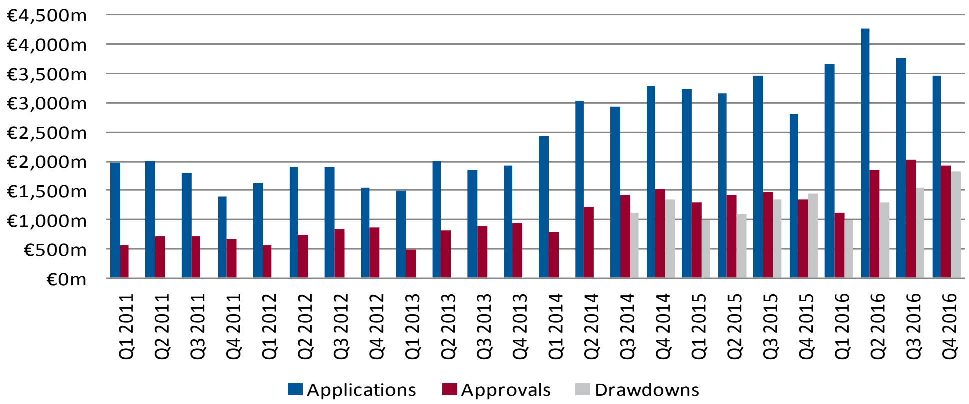
Between 2013 and 2016, the UK Government implemented a 'Help-to-Buy' scheme which primarily enabled first time buyers to access Government guarantees and equity loans for up to 20 per cent of a property's value. This acted to reduce both buyer's deposits and the size of mortgages required. Although the scheme has been linked with higher property prices[45], it does provide evidence of the stimulation of competition and innovation. In closing the scheme, the Chancellor of the Exchequer Philip Hammond stated that the scheme had attracted lenders to the high LTV segment of the market, and that State intervention was no longer required.[46]

[44] https://www.ft.com/content/c2137f05-6855-3f99-8f16-498786b4f8a0
[45] https://www.ft.com/content/fdbb8a00-5dfe-11e5-9846-de406ccb37f2
[46] http://www.telegraph.co.uk/news/2016/09/29/philip-hammond-announces-end-of-george-osbornes-flagship-help-to/

7. APPENDIX 1: IRISH MORTGAGE MARKET

- Both mortgage applications and approvals have grown in the past five years with the number of approvals peaking in Q3 2016 with 10,196 applications approved totalling €2.03 billion in value. See Figure 8.1.
- This compares to five years previously in Q1 2011 when a total of just over 3,350 applications were approved totalling €564 million in value.
- The data available for the value of drawdowns shows they peaked in 2006 at close to €40 billion but declined sharply thereafter, reaching €2.5 billion in 2013. A sustained recovery, albeit from a low base, commenced in Q1 2014 with the total value of mortgage drawdowns reaching €5.66 billion in 2016. There were 29,498 mortgage drawdown in 2016 compared with 203,953 at the peak (2006) and 14,273 in 2011.

Figure 7.1: Mortgage Applications, Approvals and Drawdowns for House Purchase (New Business, Industry Wide, €m)



Source: BPFI

Current house prices in the Irish market would suggest that mortgage demand is quite strong, however this is not necessarily reflected in the data discussed above.

- Cash sales still make up a substantial proportion of the market, which was valued at €10.8 billion in total, when cash transactions are included.[47]
- As of Q3 2016 some 43 per cent of all house purchases were made through cash transactions. This compares to a peak in Q4 2014 when cash transactions accounted for 53.5 per cent of all sales.
- The fact that cash transactions are still so prevalent in the Irish market is likely to be a consideration for any new entrant to the mortgage market.
- While price growth has reduced to stable levels, continued supply issues are likely to lead to continued growth in the medium term.

The Central Bank of Ireland also tracks the level of arrears and repossessions on PDH's and BTL's across the country on a quarterly basis.[48]

- The number of arrears cases over 90 days outstanding declined in Q3 2016 representing the twelfth consecutive decline in arrears since the peak.

