Options for Ireland's Mortgage Market

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Contents

1. Introduction 4
Government Request 4
Significance of the Market 4
Current Characteristics 5
Scope 5
Methodology 6
Options for Consideration 7
Conclusion 12
2. The Mortgage Market: A Consumer Perspective 13
Introduction 13
Mortgage Holders and Mortgage Lenders: A relationship of equals? 14
Consumers’ Attitudes to the Mortgage Market 18
Consumers’ Perceptions of Switching 19
Conclusions 21
3. Market Structure and Context 26
Introduction 26
Mortgage Lending Market – Overview, Number of Players, Market Size and Structure 26
Government Involvement in the Irish Banking Sector 40
Legislative Attempts to Control Mortgage Interest Rates 41
Regulatory Oversight 42
Independent Financial Advisers 46
Tracker Mortgages, Negative Equity and Non-Performing Loans 47
4. Mortgage Interest Rates and Competition 61
Introduction 61
The Determinants of Mortgage Interest Rates 61
Cost of Funds 66
Operating Costs 67
Credit Risk 70
Cost of Capital 72
Competitive Pressure and Mortgage Interest Rates 74
Mortgage Interest Rates in the State 79
Mortgage Markets – International Comparisons 82
5. Options 92
Introduction 92

1. Short Term Options 92

1.1 Business Friendly Initiatives 92

1.2 Switching 93

1.3 Re-building Trust: The Irish Mortgage Market is Functioning 95

2.1 Repossession Policy 98

Specialist Court and/or Case Management Process 100

Suspended Possession Orders 101

2.2 Restricting the Use of Properties Subject to PDH Mortgages as Investment Collateral 102

2.3 Review Implementation of Section 149 of the Consumer Credit Act 103

3. Longer Term Options 104

3.1 Promote the Move to Longer Term Fixed Rates 104

3.2 Pilot Alternative Funding Models 107

A. Focus Group Results ....

B. List of Respondents to the Public Consultation ....

C. Mortgage Arrears for those in Difficulty ....

D. Summary of CBI Mortgage Switching Research, April 2017 ....

E. Repossession Process in Ireland ....

Bibliography ....

Speeches and Websites ....

1. Introduction

Government Request

1.1 In May 2016, the Government published its "Programme for a Partnership Government"[1], which stated that the Government would request the Competition and Consumer Protection Commission (CCPC) to work with the Central Bank of Ireland (CBI) to *set out the options for the Government in terms of market structure, legislation and regulation to lower the cost of secured mortgage lending and improve the degree of competition and consumer protection*.

1.2 The Minister for Finance, Michael Noonan, TD, wrote to the Minister for Jobs Enterprise and Innovation (DJEI), Mary Mitchell O'Connor, TD, on the 25th October 2016 requesting that the CCPC set out options in respect of mortgage lending as described in the programme for Government. This paper fulfils the request made of the CCPC. To progress the options proposed, further consideration and study is required. The CCPC will play its part in this work.

1.3 This Paper was researched and developed by the CCPC, and the options developed in it reflect its views alone. The CCPC worked closely with the Central Bank of Ireland (CBI) with the CBI giving of its time, expertise, and market data for which the CCPC is very appreciative.

Significance of the Market

1.4 The CCPC welcomes the opportunity to develop this options paper. The mortgage market is broad and complex, touching on housing strategy, the rental market, public housing policy and policies around insolvency and repossession. While some of these factors have a bearing on the mortgage market, they are not within the terms of reference of this options paper.

1.5 Purchasing a home is probably the most important financial decision that most consumers will ever make. Access to mortgage credit is the means which allows most consumers to take this step. The mortgage market therefore affects the lives of millions of consumers, and has far-reaching impacts on many areas of the economic and social fabric of the State. Given that the mortgage market has the potential to destabilise the banking industry, its structure and operation have a fundamental impact on the lives of consumers in Ireland. As a result it is the CCPC's view that proposed interventions or structural changes should be progressed on the basis of rigorous analysis and evidence based policy making. For this reason and as a consequence of the time allowed for the study, in some areas the CCPC has taken the approach to propose options for further study

[1] http://www.merrionstreet.ie/MerrionStreet/en/ImageLibrary/Programme_for_Partnership_Government.pdf

which will allow for both intended and unintended consequences to be better understood.

Current Characteristics

1.6 The mortgage market has undergone unprecedented changes in the past 15 years. A boom-bust cycle has resulted in a number of dysfunctional market characteristics, in addition to the societal impacts that have been debated at length. Recent history and experience remind us that there is significant potential for the behaviours of both lenders and borrowers to adversely impact on the stability of the banking system as a whole and to erode the levels of trust between participants in this market. For this reason, the market will and should never operate as a freely functioning market in the traditional sense. However, the CCPC is of the view that vigorous competition between lenders is possible within a framework of appropriate prudential and conduct regulation.

1.7 The research carried out in the development of this paper points to a market that is in itself distorted. It is characterised by a high concentration of a small number of lenders, limited competition between these lenders and low levels of entry by new players. Furthermore, there are unique characteristics of the Irish mortgage market including significant government involvement, market distortions caused by the large scale of tracker mortgages, negative equity and non-performing loans. Consumers, in the post-crash era, are suspicious of new market players and are unsurprisingly risk-averse, which leads them to favour established lenders and view fixed rates as benefitting lenders, rather than borrowers. These perspectives also contribute to lower levels of switching. Many of these characteristics are attributable to the financial crash of 2008 and its aftermath. In addition, there is a continuing stigma in relation to the reputation of the Irish banking system internationally. In the course of the development of this paper, a central theme emerged in relation to the impact of an ad hoc and inconsistent debt recovery process on the market. The prevailing mortgage rates in Ireland are a reflection of these market characteristics.

Scope

1.8 For the purpose of this study, the CCPC focused on mortgages secured on a property, which includes Principal Dwelling Homes (PDH) and Buy to Lets (BTL) giving consideration to the following:

- what consumers want and expect in a properly functioning mortgage market;

- describing the unique characteristics of the Irish mortgage market, identifying gaps where competition or consumer protection is inadequate and surveying the views of stakeholders and potential new entrants on barriers to entry into the Irish mortgage market;

- identifying how mortgage interest rates are determined in the Irish market, the role that competition between lenders plays in that process and comparisons with other jurisdictions;

- setting out a range of options to improve competition and consumer protection in the mortgage market which may lead to a reduction in the cost of secured mortgage lending.

1.9 The complex nature of the mortgage market, its impact on the lives of consumers and its integration with the rest of the economy from financial services, to construction, spatial planning and regional development means that it is not possible to consider all of the implications associated with mortgage lending in one paper. There are a number of important economic and social issues that have been analysed elsewhere and while some reference may be made to them, they will not be discussed or analysed in any detail in this options paper.

1.10 Chapter 2 explores the mortgage market from a consumer perspective, discussing what consumers want from, and how consumers perceive and engage with, the mortgage market. This chapter provides an overview of the consumer research the CCPC has undertaken with mortgage holders, in recent years and as part of the development of this paper.

1.11 Chapter 3 examines the structure and context of the Irish mortgage market, providing a general overview on how the mortgage market operates, followed by a closer examination of the number of lenders in the market and the level of market concentration. This chapter also explores entry barriers and features of the Irish mortgage market which are likely to affect the decisions of new entrants.

1.12 Chapter 4 discusses how mortgage interest rates are determined. It explores matters including the role of the ECB in setting the monetary policy for the Eurozone as whole, the factors which affect the margin that banks charge on variable mortgage rates and the role of competition as a determinant of mortgage interest rates in Ireland. This is followed by a review of the current rates offered by lenders in the Irish market and some comparisons with other jurisdictions.

1.13 Chapter 5 brings together the various strands of the discussion in the previous chapters and sets out a number of options that could help to improve the level of competition in the Irish mortgage market and provide consumers with greater choice of products and providers.

Methodology

1.14 In developing this options paper, the CCPC has undertaken a multi-faceted approach. It conducted an extensive series of detailed interviews with stakeholders including consumer representatives, industry representatives, individual banks and mortgage lenders both domestic and in other jurisdictions,

independent financial advisers, new entrants and potential new entrants to the Irish market, academics, the ESRI and regulatory bodies, both domestic and foreign.

1.15 To better understand the perspectives of consumers, the CCPC commissioned Amárach Research to undertake a series of focus groups to examine their perceptions of the mortgage market, how it operates and their views on switching mortgage products. In addition, the CCPC utilised the market intelligence it receives from its consumer helpline.

1.16 The CCPC also issued a public consultation on 20 February and received 20 responses to this consultation. The list of those respondents is included in Annex B. The responses received are available on our website at www.ccpc.ie.

Options for Consideration

1.17 This paper focuses on an analysis of the current mortgage market and proposes options for short, medium and longer-term consideration which, if progressed, should allow for greater competition from new entrants, encourage lenders to compete more vigorously on price, quality and innovation, and equip consumers with the knowledge and confidence to make better choices.

1.18 In the context of a highly distorted market, regrettably there are no quick fixes which will immediately create competition and therefore bring down mortgage interest rates in Ireland. There are, however, medium to long term measures that we suggest should be considered by Government and policy-makers which would help make a better-functioning, more sustainable mortgage market.

1.19 The CCPC believes that is it important that there is a long-term strategy and shared vision for the mortgage market which would frame policy debate and give the context in which the CBI can make effective regulatory decisions. Such a vision should extend well into the future so as to avoid short term responses to long term structural changes.

1.20 Without a clear stated vision the housing and mortgage markets could once again put at risk the solvency of the banking system and severely impact the economy.

1.21 A clearly stated and shared vision would set the context for policy choices that influence both demand (including the demand for mortgage credit) and supply in the market. It is essential that Ireland’s policy-makers that should work together to develop this vision. The CCPC recommends that a suitable forum for a national debate be established and a national shared long term vision developed and articulated.

1.22 In terms of rebuilding trust and confidence in the Irish mortgage market it is important to recognise that much has already been achieved through the policy choices of the Minister of Finance.

1.23 Moves to bolster the independence of the CBI have been crucial. Consumer confidence that the market will now operate with tight controls on lending to reduce the likelihood of speculative bubbles was well reflected in the consumer focus groups for this paper. Consumers appear assured that the CBI will work assiduously to maintain market stability and will not be subject to the same political pressures that policy-makers are. The independence of the CBI is critical to the views of international investors and potential new entrants

1.24 The clear policy position as regards the sale of the State's shareholdings in AIB and its realisation in the May 30th float announcement have also given a large degree of confidence to international investors and potential new entrants, who might otherwise have viewed State ownership as a real barrier to entry

1.25 All of this points to the central importance of the Minister and Department of Finance in setting the policy context within which all of the stakeholders and market participants must operate.

Short-term options: 1-2 years

1.26 The first short-term option concerns the possible introduction of business-friendly initiatives to encourage new entrants and innovation. The options identified include that the CBI develop a process for introducing new entrant/new product friendly initiatives - in the UK such measures have included a start-up unit in the Financial Conduct Authority, an Innovation Hub and a Regulatory Sandbox. In addition, it is identified that the Department of Finance could sponsor research to determine how authorisation periods and regulatory burdens vary between Ireland and other comparable jurisdictions.

1.27 Consumers' attitudes and understanding of the mortgage market are explored at length in Chapter 2. It is clear that there is considerable work to be done to improve the ability to, and incidence of, switching. Switching is a key enabler to unlocking greater competition in the market and two options are identified to address issues in this area:

- The CCPC should work with the Legal Services Regulatory Authority to facilitate the introduction of e-conveyancing.

- To encourage consumers to switch their mortgage we suggest that the CBI, Department of Finance and CCPC undertake work in this area to establish a group to facilitate the development of automated switching processes, including legislative change where appropriate. In addition the CBI, Department of Finance and CCPC would share information from their respective switching campaigns to improve the effectiveness of information campaigns.

1.28 The third short-term option concerns addressing issues around reputation and the need to rebuild trust in the Irish mortgage market, both internationally and with Irish consumers. It is vital, for the market to work effectively for consumers,

that trust is rebuilt and relationships are restored. Four main actions are identified:

- The impact of cashback payments and loyalty discounts is also discussed in Chapter 2. These offers and their marketing are potentially exploitative of consumer biases and may result in consumers making decisions for short term gains that over the medium or long term are not in their best interest. In order to examine the appropriateness of these offers, the CBI and CCPC should establish a joint working group to examine research findings in relation to cashback payments and loyalty discounts and develop a set of policy recommendations for implementation.

- Consideration should be given by the Department of Finance and the CBI to ascertain, understand and address consumers' concerns in respect of new entrants. Such concerns illustrate scepticism based on consumers' experience of new players in the past during and after the crash and worries about the commitment of new players to the market and to their customers.

- To rebuild Ireland's reputation internationally, consideration should be given by the Department of Finance and the Department of Jobs, Enterprise and Innovation to undertake an international campaign (similar to that undertaken in the private sector when firms are seeking additional equity or pursuing mergers and acquisitions) to encourage new entrants and international funders to consider the Irish mortgage market as a commercial opportunity.

- Similar to its campaign to encourage switching behaviour in general the Department of Finance should give consideration to running a promotional campaign encouraging consumers to consider using independent brokers when applying for mortgage credit.

Medium-term options: 3-5 years

1.29 The analysis carried out in the course of this paper has indicated that a lack of predictable and consistent practices and systems when dealing with loans in arrears has increased the risk profile for mortgage lending in Ireland. This higher risk profile in turn requires banks to have more capital to write a mortgage, and as a result, the loan is more costly. However, any changes to repossession policy need to be carefully considered in a wider societal context. It must be considered that the current system adds significant uncertainty to both consumers in arrears and to lenders. In our view, the current system could be improved so that it is appropriate, considered, and predictable. Policies and practices that are more aligned to European norms would also provide more certainty for prospective new entrants.

1.30 The greater use of suspended possession orders by the court as a means to find a solution we believe is worth exploring further.

1.31 The complexity of the options in this area and the desired long-term structure of the mortgage market requires the establishment of an Interdepartmental working group or Joint Oireachtas Committee. The purpose of this would be to examine the design and implementation of the processes described, further building on the commitment in the Programme for a Partnership Government.

1.32 The issue of private family homes being used as collateral for property investment and associated borrowing is the subject of another medium-term option. In the past, homeowners were encouraged to use the increased value in their home to acquire additional mortgage finance for the purchase of additional properties for investment purposes. This led a large number of consumers to engage in risky borrowing and over extend their credit. When the financial crisis hit, these consumers were left with declining asset values, falling income and large outstanding debts.

1.33 While we note that the prudential measures implemented by the CBI are helping to protect consumers from inappropriate borrowing, some consideration could be given to further deepening consumer protection. Essentially, consideration should be given to restricting the ability of consumers to "gamble" their family home for the purposes of property investment. Greater detail on how this could be further explored is contained in Chapter 5.

1.34 The final medium-term option concerns Section 149 of the Consumer Credit Act; which requires that credit institutions, prescribed credit institutions and bureaux de change make a submission to the CBI if they wish to introduce any new customer charges or increase any existing customer charges in respect of certain services.

1.35 As a result of section 149, there are regulatory constraints applied to credit institutions in their ability to generate non-interest income. We understand that examples of such direct price intervention in the EU banking sector are very limited. Removing this provision from the statute book would have a number of effects. On the one hand lenders would have more flexibility in balancing their sources of income and this flexibility would create more opportunity to innovate. On the other hand, giving the large incumbent lenders pricing freedom could adversely affect new entrants and increase the potential for consumer harm.

1.36 Given the significance of Section 149, the Department of Finance, in conjunction with the CBI and the CCPC, should commit to regularly reviewing the appropriateness and implementation of Section 149.

Long-term options: 5 years +

1.37 In addition to the short and medium-term options outlined above, there are possible longer-term options which could have a transformative effect on the Irish mortgage market.

1.38 The first of these options concerns promoting a move to longer term fixed rate mortgages. There are several issues stemming from the fact that in Ireland, retail deposits are the predominant method of funding mortgage loan books. The increase in mortgage lending during the economic boom meant that lenders needed to secure ever more deposits to fund expanding loan books. The reliance of banks on short-term funding to finance the expansion of their balance sheets in the run-up to the crisis, together with excessive leverage, have been highlighted as key factors in the build-up of systemic risks[2]. Therefore, long-term funding of mortgage loans can help mitigate the risks that are involved in short-term, mobile deposits. A reasonable question therefore is whether short-term funding of mortgage loans is the optimum model for lenders.

1.39 From the consumer's perspective, the CCPC's focus groups found that consumers are somewhat reluctant when it comes to long-term fixed rate mortgages. There are numerous benefits from the consumer perspective: a fixed rate mortgage provides stability for household cash flow and budgeting; a fixed term for the product naturally creates a trigger point on the calendar where a consumer can plan to reassess their mortgage options; and the fixed nature of the mortgage repayments over the lifetime of the contract makes comparisons between products easier for consumers. Being on a long term fixed rate will help a consumer assess competing offers so that they can achieve the ultimate result they want, lower monthly repayments. In addition, longer-term fixed rate products mean that consumers can avoid the potential of being swayed by teaser rate offers.

1.40 Therefore a longer term option is for the Department of Finance and the CBI to examine ways to promote long-term fixed mortgage rates and secure greater long-term funding of loan books. A shift towards longer-term fixed rates could bring several benefits, notably increased transparency and stability for borrowers and more reliable, stable funding sources for lenders.

1.41 The second option focuses on piloting alternative funding models. The dominant model in Ireland, the use of deposit funding, has risks for the mortgage consumer and the lender alike, with the lender accommodating changes to its funding costs by passing these variations on to the customer. Consideration should be given by the CBI to examining the appropriateness and the potential costs and benefits associated with piloting "the Danish model" (either in whole or in part) in the Irish market. This model is characterised by match-funding: there is a direct match between the loan and the bonds which a mortgage bank issues to fund the loan. This could result in a market with a number of attributes that would

[2] Bank Funding Structures and Risk: Evidence from the Global Financial Crisis, IMF working paper, WP/12/29, 2012

be attractive in an Irish context, namely that borrowers are ensured low and transparent loan rates, bond investors incur much reduced default risk and a model, as a whole, which has a stabilising effect on the economy.

Conclusion

1.42 The CCPC is proposing these options to Government for consideration. We would suggest the postponement of additional policy proposals on related issues until these options have been fully considered. The mortgage market is characterised by a number of highly interconnected moving parts and is composed of a complex set of relationships between these parts, with numerous links to the wider economy which it both affects and is affected by. Likewise, the options set out here are interconnected. The options set out need to be considered, planned and implemented with close attention to the sequencing of that implementation. Otherwise the risk of unintended and potentially harmful consequences is high, which could in turn result in poorer outcomes for consumers.

1.43 While the CCPC consulted with a number of public sector and private sector stakeholders during the course of this exercise the views expressed are those of the CCPC alone and do not purport to represent those of any other party.

1.44 The CCPC would like to thank all those who participated in the development of this paper, particularly the Central Bank of Ireland, those who we interviewed, those who responded to our consultation and the consumers who took part in focus groups. In addition, we would like to thank those with whom we met at various stages of the process who gave valuable input and views on the emerging options.

2. The Mortgage Market: A Consumer Perspective

Introduction

2.1 As a competition and consumer protection agency, improving the welfare of, and outcomes for, consumers is at the centre of the CCPC's objectives. With regard to the market for mortgage lending this means that before examining how the market operates we must first attempt to understand what consumers want from, and how consumers perceive and engage with, the mortgage market.

2.2 Although the housing market itself is outside the scope of examination of this paper, it is a closely related market. House price inflation, reflecting high demand for housing and the low level of housing supply, is a very real consideration for borrowers whose main concern is affordability in terms of both the purchase price and the level of repayments. It should be noted that the introduction of the macro-prudential mortgage market regulations in 2015 in addition to the primary prudential objective has also resulted in restraining house price inflation. This was evidenced by the curb in house price inflation following the initial introduction of these regulations and the subsequent rise in house prices following the review of the measures in November 2016.

2.3 While competition in the mortgage market can reduce mortgage interest rates and improve service levels, it can only do so within an overall housing policy framework. As such, in a rapidly inflating housing market, mortgage market competition would have a limited impact on affordability. Critically, therefore, it is important to realise that a whole series of policy choices feed into the mortgage market.

2.4 According to the Department of Housing, Planning, Community and Local Government, *"every household should have access to secure, good quality housing suited to their needs at an affordable price in a sustainable community"*.[3] Furthermore, it would seem clear that the need for stable, secure and affordable housing is central for a properly functioning and sustainable economy. However, access to housing does not necessarily mean access to home ownership. Access to housing is provided for through a number of channels: Government-supported home ownership and rental provision, private rental accommodation and private home ownership (i.e. homes purchased with mortgage and/or other private sources of funds). Private home ownership in this context means homes purchased by consumers as their principal dwellings which is the main focus of this paper. While it is vital to have a private rental sector, the financial risks of

[3] See http://www.housing.gov.ie/housing/housing-policy

lending to consumers to fund property investment have been obvious and should be carefully considered by both lenders and borrowers.

2.5 Furthermore, these risks are further aggravated by, for example, leveraging principal dwelling homes to finance speculative property investments. Permitting the housing market to be subject to intense speculation can reduce affordability and may result in the domestic housing needs of a proportion of the population having to be borne, ultimately, by the exchequer.[4] There should therefore be a clear distinction between the supply of mortgage credit to consumers to purchase a "family home" and the supply of mortgage credit for the purchase of property to be used as investment vehicle either as rental accommodation and/or for speculative purposes. Moreover, this distinction should be recognised in terms of the supply and cost of mortgage funding by lenders and in terms of the consumer and social protection policies of regulators.

2.6 This section provides an overview of the consumer research the CCPC has undertaken with mortgage holders, in recent years and as part of the development of this paper. The findings from this research mirror similar research in other jurisdictions.[5]

Mortgage Holders and Mortgage Lenders: A relationship of equals?

2.7 As part of a study to inform our financial education work, in late 2015 and early 2016 the CCPC commissioned Behaviour and Attitudes to undertake consumer research on the mortgage market in the State (CCPC B&A)[6]. The project involved two inter-related phases, one of which enabled the sizing and scoping of the market for mortgages, and the second a more in-depth review of mortgage holders' attitudes and experiences. In 2017, as part of this review of the mortgage market, the CCPC commissioned Amárach Research to further examine consumers' views on the mortgage market (CCPC AR). This was undertaken using a focus group approach (see Annex A).

2.8 In terms of what consumers want from the market, the most important consideration (for either first time buyers or movers) appears to be how much credit they can access, since this determines the property they can buy. From here the consumer's priority changes to the monthly repayment. Consumers usually have a target level of repayment in mind which is based on their finances,

[4] According to MABS there are currently 91,600 households on the waiting list for social housing, over 7,000 people experiencing homelessness (including over 2,000 children and dependents), and an estimated future net increase in household formation of between 16,000 and 33,000 per year.

[5] See for example, Financial Conduct Authority (July, 2015).

[6] See https://www.ccpc.ie/business/research/market-research/mortgage-holding-switching-2016

and lifestyle. It's within this context that consumers are concerned with mortgage repayments.[7]

2.9 The CCPC B&A research[8] found that while 86% of mortgage holders were acutely aware of their monthly repayments only 52% were aware of the interest rate they were paying. This general lack of awareness of interest rates was confirmed in the CCPC AR focus groups in 2017 and furthermore:

> *"There was no sense in any group that people were aware that rates currently were well below historic rates or of any consideration that rates might rise substantially in the future."*

2.10 Standard economic theory suggests that consumers will act rationally and chose the mortgage product with the lowest cost that suits their needs. However, insights from behavioural economics suggest that consumers do not act this way in reality:

> *"...consumers often do not make decisions in the way that economists have traditionally assumed. The findings show that consumers have limited capacity for attending to and processing information and that they are prone to systematic biases, all of which may lead to disadvantageous choices. In short, consumers may make costly mistakes."*[9]

2.11 The same is true when it comes to mortgages:

> *"...Consumers often enter the market without knowing exactly what kind of mortgage they want or need, and therefore are susceptible to outside influence.*
> *... Given the complexity of loan pricing and the variation of loan features, consumers have difficulty understanding alternative mortgage products.*
> *... Given that the mortgage transaction has multiple time and cost dimensions, consumers often are unable to determine what actual risks they face over time.*
> *... While standard economic theory assumes that consumers shop for the best available price and terms, even the most sophisticated borrowers often find it difficult to effectively shop for mortgages."*[10]

[7] Of course, this concern is somewhat different for those experiencing mortgage difficulties – approximately 35,000 mortgage accounts in the State were in deep arrears by the end of Q 2, 2016 (i.e. greater than two years). Box C.1 in Annex C collated from the response of MABS National Development CLG (MABS) to the CCPC public consultation provides this context.

[8] This research also found that in the State approximately 22% of adults hold a mortgage (the vast majority of which (21%) are mortgages on principal private dwellings). Over three quarters of mortgages were taken out before 2008 (47% in the boom period between 2002 and 2008, and 39% prior to 2002) and 66% of mortgages are held by those aged between 35 years and 64 years. See https://www.ccpc.ie/business/research/market-research/mortgage-holding-switching-2016

[9] PRICELAB (2016) p. x.

[10] Apgar, W. & Essene, R.S. (2007) pp. ii–iv.

2.12 Thus understanding how the mortgage market works and identifying the most appropriate products can be difficult for consumers. This is exacerbated by the introduction of additional elements such as up-front cashback offers and loyalty discounts. The more product attributes that a consumer is required to consider when choosing between products, the more difficult it is for the consumer to accurately assess the options available. Therefore, there may be limits on the ability of competition alone to ensure that consumers obtain better value and indeed *"there is a danger that competition incentivises some firms, perhaps especially those defending high market shares, to act in ways that increase the complexity of the product."* [11]

2.13 The focus groups conducted as part of the CCPC AR focus groups in 2017 confirm this to be the case for mortgages:

> *"They have limited knowledge of mortgages and how they work. They understand the concept of repayment in cash terms but not much more than that. The lack of knowledge makes them risk averse.*
>
> *They fundamentally believe that mortgages and mortgage switching is complicated. Those who switched have more confidence (which is either why they switched or because they switched) but it would not be hard to knock them off track if required."*

2.14 Some of the individual comments of participants point to varying levels of knowledge of the market:

- *"you don't hear too much of the Scottish banks in Ireland nowadays"*
- *"you are not allowed switch if your mortgage is less than €40,000"*
- *"Is it hard to get a tracker nowadays?"*
- *"Any change* [as a result of switching] *would have to be guaranteed"*
- *"If the euro collapses, will I have to pay my Bank of Scotland* [Ireland] *mortgage in sterling?"*

2.15 In a "pre-task" to the CCPC AR focus groups, participants were asked to compare the offering of four lenders in the Irish market. The range of products offered by the chosen lenders included fixed and variable interest rates, cashback offers and additional loyalty discounts. The participants in the focus groups found it difficult to compare the pros and cons of each of the products:

> *"Fundamentally they stuck with the brands and organisations that they know – and even though many were impressed by the simplicity of the* [new lender] *offer, they were not fully persuaded in the end."*

[11] Price Lab (2016). Op. cit. p.94.

2.16 Research carried out for the Financial Conduct Authority in the UK drew similar conclusions – consumers appear unable to choose between alternative products, effectively:

> *"Consumers' lack of understanding of the types of mortgage products available and reported absence of discussions with mortgage advisers around alternatives means that some consumers are finding themselves considering a particular product at the expense of others which may have been better suited to their needs and circumstances. Many found it difficult to fully explain what their chosen product offered ahead of others, and what the benefits of other mortgage products were."*[12]

2.17 The CCPC AR focus groups conclude that this lack of knowledge and confidence is further compounded by consumers' inability to recognise their own power as consumers in the process: and they regard themselves as vulnerable participants rather than peers in the relationship:

> *"... you know if I think about when I was 22 and I took my first mortgage at the National & Provincial Building Society, ... it was an interesting journey, you knew you were there and you had to put a suit on and you had to go and get interviewed... ."*
>
> (emphasis added)

2.18 This in turn is reinforced by an absence of trust in the lenders and the view that the lenders deliberately hide behind jargon and complexity:

> *"In an absence of trust or control, they believe that banks rely on jargon; that they won't act in the customer's best interest (and the customer doesn't know what that best interest is) and that they will engineer pitfalls."*

> *"In MABS experience there is a significant lack of trust in banks, financial institutions and funds. The 'Tracker Review' which is ongoing further compounds the issue. There is an amount of work to be done in rebuilding trust in Irish financial institutions and the lenders themselves need to be more proactive in this regard."*[13]

2.19 For the reasons outlined above, consumers need a very significant level of protection in financial markets, including the mortgage market, from an independent body with the appropriate level of expertise and legislative powers to implement consumer protection policies. In Ireland this is part of the remit of

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[12] FCA (2015) Op. cit. p. 22.

[13] MABS National Development CLG response to Public Consultation on the Irish Mortgage by the CCPC, March 2017, p. 8

the CBI – see Box 2.2 for a more detailed explanation of the consumer protection framework for residential mortgages.

2.20 From the discussion above it is clear that there is a significant imbalance of power between lenders and borrowers in the mortgage market. Lenders have not only considerable expertise in the design of products offered to borrowers but they also possess significant capability and substantial resources for marketing these products and exploiting the behavioural biases of consumers. For their part, consumers are risk averse and require knowledge and capability to be able to correctly assess products. When the product set offered is further complicated by lenders through offers of cashback and loyalty discounts, consumers become more unsure in their decision making and ultimately fearful and mistrustful of lenders. There is therefore a strong imperative for continuing consumer education and robust consumer protection. Furthermore this education and protection must be reactive to developments in the market such as cashback, discounts and teaser offers.

Consumers' Attitudes to the Mortgage Market

2.21 In addition to the findings reported above, the CCPC AR focus groups conducted in 2017 explored the perceptions of consumers with respect to a number of other issues in the Irish mortgage market. These views can be summarised as follows (they are reproduced in full in the report by Amárach Research in Annex A):

- Generally, despite some misgivings, consumers have a positive view of how the market is operating at present, believing that there is enough competition in the market. Some negative views were expressed regarding the behaviour of banks and their operating models (i.e. lack of personal relationships with bank staff);

- The attitude towards new entrants is one of scepticism based on participants' experience of new players in the past during and after the crash and worries about the commitment of new players to the market and to their customers. In general, consumers do not want to be exposed to lenders who they perceive may exploit them in the future;

- Participants had a broadly positive view of the CBI regulations on residential mortgage lending, believing that loose lending before the crash was a key contributory factor. Some however expressed a view that this intervention, given the review of the rules, will disproportionately impact second time buyers;

- A positive view was also provided with regard to the role played by mortgage brokers by those in the groups who had used them; a view was expressed that brokers are on the side of the consumer (more so than mortgage

providers) and that brokers had an expertise and insight that consumers lacked;

- Consumers are generally risk averse and in terms of fixed interest rate mortgages this was illustrated by the view that while the certainty of fixed rates at specific times is attractive, they are more concerned about being 'caught out' on a fixed rate that is materially different from the variable rate.[14] Consequently, fixed rates for short periods are acceptable while there is very little appetite for fixed rate mortgage products for extended periods (10+ years);

- Regarding repossessions, there is broad agreement for adopting a different approach for tackling PDH and BTL mortgages in arrears (although there was an awareness of the knock-on consequences for tenants of a more aggressive approach to commercial repossession). When asked whether a more streamlined process would be beneficial, respondents were sceptical that there were benefits and whether these would be passed on by the banks in any event.

Consumers' Perceptions of Switching

2.22 The issue of switching behaviour and consumer's attitudes to switching, both in general and with regard to mortgages, has been the focus of a number of research initiatives and information awareness campaigns on behalf of the CCPC[15], the Department of Finance[16] and the CBI[17].

2.23 The CCPC study "Mortgage Holding & Mortgage Switching Market Research Findings" found that only 6% of mortgage holders had considered switching their mortgage provider over the 5 years prior to January 2016 and only 2% had actually switched. In terms of the practical difficulties of switching those who had switched reported that complexity (38%), paper-heaviness, i.e. too much

[14] In economics this is typically referred to a "loss aversion": consumers have a recognised and well defined preference for avoiding the loss a certain amount (E.G. €10) compared to gaining the same amount. This in turn affects the choices consumers will make. In the context of fixed mortgage rates the loss aversion affects both the take up of fixed rates and the length of time for which consumers will fix.

[15] See https://www.ccpc.ie/business/research/market-research/consumer-switching-behaviour-2017 and https://www.ccpc.ie/consumers/money/mortgages/changing-your-mortgage/switching-lenders-or-mortgage and the CCPC study Mortgage Holding & Mortgage Switching Market Research Findings, conducted by B&A, January 2016.

[16] See https://www.switchyourbank.ie/

[17] See https://www.centralbank.ie/news/article/central-bank-publishes-further-research-on-mortgage-switching, and Devine, Frost & McElligott, (2015).

documentation and form filling (48%), slow speed of the process (35%) and upfront costs (20%) were all negative factors.[18]

2.24 These findings resonate with those of the CCPC AR focus groups which examined the issue of consumers' attitudes towards mortgage switching in some depth and found that at the heart of the issue there is a significant information gap which is central to increasing the incidence of switching. This information gap is creating fear and uncertainty among consumers and will only be overcome by an integrated consumer centric approach built around existing market players (see Box 2.1).

Box 2.1 – CCPC Focus Group Research on Mortgage Switching, 2017

Information Gap

- *Consumers know how to change most suppliers (including for complex products like health insurance), but they don't know how to change mortgages:*
    - *They are unaware of the costs and benefits.*
    - *They have an exaggerated view of the risks*
    - *They do not know where to turn.*
    - *They know how the process starts, but are unsure of what happens next.*
    - *They lack real financial knowledge – and as a consequence, confidence.*

Uncertainty and Fear

- *Reasons cited for not switching include:*
    - *I'd have to take time off work.*
    - *We might not get it.*
    - *Better the devil you know.*
- *They fear revisiting the mortgage issue: will they be penalised/lose their mortgage?*
- *They don't have a sense of how the system works.*

Consumer Centric Strategy

- *There is a requirement for people to understand that it can be done – that people like them switch all of the time and live to tell the tale.*
- *There needs to be a move to a peer to peer relationship.*
- *Consumers need the process to be fully explained end to end.*
- *A transparent estimate of the costs and benefits of switching needs to be provided that should focus on the language that can be understood (i.e. repayments per month).*

Trust

- *Consumers are sceptical of new players in the market place. Trust needs to earned in order for consumers to switch from incumbents to new entrants.*

Source: See Annex A

[18] See https://www.ccpc.ie/business/research/market-research/mortgage-holding-switching-2016

2.25 These findings are replicated in those in the CBI Mortgage Switching Research (See Annex D for a summary):[19]

> *"Many participants were uncertain as to how to go about switching mortgage and were not aware of the savings that could be made in so doing. In order to encourage consumers to consider switching, they would need more detailed information about the mortgage switching process, information on eligibility to switch, direction to information tools on the various products on offer, confirmation that there would be savings to be made and greater clarity about any fees and charges that are likely to be levied. Participants reported that switching incentives offered by mortgage lenders should cover the cost of the actual switch, so that it is possible for the consumer to calculate the actual savings to be made over the life of the mortgage and the cost of switching should not cancel out any savings to be made."*

2.26 The CBI intends publishing a consultation paper later in 2017 which will propose a number of additional measures to facilitate mortgage switching including:

- Whether lenders should provide greater clarity to consumers on the switching process itself, including timeframes and the potential costs;
- Whether lenders should consider having dedicated switching contact points;
- The possibility of further disclosure rules at trigger points in the mortgage life cycle;
- The possibility of increased co-operation between lenders during the switching process.

Conclusions

2.27 Undeniably, buying a home is one of the most significant events in a person's life. During the rapid credit expansion in the early to mid-2000s, homes acquired an additional investment dimension. In the hubris of the 'Celtic Tiger' era this was compelling for those who had seen their equity increase several times over following several years of house price inflation.

2.28 The steep and prolonged reversal has been universally and profoundly felt. The sense of shock experienced by consumers, as described by the focus groups and widespread market commentary, has resulted in a high degree of mistrust and vulnerability.

[19] CBI (2017). Mortgage Switching Research, p. 10.

2.29 The prudential measures instituted by the CBI help to assuage depositor concerns about credit firms' lending practices and also help protect consumers from inappropriate borrowing. As such, these measures do much to reduce the risk of informational asymmetry of depositors and borrowers with respect to lenders. Additional measures are perhaps required to make clearer the distinction between mortgage credit for home purchase and that for investment purposes.

2.30 It is also important that consumers themselves can access, assess and act on the information before them. If not, the feedback mechanism that encourages firms to compete on the right dimensions can be broken or distorted[20] with negative repercussions for the protection of the consumer. Based on what we have experienced since the financial crisis and on the views and attitudes of consumers, there appears to be much left to do to improve the level of financial education to secure consumer empowerment and to re-establish trust.

[20] Comments by Deb Jones, FCA UK, Westminster Business Forum Keynote Seminar: The UK Mortgage Market - competition, financial stability and the impact of Brexit 2nd February 2017.

Box 2.2 Consumer Protection Framework for Residential Mortgages[21]

European Union (Consumer Mortgage Credit Agreements) Regulations 2016

On 21 March 2016, the Mortgage Credit Directive (MCD) was transposed in Ireland via the European Communities (Consumer Mortgage Credit Agreements) Regulations 2016 (the Regulations). The objective of the MCD is to provide for a more harmonised mortgage credit market containing a high level of consumer protection. The MCD introduced an EU passport scheme that allows mortgage credit intermediaries authorised to operate in any EU country to deliver services across the EU.

The Regulations apply to credit agreements, entered into by consumers, which are secured either by a mortgage or by another comparable security commonly used in a Member State of the European Union on residential immovable property. They also apply to credit agreements which are used to acquire or retain property rights in land or in an existing or projected building. The Regulations, therefore, also apply to 'Buy to Let' credit agreements and relevant bridging loans. Credit agreements provided by creditors (credit institutions, retail credit firms and credit unions) after 21 March 2016, are within the scope of the Regulations.

The Regulations include consumer protections in the areas of advertising, and provision of pre- and post-contractual information, including information about interest rate changes. The Regulations introduced a standardised form, the European Standardised Information Sheet (ESIS). The ESIS standardises, across all EU Member States, the content, layout and presentation of personalised information thus, facilitating greater cross-border comparability of mortgage credit agreements. The ESIS must be provided to the consumer, before or at the latest, at the same time, as the creditor issues a binding offer of credit to the consumer.

The Regulations prescribe the calculation of the Annual Percentage Rate of Charge. They require that the cost of opening and maintaining a specific account, costs of using a means of payment for both transactions and drawdowns on that account and of other costs relating to payment transactions must be included in the total cost of credit to the consumer.

[21] While the brief summary provided by the CBI in Box 2.1 focuses on the consumer protection framework for residential mortgages, a suite of financial services legislation exists which is relevant to mortgages. In line with its mission of safeguarding stability and protecting consumers, the CBI's work on mortgages spans its consumer protection, prudential supervision, and financial stability mandates, including ensuring 'the proper and effective regulation of financial service providers and markets, while ensuring that the best interests of consumers are protected'.
As part of its goal to safeguard financial stability and contribute to the long term resilience of the financial system, the CBI introduced a series of Mortgage Measures in 2015. These regulations set ceilings on the amount of money that can be borrowed to buy residential property through loan to value (LTV) and loan to income (LTI) limits. The mortgage measures are designed to ensure that banks and other credit institutions lend sensibly, house buyers do not over-borrow and excess credit does not build up within the Irish financial system. The Mortgage Measures were subject to a review in 2016.

Before providing credit, creditors must assess the consumer's creditworthiness to verify the prospect of the consumer meeting his/her obligations under the credit agreement. The Regulations also include consumer protections where the credit agreement has been designated a foreign currency loan.

Consumer Protection Code

The Consumer Protection Code 2006 (the 2006 Code) was introduced in August 2006 and became fully effective on 1 July 2007. The 2006 Code set out the requirements that regulated firms must comply with when dealing with consumers in order to ensure a similar level of protection for consumers, regardless of the type of financial services provider.

In May 2008, an Addendum to the 2006 Code was introduced in respect of the activities of retail credit firms and home reversion firms. Following a full review of the 2006 Code, the Consumer Protection Code 2012 (2012 Code) came into effect on 1 January 2012. Further addenda followed in 2015 for credit servicing firms, and in 2016 for increased transparency measures for variable rate mortgage holders and consequential amendments arising from the transposition of the MCD.

In the context of mortgages, the 2012 Code applies to credit institutions, retail credit firms, credit servicing firms and mortgage credit intermediaries. It does not apply to credit unions or local authorities when providing mortgages. The 2012 Code includes requirements in the areas of advertising and the provision of pre- and post-contractual information, including information to be provided annually to the consumer. These requirements complement requirements in the same areas set out in the Regulations above.

The 2012 Code places specific requirements on regulated entities to gather and record sufficient information from consumers prior to offering, recommending, arranging or providing a product or service. A regulated entity must ensure that any product or service offered to a consumer is suitable to that consumer, having regard to the facts disclosed by the consumer and other relevant facts about that consumer of which the regulated entity is aware. Under the suitability requirements, regulated entities must, for credit, assess the affordability of credit. The 2012 Code also includes arrears handling requirements which can apply to mortgages outside of the scope of the Code of Conduct on Mortgage Arrears (see below).

Also, by way of addendum to the 2012 Code, a number of increased protections for variable rate mortgage holders were introduced. These measures enhance transparency and facilitate consumer choice. They became effective in February 2017 and require lenders to explain to borrowers how their variable interest rates have been set, including in the event of an increase. They also improve the level of information required to be provided to borrowers on variable rates about other products.

In April 2017, the Central Bank published research on mortgage switching. This research seeks to gain a better understanding of consumers' perceptions, attitudes and experience of mortgage switching in order to identify areas where further action by the Central Bank could assist borrowers who are considering switching their mortgage. The results of this research will inform the Central Bank's Policy work in the area of mortgage switching, and particularly, the

consideration of further consumer protection rules in this area. To that end, the Central Bank will publish a consultation paper in Quarter 3 2017 proposing additional measures to facilitate mortgage switching for those consumers minded to switch. Specific proposals to be explored will include:

- lenders providing greater clarity to consumers on the switching process itself, including as to timeframes and potential costs of switching;
- the benefits of lenders having dedicated switching contact points;
- further disclosure rules at trigger points in the mortgage life cycle e.g. end of a fixed interest-rate term; and
- the scope for increased co-operation amongst lenders during the mortgage switching process.

Code of Conduct on Mortgage Arrears

The Code of Conduct on Mortgage Arrears (CCMA) is a statutory code first introduced in February 2009. The existing CCMA has been revised three times since 2009, with the current CCMA becoming effective from 1 July 2013. Banks, retail credit firms and credit servicing firms servicing loans on behalf of unregulated loan owners are all required to comply with the CCMA. The CCMA does not apply to credit unions or local authorities when providing mortgages.

The overriding objective of the CCMA is to ensure the fair and transparent treatment of consumers in mortgage arrears or pre-arrears, and that each case of mortgage arrears is unique and needs to be considered on its own merits. The CCMA recognises that it is in the interests of borrowers and regulated entities to address financial difficulties as speedily, effectively and sympathetically as circumstances allow. It sets out the Mortgage Arrears Resolution Process (MARP), a four-step process that regulated entities must follow:

Step 1: Communicate with borrower;
Step 2: Gather financial information;
Step 3: Assess the borrower's circumstances; and
Step 4: Propose a resolution.

Each regulated entity must consider the borrower's situation in the context of the solutions they provide, which may differ from firm to firm. The CCMA does not prescribe the solution which must be offered. At the end of the MARP process, regulated entities are required to provide a three-month notice period to allow co-operating borrowers time to consider their options, such as voluntary surrender or an arrangement under the Personal Solvency Act, before legal action can commence.

Under the CCMA, a regulated entity may only commence legal proceedings for repossession where it has made every reasonable effort to agree an alternative repayment arrangement (ARA) with the borrowers and other clear requirements are met or the borrower has been classified as not co-operating.

Regulated entities must have an appeals process to enable a borrower to appeal a decision by a regulated entity, including where the borrower is not willing to enter into an ARA offered, where the regulated entity declines to offer an ARA and where a regulated entity classifies a borrower as not co-operating.

Source: Central Bank of Ireland

3. Market Structure and Context

Introduction

3.1 In this section we present an overview of the main characteristics of the market for mortgage lending in the State.[22] We begin with a general overview on how the mortgage market operates followed by a closer examination of the Irish mortgage market looking at the number of lenders currently offering mortgage products in Ireland and the level of market concentration. The size of the market is discussed, with reference to both the potential for growth in new lending and the likely pool of mortgage switchers, since the scale of opportunity is an important consideration for new lenders.

3.2 Next we look at entry barriers, the recent entry by Pepper Mortgages and Dilosk, and we discuss the potential expansion of the mortgage product offered by the Credit Union movement. A number of the other features of the Irish mortgage market which are likely to affect the decisions of new entrants are also discussed in detail. These include the level of regulatory oversight, the extent of Government involvement, legislative proposals to control mortgage interest rates, the role of Independent Financial Advisers (IFAs, also referred to as brokers) and, the implications for the evolution of the market of tracker mortgages, negative equity, non-performing loans and repossession policies.