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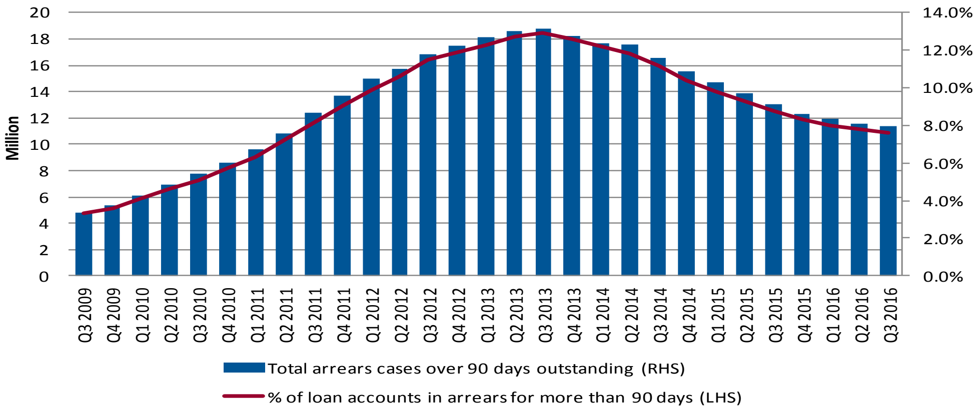
[47] CSO data based on an analysis of the Property Price Register.
[48] The data provided here is not segmented by FTB, Mover, etc.

- The outstanding balance on all PDH mortgage accounts in arrears of more than 90 days was just over €11.3 billion in Q3 2016, equivalent to 11 per cent of the total outstanding balance on all PDH mortgage accounts. See Figure 8.2.

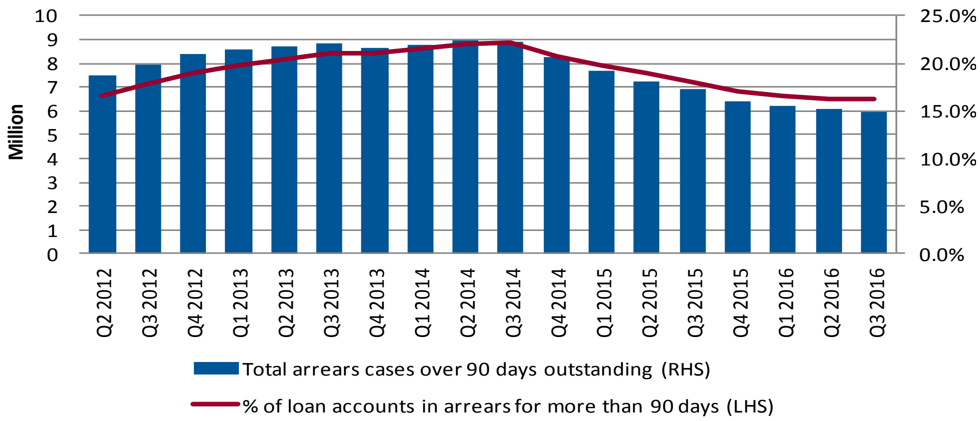
Figure 7.2: TOTAL ARREARS CASES OVER 90 DAYS OUTSTANDING – PRINCIPLE DWELLING HOME



Source: Central Bank of Ireland

- Of the total BTL stock (some 132,600 BTL mortgages with a value of €24.6 billion) some 16 per cent were in arrears of more than 90 days, as of Q3 2016.
- The outstanding balance on all BTL mortgages accounts in arrears of more than 90 days was equivalent to 24 per cent of the total outstanding balance. See Figure 8.3.