Mortgage Lending Market – Overview, Number of Players, Market Size and Structure

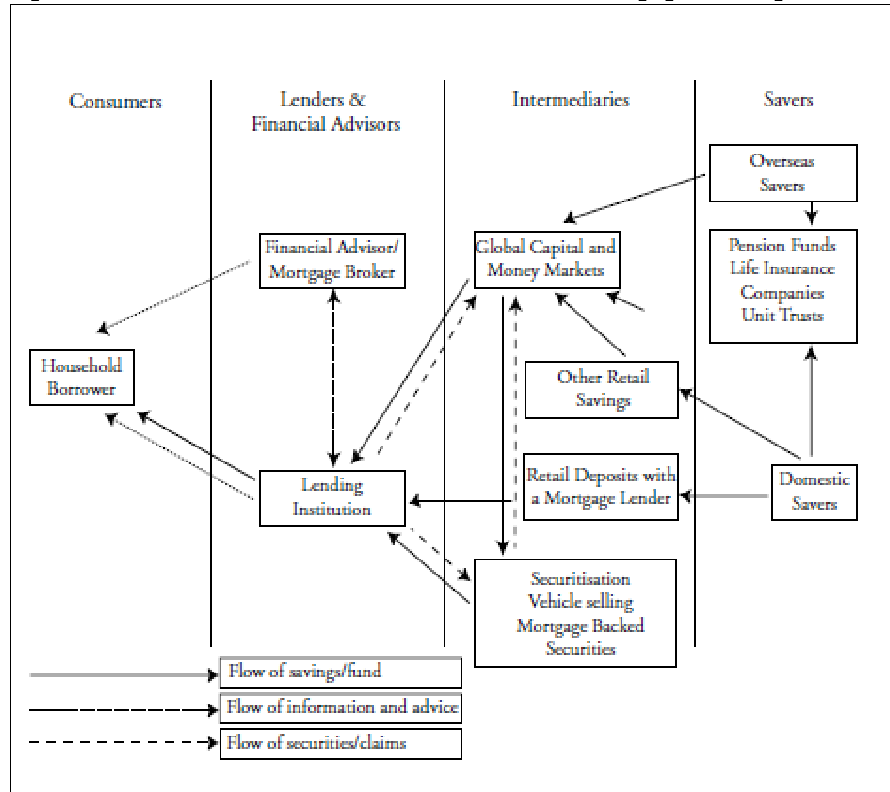
Overview of the Market

3.3 The provision of mortgage credit plays a vital role in the day to day lives of individuals, in the efficient operation of the financial system and in the performance of the macro economy. In Q4 2016, PDH mortgage debt in Ireland amounted to approximately €86.2bn, while BTL mortgage debt accounted for €19.6bn. Together this accounts for approximately 74% of the total outstanding balance of household debt in the State.[23] Consequently, it is essential that the market for mortgage credit works well and delivers robust outcomes for consumers and the economy as a whole. Figure 3.1 below, although based on the UK, presents an illustrative overview of the operation of the mortgage market.

[22] It is important to note at the outset that the Irish financial system, similar to other developed financial systems, comprises of a broad mixture of banks (retail, wholesale, investment etc.) and other financial service providers, of which only a subset are involved in the provision of PDH and BTL mortgage credit. This chapter is concerned only with this subset.

[23] See CBI (2017). Household Credit Market Report, H1 2017.

Figure 3.1 Illustrative Overview of the Market for Mortgage Lending



Source: The UK Mortgage Market: Taking a Longer-Term View, Final Report and Recommendations (2004).

3.4 Figure 3.1 shows that the market for mortgage lending is characterised by a complex set of relationships which include not only lenders (usually the traditional retail banks and also specialist lenders) and borrowers, but also independent financial advisors and brokers, intermediaries[24] and the suppliers of funds to these intermediaries.

3.5 In the most basic model, mortgage credit is, to lenders (i.e. banks), one of a number of options for asset allocation. Lenders assess the potential returns (controlling for risk) across all of these options using internal risk adjusted rate of return models. They then allocate credit accordingly in order to maximise their returns across the range of asset classes.[25] In order to provide the level of credit required lenders can look to either; (i) internally generated equity/shareholders' funds; (ii) their own deposit base (i.e. the savings deposits of their customers); (iii) wholesale lending markets; or (iv) a combination of each.

[24] Where the term intermediaries means intermediation between depositors/deposit takers and lenders

[25] How banks price this credit is discussed in more detail below.

3.6 It is important not to underestimate the role of the ultimate funders in the decision making process with regard to provision of funds to lenders and at what price. The providers of these funds (i.e. pension funds, life insurance companies, etc.) will have a range of alternative opportunities available to them and will choose among these options based on the perceived risk/return trade-off. They will impose not only an additional premium on funds to lenders in markets that are perceived as "riskier", but may also issue terms and conditions restricting how these funds can be used in those markets.

3.7 From the consumer's perspective the market looks very much simpler than that presented in Figure 3.1. Consumers will interact either directly or through an IFA/broker with a number of banks in order to obtain approval for the level of credit they need to purchase the property they desire (assuming they meet affordability tests). On the other hand, lenders will compete for that consumer on the basis of price (i.e. the mortgage interest rate) and non-price elements (i.e. fixed rates, cash back incentives, etc.). Like all markets, demand and supply will help to determine the equilibrium price and where supply is restricted with constant (or growing) demand, prices will rise. Thus in a market like Ireland, where there are now fewer lenders in a market with increased demand for mortgages, it is likely that mortgage interest rates will be higher than they would otherwise be.

3.8 In the CCPC's public consultation, respondents were asked for views about the current state of competition in the Irish mortgage market, whether it is functioning properly and whether the highly concentrated nature of the market might be acting as a barrier to new entrants. The view of the majority of respondents was that there is insufficient competition in the Irish mortgage market and that it is not functioning as a competitive market should.

3.9 The largest lenders in the Irish market maintain an opposite view and while acknowledging there are challenges in the Irish market they regard the level of competition as not only sufficient but even *"robustly and intensively competitive"* and that the market is no more concentrated than it was pre-boom.

3.10 Overall while respondents did not feel strongly that the current level of concentration is acting as a deterrent to entry, they did note that there are other stronger deterrents - some of which are partly a result of the concentrated nature of the market. These are discussed below.

Market Structure: Number of Players and Market Concentration

3.11 A consequence of the banking crisis that began in 2008 was that the mortgage lending market in Ireland changed radically with a significant reduction in the number of lenders offering mortgage products to Irish consumers.[26]

[26] For a concise and comprehensive overview of the boom and subsequent bust in mortgage lending in Ireland see Norris, M. and Coates, D. (2010).

3.12 In 2007 there were 10 large lenders in the Irish mortgage market. This fell to just 5 by 2013 with the merger of AIB and EBS, the exit of Bank of Scotland (Ireland) and Danske Bank, the winding down of Anglo Irish Bank and Irish Nationwide, and the subsequent liquidation of the Irish Bank Resolution Corporation. Since then there has been some limited new entry: Pepper, an Australian firm which specialises in asset management and third party loan and servicing activities, began offering PDH and BTL mortgages on a limited basis to Irish customers in 2016 and Dilosk started offering BTL mortgage finance in the Irish market in 2017.

Table 3.1 Lenders offering Mortgage Products in 2007 and 2017

Lenders in 2007	Lenders in 2017
BOI (+ICS)	BOI
AIB (+Haven)	AIB (+Haven +EBS)
Ulster Bank	Ulster Bank
Irish Life and Permanent (PTSB)	KBC
KBC	PTSB
EBS	Dilosk
Irish Nationwide	Pepper
Dankse	
BOS (Irl)	
ACC/Rabobank	

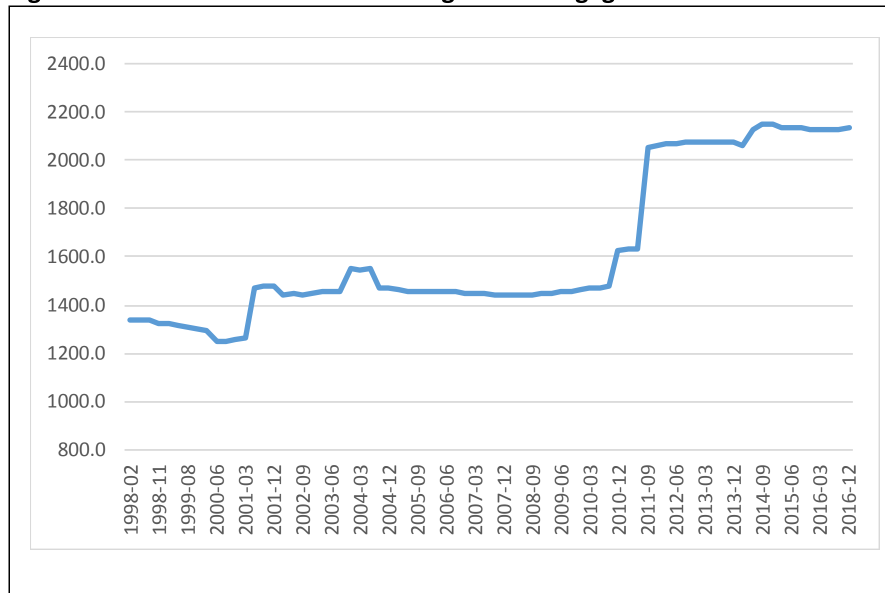
3.13 The reduction in the number of lenders led to an increase in the level of concentration in the market for mortgage lending in the State. Figure 3.2 below presents the HHI[27] measure of concentration for the stock of outstanding Irish mortgages. Stock is the gross position owed on loans by customers[28] recorded at a particular date (i.e. according to the Central Bank of Ireland there was €59.5bn in PDH loans outstanding as at the end of December 2016). This is distinct from the value of transaction volume[29], where there was €449m of credit advanced for PDH purchase during the month of December 2016)[30].

3.14 The HHI has increased since the onset of the crisis and is currently high from a historical Irish perspective. The sharp increases in 2011 relate to the market exits, mergers and loan transfers mentioned above.

[27] Herfindahl-Hirschman Index. This measure is the sum of the squares of each institution's market share and is a widely accepted measure of concentration. Highly concentrated markets are at risk of tacit collusion among competitors leading to higher prices and harm to consumers.
[28] More formally, customers are credit institutions' counterparties. For further detail see Central Bank Private Household Credit and Deposits Explanatory Notes.
[29] Transactions are differences in outstanding amounts adjusted for reclassifications, other revaluations, exchange rate variations and any other changes which do not arise from transactions. For further detail see Central Bank Private Household Credit and Deposits Explanatory Notes.
[30] See Central Bank of Ireland Statistical Releases - Table A.18.1 Credit Advanced to Irish Resident Private Households for House Purchase.

3.15 Typically values greater than 1800[31] are internationally accepted by competition practitioners to be high. As the current Irish level significantly exceeds this threshold, this indicates a highly concentrated market.[32]

Figure 3.2 HHI for Stock of Outstanding Irish Mortgages – 1998 to 2016



Source: Statistics Division data, CBI. Household Credit Market Report, H1 2017, Figure 31.

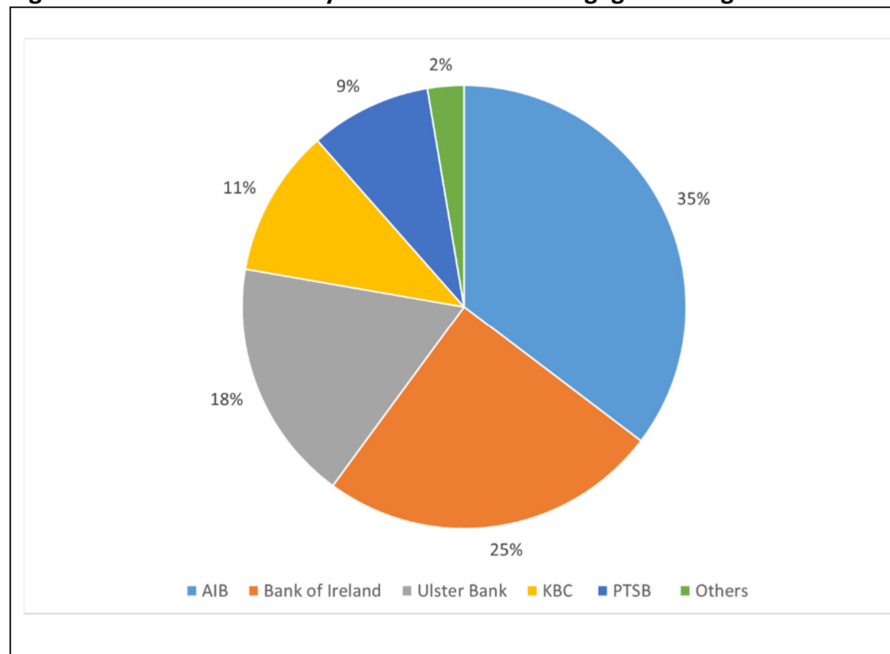
3.16 Figure 3.2 refers to the entire stock of outstanding mortgage debt held by lenders in the Irish market. However, it could be argued that instead of using the stock outstanding mortgage debt as a measure, a more appropriate measure is the market shares of the lenders in Ireland for the value of new lending transacted.

3.17 Figure 3.3 presents market shares by lender for new lending issued in 2016. The HHI for *new lending* is approximately 2,370, which is greater than the circa 2,200 illustrated above for the stock of outstanding mortgages. By way of explanation we would note that PTSB has a relatively lower ratio of new lending to outstanding mortgages, indicating a recent reduction in its lending levels. As a result, its share of new lending is less than its share of outstanding loans, leading to a relative increase in the market shares of the larger players as measured by new lending and the corresponding increased HHI.

[31] The CCPC Guidelines for Merger Analysis regards a market as highly concentrated if the HHI is greater than 2,000.

[32] While there are a number of different ways in which market concentration and competition can be measured and there is some debate in the literature regarding the advantages and disadvantages of each method (see CMA (2015), Appendix A) it is not unreasonable to describe the Irish market for mortgage lending as one which is highly concentrated.

Figure 3.3: Market Shares by Lender for New Mortgage Lending Issued in 2016



Source: Company reports, BPFI, CCPC estimates. The 'others' figure represents CCPC estimates for Pepper and Dilosk.

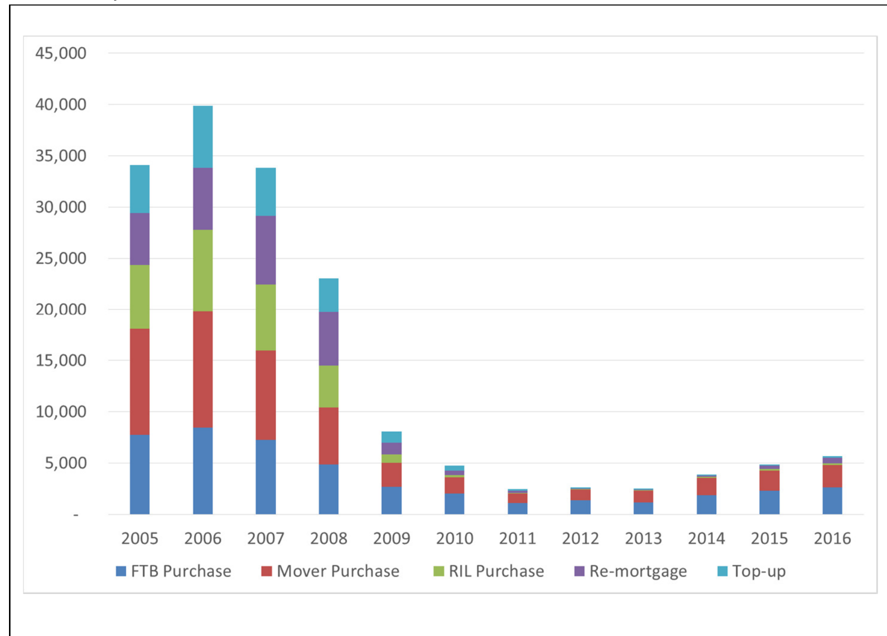
Market Size

3.18 The relative size of the Irish mortgage market and the opportunity it offers to new entrants was raised by a number of respondents in their submissions to the public consultation. The views provided differed, with some respondents (Lender 2 and BOI) recognising it as a challenging issue, while others did not believe it was a significant barrier to entry.

3.19 The size of the market for mortgage lending in Ireland is composed of (i) new lending written by lenders each year and (ii) the contestable market for switching by those currently holding mortgages.

3.20 In terms of new lending the experience of recent years (from at least 2005 to the present) does not provide an accurate estimate of the 'normal' level of new mortgage lending in the Irish market. In the years prior to the financial crisis mortgage lending in Ireland grew at an exponential rate with gross new lending reaching almost €40 billion in 2006. The impact of the recent recession in terms of rising unemployment, reductions in household disposable income and the disintegration of the construction sector meant that the volume of new mortgage lending declined very significantly and very sharply hitting a low of just under €2.5bn in 2011.

Figure 3.4 Value of Residential Loans (€m) Drawdown by Year and by Type in the State, 2005 to 2016.



Source: Banking and Payments Federation of Ireland, FTB: First Time Buyer, RIL: Residential Investment Letting

3.21 In more recent years, since 2014, the Irish economy has begun to recover and correspondingly, activity in the mortgage market has started to increase. However, it is difficult to estimate the level at which the mortgage market can be said to have returned to "normal" levels. Feedback received from stakeholders during our consultation phase has indicated that the size of a 'normal' mortgage market in Ireland would be in the region of €10bn per annum with 30,000 new build units per year[33] and that this would be the expected level by 2020.[34] For reference, the value of new lending in the Irish mortgage market in 2000 was €7.6bn[35].

3.22 To put these two figures in context we set out in Figure 3.5 a chart illustrating the quarterly change in Gross Residential Mortgage Lending across selected European countries. The chart is rebased to 1 for each market as at Quarter 1, 1999. Figure 3.5 shows that most of the markets have experienced a more stable environment than Ireland and have had moderate growth since 1999. Taking these trends into consideration, mortgage lending in Ireland of €10bn for 2020

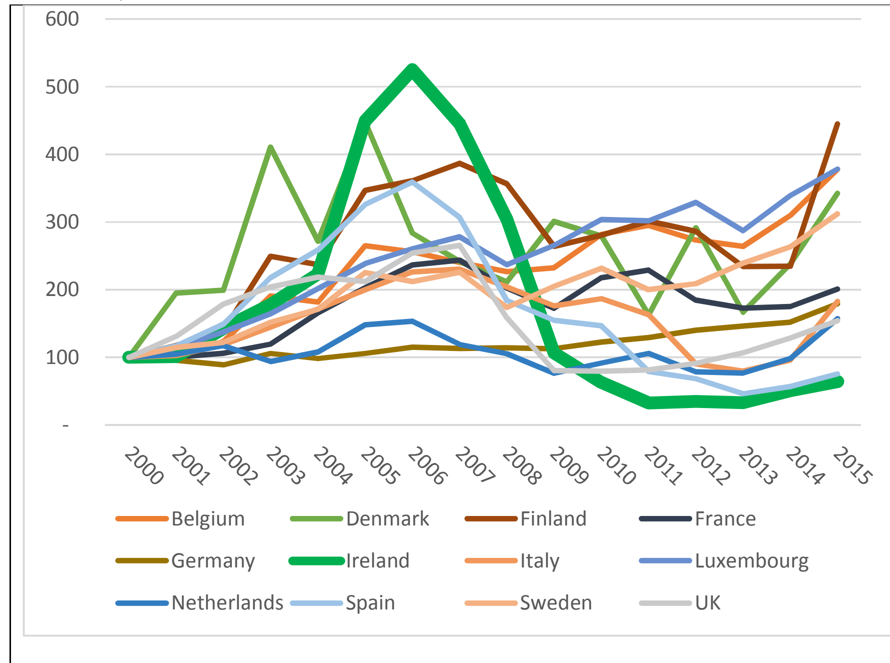
[33] ESRI Macro Economic Forecasting, December 2016, "Demographic Change, Long-Run Housing Demand and the Related Challenges for the Irish Banking Sector", David Duffy, Daniel Foley, Niall McInerney and Kieran McQuinn.

[34] Taking the estimate for new builds and assuming an average price of €300,000, and borrower equity of 85% this would translate into an annual mortgage market for new builds of €7.2bn, the balance being made up of the rotation of existing housing stock.

[35] Gross Mortgage Lending, European Mortgage Federation.

would not appear unreasonable in a European context. Importantly, mortgage growth in Ireland where lending reached €40bn in 2006, is shown to have been decidedly out of step with the European experience and the earlier growth profile in Ireland.

Figure 3.5 New Mortgage Lending (Index 2000=100) for selected European Countries, 2000 to 2016



Source: European Mortgage Federation Annual Statistics - Note: frequently the basis for country calculations are altered, as such the trends should be seen as indicative rather than precisely representing each national market.

The Contestable Market for Mortgage Switching

3.23 In addition to originating new loans, a lender can also encourage customers of another lender to refinance their home loans with them (i.e. to switch). Thus the contestable market for a new entrant would be larger than the value of new loan originations alone. Because of the high level of fixed costs in mortgage lending and the importance of scale in overcoming these, the incidence of switching, by expanding the potential market, could have a significant impact on the prospects for profitable market entry by new lenders.

3.24 Switching in the mortgage market can help improve pricing through the promotion of healthy competition between existing players in the marketplace and by attracting new entrants, who could gain market share by attracting switching customers. It can also act to protect consumers, as banks that increase

their rates relative to the competition would lose mobile customers in a market with active switching[36].

3.25 We noted earlier that there are a number of initiatives to encourage greater switching currently underway but that encouraging people to switch mortgages is challenging. Therefore we asked respondents to the public consultation to provide their views on the possible barriers to switching. Nearly all the respondents noted that from a consumer's perspective switching mortgages was regarded as a complex and difficult process and that consumers required greater transparency on the potential savings, more education on how to go about it and deeper trust of the banking system in general. One respondent referred to the 'Bersani Decree' in Italy which sets out in legislation the process and timelines for switching mortgages between banks at the borrower's request and with no additional costs to the borrower.[37] According to Lender 1 this has seemingly transformed the switching market in Italy: in 2015 over 30% of new lending was generated by switching.

3.26 The Campaign for Fair Mortgage Rates noted that between 2005 and 2008, mortgages to the value of €6 billion switched each year but that in the current market pricing is less transparent with cash back offers making it difficult for borrowers to compare rates. However they go on to say that *"If any lender were to offer rates closer to the euro area rates, the benefits from switching would be sufficient to overcome all the excuses given for not switching: legal costs, apathy and the hassle factor."*

3.27 There was a general consensus that low switching rates were also influenced by the existence of legacy tracker mortgages, negative equity, and fixed rate mortgages, which usually contain a breakage cost.

3.28 One of the unique features (in an international context) of the mortgage market in Ireland is the relatively high proportion of borrowers who are on tracker mortgages: of the €107bn in loans outstanding as at year end 2016, 49% (€52bn) were on tracker mortgages.[38] Because of the relatively low interest rates attached to these products at present, and the certainty in terms of the impact of any future ECB changes, it is unlikely that any of these customers would form part of the contestable market for switching.

3.29 Additionally, although borrowers may get a lower rate from another lender, it may not be in the interest of all borrowers to switch because the loan has matured to the extent that there are little savings to be gained. At the other end

[36] "Switch and Save in the Irish Mortgage Market?" Vol 2015, No. 8, Economic Letter Series, CBI
[37] *"Prior to the Bersani Law, banks used to charge a penalty of at least 1% of the value of the loan for early mortgage termination. Furthermore, since the old mortgage had to be cancelled and replaced by a new contract, the procedure involved additional costs, such as the registration taxes and the notary fees. As a result the overall cost of changing a mortgage provider reached at least 3% of the mortgage amount and the magnitude of these costs discouraged mortgage holders to switch to another bank."* Djordjevic, L. Brunetti, M. and Ciciretti, R. ICIRETTI (2017) pp. 8-9.
[38] CBI, Credit Money and Banking Statistics, Private Household Credit and Deposits, December 2016.

of the scale, lenders will also be reluctant to refinance those loans that are in arrears or those with high LTV ratios.