Figure 7.3: TOTAL ARREARS CASES OVER 90 DAYS OUTSTANDING – BUY-TO-LET



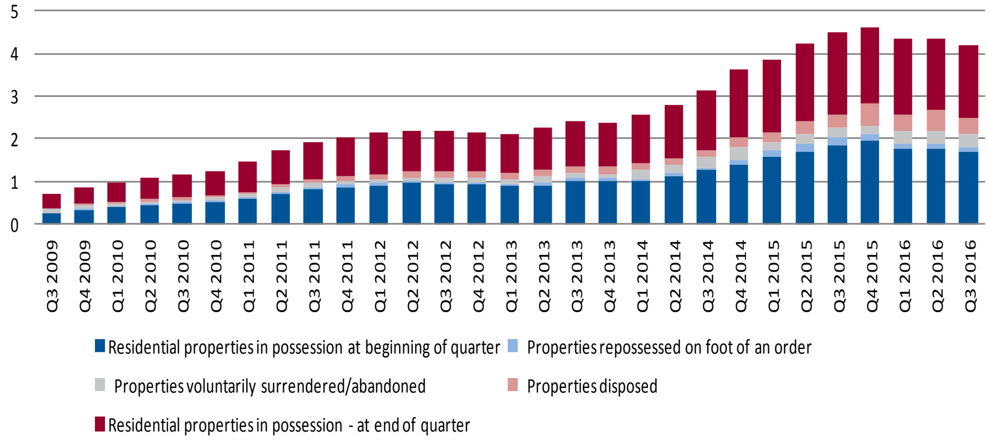
Source: Central Bank of Ireland

Restructuring agreements between the banks and PDH and BTL mortgage holders have been on the increase in recent quarters.

- Legal proceedings were issued to enforce the debt on some 1,200 PDH mortgages in Q3 2016.
- The number of repossessions increased considerable in the six years to Q4 2015. At the end of Q3 2016, lenders were in possession of some 1,700 PDH properties. See Figure 8.4.

- Of 26,000 BTL accounts that were in arrears at the end of Q3 2016, some 24 per cent were classified as restructured.
- The number of BTL accounts with rent receivers[49] appointed increased to just over 6,000 during Q3 2016, an increase of 5 per cent from the end of Q2 2016.

Figure 7.4: Repossessions – Principle Dwelling Home (000s)



Source: Central Bank of Ireland

[49] Given the current challenges in the Irish property market, the appointment of a rent receiver to manage the mortgages property for the benefit of the lender has become an alternative to the repossession route.

8. APPENDIX 2: COMPARATOR INTERNATIONAL MORTGAGE MARKETS

Characteristics which make the selected mortgage markets suitable comparators for Ireland:

Australia:

- Four pillar bank policy.
- Trends towards relaxed lending standards pre-financial crisis have been reversed.[50]
- Variable rate mortgages are the primary residential loan product.[51]
- Middling levels of outstanding residential debt relative to GDP of 52 per cent in 2015.
- Strengthening financial regulation over the past ten years.
- High owner-occupancy rates of 70 per cent in 2016 (Ireland's rate in 2013: 70 per cent).[52]

Belgium:

- Four main banks (Fortis, Dexia, KBC and ING Belgium) underpin the mortgage lending market. As with Ireland, the market was more fragmented in the past, but mergers and acquisitions in the 1990s resulted in a greater level of concentration.[53]
- Membership of the Eurozone.
- Population which is small relative to its European counterparts (c.11 million).
- Typical Loan-to-Value ratios in the region of 65 per cent (c.70 per cent in Ireland).[54]
- Middling levels of outstanding residential debt relative to GDP of 51 per cent in 2015 (Ireland's rate in 2015: 42 per cent, albeit with 'inflated' GDP figures).[55]
- A housing market which has a clear distinction between the Capital, Brussels, and the other regions in terms of house price movements.[56]
- Strengthening financial regulation over the past ten years.
- High owner-occupancy rates of 72 per cent in 2013 (Ireland's rate in 2013: 70 per cent).[57]

Canada:

- Six large banks are the main providers of mortgages. This concentration has been increasing since the 1990s.[58]
- A mortgage market in which variable rates are becoming more popular, despite the historical prevalence of fixed rates.[59]
- Strengthening financial regulation over the past ten years.

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[50] http://eprints.utas.edu.au/17829/1/2014-01_Yanotti.pdf
[51] https://www.finsia.com/docs/default-source/jassa-new/jassa-2014/jassa-2014-issue-4/mortgage-product-choice-in-australia-the-impact-of-market-stress.pdf?sfvrsn=7
[52] http://www.hypo.org/content/default.asp?PageID=524
[53] http://www.globalpropertyguide.com/Europe/Belgium/Price-History
[54] http://www.hypo.org/content/default.asp?PageID=524
[55] http://www.hypo.org/content/default.asp?PageID=524
[56] http://www.globalpropertyguide.com/Europe/Belgium/Price-History
[57] http://www.hypo.org/content/default.asp?PageID=524
[58] http://www.bankofcanada.ca/2012/02/working-paper-2012-4/
[59] Mortgage Professional Canada: https://www.scribd.com/document/334195686/Annual-State-of-the-Residential-Mortgage-Market-in-Canada#from_embed

- Relatively high mortgage indebtedness at 69 per cent of GDP (Ireland's rate in 2015: 42 per cent, albeit with 'inflated' GDP figures).[60]
- High owner-occupancy rates of 68 per cent in 2016[61] (Ireland's rate in 2013: 70 per cent).

Denmark:

- Concentration which is amongst the highest in Europe[62,63], driven by six 'systemically important financial institutions' (SIFIs) which have designated by the government.[64]
- A small population of c. 5.6 million as of 2013.
- Extremely high levels of outstanding residential debt relative to GDP of 90 per cent in 2015 (Ireland's rate in 2015: 42 per cent, albeit with 'inflated' GDP figures).[65]
- Typical loan-to-value ratios in the region of 70 per cent (also c.70 per cent in Ireland).[66]
- A housing market which has a clear distinction between the Capital, Copenhagen, and the other regions in terms of house price movements.[67]
- High owner-occupancy rates of 65 per cent in 2013 (Ireland's rate in 2013: 70 per cent).[68]

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[60] DKM calculations using data from Statistics Canada.
[61] http://www.bankofcanada.ca/wp-content/uploads/2016/08/swp2016-41.pdf
[62] http://www.nationalbanken.dk/en/financialstability/danish_financial_sector/Pages/Default.aspx
[63] http://fineanalytics.com/wp-content/uploads/2016/10/the_danish_mortgage_bond_market.pdf
[64] http://www.nationalbanken.dk/en/financialstability/danish_financial_sector/Pages/Default.aspx
[65] http://www.hypo.org/content/default.asp?PageID=524
[66] http://www.hypo.org/content/default.asp?PageID=524
[67] http://www.bis.org/review/r161013j.pdf
[68] http://www.hypo.org/content/default.asp?PageID=524

Table 8.1: Key Indicators in Selected Mortgage Markets

	Population (000s)	Households (000s)	Home Ownership Rate %	Dwelling Completions	Dwelling Completions per 1,000 Population	Value of Gross Mortgage Lending (4Qrs to Q3 2016, €m)	Residential Property Transactions (2015)	Residential Property Transactions per 1,000 population	Value of Outstanding Residential Mortgages (Q3 2016) €m	Number of Main /Large Banks
Australia	24,545	9,242	67.00	190,075	8	157,716	471,107	19	625,256	4
Belgium	11,261	4,850	70.10	26,800	2	36,258	103,800	9	214,772	4
Canada	36,286	13,321	66.50	194,461	5	276,280	n/a	n/a	1,393,678	6
Denmark	5,755	2,682	62.70	14,500	3	37,174	74,200	13	241,129	6
UK	65,572	27,762	63.00	166,000	3	306,726	1,229,080	19	1,528,439	Top 5 = 66%
Ireland	4,758	1,763	69.70	14,932	3	5,281	48,925	10	108,105	7

Sources:

Euroconstruct, November 2016.	
European Mortgage Federation	A Review of Europe's Mortgage and Housing Markets, Hypostat 2016.
Canada house completions	https://www03.cmhc-schl.gc.ca/catalog/productDetail.cfm?lang=en&cat=55&itm=1&fr=1490030301171
Canada home ownership rate	http://www.tradingeconomics.com/canada/home-ownership-rate
Australia households	http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/3236.0Main%20Features42011%20to%202036
Australia Home Ownership rate	http://www.tradingeconomics.com/australia/home-ownership-rate
Australia dwelling completions	https://www.corelogic.com.au/news/dwelling-completions-boom-as-population-growth-slows
Belgian outstanding mortgage debt	Financial Stability Report, 2016
Australian residential Property Transactions	https://www.corelogic.com.au/news/transaction-volumes-trending-lower-as-housing-market-cools (12 months to March 2016)
Property transactions	https://sdw.ecb.europa.eu/browse.do?node=9689360 (Belgium, Denmark, UK)
Canadian mortgage originations 2016	https://economics.cibccm.com/economicsweb/cds?ID=2272&TYPE=EC_PDF