3.30 Taking these factors together: the size of the tracker book; the number of accounts in arrears; accounts with high LTVs; and those accounts where switching would not generate material savings, the contestable market available for mortgage switching would be considerably less than the total outstanding book of mortgage loans. While arriving at a definitive figure for the size of likely contestable market for switchers is challenging, the total contestable market for switching would be at least €30bn as at year-end 2016. The CBI has suggested that the market would be higher, which is in line with some market commentary. This, given the effects of house price trends on homes that were in negative equity, is broadly consistent with 2015 research carried out by CBI staff[39]. Taking the 15% switching rate seen in 2006[40] then the value of switching in the market could be in the order of €4bn to €6bn per annum. However, should reforms be put in place to promote switching this figure could be significantly higher.

Recent Market Entry and Entry Barriers

3.31 There have been two recent entrants to the mortgage lending market in Ireland.

3.32 Pepper Mortgages, which is part of a larger Australian head-quartered financial services firm, entered the Irish loan servicing market in September 2012. Pepper manages €4.5bn of residential and buy-to-let mortgages on behalf of Irish retail banks and international investors[41]. It subsequently entered into the mortgage lending market in January 2016 through the broker channel and has since begun a direct mortgage offering. According to news reports, Pepper has set up a new sales division here to offer commercial mortgages starting June 2017. Pepper said it hopes to issue about €300 million worth of commercial loans in Ireland over the next two years[42].

3.33 Dilosk DAC, trading as Dilosk and ICS Mortgages, entered the Irish mortgage market through the acquisition of ICS Mortgages, including the brand and distribution platform, from Bank of Ireland in 2014. Dilosk offers an ICS mortgages BTL product for borrowers seeking to purchase or refinance residential investment properties located in the Republic of Ireland[43].

3.34 We estimate that the combined market share of new lending in the residential mortgage market in Ireland for Dilosk and Pepper was less than 2% in 2016.

[39] According to research produced by CBI staff [Economic Letter Vol 2015, No. 8], as at end 1Q 2015, once the tracker accounts have been excluded from their sample, only 39% of the remainder are likely to be successful in the switching process once the new lender criteria are applied.
[40] According to the BPFI the value of re-mortgages in 2006 was €6.1bn accounting for 15% of the value of total drawdowns €39.9bn (source BPFI Mortgage Drawdowns data).
[41] https://www.peppergroup.ie/asset-management/residential-servicing.html#sthash.K5LnqLtr.dpuf.
[42] Pepper Money to offer commercial property loans in Ireland, Irish Times, Wed, Jun 7, 2017
[43] http://dilosk.com/site/#about

However, with reported combined funding capacity of between €400m and €500m we expect that market share to grow during 2017.

3.35 It should be noted however that both Pepper and Dilosk have entered very specific/niche sections of the market in a limited way reflecting both the credit risk concerns of those investors providing the underlying funding and the requirements of their own business models to write new business with strict controls for risk.

3.36 Frank Money Limited, trading as The Frank Mortgage, (Frank) is currently seeking a Retail Credit Firm licence from the CBI[44]. Its business model differs from retail lending banks. Instead of deposit based lending, it aims to partner with long-term investors, such as pension funds and insurers who are generally seeking long-term, low risk and stable cash flow investments. The Frank model aims to provide mortgages at long-term fixed rates beyond 10 years. According to Frank aligning the interests of borrowers and pensioners within a matching structure will bring increased security and stability to the Irish financial system.

3.37 The submission by Frank to the public consultation cites, as an example, how the lack of competition in the Dutch market was addressed through the introduction of non-bank lenders since 2014. Non-bank lending models now account for almost 30% of all new mortgages in the Netherlands in 2016[45] and this has been accompanied by a notable downward trend in the gross margins achieved by lenders on mortgage products[46].

3.38 There has been a lot of speculation both in the media and in other public fora about the desire of the credit union movement and individual credit unions to enter the mortgage market to a greater degree than at present[47]. Generally, respondents to the public consultation (with the exception of the individual consumer respondents) welcomed the increased participation by credit unions in the mortgage market with a number of incumbent lenders highlighting the need for a level playing pitch in regulatory terms for all financial institutions providing mortgage credit in the Irish market.

3.39 MABS welcomes increased participation noting that the mutuality afforded by the credit union movement, combined with appropriate regulation and strong corporate governance, offers a potential solution to some of the difficulties in the mortgage market. It is the view of MABS that credit union participation would be particularly useful for the Mortgage to Rent scheme and in the area of providing mortgages to distressed borrowers to buy-out mortgages already sold to funds.

[44] http://thefrankmortgage.ie/
[45] De nederlandsche bank (2016) p. 4.
[46] Ibid, p. 18.
[47] http://www.cuda.ie/new-credit-union-mortgage-framework-launches-through-solution-centre/

3.40 Both the ILCU and CUDA, representative bodies for credit unions, provided significant responses on this issue noting the following:

- Credit unions have a total of €16bn in assets. The average sector capital ratio stands at 16%, while the minimum regulatory reserve requirements are 10%. The sector is well capitalised. Furthermore credit unions are required to maintain a minimum liquidity ratio of at least 20% on an ongoing basis increasing to 30% depending on the volume of lending an individual credit union has over 5 years. Overall, liquidity for the sector as a whole is 36%.

- With the transposition of the Mortgage Credit Directive, EBA Guidelines, macro-prudential requirements and the 2016 Credit Union Regulations, credit union mortgage lending is subject to a similar level of legislative oversight as mainstream mortgage providers. Credit unions are not obliged to adhere to the Code of Conduct on Mortgage Arrears (CCMA), the MARP process or the Consumer Protection Code 2012. However it is claimed that credit unions are adopting these codes by way of best practice to ensure a consistent level of consumer protection for their members.

3.41 According to the credit union representative bodies the measures necessary to facilitate greater credit union involvement in mortgage lending are as follows:

- Amendments to the regulatory limitations on the volume of lending that credit unions are permitted to issue over 10 years:

    - The Credit Union Advisory Committee (CUAC) recommended in June 2016 a full review of the regulatory lending limits including the basis of the calculation of the limits, together with the liquidity requirements attaching to same.

    - CUAC recommended that a more proportionate regulatory model is required to allow credit unions in the top tier (i.e. larger, more developed credit unions) develop their business model and get into longer term lending. Whilst requesting that the regulatory limitations are broadened, the representatives agree that this should occur in a phased approach to prevent concentration of loan maturity.

- Amendments to the Common Bond[48] that will allow a greater degree of member choice and diversity:

[48] Section 6 of the Credit Union Act, 1997, requires that for a society to be registered under this Act as a Credit Union that the Registrar is satisfied that, among other things, *"admission to membership of the society is restricted to persons each of whom has, in relation to all the other members, at least one of the common bonds specified"* in section 6(3). The common bond of a Credit Union is the factor which unites all the members of that particular credit union (e.g. a community bond (here all the members live a particular locality; occupational bond where all members are in the same profession or work for the same employer; associational bond where all the members are in the same society or association).

- The Common Bond as currently defined can place limits on the potential for credit union product and service growth. This in turn may result in some members being only able to avail of a limited product range from the credit union within their Common Bond. This could prevent some credit unions from entering into mortgage lending.

- Pooling of funds between credit unions is a complex financial, legal and regulatory issue which requires detailed assessment.

3.42 Recent market commentary has suggested that regulatory requirements and the role of the CBI has in some way slowed the entry of credit unions into the Irish mortgage market. However, the CBI notes that while it has engaged with the credit union movement on this issue no firm proposal has to date been provided for it to evaluate:

> *"And to return to mortgage lending. We have engaged over many months on the one high-level sectoral focused initiative that has been raised with us. This has yet to crystallise into a proposal submitted to us, despite being first raised in 2014. Where our input was sought on this initiative, we have been demonstrably constructive throughout the process and provided formal feedback to support a more robust proposal - highlighting key risk considerations including lending limits and our preparedness to engage on these issues. We await commencement of this engagement. Nonetheless, we consistently hear that the Central Bank is holding back a sectoral solution to provision of mortgages in scale, despite there being no credible proposal submitted to us.*
>
> *We take our responsibility regarding well-being very seriously, and for Credit Unions, we go well beyond any other regulated sector in terms of proactive support and engagement. But it is not the Central Bank's responsibility to develop implementable strategies, change and product development for the sector."*[49]

3.43 The public consultation sought views on perceived operational barriers to entry into the Irish market and enquired whether there are any unique features of the Irish context that make entry less attractive and what could be done to attract and/or facilitate entry.

3.44 Most respondents identified lack of scale and legacy issues of Non-performing loans (NPLs) and poor access to collateral (i.e. the difficulties and timelines faced by lenders when attempting to repossess properties on which mortgages are not being, nor are likely to be, repaid – see the discussion from paragraph 3.102 to 3.104 and Box E.1 in Annex E) as unique barriers to entry in the Irish case.

[49] The long-term well-being of Irish Credit Unions – turning aspiration into reality. Speech by Ed Sibley, Director of Credit Institutions Supervision, CBI to the ILCU conference, 22 April, 2017.

3.45 Some respondents mentioned a number of other issues which are likely to affect the decisions of potential entrants which included the conveyancing process, the extent of current regulation and the possibility of political intervention in the form of legislated interest rate caps.

3.46 Dr Edward Shinnick's contribution offered a comprehensive summary of the various views offered by several respondents:

> *"In addition to the potential barriers to entry posed by regulation, other forms of non-regulatory entry barriers and sunk costs may also exist. These include:*
> - *Access to finance*
> - *Consumer inertia resulting in low switching rates*
> - *Information asymmetries and high switching costs*
> - *Size of the domestic market*
> - *Costs of establishing a branch network for retail banking, and*
> - *Legal and institutional barriers."*

3.47 The view of the Fair Mortgage Rates Campaign was that *"foreign lenders were making a mistake"* by not entering the market and that while *"difficulty in enforcing security is a particular problem in Ireland"* this is only for high LTV mortgages.

3.48 In terms of measures to facilitate entry a number of issues were raised in the public consultation including simplifying conveyancing and measures to make the switching process easier and quicker. Irish Mortgage Brokers (IMB) noted that the *"single biggest policy opportunity at present would be to create a 'passporting office'*[50] *for financial products. This would give capacity for much wider choice on a large range of products, not just mortgages."*

3.49 By way of contrast, PTSB responded that it did not see any particular features that are unique to the Irish context that make entry less attractive and therefore did not see the need for special measures to facilitate entry.

3.50 With the imminent introduction of the Central Credit Register (CCR) in 2017 and noting that even with access to the CCR new entrants are likely to have an information deficit compared to incumbents, we asked respondents to consider the type of information which would be most useful to new lenders. Respondents were generally of the view that easily accessible, reliable and available information on mortgage applicants' credit details would be beneficial to all lenders and more specifically to new entrants.

3.51 From a borrowers perspective, MABS was of the view that if the correct data was collected then the CCR *"should be capable of being used constructively by consumers to reflect a payment history in respect of a wide range of debt types*

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[50] By "passporting office" the IMB is referring to a specific unit within the CBI which would proactively facilitate financial providers in other member states to offer their products in the State.

and, therefore, to enable those consumers who have heretofore been excluded from mainstream credit to build a positive credit rating."

3.52 A number of respondents suggested additional data could be included in the CCR including, overdraft facilities, utility bill payments and tax clearance information.

Government Involvement in the Irish Banking Sector[51]

3.53 To assist in dealing with the financial crisis facing Ireland, in 2009 the Minister for Finance decided to utilise some of the assets of the National Pension Reserve Fund (NPRF). This led to the enactment of the Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act, 2009.

3.54 In 2009 and 2010 the Minister for Finance directed the NPRF to invest a total of €10.7bn in AIB and Bank of Ireland. In late November 2010, the Government announced that the NPRF would further provide up to €10bn of the State's €17.5bn contribution to the €85bn EU/IMF Programme of Financial Support for Ireland[52].

3.55 Within the Department of Finance the Shareholding Management Unit (SMU) is responsible for the management of the shareholdings and investments of the Minister for Finance in the banking sector. These include investments in Allied Irish Banks (AIB), Bank of Ireland (BOI) and Permanent TSB (PTSB))[53].

3.56 The State's total investment in AIB has amounted to circa €21bn. Following the capital reorganisation the State still owns 99.9% of AIB's Ordinary Shares. The priority for the Department of Finance is to protect the State's investment in AIB while planning a phased exit over time that maximises the recovery to the taxpayer. The intention is now to float circa 25% of the Irish government's stake in AIB[54].

3.57 To date, the total investment in Bank of Ireland by the State has been €4.7bn. The State maintains a 14% equity stake in the Bank. By virtue of its different ownership position, the Minister for Finance's role and level of oversight with Bank of Ireland is more limited than at AIB. It is government policy ultimately to exit from its remaining equity stake in the bank.

3.58 The State's total investment in Permanent TSB (PTSB) and Irish Life is €4bn. As with the other banks, the SMU's objective is to protect the State's investment in PTSB by ensuring it returns to profitability as quickly as possible and minimises the cost of legacy assets consistent with an approach that supports the

[51] For an overview see Gorecki, P. and O'Toole, F, (2015). Table 1 p. 6.
[52] http://isif.ie/about-us/history/
[53] http://www.finance.gov.ie/what-we-do/banking-financial-services/shareholding-management-unit/shareholding-management-unit
[54] Minister for Finance, Michael Noonan T.D., announces part flotation of Allied Irish Banks (AIB), 30 May 2017

sustainable recovery in the Irish economy. The State retains a 74.92% shareholding in PTSB.

3.59 Government involvement in the banking sector could be considered a negative feature from the perspective of new entry into the Irish market. However, respondents to the public consultation noted that while it may be a challenge it was not a significant barrier to entry because of the Government's commitment to unwind its shareholding and because the Government's bailouts were seen as a necessary response to the financial crisis.

Legislative Attempts to Control Mortgage Interest Rates

3.60 A specific issue that relates to the matter of State involvement, rather than Government involvement, is the the proposed Central Bank (Variable Rates) [Private Members] Mortgage Bill, 2016, that intends to give the CBI powers to impose caps on retail mortgage interest rates. This Bill has been proposed by an opposition party rather than the Government; however, if it were enacted it would represent State involvement in the operation of the market, and would be perceived by global investors as such. Generally any move by the legislature to intervene in the market and regulate interest rates generates negative perceptions among international funders and raises the possibility of further interventions, which introduces additional risk for funders and makes entry less attractive.

3.61 The proposers of the Bill note that currently there is nothing to stop the buyers of mortgage loan books from increasing rates to 6% or 7% or even higher. It is within this context, and within the context of additional legislation and incentives (outlined in the Fianna Fail response to the consultation), that the Bill is being proposed. Two other respondents to the CCPC's consultation support the initiative to cap rates, namely the Fair Mortgage Rates Campaign and an individual consumer Domnall McGiollaPhadraig.

3.62 All of the other respondents who addressed this issue believed that interest rate caps would be damaging to the market and would send the wrong signal to potential entrants. The views of PTSB are representative of incumbent lenders while a potential new entrant Frank Mortgage and the broker IMB are representative of the views of other respondents:

> *"Interest rate caps, and the risk of regulatory or political interference in markets that they represent, would not be viewed as a positive development by potential entrants (or incumbents)."*

> *"The introduction of interest rate caps would heighten investor uncertainty, deter new entrants, raise banks' cost of capital, undermine competition, and delay the restoration of bank profitability."*
>
> *PTSB*

> *"Capping mortgage rates is not the way to improve competition. It is better to introduce more price competition, with alternative funding models."*
>
> *The Frank Mortgage*

> *"Mortgage rate intervention to cap rates is effectively price fixing, and inappropriate. Competition and greater ease of switching is the solution.*
>
> *There is the risk that CBI policy becomes politicized and the legislation is used in a damaging fashion."*
>
> *IMB*

3.63 The CCPC has provided its observations on the proposed bill to the Joint Oireachtas Committee on Finance, Public Expenditure and Reform, and Taoiseach[55]:

- 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;
- 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;
- Banks typically react to rate caps by withdrawing cheaper products aimed at winning new customers. 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;
- Rather than seeking to cap mortgage interest rates the focus should be on introducing measures which will encourage greater competition in the sector over the medium term.

Regulatory Oversight

3.64 The CBI regulates more than 10,000 firms providing financial services in Ireland and overseas. The objective of the CBI's regulatory role is to ensure financial stability, consumer protection and market integrity.

[55] See https://www.ccpc.ie/business/business/research/submissions/central-bank-variable-rate-mortgages-bill-2016

3.65 Of relevance to this exercise are the following industry and market sectors, Credit Institutions; Credit Servicing Firms; Credit Unions and Debt Management Firms.

3.66 The CBI also plays a role in the recovery and resolution of financial institutions. The CBI requires all banks and investment firms within scope to prepare recovery plans, which set down the measures they would adopt in the event of their financial deterioration.

3.67 The CBI is also mandated to establish and operate a Central Credit Register which will maintain records of loans to individuals and businesses. This aim of this register is to enhance the CBI's insight into credit information.

Credit Institution Prudential Supervision

3.68 Historically, the CBI has had overall responsibility for the authorisation and supervision of credit institutions operating in Ireland. In 2014 this changed with a number of supervisory responsibilities and decision making powers moving to the European Central Bank (ECB) through the establishment of the Single Supervisory Mechanism (SSM).

3.69 The ECB is responsible for all core supervisory responsibilities[56]. For Significant Institutions[57], a Joint Supervisory Team (JST), led by the ECB and consisting of both ECB and CBI supervisors directly supervise these firms. The CBI remains responsible for the supervision of activities of institutions defined as Less Significant. The objectives in supervising Credit Institutions are:

(a) to foster a stable banking system;

(b) to provide a degree of protection to depositors with individual credit institutions

Credit Servicing Firms

3.70 Credit Servicing Firms are typically firms that manage or administer credit agreements such as mortgages or other loans on behalf of unregulated entities. The Consumer Protection (Regulation of Credit Servicing) Act 2015 ("the 2015 Act") provides for a regulatory regime in respect of Credit Servicing Firms, bringing such firms within the CBI's regulatory remit.

3.71 This legislative amendment ensures that relevant borrowers whose loans are sold to unregulated third parties maintain the regulatory protections they had prior to the sale including the protections provided by the CBI's statutory Codes of Conduct. Under the 2015 Act a person who meets the definition of a Credit Servicing Firm is required to obtain authorisation from the CBI in order to provide these services.

[56] As defined in the Council Regulation (EU) No. 1024/2013 (SSMR)
[57] AIB, Bank of Ireland, Permanent TSB, Ulster Bank and their relevant subsidiaries

Credit Unions

3.72 The Registry of Credit Unions (RCU) is the Division within the CBI which is responsible for the registration, regulation and supervision of credit unions. In recognition of the unique nature of credit unions, a statutory position of Registrar of Credit Unions was explicitly created within the CBI with responsibility for the regulation and supervision of credit unions.

3.73 Under Section 84 of the Credit Union Act 1997 the functions of the CBI are to administer the system of regulation and supervision of credit unions with a view to the:

a. Protection by each credit union of the funds of its members; and

b. Maintenance of the financial stability and well-being of credit unions generally.

Debt Management Firms

3.74 Under the CBI Act 1997, a person who meets the definition of a debt management firm is required to obtain authorisation from the CBI in order to provide these services. The Act defines “debt management services” as meaning:

a. Giving advice about the discharge of debts (in whole or in part), including advice about budgeting in connection with the discharge of debts,

b. Negotiating with a person’s creditors for the discharge of the person’s debts (in whole or in part), or,

c. Any similar activity associated with the discharge of debts.

Views of Respondents

3.75 With regard to the current regulatory regime and its impact on the functioning of the market and on potential entry as a whole, respondents to the public consultation provided mixed views. While there appears to be general support for the idea that robust regulation is required and that conduct regulation and the macro-prudential measures are necessary, there are some differences regarding the impact that regulation is having on lenders. PTSB and BOI support the current regulatory regime while Lender 1 and Lender 2 express the view that it is more onerous in Ireland compared to other jurisdictions.

> *“Regulatory policies and practices in Ireland are more onerous due to proprietary Irish mortgage regulation, specifically;*
>
> - *Macro-prudential Measures;*
> - *Code of Conduct on Mortgage Arrears;*
> - *S149 of CCA 1995 - this is also unique to the Irish market.*

Additionally, the small nature of the Irish market and its highly contended nature means that regulatory costs which are relatively fixed are significant relative to income."

Lender 2

3.76 A number of other respondents emphasised the need for clarity, transparency and certainty in regulation while the UK Council of Mortgage Lenders referred to the experience in the UK where the *"constant evolution of regulation has led to resources being focused on delivering extensive costly system changes to meet regulatory requirements rather than on innovation aimed at the borrower."*

3.77 The submission of Dr Ed Shinnick refers to an earlier study conducted with his colleagues Seamus Coffey and Don Walshe for the Department of Finance in 2016. The authors identified a number of regulatory issues such as untimely responses from the regulator[58] and the burdensome costs imposed by the regulatory process and a lack of transparency and accountability. While the evidence here cannot be taken as definitive, it does suggest that approval periods in Ireland are worthy of further study and comparison with other EU jurisdictions.

3.78 Based on the findings of the above study and on studies carried out in the UK by the OFT, the Independent Commission on Banking, the Bank of England and the Financial Services Authority and a review of competition in the Dutch financial services sector carried out by the ACM[59], Dr Shinnick offers a number of positive suggestions for improving the regulatory process as follows (see the full response from Dr Shinnick for more detail):

"To prevent regulatory rules becoming a barrier to entry it is important to constantly review prudential requirements and other banking regulations to ensure that new entrants and smaller banks are not disproportionately affected. Examples of where such difficulties may occur include:

- *Different capital requirements for entrants compared to incumbents*
- *A more cumbersome authorisation/licensing process for entrants offering services outside of the traditional banking model*
- *Using the business model adopted by traditional banks as the starting point in designing new rules, and*

[58] Two market participants who the CCPC met and interviewed (who do not wish to be identified) provided the CCPC with specific recent examples of the delay in acquiring the necessary regulatory approval to participate in the mortgage market. One of these noted that it is a long process to get approval as a retail credit provider. The FCA process (in the UK) for changing permissions took 90 days, while a similar task in Ireland took 18 months.

[59] (i) Review of barriers to entry, expansion and exit in retail banking, Office of Fair Trade, UK, November 2010; (ii) A review of requirements for firms entering into or expanding in the banking sector, Bank of England, Financial Services Authority, UK, March 2013; (iii) Independent Commission on Banking, Final Report Recommendations, UK, September 2011; and, (iv) "Barriers to Entry Dutch Retail Banking Sector", report available from: https://www.acm.nl/en/publications/publication/13257/Barriers-to-entry-into-the-Dutch-retail-banking-sector/

- *Difficulties or delays in seeking approval for new innovative services and technologies."*

3.79 Additional views on the regulatory process were also put forward. PIBA acknowledged the need for some controls to prevent excessive lending. However 87% of brokers surveyed by PIBA felt that because non-first time buyers (FTBs) cannot trade up in the current market, the new macro-prudential rules are having a negative impact on the number of suitable properties available for FTBs on lower incomes. PIBA also noted that while there are a number of jurisdictions that use LTV restrictions, in some countries lenders can lend over the LTV cap where there is mortgage insurance in place. PIBA suggested that this should be an option for lenders who are willing to accept mortgage indemnity insurance.

3.80 MABS in its submission highlighted the issue of mortgage loans transferred to third parties and the need to ensure that existing consumer protections continue to attach to these mortgages. MABS suggested that the Central Bank of Ireland's Code of Practice on the Transfer of Mortgages, issued in 1991, could be placed on a statutory footing either by promotion to a statutory code, as in the case of the Code of Conduct on Mortgage Arrears, or as part of a Regulation of the area generally.

Independent Financial Advisers

3.81 Independent Financial Advisors (IFAs) are an important distribution channel, particularly for new entrants. In addition to reducing the overheads for new entrants by allowing them to avoid establishing a costly branch network, a vigorous broker channel could help to promote switching by consumers. We asked respondents to consider whether there is an adequate independent broker network in the State to facilitate the entry of new lenders and give views on the incentives of brokers to provide unbiased advice and the framework for regulating broker activity.

3.82 The consensus of respondents was that the current broker channel is sufficient, well-regulated and fit for purpose. The IFA application process is comprehensive and ensures that only those with appropriate experience, qualifications and regulatory and compliance structures are appointed to act as IFAs.

3.83 Some concerns were raised with respect to broker income and the potential for incentives to lead a broker to recommend the mortgage product which offers them the highest commission, rather than one which best meets the needs of the customer. MABS expressed some concerns with the broker channel given some of the practises in the past and stressed the requirement for IFA regulation with an emphasis on quality of information provision, independence, and high standards of fitness and probity. More specifically, with regard to promotion of switching by brokers, this should only be promoted where the product provides objectively and demonstrably better financial outcomes for the borrower.

3.84 PIBA, whose members are the most directly affected by the legislation and framework in place that regulates the activities of brokers, highlighted a number of areas in which they claim that the legislation and the implementation of regulation could be improved:

- The current authorisation process as set down by the Central Bank for the authorisation of intermediaries under the European Union Consumer Mortgage Credit Agreements Directive (CMCAR) and the Consumer Credit Act 1995 (CCA) is acting as a significant barrier to entry and continuation in the market:
    - Mortgage Intermediaries are required to renew their authorisations on either a 5 or 10 year basis under the CCA. However there is no such requirement in the primary EU legislation of the Consumer Credit Directive. PIBA understands that Ireland is the only EU country that has built into local legislation a 10 year renewal for CMCAR authorisation;
    - The Central Bank timeline for re-authorisation is 90 working days. However, according to PIBA, feedback from members indicates that it is taking approximately 4-6 months as applicants are "drip fed" questions in relation to their application. Each time a question is sent to the application, the Central Bank 'stops the clock' on the 90 working day timeframe.
- The detrimental effect of a disproportionate application form is evident in the Debt Management sector. Many intermediaries provided these services in tandem with their mortgage services, however since the introduction of the authorisation process in 2013 only 52 firms sought authorisation.
- PIBA also believe that the current requirement under section 116. 1 (b) of the CCA for an intermediary to hold an appointment in writing from a lending institution to advise upon a mortgage from that institution is restrictive.
- Currently, where a lender decides not to deal through the broker channel for commercial reasons an intermediary is restricted in that they cannot provide market wide advice including these lenders' products to their customers.
- The Act in its current format does not allow the intermediary to deal with any after sale queries if the lender has withdrawn from the marketplace (BOSI) or has changed its business strategy (BOI or Ulster Bank). Therefore, the consumer is being affected as they are not able to obtain any impartial advice from their appointed intermediary after they have drawn down their mortgage.

Tracker Mortgages, Negative Equity and Non-Performing Loans

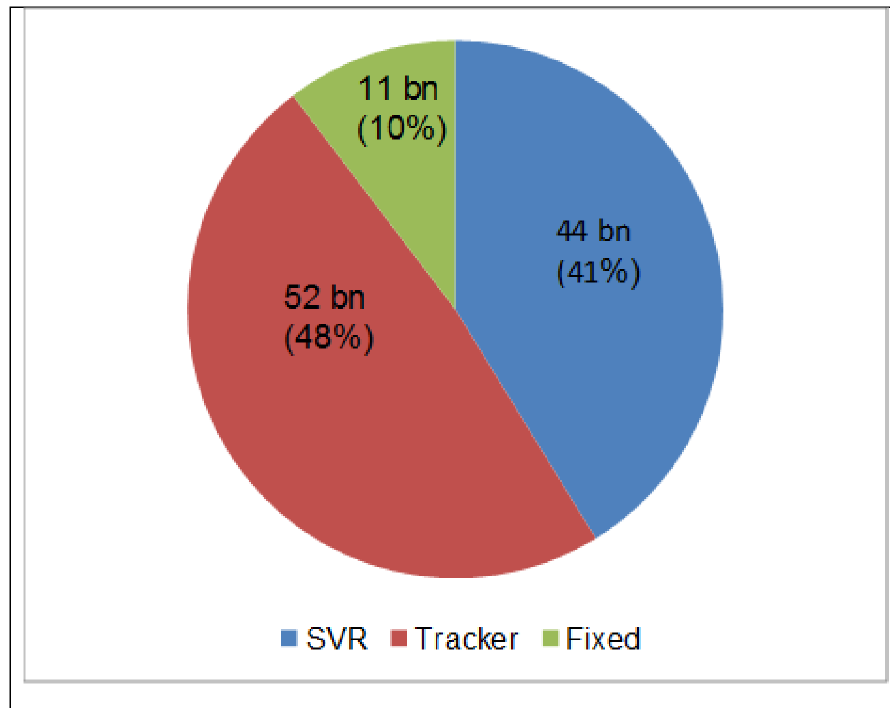
3.85 Tracker mortgages (i.e. those mortgage loans whose interest rate is contractually pegged to the ECB Policy Rate), properties in negative equity (i.e. those

properties where the market value of the property is below the outstanding amount of a mortgage secured on it) and non-performing loans (i.e. loans that are at least 90 days in arrears) are all normal characteristics of a mortgage market. However, following the financial crisis, the scale of these factors in the Irish context is unique and has led to significant distortions to the Irish market.

Tracker Mortgages

3.86 Figure 3.6 provides an overview of the outstanding stock of mortgage credit by interest rate type. Tracker mortgages account for nearly half of the total outstanding stock of mortgages.

Figure 3.6 Interest Rate Type Composition of Credit Advanced to Irish Resident Households for Home Purchases, Year-end 2016, Percentage Split and Euro Value.



Source: CBI, Credit Money and Banking Statistics, Private Household Credit and Deposits, December 2016. The corresponding balances for PDH only mortgage loans are €37.9 billion (Tracker); €37.5 billion Standard Variable Rates (SVR) and €10.8bn (Fixed).

3.87 As discussed earlier, the relatively high prevalence of trackers in Ireland reduces the pool of potential switchers and is negatively affecting the level of switching in the Irish mortgage market. Given the low ECB interest rate, those with tracker mortgages are paying significantly less in repayments than those with similar borrowings on non-tracker variable rates. In addition, those with trackers are less inclined to move house (for fear of losing their tracker rates) and this in turn is acting as a drag on liquidity in the housing market with less housing stock

coming onto the market as people postpone their normal upgrading and downgrading decisions.

3.88 From the perspective of the lenders, trackers are a low yielding product. As the ECB began to lower its policy rate, the lenders began to lose margin on these products. This escalated to the point that lenders in the Irish market, in order to rebuild their profitability, individually, implemented a strategy[60] of not passing on policy rate cuts on non-tracker variable rates. Before the financial crisis, the normal response of lenders in the Irish market had been to pass on some or all of these cuts to non-tracker variable rates.[61]

> *"Ireland's mortgage market is skewed towards variable rate mortgages and in the bubble, these were trackers. Irish banks fixed the margin that borrowers would pay above the ECB rate, for the lifetime of the mortgage. They then gambled – in spectacularly unsuccessful fashion – that they would be able to roll over their own debt at a cost close to the ECB rate. Of course, when the so-called "Great Moderation" came to an end, and the "Great Recession" started, Irish banks suddenly found that borrowing short to lend long was a recipe for wipe-out.*
>
> *But the trackers that helped to destroy them still exist. So, with ECB rates currently at 0% (yes, zero!), there are plenty of Irish households who borrowed in the bubble who are paying 1% or less interest. Irish banks, however, struggle to borrow themselves at such low rates and cover costs associated with being a financial intermediary. And if their own lenders aren't subsidising legacy trackers, there is only one other group that could: new borrowers. The reason Irish borrowing is expensive now is precisely because it was so cheap ten years ago."*[62]

3.89 From the perspective of new borrowers and those not on trackers, the prevalence of historic trackers is having a negative influence on their perceptions of the cost of mortgage credit. Although the price of mortgage credit is at historically low levels, those new borrowers and those not on trackers are more inclined to make comparisons with their friends, colleagues and family members who are on tracker rates. This "tracker envy" is arguably one of the driving forces behind the current narrative with regard to mortgage interest rates. As discussed in Chapter 2, consumers in the focus groups did not have a sense that mortgage rates were currently at historic lows.

3.90 But trackers may also pose an existential risk to the future of the Irish banking sector. As consumers are constantly reminded in the terms and conditions attached to credit finance, interest rates may rise as well as fall, and so it is with

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[60] The CCPC has no evidence of coordinated behaviour on the part of lenders in the Irish market. Should such evidence be provided this will be thoroughly investigated by enforcement divisions of the CCPC.
[61] McQuinn, K. & Morley, C. (2015).
[62] Ronan Lyons, "Bubble Era Trackers Still Casting a Shadow", Sunday Independent, February 26, 2017.

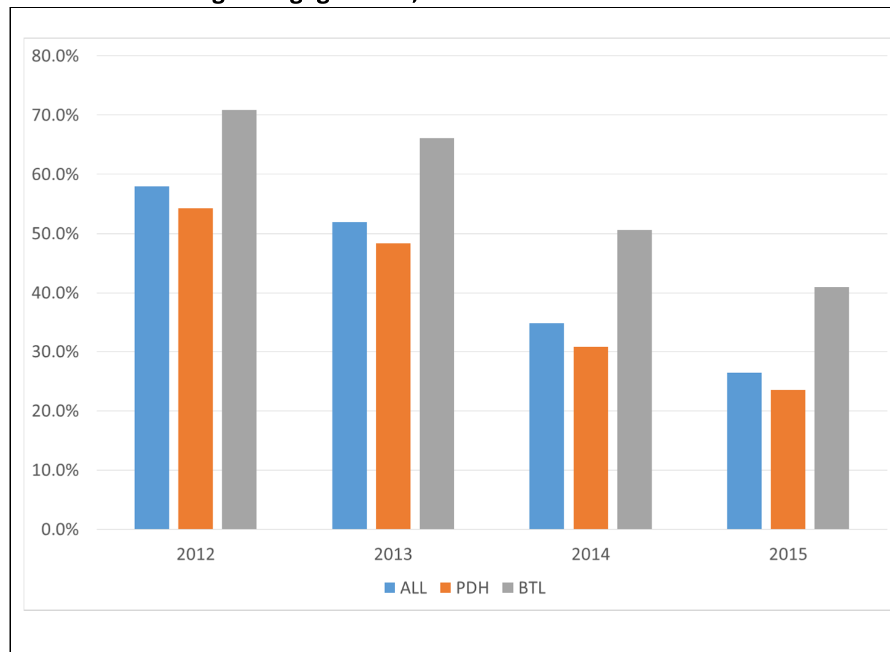
the ECB policy rate. When the European economy fully emerges from the Great Recession and economic activity picks up the ECB policy rate will undoubtedly rise. This will negatively impact on those who are currently able to meet their repayments because they are on trackers and thus has the potential to force more mortgage holders into arrears.

> *"This enormous debt is the great unexploded financial time bomb ticking away in Ireland, waiting to be detonated by rising ECB interest rates.*
>
> *If either rates increased or the economy contracted rapidly, defaults on trackers would increase significantly and the banks would end up with more bad debts."*[63]

Negative Equity

3.91 Figure 3.7, taken from the CBI report on household credit presents data for those in negative equity. It shows that while the numbers have decreased steadily, there is still a high number of PDH mortgage accounts (23.5%) where the loan is greater than the value of the property.

Figure 3.7 Mortgage Loans in Negative Equity – As a Percentage of the Balance of the Outstanding Mortgage Stock, 2012- 2015



Source: CBI, Household Credit Market Report, H2 2016, Figure 27: Data relates to BOI, AIB and PTSB activities.

[63] David McWilliams, "Our massive tracker mortgage debt is a ticking time bomb waiting to be set off by an ECB rate hike", Irish Independent, August 4, 2016.

3.92 As noted earlier, this cohort of borrowers is unlikely to form part of a readily contestable market for switching and like those with tracker mortgages, is acting as a drag on the supply of the housing stock since they are unlikely/unable to move.

3.93 An additional effect of a high level of negative equity is that it may artificially increase the level of mortgage accounts in arrears through what is known as "strategic default", i.e. those people in deep negative equity who decide that there is no point making repayments since the property value is unlikely to ever meet the value of the outstanding mortgage loan. The CBI estimates that 12% of PDH loans and 23% of BTL loans were in negative equity at end June 2016. Table 3.2 shows that for both PDH and BTL loans the ratio of 'arrears' to 'performing' was far higher for those in negative equity.[64] Thus there would appear to be a greater tendency for loans in negative equity to be in default compared to those in positive equity.

Table 3.2 Split of Mortgage Loans by Negative Equity and Default Status, June 2016

	PDH Mortgages	
	In Positive Equity	In Negative Equity
Performing	84%	10%
In Default	3%	2%
	BTL Mortgages	
	In Positive Equity	In Negative Equity
Performing	71%	16%
In Default	7%	7%

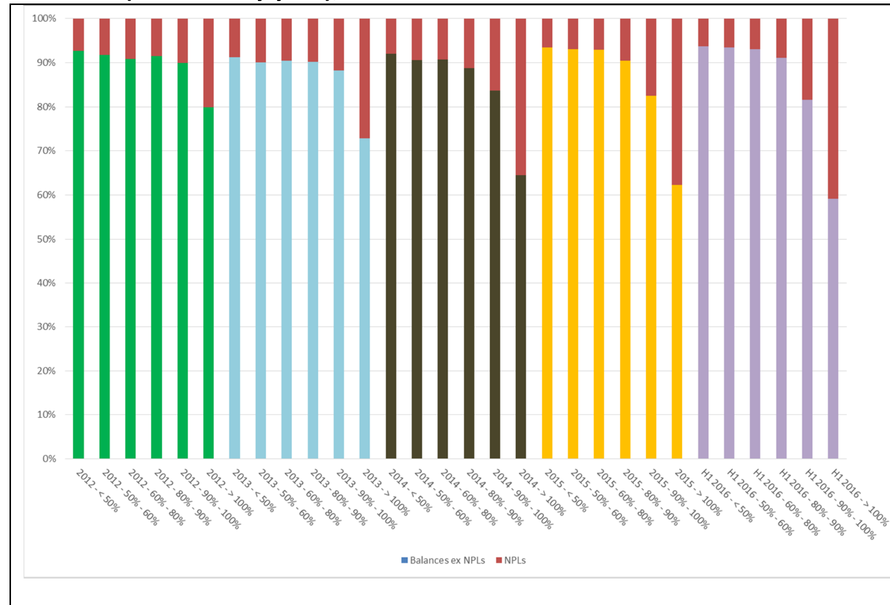
Source: Source: CBI, Household Credit Market Report, H1 2017, Table 7

3.94 Figure 3.8 below illustrates the impaired loans/arrears profiles across different loan to value classes for non-tracker mortgages. The tendency is for arrears to increase as a proportion of the balance as LTV rates increase. Data obtained from

[64] CBI (2017). Data for AIB, Bank of Ireland, and PTSB, Household Credit Market Report H1 2017 p.19

the Central Bank showed that 41% of loan balances with LTVs greater than 100% were non-performing at the end of June 2016, up from a figure of 20% in 2012.

Figure 3.8 NPL Split of Non-Tracker Irish Mortgage Portfolio Information[65] by LTV Ratio (coloured by year), 2012 to 2016



Source: Central Bank of Ireland, CCPC calculations

Non-Performing Loans and Debt Recovery

3.95 High levels of NPLs, and in particular those in long term arrears, have a key impact on the functioning of the mortgage market, the perceptions of the market by international funders and the decisions of new entrants.

> *"NPLs influence bank lending through three interrelated key channels—profitability, capital, and funding. Bank profitability suffers because high NPLs require banks to raise provisions, which lowers net income, while NPLs carried on banks' books do not usually generate income streams comparable to performing assets. NPLs, net of provisions, may also tie up substantial amounts of capital due to higher risk weights on impaired assets. And a deteriorating balance sheet raises a bank's funding costs because of lower expected revenue streams and, hence, heightened risk perceptions on the part of investors. Together, these factors result in some*

[65] Notes: NPL = impaired loans and/or arrears > 90 days and/or non-performing. Non-tracker means only mortgage loans with a variable or fixed rate are included. Data based on AIB, BoI and PTSB only for Irish PDH mortgage exposures. Data for KBC and Ulster are only available from end 2015 onwards.

> *combination of higher lending rates, reduced lending volumes, and increased risk aversion."*[66]

3.96 In addition to the impact on the functioning of the mortgage market it is important to note that NPLs, in particular those in long term arrears for PDH mortgages, have a very negative impact on the lives of consumers:

> *"NPLs cause untold distress and difficulties for borrowers, increasing risks regarding their fair treatment, and, as is the case in Ireland, have significant societal implications."*[67]

3.97 The number of non-performing PDH and BTL loans in the State has reduced considerably since their peak in 2013 and are continuing to fall (see Figure 3.8). According to the CBI's Report on Mortgage Arrears (2016), since the June 2013 peak, considerable progress has been made in addressing mortgage arrears, primarily through the use of restructures, rather than loss of ownership. PDH mortgage arrears have declined by 43% since the end of June 2013. Over 120,000 PDH residential mortgages have been restructured in Ireland and 88% of these loans are meeting the terms of the restructuring agreement. The majority of the different categories of arrears, including the over 720 days' category, declined in Q4 2016. This category recorded a sixth consecutive decline, having declined for the first time in Q3 2015. The decline of 3.2 per cent in Q4 2016 was the largest decline in this category to date[68].

3.98 At end-December 2016, a total of 77,493 (11%) of mortgage accounts were in arrears. CBI data revealed that accounts in arrears over 720 days in Q4 2016 constitute 43% of all accounts in arrears (approximately 33,300 accounts) and 88% of arrears balances outstanding.[69]

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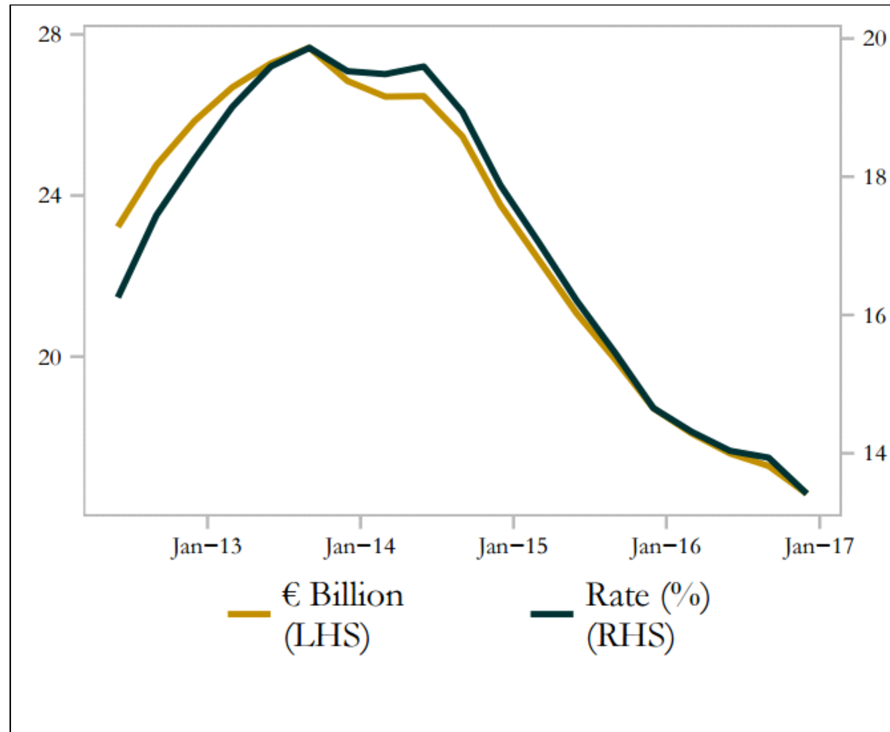
[66] IMF (2015) pp.9/10.

[67] Address by Ed Sibley, Director of Credit Institutions Supervision, CBI at the Banking and Payments Federation of Ireland (BPFI) on Non-Performing Loans, 30 September, 2016.

[68] CBI, Residential Mortgage Arrears and Repossessions Statistics: Q4 2016.

[69] Ibid.

Figure 3.9 Mortgage Arrears PDH loans and BTL loans by Rate and Balance, Q2 2012-Q4 2016



Source: CBI, Household Credit Market Report, H1 2017, Figure 22.

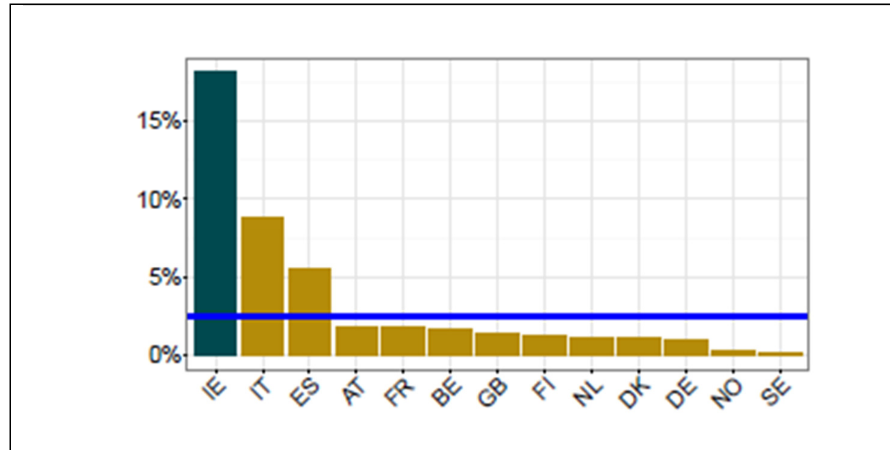
3.99 However, the level of NPLs (and those in long term arrears) in Ireland still remains excessively high by international standards.[70] The aggregate value of accounts in longer-term arrears (i.e. over 360 days) remains significant, amounting to just over €9bn at end-December 2016.

3.100 Figure 3.10 below compares the aggregated mortgage default ratio of all Irish banks to those in other EU countries. It can be readily observed that the Irish

[70] *"With regard to credit risk, despite considerable recent progress European Banking Authority, EBA, stress test data show that Ireland's mortgage default rate is more than ten times higher than that in many other eurozone and European Union countries."* Introductory statement by Ed Sibley, Director of Credit Institutions Supervision, before the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, 8 Dec 2016.

mortgage lending portfolio default ratio remains the highest compared to select other European countries.

Figure 3.10 Mortgage Default Ratio for Selected Countries – end December 2015



Source: EBA, CBI Author's calculations, Blue line is aggregate default ratio for all countries. See Box 3 in Household Credit Market Report H2 2016.

3.101 Compared to many other European jurisdictions, including those with lower levels of non-performing loans, the legal process through which lenders effect security takes substantially longer in Ireland. The time taken to go through the court process for residential property repossessions has also meant that there will continue to be backlog of cases in the system for some time.[71] According to the CBI in its 2016 report on mortgage arrears, the stock of accounts with court proceedings issued against them has remained at approximately 14,000 accounts over the past 18 months[72].

3.102 In the same report it was also noted that[73] the average quarterly PDH repossession rate in Ireland was 0.7%. The equivalent figure in the UK was approximately 1.7%. The UK repossession rate was well above the Irish figure,

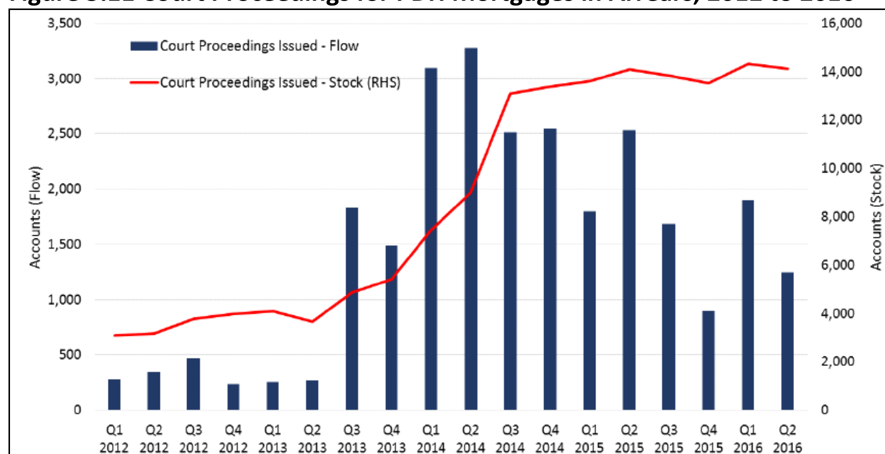
[71] To set these figures in context it is important to note that in addition to the high levels of mortgage distress experienced in Ireland since the financial crisis various conflicting court rulings with respect to certain types of mortgages (subject or potentially subject to repossession proceedings) led to a degree of uncertainty during which time (prior to mid-2013) repossession proceedings could not be effectively initiated. See Box E.1 in Annex E which describes the repossession process in some detail.

[72] CBI, Report on Mortgage Arrears 2016

[73] CBI, Report on Mortgage Arrears 2016

even taking into account that the level of arrears in the UK is at its lowest level since 1994.

Figure 3.11 Court Proceedings for PDH Mortgages in Arrears, 2012 to 2016



Source: CBI Report on Mortgage Arrears 2016

3.103 The essential nature of a mortgage is that the loan is secured against an asset and is priced accordingly. The relative value of the security versus the loan also effects the price of the mortgage. This is clearly evident in lenders' published schedules of rates for home loans with different loan-to-value ratios. Correspondingly, if a lender is unable to access the security backing the mortgage this makes the loan a riskier prospect, affecting the interest rate the lender requires. Objectively, the scale of non-performing loans in Ireland is high relative to European peers and the number of loans in arrears over 720 days is also exceptionally high. Despite this, repossession rates are low.[74] Clearly there are restrictions on the ability of lenders to possess loan security in the event of default. As set out earlier, this results in higher loan prices/higher interest rates than would otherwise be the case.

3.104 According to the ECB, high levels of NPLs are also of particular prudential concern and, in this regard, the ECB shares the view that high NPL levels negatively impact bank profitability and resilience and constrain the utilisation of capital for more economically productive lending activity. High levels of NPLs furthermore elevate funding costs for banks. NPLs are therefore a drag on banks and on the economies in which they operate.

3.105 During the pre-consultation phase and in the responses to the public consultation, stakeholders consistently and compellingly raised the issue of NPLs, the risk of default and the difficulties lenders have in attempting to repossess the security on defaulted mortgages as a significant and determining

[74] *"To illustrate this point, between 2009 and June 2016, just over 6,000 PDH properties have been repossessed in Ireland, two thirds of which were either voluntarily surrendered or abandoned by the borrower. Approximately one in five mortgages is or has been in default, and fewer than one in 300 has lost possession of a house through the courts."* Introductory statement by Ed Sibley, 8 December 2016. Op. cit.

consideration for new entrants. Even where new entrants would be unencumbered by the legacy of a poorly performing back book, when faced with a choice between two markets, funders will choose the one with the less risky outcomes based on previous experience. The risk weighting attached to Ireland is perhaps even greater still given that the Irish market has not dealt effectively with the current NPL crisis, has not put in place a consistent and credible process for dealing with current NPLs and is therefore less likely to be able to respond effectively to any future crisis.

3.106 Nearly all of the respondents to this question in the public consultation agreed that the level of mortgage arrears coupled with long and uncertain repossession policies were acting as a potential barrier to entry. While PTSB commented that loan defaults are inevitable in any lending environment and their effect is to make a market less attractive Lender 2 went further and noted that "*repossession policies and practices are a barrier to entry to the Irish market for the following reasons: access to loan security is uncertain; the timing to security realisation is protracted; associated capital and operating costs are significant. … The time to resolution in Ireland is also typically much more protracted than elsewhere. In Ireland, this ranges from 18 to 72 months. By contrast, the UK range is 9 to 12 months, with Northern Ireland and Denmark at 6 months.*"

3.107 It can be argued that these are legacy issues and with the new controls in place regarding credit risk they should not be as much of a concern to new lenders. On the other hand there is a concern that when it comes to new entrants if the process in Ireland is perceived to be weaker or to take longer than in other jurisdictions, this may constitute a barrier to entry. Furthermore if the process for dealing with NPLs efficiently, transparently and in line with international norms is not put in place now then this will undermine the perceived (from the perspective of new entrants) credibility for dealing with future crises.

3.108 While respondents suggested that the processes for working out NPLs and arrears should be improved and that repossession practises should be streamlined there was little support for the wholesale implementation of repossession, particularly for family homes. This once again supports the notion that supply and cost of mortgage credit and the regulatory framework around this should be distinct for purchasing a "family home" compared to purchasing property as an investment vehicle.

3.109 Respondents did however, express some frustration with the levels of non-engagement by some borrowers and the apparent lack of consequences for those who adopt such strategies. Respondents provided some suggestions on how the issue could be dealt with more effectively which included:

- Making the process less court-driven;
- If using the courts, then greater use of specific courts or specialist judges;
- Employing case management guidelines;

- Introduction of suspended possession orders, which effectively grant lenders a possession order at a future date, forcing the consumer to engage with the lender. Lender 2 would like to see a more streamlined court process and, for example, a specific court to hear mortgage cases.

3.110 Some alternative views were also provided which included: (i) that *“personal debts need to be written down, and properties must be restored to rightful owners”*; and, (ii) making greater use of non-recourse loans. It is argued that this would change the incentives of defaulting borrowers, encouraging them to surrender properties and allow the whole process to be executed much more quickly (see the discussion in Chapter 5).

3.111 Some of the respondents to the consultation noted that the policy and practice of dealing with arrears is a societal choice to ensure that families do not lose their family home. Quite apart from the domestic upheaval wrought by foreclosure, the State may, in some cases, also have a role in providing housing following repossession. Some respondents highlighted that if this were the case part of the cost of default would be moved from the lenders to the exchequer.

3.112 Many of the respondents noted that the current repossession practices make for a high degree of uncertainty. With this uncertainty, price discovery becomes more challenging and as a result prices rise, loan volumes reduce, and lenders ration credit to those accounts exhibiting the least risk.

3.113 Furthermore, where there are restrictions on the ability of lenders to repossess properties, borrowers may stop making repayments, although fully able to do so. In effect, such customers can increase the scale of arrears over what would normally be the case. In a related sense, in a scenario where the prospect of repossession is vague and distant, borrowers who are in arrears and who are unable to meet their repayments are not incentivised to engage with their lender. This can create more uncertainty, and hold up a process which ordinarily could produce, at an early date, some form of beneficial resolution for both borrower and lender alike.

3.114 In our meetings with stakeholders and from the responses to the consultation it was clear that the overwhelming majority of people do not want to see people lose their homes and that if it is required then it should only be as a last resort. The cost of doing nothing however in this regard will be higher prices, a potential for increased incidence of default, relatively tighter credit standards and reduced involvement in the overall development of European monetary and banking union.

3.115 According to the ECB[75], a number of macro-economic factors are currently conducive to NPL resolution (such as improving employment trends and the low interest rate environment). However, a potential future deterioration in macro-

[75] Stocktake of national supervisory practices and legal frameworks related to NPLs, September 2016.

economic conditions, for example rising interest rates and "Brexit"-related economic headwinds, may pose a significant risk to the sustainability of continued NPL reduction. This is especially the case given the high Irish household indebtedness compared with European peers and an economy which is heavily export reliant. There is therefore a strong imperative to design and implement a transparent, predictable and consistent NPL resolution process in the immediate term.

3.116 The ECB further notes[76] that the high volume of cases moving through the Irish judicial system and the timelines associated with the repossession process primarily for PDH mortgages are a key challenge for Irish banks and their ability to repossess and sell PDH collateral in an efficient manner. This is in contrast to the commercial sector where the appointment of receivers to take control of defaulted borrowers' assets has resulted in a faster process. Chapter 2 raised the possibility of a clear distinction between mortgage credit provided for purchasing a "family home" and that provided for purchasing property as an investment vehicle and, that the supply and cost of mortgage funding and the regulatory framework should recognise this distinction. This concept is developed further in Chapter 5.

3.117 More broadly and separate to the effect of NPLs on pricing, there is the move to deepen Economic and Monetary Union (EMU) across Europe. The completion of the Banking Union is seen as an indispensable element of this plan[77]. Furthermore, EMU is also seen as needing a fully-functioning Banking Union to ensure effective transmission of the single monetary policy, better risk diversification across Member States and adequate financing of the economy[78]. However, Danièle Nouy, Chair of the Supervisory Board of the ECB[79] has stated that *"Unfortunately, one of the pillars of the banking union, a common deposit insurance scheme, is still missing"* while the EU Commission noted that additional risk-reducing measures will be need to be developed in parallel to establish European Deposit Insurance Scheme[80] and that one of the risk reducing measures the Commission will consider is:

> *"… bringing forward proposals enhancing legal certainty and encouraging the timely restructuring of borrowers in financial distress, which is*

[76] Ibid.
[77] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions *"Towards the completion of the Banking Union"* COM(2015) 587 final
[78] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions *"Towards the completion of the Banking Union"* COM(2015) 587 final
[79] Interview with Danièle Nouy, Chair of the Supervisory Board of the ECB, Handelsblatt, published on 18 April 2017.
[80] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions "Towards the completion of the Banking Union" COM/2015/0587 final.

particularly relevant for the success of strategies to address the problem of non-performing loans (NPLs) in some Member States."

3.118 Thus addressing NPLs and the repossession practices and policies in Ireland may become a condition of Ireland's participation in the further development of European monetary and banking union.

4. Mortgage Interest Rates and Competition

Introduction

4.1 This chapter discusses how mortgage interest rates are determined. The CBI paper from May 2015, *Influences on Standard Variable Mortgage Pricing in Ireland,* (CBI-SVR report)[81] noted that the range of factors which affect the margin that banks charge on variable mortgage rates (and as a consequence the interest rate consumers face) includes:

- The cost of funds;
- The credit risk associated with lending;
- The operational costs of running a bank;
- The cost of capital;
- The market structure and competitive environment faced by each bank.

4.2 We begin with a discussion of the role of the ECB in setting the monetary policy for the Eurozone as whole. Next we apply the factors referred to above to the conditions existing in the Irish market. We then explore the role of competition as a determinant of mortgage interest rates in Ireland and this is followed by review of the current rates offered by lenders in the Irish market and some comparisons with other jurisdictions.

The Determinants of Mortgage Interest Rates

ECB Policy and Mortgage Interest Rates

4.3 The general trend in interest rates across Eurozone EU countries reflects the monetary policy of the ECB which is set by the Governing Council of the ECB through a number of key interest rates for the euro area. These key interest rates are:

(a) The interest rate on the main refinancing operations (MRO), which provide the bulk of liquidity to the banking system.

(b) The rate on the deposit facility, which banks may use to make overnight deposits with the Eurosystem.

(c) The rate on the marginal lending facility, which offers overnight credit to banks from the Eurosystem.

[81] CBI (2015). Influences on Standard Variable Mortgage Pricing in Ireland. May 2015.

Table 4.1 Key ECB Interest Rates, December 2008 to Present

With effect from		Deposit facility (%)	Main refinancing operations (%)	Marginal lending facility (%)
2016	16 Mar.	−0.40	0	0.25
2015	9 Dec.	−0.30	0.05	0.3
2014	10 Sep.	−0.20	0.05	0.3
	11 Jun.	−0.10	0.15	0.4
2013	13 Nov.	0	0.25	0.75
	8 May.	0	0.5	1
2012	11 Jul.	0	0.75	1.5
2011	14 Dec.	0.25	1	1.75
	9 Nov.	0.5	1.25	2
	13 Jul.	0.75	1.5	2.25
	13 Apr.	0.5	1.25	2
2009	13-May	0.25	1	1.75
	8 Apr.	0.25	1.25	2.25
	11 Mar.	0.5	1.5	2.5
	21 Jan.	1	2	3
2008	10 Dec.	2	2.5	3

Source: ECB[82]

4.4 Table 4.1 above sets out the historic evolution of each of these rates from the end of 2008. In a very simplified framework, monetary policy is transmitted, via the CBI's intervention in the money markets, to bank lending and deposit rates. Subsequently, changes in these interest rates affect decisions on consumption and investment, which, in turn, ultimately determine the level of prices. This channel of policy transmission is known as the interest rate channel[83].

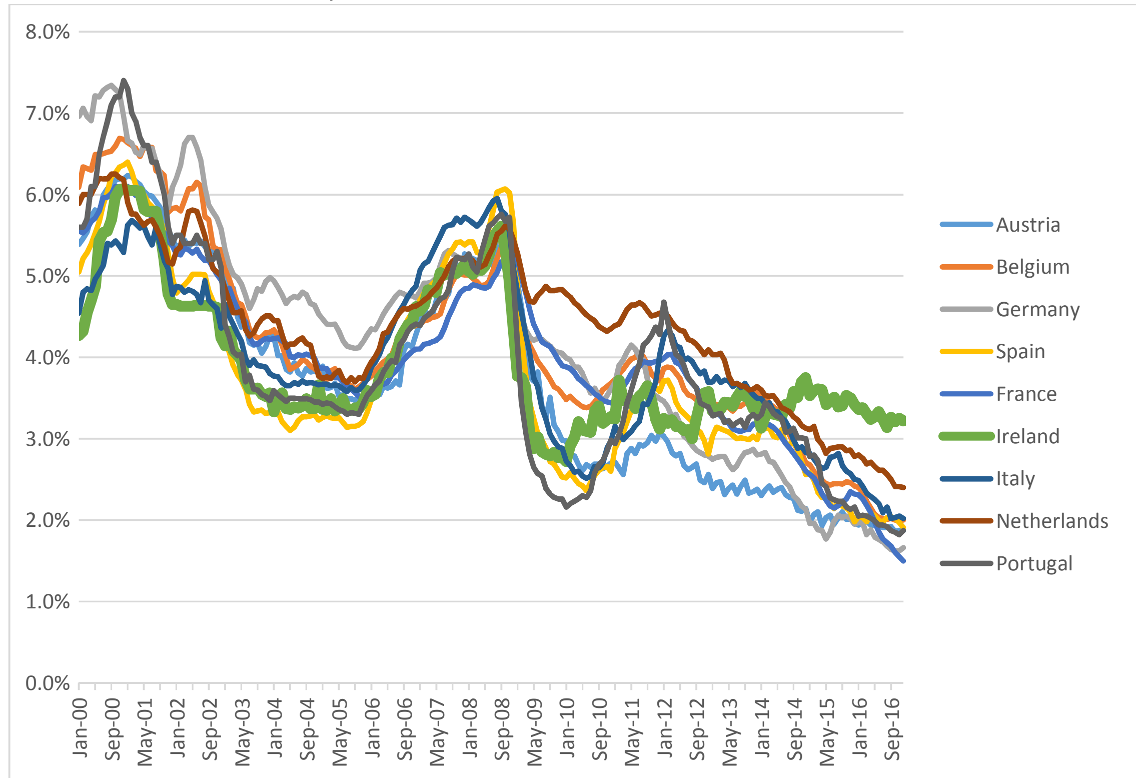
4.5 The effect of this policy is visible below (see Figure 4.1) on a country-by-country basis. While the trends have been similar, in response to changes in monetary policy, it is apparent that this policy has not been transmitted to the same extent in Ireland as elsewhere. ECB commentary notes that differences still exist in the financial systems of the Member States and in the level of retail interest rates, and that these have been exacerbated by the economic and financial crisis and the consequent increased incidence of NPLs and loans for debt restructuring.[84]

[82] http://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html

[83] ECB Monthly Bulletin May 2010.

[84] ECB/CBI, Manual on MFI interest rate statistics, 2017.

Figure 4.1 New business Interest Rates for Lending for House Purchases, Selected Countries, 2000 to 2016



Source: ECB Statistical Data Warehouse

4.6 The monetary policy transmission mechanism has typically been based on the assumption that there is a low and stable level of risk, that financial institutions are well capitalised and that there is no fragmentation in bank funding conditions (i.e. differences in the ability of banks in different member states to source funding). However, the financial crisis and the euro area sovereign debt crisis have demonstrated that credit risk and risk perceptions, low levels and poor quality of bank capital and fragmentation in funding conditions have a direct and significant impact on bank lending rates and bank lending policies more generally.[85]

4.7 Furthermore, according to the ECB[86], structural factors affecting lending rates include the fact that financial market structures differ across countries. Thus lending rates tend in general to be lower in those markets where there is strong competition between banks and ready access to alternative market-based sources of finance.

[85] ECB Monthly Bulletin August 2013 p. 85.
[86] Ibid.

> *"The reduction of two further steps in the European Central Bank's main policy interest rate has had a complicating influence on financing conditions in Ireland.*
>
> *… The data indicate that the standard variable rates borrowers are paying are still less than they were before the crisis but not by all that much. A widening of mortgage interest rate spreads over policy rates also occurred in the United Kingdom and in many euro area countries after the crisis but spreads have begun to narrow in the UK and elsewhere. Until recently, bank competition has been too weak in Ireland to result in any substantial inroads on rates."*[87]

4.8 Different interest rate adjustment paths may also reflect country-specific institutional factors, such as fiscal and regulatory frameworks, enforcement procedures, access to collateralised security, and access to liquidity since secured lending among banks in the interbank market is usually conducted using sovereign debt as a surety:

> *"…downward adjustments in market reference rates have translated into a concomitant reduction in bank lending rates. In the case of Spain, Italy, Ireland and Portugal, the fall in market reference rates associated with the drop in policy interest rates over the same time period has also put downward pressure on retail bank lending rates, as expected. However, the monetary policy pass-through in these countries appears to have been obstructed by the increases in macro and borrower risks, the impact of sovereign tensions and increasing bank risk. Therefore, lending rates in Spain, Italy, Ireland and Portugal could have declined at a faster pace, absent the impact of these factors."*[88]

4.9 Thus, aside from competitive pressure at the retail level, collateral recovery practices, risk perceptions, capital constraints and market structure have played materially significant roles in the evolution of mortgage lending rates in Ireland when compared to other jurisdictions.

The Determinants of Mortgage Interest Rates in Ireland

4.10 The CBI-SVR report outlined the range of factors which affect the margin that banks charge on variable mortgage rates and as a consequence the interest rate consumers pay. These factors include:

- The cost of funds – for banks, the gross return on lending must be higher than the cost of funding given the existence of operating costs and the risk

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[87] Remarks by Professor Patrick Honohan at the Joint Committee on Finance, Public Expenditure and Reform on 26 November, 2014.
http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/committeetakes/FIJ2014112600002?opendocument

[88] ECB (2014) pp. 30/31.

of default. In the aftermath of the financial crisis, the predominant source of funding to Irish banks has been the retail channel.

- The credit risk associated with lending – the greater the scale of negative equity and indebtedness of borrowers, the higher the risk in lending.

- The operational costs of running a bank – outside of funding costs and asset performance, the efficiency with which the bank conducts its operations has a bearing on the overall level of profitability.

- The cost of capital – capital acts as a buffer to cover losses on a loan book. The cost of this capital has in recent years significantly depended upon (1) increased requirements in relation to the quality and amount of capital required to be held by banks and (2) changes in the risk weighting applied to loans arising from loan losses. As this capital is invested by equity holders, a bank needs to generate some return to reward its owners for the risk that they have taken. The greater the amount of capital required, the higher the expected nominal return would be to cover its allocation.

- The market structure and competitive environment faced by each bank – simply put, the fewer the number of players, the more concentrated the market structure, which is an indicator of a less competitive market structure. Research indicates that less competitive markets are associated with higher lending margins (see below and Annex 1 of CBI-SVR report).

4.11 Three of the five variables listed above, which affect the interest rate calculation of lenders, have decreased since 2012, namely the cost of funds to Irish banks, the credit risk associated with lending (following the implementation of the LTV and LTI thresholds imposed by the CBI) and the operational costs faced by Irish lenders. In contrast, the cost of capital for lenders in the Irish market has increased on foot of the requirements from the CBI. In addition, the competitive environment has weakened somewhat allowing lenders to increase their margins above the levels that could be expected in a more competitive environment.

> *"From a competition perspective, if there were enough competitors in the market one might expect margins to be competed down to some extent. But if there is no entry and no effective competition, lenders are in a tight oligopoly. This is likely to reduce the extent of pass-through,* [passing on reductions in the ECB policy rate] *and has been shown to do so by international authors (Van Leuvensteijn et al., 2013)."*[89]

4.12 Below we briefly revisit the themes set out in the CBI-SVR report in relation to variables presented using updated data.

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[89] McQuinn et al. (2015). Op. cit.

Cost of Funds

4.13 According to the CBI, for profitability banks require the gross return on lending to be higher than the cost of funding given the existence of operating costs and the risk of default. A key contributory factor influencing the costs of funds that banks require in order to advance credit relates to the available sources of funding. These include:

- retail sources (e.g. household and corporate deposits with the bank);
- wholesale sources (e.g. secured and unsecured debt on international wholesale money markets);
- official sources (e.g. ECB monetary policy operations); and,
- other capital sources (e.g. equity investors and investors in bank debt capital instruments).

4.14 In the aftermath of the financial crisis, the predominant source of funding for Irish banks has been the retail channel[90], namely the funds that households and the corporate sector have deposited in the banks. However, the sources of funding change over time and the exact composition between the different types depends on a range of factors that include the ability of the bank to access financial markets, its credit rating, the operating environment within which the bank does business and the level and quality of capital available to the bank.

4.15 At the time of the CBI-SVR report, funding conditions had eased considerably for Irish banks, relative to the 2011-2012 period. This reflected a number of internal and external factors such the lower official interest rates set by the ECB, the improved sentiment towards Irish banks, the corrective policies pursued by the Irish Government and the global search for yield in a low interest rate environment. Although rates had eased there were still, at that time, a number of risks - for example, new regulatory requirements such as the Liquidity Coverage Ratio, (due to come into force in late 2015), Net Stable Funding Ratio (due to be introduced over the coming years under the CRD IV) and common rules being devised by the BRRD for dealing with failing banks and large investment firms across Europe - that could see funding costs remaining level or indeed increasing.

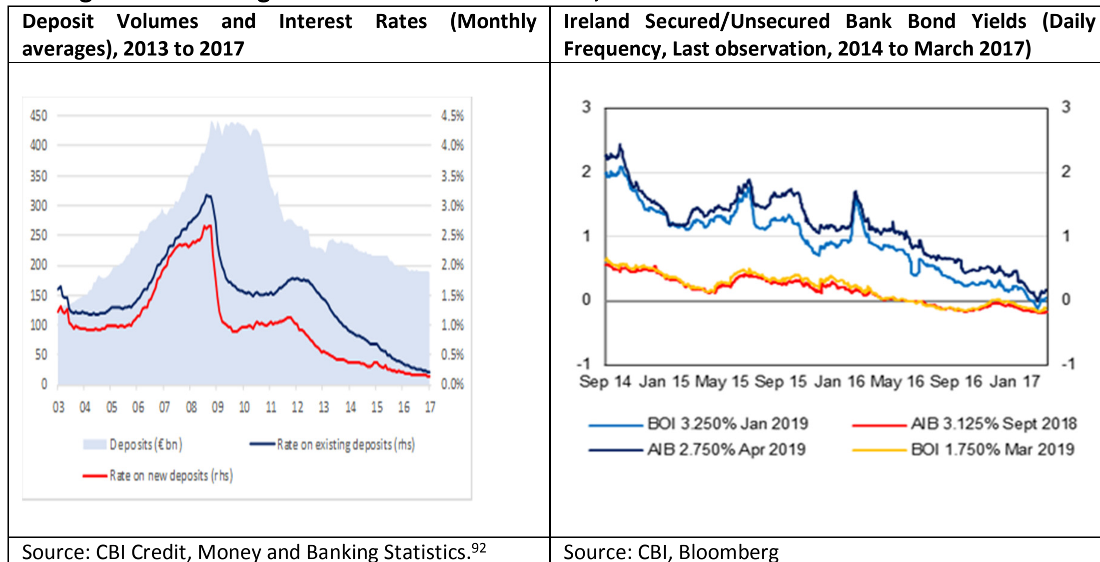
4.16 However, updated data suggests that the costs of deposit and wholesale funding have continued to decline and importantly, that the rates for existing deposits have reduced to near those for new business. Despite lower volumes, current competition for deposits, as indicated by deposit rates, has declined as demand for deposits has weakened as banks have faced limited options to deploy their liabilities.

[90] CBI (May 2015) p. 9.

4.17 Similarly, yields on secured and unsecured wholesale instruments are respectively negative and close to zero. As such, the previously identified risks to funding costs have not materialised to an obvious extent and the cost of funding appears to be now at historic lows. Furthermore, the rating agency Moody's Investors Service in September 2016 upgraded the deposit ratings of three Irish banks: AIB, Bank of Ireland and Permanent TSB.[91] Moody's stated that the rating actions were driven by a sharply improved operating environment, which led to an increase in the macro profile of Ireland (A3 positive) to 'Strong' from 'Moderate+' under Moody's banking methodology, as well as favourable developments in other credit fundamentals, notably asset quality.

4.18 On balance, therefore, and looking at the deposit rates and bank bond yields below, the funding environment for Irish banks has eased considerably and access to funding has improved (see Figure 4.2).

Figure 4.2 Funding Environment for Irish Banks, 2013 to 2017

Deposit Volumes and Interest Rates (Monthly averages), 2013 to 2017	Ireland Secured/Unsecured Bank Bond Yields (Daily Frequency, Last observation, 2014 to March 2017)
	
Source: CBI Credit, Money and Banking Statistics.[92]	Source: CBI, Bloomberg

Operating Costs

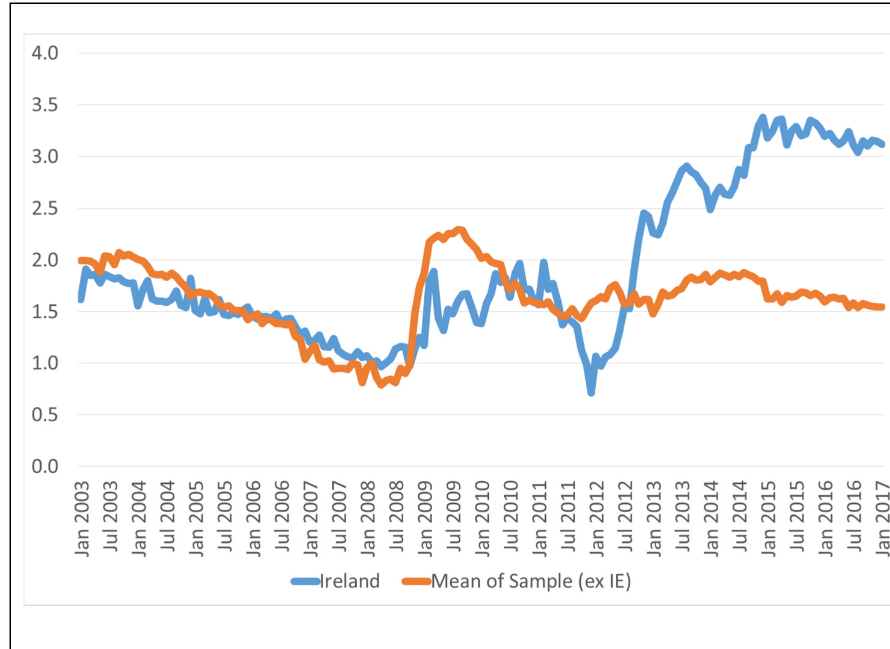
4.19 Banks act as intermediaries between customers with surplus cash to invest and borrowers seeking credit. The difference between the cost of the liabilities and asset pricing is a bank's margin. To capture the combined effect of funding costs

[91] The deposit ratings on KBC Bank Ireland PLC (KBCI), Ulster Bank Limited (UBL) and Ulster Bank Ireland DAC (UBID) were affirmed. See Moody's takes rating actions on Irish banks, 19 Sep 2016

[92] Deposits: Table A.4.2 Credit Institutions (Irish-Headquartered Group) - Aggregate Balance Sheet; Rate on existing deposits: Table B.1.1 Retail Interest Rates - Deposits, Outstanding Amounts; Rate on new deposits: Table B.1.1 Retail Interest Rates - Deposits, Outstanding Amounts; and Table B.2.1 Retail Interest Rates and Volumes - Loans and Deposits, New Business. Note: Volume of deposits is shown for Irish-headquartered credit institutions and from all depositors. Deposit rates are shown for all Irish-resident credit institutions. Rates describe deposits from household and non-financial corporations in the euro area.

and new lending rates we present in Figure 4.3 the margins generated in new mortgage lending.

Figure 4.3 Interest Rate Margins on New Mortgage Lending (%), 2003 to 2017



Source: ECB, ESRB Systemic Risk Indicators, CCPC Calculations. Included countries in the sample are: Austria, Belgium, Germany, Spain, Finland, France, Greece, Ireland, Italy, Luxembourg, Netherlands & Portugal.

4.20 It should be noted that part of the cross-country variation can be explained by the different proportions of variable and fixed rate mortgages in total new loans in each country[93], as fixed rates tend to have a higher interest rate than variable rates, given the cost of longer term funding.

4.21 Based on the data, margins in Ireland have been the highest in the sample from July 2014 to the last observation in January 2017, a period of some 31 months. Furthermore, the margins have been persistent and do not show an indication of materially reducing.

4.22 It is plausible that the higher margins on new lending are required to support an industry that has higher built-in operational costs. Commentary on the operating costs (see Figure 4.4) for Irish Banks, in the CBI-SVR report noted that notwithstanding the fact that deleveraging had reduced, the cost-to-income ratio for Irish banks was still high in 2015, relative to the European average. Furthermore, pressure on income from the low interest rate environment was creating challenges[94] for banks to generate enough profits to cover their day-to-

[93] Data include restructured mortgage contracts and renegotiated loans (mortgage switchers) so do not only capture the interest rates on new mortgage drawdowns.

[94] *"Other things being equal, lower rates will decrease net interest income [profitability] over the long term. If the decline in rates is accompanied by a flattening of the yield curve, the margin*

day running costs alongside other costs of lending[95]. Rolling forward to year-end 2016, we see that the efficiency rates for AIB and PTSB had improved materially and while Bank of Ireland has seen its cost-income ratio increase, it is still below the weighted average of the survey. Reasonably, the pressure on income from the low interest rate environment that was cited in the CBI-SVR report has reduced due, in part, to the higher interest rates charged by Irish lenders. As a consequence, on an operating basis the Irish lenders, in aggregate, appear to be much improved compared to 2014/5 and earlier.

Figure 4.4 Cost-to-Income Ratio for Irish Banks, 2015 and 2016

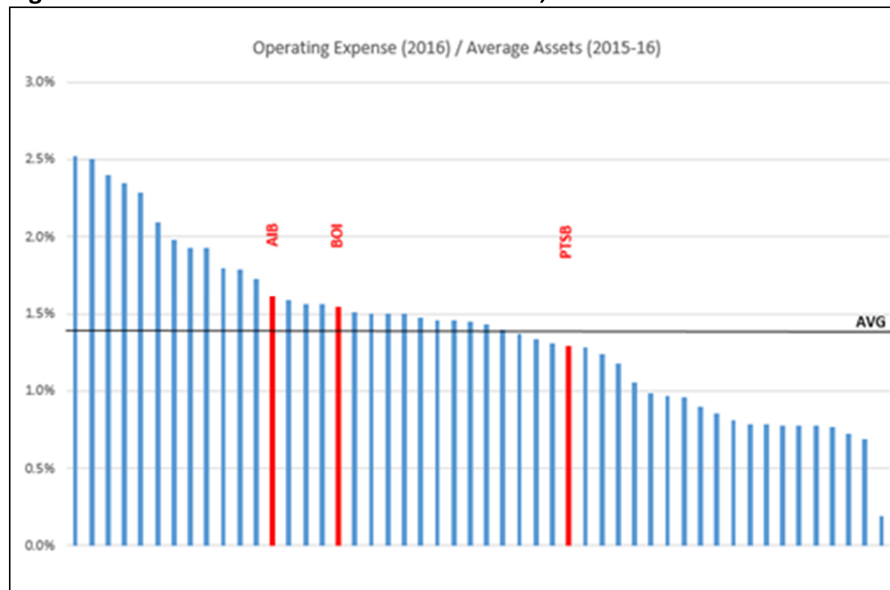
Source: SNL Financial and CBI calculations. Income excludes trading gains/losses and gains/losses on sales of other assets.

4.23 On the other hand, the cost-to-asset ratio for Irish banks relative to European peers has increased over the period 2014-2016, although they remain broadly in line with the European average (see Figure 4.5). This in part could be explained by the reduction in the loan books in Ireland, whereby administrative costs remained largely unchanged, while assets (the denominator) reduced.

between lending and borrowing eventually compresses, reducing net interest income" Speech by Benoît Cœuré, Member of the Executive Board of the ECB, at the Yale Financial Crisis Forum, Yale School of Management, New Haven, 28 July 2016

[95] However market power can also play a role in interest rate spreads. See Federal Reserve Bank of Richmond (2016).

Figure 4.5 Cost-to-Assets Ratios for Irish Banks, 2015-16

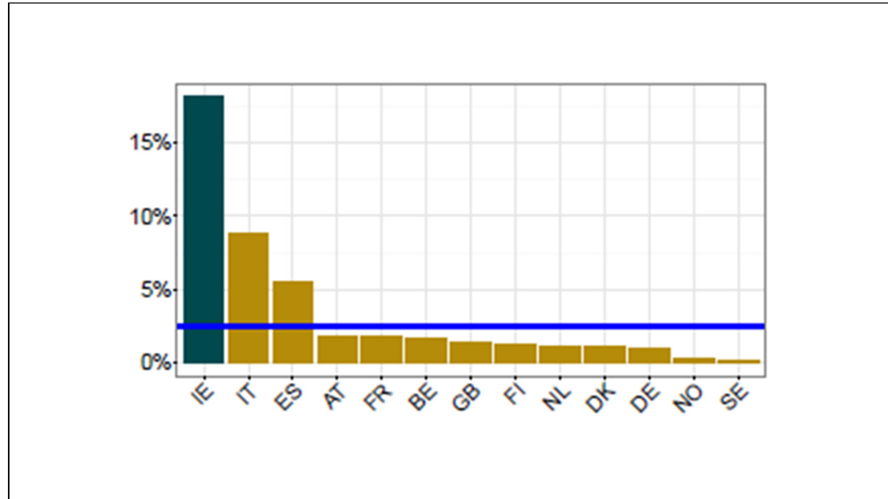


Source: SNL. Excludes deferred tax assets as these inflate denominator and are not productive assets.

Credit Risk

4.24 Chapter 3 discussed how the relatively high incidence of NPLs and negative equity in Ireland compared to other jurisdictions has increased the risk associated with lending to Irish borrowers. Because of this 'riskiness' the lending rates faced by consumers are correspondingly higher than would ordinarily be the case. For example Figure 4.6 below, describing default ratios across Europe, gives an indication of the relative 'riskiness' attached to mortgage credit in Ireland compared to other jurisdictions.

Figure 4.6 Mortgage Default Ratio Ireland and Selected European Countries, End December 2016



Source: EBA, CBI Author's calculations, Blue line is aggregate default ratio for all countries. See Box 3 in Household Credit Market Report H2:2016.

4.25 Therefore, it is reasonable to expect that there would be a significant credit risk premium built into pricing for new mortgage loans relative to both mortgage credit in other countries and comparable to pre-crisis borrowing costs:

> *"The financial crisis and the euro area sovereign debt crisis have brought to the fore the importance of credit risk and risk perceptions, banks' undercapitalisation or poor asset quality of their assets and fragmentation in bank funding conditions for bank lending rates and bank lending policies."* [96]

4.26 It should be noted, however, that there is an important distinction to be made between the influence on pricing that arrears have for an existing lender and the credit risk that a new lender would face in the current macro-prudential environment. The strict LTV and LTI limits imposed by the CBI are aimed at reducing, significantly, the capacity of lenders to adopt credit risk on individual loans[97]. As a result, a new entrant in the Irish mortgage market would find itself in a benign pricing environment where risks on newly originated loans have reduced significantly. Ensuring therefore that there are no disproportionate barriers to entry is crucial to improving competition to bring about reductions in mortgage interest rates. One of the most significant barriers for new entrants is the failure, thus far, to adequately deal with NPLs which brings with it expectations that any future crisis will result in a similar outcome for lenders. It is important therefore that policy-makers design and implement in the immediate term a set of consistent and transparent policies for resolving NPLs.

[96] ECB (2014). Op. cit. p.5.

[97] LTV and LTI requirements are set out as instruments to achieve the objectives of mitigating and preventing excessive credit growth and leverage, see "A Macro -Prudential Policy Framework for Ireland", Page 5, Central Bank of Ireland, 2014

Failure to do so will impact negatively on the credibility of the Irish banking system to deal with any future crises.

Cost of Capital

4.27 The CBI-SVR report provides a number of reasons why the cost of capital for Irish banks is and will continue to remain high:

- Although CRD IV required that common equity tier 1 (CET1) increase to a minimum of 7% after deductions, most banks are targeting 10% plus on a fully loaded basis. However, Irish banks are holding significant deferred tax asset deductions which need to be supported through additional equity. Thus to reach 10% CET1, Irish banks are required to hold almost two and a half times the level of equity capital they held pre-crisis as a percentage of risk weighted assets;

- Irish banks use internal ratings based (IRB) models to estimate their credit risk weighted assets. In the case of mortgage credit these models are driven by probability of default (PD) and loss given default (LGD) which tend to be based on the banks' historic experiences of default. Given the historic level of mortgage arrears experienced by Irish banks, this variable remains relatively high. Inputting this data into the IRB models means that a new mortgage loan issued today will have a risk weighting applied that is 50% higher than in the pre-crisis period.

4.28 The CBI estimates that the cumulative effect of the above is that the equity capital required to support a new mortgage is now estimated to be almost four times higher than it was pre-crisis. While it is expected that in the longer term this risk premium will decline, the CBI is not so optimistic for the medium term, concluding in the CBI-SVR report that:

> *"In the medium term, with a need for banks to transition to capital levels meeting or in excess of fully loaded CRD IV rules; high levels of outstanding non-performing loans; weak recurring pre-provision profitability (due to legacy assets on which pricing does not reflect the crisis and the balance sheet structure demanded under new regulatory rules); and a relatively less certain economic outlook than pre-crisis, the risk premium on Irish banks will remain relatively high."*[98]

4.29 In July 2016 the European Banking Authority (EBA) published the results of the 2016 EU-wide stress test (2016 Stress Test) of 51 banks from 15 EU and EEA countries covering around 70% of banking assets in each jurisdiction and across the EU[99]. The objective of the 2016 Stress Test was to provide supervisors, banks and other market participants with a common analytical framework to

[98] CBI-SVR report Op. cit. p.17.
[99] http://www.eba.europa.eu/-/eba-publishes-2016-eu-wide-stress-test-results

consistently compare and assess the resilience of large EU banks to adverse economic developments.

4.30 The 2016 Stress Test was based on a general macro-economic downturn scenario over a 3-year time-horizon[100]. The scenario was hypothetical and not designed to capture every possible scenario. However, in combination with risk-type specific scenarios and methodological constraints, it aimed to provide an analytical tool to understand what happens to banks' balance sheets if an economic downturn materialises, regardless of the specific triggering shock. The results were made available for each of the 51 banks covered, two of which were AIB and Bank of Ireland.

4.31 Table 4.2 sets out selected data from the 2016 Stress Test illustrating the impact of the stress testing exercise on the Irish banks compared to weighted average of the 51 banks. What is striking is the relative change in solvency in Irish banks under the adverse scenario compared to the average, which points to a higher susceptibility to an adverse scenario for Irish lenders. BOI's starting CET1 ratio was 11.3% (December 2015) which grew to 15% in baseline scenario; however it lost 520 basis points (bps)[101] of CET1 in an adverse scenario test to 6.1%. The swing for AIB was more severe: from a starting point of 13.1% (December 2015) which grew marginally to 13.9% in a baseline scenario it lost 880bps of CET1 to 4.3% in the same adverse scenario test. This was noticeably behind the 380bps average decline in CET1 seen by the other 49 banks in the test.[102]

[100] 2016 EU-Wide Stress Test Results 29 July 2016,

[101] 1 basis point is 0.01 percentage points, 520 basis points is therefore 5.2 percentage points.

[102] It should be noted that market commentators, who influence international sentiment, reacted negatively to the impact of the stress tests on Irish banks. For example in commenting on the results stockbroking firm Cantor Fitzgerald noted that both BOI and AIB were among the worst performing banks, although this test excluded any Portuguese or Greek banks; Bloomberg quoted S&P as saying after the stress test results came out that *"while Irish banks have made substantial progress, they remain vulnerable"; and i*n a research report following the results Unicredit noted that the very large decline in solvency levels at AIB was driven by large losses in the adverse scenario driven by higher impairments. Bank of Ireland showed a similar decline.

Table 4.2 Selected EBA 2016 Stress Test Data

CET 1 Ratio Fully Loaded		**2015**	**2016**	**2017**	**2018**
Adverse Scenario	Europe	12.57%	9.76%	9.33%	9.22%
	AIB	13.11%	8.56%	6.38%	4.31%
	Bank of Ireland	11.28%	10.79%	8.49%	6.15%
Baseline Scenario	Europe	12.57%	12.97%	13.46%	13.84%
	AIB	13.11%	13.03%	13.44%	13.90%
	Bank of Ireland	11.28%	12.40%	13.69%	15.03%
Tier 1 Ratio Fully Loaded					
Adverse Scenario	Europe	13.41%	10.55%	10.09%	10.02%
	AIB	13.95%	9.36%	7.18%	5.11%
	Bank of Ireland	12.69%	12.17%	9.81%	7.41%
Baseline Scenario	Europe	13.41%	13.80%	14.30%	14.71%
	AIB	13.95%	13.86%	14.27%	14.73%
	Bank of Ireland	12.69%	13.80%	15.09%	16.43%
Leverage Ratio					
Adverse Scenario	Europe	4.79%	4.02%	3.95%	3.94%
	AIB	7.80%	5.51%	4.27%	3.01%
	Bank of Ireland	5.74%	5.61%	4.73%	3.74%
Baseline Scenario	Europe	4.79%	5.00%	5.20%	5.39%
	AIB	7.80%	7.91%	8.12%	8.38%
	Bank of Ireland	5.74%	6.30%	6.87%	7.47%

Source: European Banking Authority

4.32 On balance, in light of the 2016 Stress Test results, the global investment community and regulators will be more cautious on bank lending in Ireland compared to other jurisdictions. This will therefore have a knock-on effect on solvency requirements, the corresponding cost of capital and lending rates, leading to an overall tightening in credit standards.

Competitive Pressure and Mortgage Interest Rates

"Another element of interest-rate pricing relates to market structure. ... A lack of competition can result in opportunities for excess profits for incumbents in a market and research indicates that competitive financing markets are important for the degree of efficiency in the production of

> *financial services, the quality of financial products and the degree of innovation."* [103]

4.33 As noted at the start of Chapter 3 markets where demand is robust and growing and in which the number of providers is relatively low will result in higher prices. This is no less true of the mortgage market compared to any other product or service.

4.34 In Annex 1 of the CBI-SVR report (Relevant Research on Bank Lending Margins) the CBI refers to a number of international studies that examine the impact of competition and market structure on the gross margins of banks. In summary, margins increase as competition decreases. In an Irish context McQuinn and Morley[104] examine the factors which affect how changes in the ECB policy rate are reflected in changes to the SVR charged by lenders in the Irish market (building on the earlier analysis conducted by Goggin et al. (2012)[105] and find that:

> *"From a competition perspective, if there were enough competitors in the market one might expect margins to be competed down to some extent. But if there is no entry and no effective competition, lenders are in a tight oligopoly. This is likely to reduce the extent of pass-through, and has been shown to do so. The fall-out from the financial crisis has made the possibility of households switching from one mortgage provider to another more difficult for those with existing mortgages. It has also reduced the number of institutions active in the market and made entry more difficult as there are few housing transactions requiring new loans."*

4.35 Likewise in the UK, the CMA's review of the literature as part of their retail banking market investigation concluded that:

> *"The majority of papers* [reviewed by the CMA] *suggest that the structure of banking markets is important and that the greater concentration leads to worse outcomes for consumers, such as lower interest rates on deposits and higher rates on loans and overdrafts... ."* [106]

4.36 Similarly research published by the Dutch Competition Authority (NMa)[107] in 2011 found statistically significant evidence that the degree of competition in the Dutch mortgage market, measured by concentration levels, affected the level of the mortgage interest rates during the period 2004 - 2010. In this period, the degree of competition fluctuated in response to the entrance and disappearance of a number of banks.

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[103] CBI-SVR report. Op. cit. p. 20.

[104] Standard Variable Rate (SVR) Pass-Through in the Irish Mortgage Market: An Updated Assessment, Kieran McQuinn and Ciara Morley, ESRI Research Notes 2015/2/3, p. 2.

[105] Goggin J., S. Holton, J. Kelly, R. Lydon and K. McQuinn (2012).

[106] See CMA (2015) p.2.

[107] NMa (2011).

4.37 In summary, economic research, both international and domestic, strongly supports the argument that the gross margins achieved by lenders and the interest rates supporting these margins are greater when competition is weak.[108]

4.38 Results from the Bank Lending Survey (BLS)[109] carried out by the CBI and the ECB supports this view (see Table 4.3). Five Irish banks participated in the survey and their responses are based on changes in credit market conditions throughout the euro area. In its commentary on the Q3 2016 survey[110] the European Mortgage Federation (EMF) notes that competitive pressures were an especially predominant factor of easing credit standards among European banks. The survey supports the view that the lack of pressure from competition in Ireland is consistent with the concentrated nature of the Irish mortgage market (see Table 4.3).

Table 4.3 Factors affecting Irish banks' credit standards as applied to the approval of loans to households for house purchase Q4, 2014 to Q3, 2016

	4Q 14	1Q 15	2Q 15	3Q 15	4Q 15	1Q 16	2Q 16	3Q 16
Change in Credit Standards Overall	-10	0	30	-10	20	-10	10	0
Impact of funds and balance sheet constraints	0	0	0	0	0	0	0	0
Perception of risk	-10	0	3	0	7	-3	0	3
Pressure from competition	0	0	0	0	0	0	0	0
Risk Tolerance			20	0	0	-10	3	0

Source: European Mortgage Federation Quarterly Review - Q3 2016[111]

4.39 The survey data from the BLS in Figure 4.7 below illustrates the cumulative changes in the factors affecting credit standards in Ireland. When credit standards are tightened there is less available lending capacity, and with the reduction in supply, prices, in the form of margins, increase. This is reflected in Figure 4.4, presented earlier, illustrating margins on new lending.

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[108] *"…in the euro area countries, bank interest rate spreads on mortgage loans, consumer loans and short-term loans to enterprises are significantly lower in more competitive markets. This result implies that bank loan rates tend to be lower under heavier competition, thus improving social welfare."* Van Leuvensteijn, M. Sørensen, C. Bikker, J. and Van Rixtel, A. (2008).p. 28.

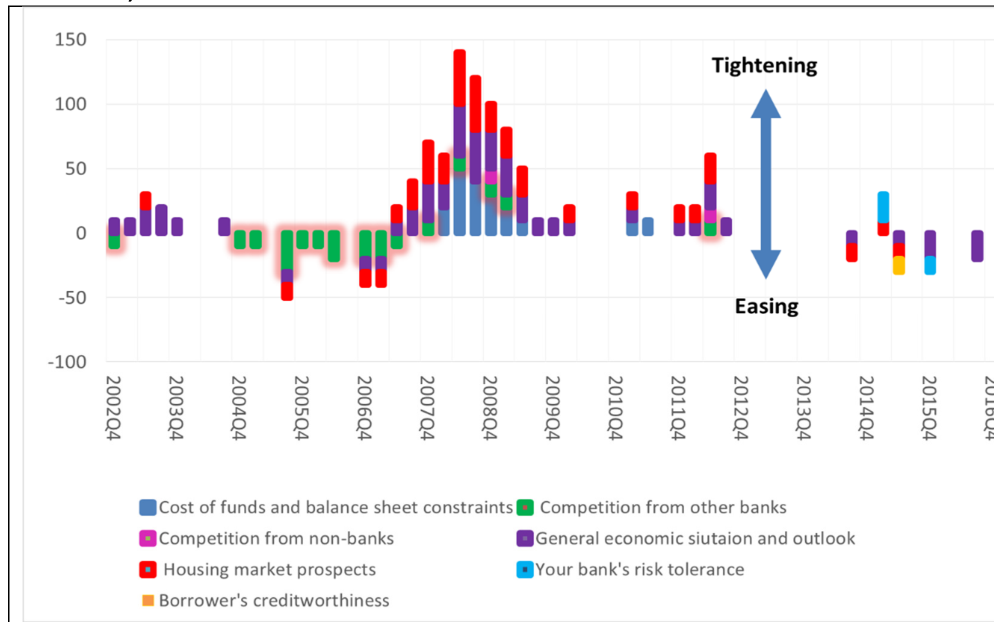
[109] The BLS for the euro area was launched in 2003. It is conducted four times a year and is addressed to senior loan officers of a representative sample of euro area banks. The sample group comprises around 140 banks from all euro area countries and takes into account the characteristics of each country's national banking structures. Given the survey nature of the questionnaire, the responses are qualitative.

[110] European Mortgage Federation Quarterly Review - Q3 2016.

[111] Note – the breakdown figures do not necessarily sum to the Change in Credit Standards Overall total.

4.40 Looking at the role of competition (in green in Figure 4.8), in the 5 year period leading up to late 2007, competition was seen as the main factor in easing credit standards. After this period, as lenders retrenched or exited the market, competition lessened coupled with what can be reasonably inferred to be the consequent effect of tightening credit standards. Figure 4.8 shows that competition has not acted as a factor in easing credit standards since mid-2007, almost ten years ago.

Figure 4.7 ECB Bank Lending Survey - Factors Affecting Credit Standards on Loans to Households for House Purchases in Ireland, Quarter 4, 2004 to Quarter 4, 2016[112]



Source: CBI, CCPC Calculations

4.41 As discussed in Chapter 3, following the banking crisis the Irish mortgage lending market has become significantly more concentrated. In 2007 there were ten large lenders in the Irish mortgage market and this fell to just five by 2013. Although there has been limited new entry by Pepper Mortgage and Dilosk, and KBC have reaffirmed their continued presence in the Irish market, the top three providers of mortgage loans (AIB, BOI and Ulster Bank) together held nearly 70% of the market for new mortgage loans in 2016.

4.42 Figure 4.8 illustrates the impact of increased concentration among lenders in the Irish market. A market with a high level of concentration may lead to direct or tacit coordination. Even where there is little likelihood of coordination, such a market structure can, in itself, result in a significant impediment to competition and as a consequence increase consumer detriment:[113]

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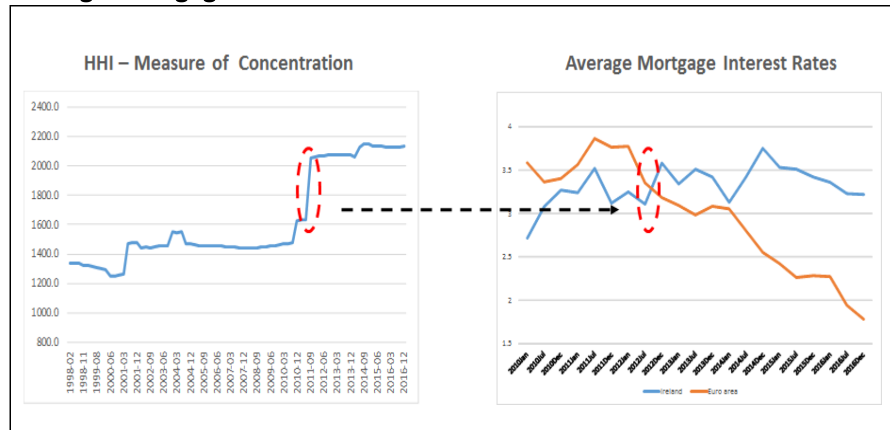
[112] See Central Bank of Ireland website, Euro Area Bank Lending Survey.

[113] See for example the discussion in Gorecki et al. (2015) Op. cit. p. 6: *"The more concentrated market structure created by the AIB/EBS merger contributed to a less competitive environment,*

"While a reduction of the oversized banking system of six Irish banks was clearly needed, the two-pillar system may lead to too little competition in Irish banking. This may result in high interest rate margins with high borrowing costs and low saving rates for business and retail customers."[114]

Figure 4.8 Stylised View of the Impact of Increasing Concentration on Average Mortgage Interest Rates in the State



Source: CBI, Household Credit Market Report, H2 2016, European CBI MFI Retail Interest Rate Statistics

4.43 Since a central factor in reducing lending margins, the pressure from competition, has reportedly disappeared, the margins achieved by Irish lenders on new lending have increased and have remained significantly higher than the average for a selected group of EU Member States for over two and half years (see Figure 4.3).

4.44 In the CBI-SVR report, the Central Bank noted that the ability of the banks to partially compensate for the burden of trackers by retaining higher spreads on variable rate lending is likely to be transitory. It anticipated that over time these spreads would reduce as competition increased through new entry. Despite the backdrop of higher margins, there has, to date, been limited market entry, which appears to have had only marginal effects on market concentration – while lending margins have remained at historic highs. This suggests that some of the potential barriers discussed in Chapter 3 are continuing to prevent entry into the Irish market.

4.45 In conclusion, competitive pressure in the Irish mortgage market can be described as relatively weak. The result is that the prices faced by Irish borrowers are relatively higher than they would otherwise be, even taking into account the

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particularly in the mortgage market that led, at least in part, to higher standard variable mortgage rates."

[114] Schoenmaker, D. (2015) Op. cit.

various explanatory factors described above accounting for the interest rate differential between Ireland and other jurisdictions.[115]

4.46 Given the systemic impact of the mortgage market, we reiterate that the need for prudential supervision is in everyone's interests. Unconstrained and unregulated competition in banking is not a model to be pursued but within a framework of appropriate prudential and conduct regulation, vigorous competition between lenders in the mortgage lending market is possible and can deliver better outcomes for consumers. However, increased competition in the Irish mortgage market requires new entrants to stimulate it and consumers who are willing to switch or at least threaten to switch to these new entrants:

> *"The literature on competition in retail banking suggests that new entry and customer mobility are the most important competitive pressures in retail banking.[116] Entry or even the threat of entry by new banks keeps incumbent banks focused on meeting their customers' needs while the ability of customers to switch banks easily gives them the ability to negotiate better terms from their banks. Having a contestable system may be more important to assure competitiveness than a system with low concentration."[117]*

Mortgage Interest Rates in the State

4.47 There has been much focus on the disparity between interest rates in Ireland and other member states in the Eurozone. Much of the debate has centred on Standard Variable Rates as a means of comparison. To examine this issue further the public consultation asked respondents about the usefulness of the standard variable rate (SVR) when comparing rates in other jurisdictions and what other measures may be more appropriate.

4.48 Given the prevalence of fixed rates (of varying lengths) in other countries (and more recently in the Irish market), the extensive use of managed rates with different LTVs, teaser rates offered for short periods and other factors such as arrangement fees and tied insurance products the headline SVR rate is not considered a useful benchmark by the respondents to the public consultation.

4.49 Instead, respondents encouraged the use of like for like comparisons using the European Standard Information Sheet (ESIS) or the Annual Percentage Rate of Charge measure from the ECB. The Fair Mortgage Rates Campaign noted that *"One should compare untied products in other euro area countries with untied*

[115] We recognise that there is some considerable debate regarding the trade-off between competition and stability in banking and that given the appropriate regulatory framework this trade-off can be mitigated. We do not develop this discussion any further in this paper. For a comprehensive overview of the debate see Vives, X. (2016).
[116] De Larosière, J. (2009).
[117] Claessens, S. and Laeven, L. (2003).

products in Ireland. Whatever comparison is used, Irish rates will still be around 1.7% higher than in the rest of the euro area."

4.50 Each of the lenders identified in Table 3.1 above offer a range of managed variable and fixed interest rates across a suite of different products to both PDH and BTL mortgage holders. Quite apart from the historical tracker rates, which are still in place but not currently offered by lenders in the Irish market for new business, non-fixed rates vary according to different loan to value thresholds, while fixed rates vary according to both loan to value and the length of the fixed term.

Table 4.4 Variable Mortgage Rates in the Irish Market, CCPC Comparison Tool as at 14 June, 2017[118]

Provider	Product name	Initial Interest Rate (%)
AIB	Variable, LTV greater than 50% and less than or equal to 80%	3.3
Bank of Ireland	Variable, LTV between 61% and 80%	4.2
EBS d.a.c	Variable, LTV greater than 50% and less than or equal to 80%	3.5
Haven Mortgages Limited	Variable, LTV greater than 50% and less than or equal to 80%	3.3
KBC	Variable Rate (Residential Properties), LTV greater than 60% and less than 80%	3.1
Mortgagestore.ie	Variable, LTV greater than 60% and less than 80%	4.05
Pepper Money	Essential, Variable LTV up to 80%	3.6
Permanent TSB	Variable, LTV greater than 70% and less than or equal to 80%	4.0
Ulster Bank	Lifetime Flexible Variable, LTV up to 80%	3.7
Ulster Bank	Lifetime Loyalty Flexible Variable, LTV up to 80%	3.3
Ulster Bank	Lifetime Loyalty Plus Flexible Variable, LTV up to 80%	3.1

Source: CCPC Mortgage Comparison Calculator, 14 June, 2017

4.51 Tables 4.4 above and 4.5 below provide the data from the CCPC comparison site for a PDH loan of €200,000 on a property worth €250,000 for a period of twenty years for variable and fixed products. The tables clearly show that there is a wide variance between the highest and lowest products on offer in the Irish market. For variable rates the lowest figure was 3.1% and the highest figure was 4.2% -

[118] For illustrative purposes only. Does not include cash back offers, other incentives or additional discounts for holding current accounts.

over 35% higher than the lowest rate on offer. For 5 year fixed rates, the difference between the highest and lowest rates on offer was over 24%.

Table 4.5 Fixed Term Mortgage Rates in the Irish Market, CCPC Comparison Tool as at 14 June, 2017[119]

Provider	1 Year Fixed Initial Interest Rate (%)	5 Year Fixed Initial Interest Rate (%)
AIB	3.5	3.8
Bank of Ireland, LTV between 61% and 80%	3.2	3.2
EBS d.a.c	3.5	3.8
Haven Mortgages Limited	3.5	3.8
KBC, LTV between 60% and 80%	2.9	3.05
Permanent TSB, New Business Fixed, LTV less than or equal to 80%	3.2	3.5
Mortgagestore.ie LTV greater than 60% and less than 80%		3.3
Ulster Bank, 5 Year Fixed Loyalty Plus, LTV up to 80%		3.1
Ulster Bank, 5 Year Fixed Loyalty, LTV up to 80%		3.3
Ulster Bank, 5 Year Fixed, LTV up to 80%		3.4

Source: CCPC Mortgage Comparison Calculator, 14 June 2017.

4.52 Because of the wide variability, it is therefore very difficult to compile an average rate within the State. However, Figure 4.9 below (calculated using CBI and ECB data) attempts to do just this for illustrative purposes. An aggregated interest rate across all lenders on new business loans for house purchase for Ireland is compared to the median across a group of selected European countries (left hand diagram in Figure 4.9. For more information see the footnote to Figure 4.9). Percentiles and the sample maximum and minimum are also presented. The interest rate in Ireland as of March 2017, at approximately 3.2%, was the highest of the countries presented[120]. Based on the chart the median interest rate of the countries surveyed appears to have been approximately 2.5% for Q1 2017. While

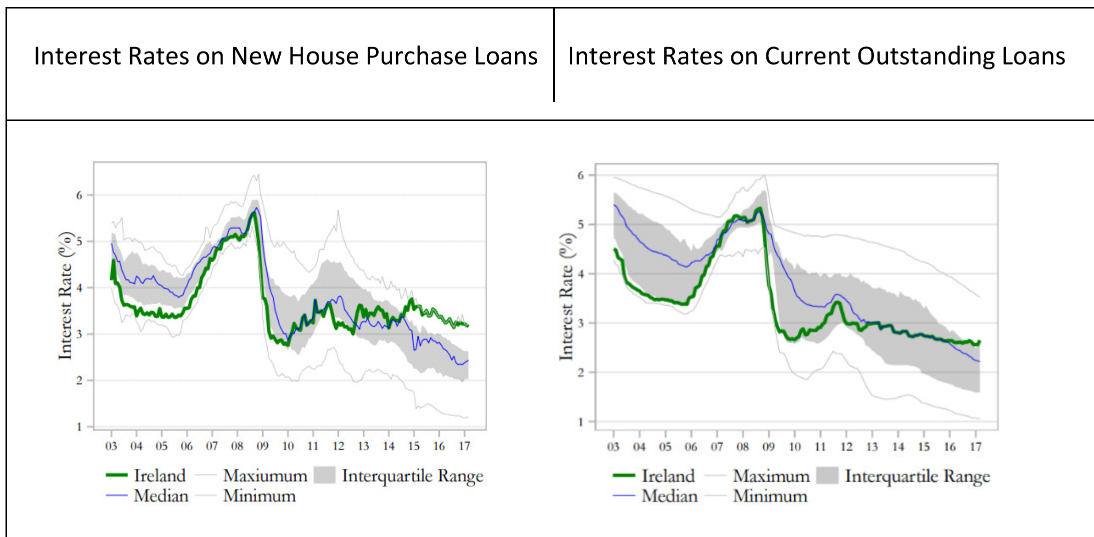
[119] For illustrative purposes only. Does not include cash back offers, other incentives or additional discounts for holding current accounts.

[120] Central Bank of Ireland, Household Credit Market Report, H1 2017

in terms of new lending in Ireland, the average standard or LTV variable rate on new PDH mortgages was 3.38% as of Q1 2017[121].

4.53 What is apparent from the chart is that, although the interest rate trend is downward, Irish interest rates have migrated from seemingly being among the lowest in the sample up to 2010, to being persistently the highest for approximately the past two years.

Figure 4.9 Ireland - European Mortgage Interest Rate Comparison, Jan 2003-Mar 2017



Source: Central Bank of Ireland, Household Credit Market Report, H1 2017.[122]

4.54 However, when taking low rate tracker mortgages into consideration, the overall interest rates as of March 2017 on current outstanding mortgages in Ireland (right hand diagram of figure 4.9), which aggregates the rates across trackers and SVRs, was 2.65%, some 55bps less than the new loan rate (with the median rate for outstanding mortgages among countries surveyed being slightly over 2% for the same period).

4.55 Despite the aggregate rate being lower thanks to trackers, the CBI commented that interest rates in Ireland remain high relative to the sample median[123].

Mortgage Markets – International Comparisons

4.56 International comparisons of mortgage interest rates, while informative, are of limited value when assessing competitive performance in the Irish market and the barriers faced by potential new entrants. This is due to the essential

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[121] Central Bank of Ireland, Household Credit Market Report, H1 2017

[122] Countries were selected due to data availability. Included countries are: Austria, Germany, Spain, Finland, France, Greece, Ireland, Italy, Luxembourg, Netherlands & Portugal. Belgium data included for Outstanding Mortgage Rates but not New Loan Rates

[123] Central Bank of Ireland, Household Credit Market Report, H1 2017

character of the mortgage product, which is intrinsically linked to the location of the property, and will, therefore, to a certain extent, always be subject to the national framework.

4.57 Furthermore in order to offer attractive interest rates, lenders must keep funding costs low which requires large volumes and a broad international investor base. In other words, there are economies of scale involved in the "production" of mortgage loans. On this basis, as a relatively small economy, Ireland would not possess the same levels of scale as those found elsewhere in the Eurozone.

4.58 Mortgage products are also inextricably linked to housing policy, taxation and national economic policy. When a mortgage loan is tailored to the legal framework of a specific country, offering that same product in another country for the same price and under the same conditions is not always possible. The fact that there is a business case in one country for a particular product does not necessarily mean that this is the case in another market with a different legal, cultural and commercial context.

4.59 The variety of mortgage products and interest rates offered in different countries is considerable. Moreover, the terminology used to designate the same mortgage interest rate may differ from one country to another, or the same name may be used for different types of mortgage interest rates. It should also be noted that in respect of the description and definition of main interest rate types in individual countries (fixed, initial fixed, variable, others) definitional standards should be borne in mind, as interest rate types largely differ in definitions across the EU: initial fixed, fixed to maturity and variable are the most common types, but these definitions are not the same in all EU markets.

4.60 Country-specific factors such as the general market interest rates, options given to the borrower, funding methods and regulation (consumer regulation and product innovation) also play a role in the product choice.

4.61 On balance therefore, raw comparisons of Irish rates with those found elsewhere in the Eurozone would be more properly undertaken following consideration and appropriate regard for factors such as: taxation levels; cost of funding; the length of foreclosure procedures; levels of average income and value of consumer assets; mortgage market regulations in Member States (i.e. early repayment fees, free mortgage switching procedures, etc.).

4.62 We set out below some of the countries examined[124] and salient features within their mortgage markets that help in explaining the differences between these countries' mortgage markets and Ireland.

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[124] Source: European Mortgage Federation Hypostat 2016 Country Reports.

Finland

4.63 In 2015, Finland's economy grew slightly after three years of downturn. GDP grew by 0.2% compared to a decline of 0.7% in 2014. At the end of 2015, the total loan portfolio for housing stood at €92bn with housing loan stock growing steadily throughout the year.

4.64 The main source of mortgage funding for Finnish banks is deposits. At the end of December 2015 credit institutions' deposit stock amounted to €148 billion. On the asset side, housing loans in Finland are most often linked to Euribor rates, covering 96% of all housing loan agreements concluded in 2015. According to the IMF[125], even though most mortgages in Finland have variable rates (tied to Euribor or another prime rate), about 70% of households have fixed total monthly mortgage payments. Consequently, in the event of an interest rate increase, monthly mortgage payments will not rise but the effective maturity of the loan will increase as a smaller share of the monthly payment will go to amortizing the loan.

4.65 As at December 2015, 79% of Euribor-linked new housing loan agreements were fixed for 12 months while in many other euro countries housing loans are linked to fixed rates where the interest rate is agreed beforehand for several years. In addition, since the Euribor rates were close to zero in December 2015, the average interest rate on new housing loans in Finland stood at 1.3%, which approximates to the all-time-low rate for Finland and is low in a European setting.

4.66 In terms of loan book risk profile, according to a 2016 report issued by Davy Stockbrokers[126] Finland's defaulted stock to total stock was 1.2% (in Ireland by comparison it was 18.1%), while the risk weighting of mortgage assets was 11% (for Ireland it was 50%). On the basis that default rates and low risk weightings result in lower capital requirements, this would in part explain Finnish new business variable mortgage rates being comparatively low at 1.09% compared to 3.07% in Ireland[127].

4.67 Importantly in the context of lenders setting mortgage rates, for new mortgage loans in Finland, banks usually require additional collateral for a loan. The bank decides what it will accept as collateral and at what value in each particular situation[128]. From the information we have obtained from the Federation of Finnish Financial Services, the average LTC (loan-to-collateral) for new loans is 68%. This is distinct from the LTV figures normally used, as the denominator is

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[125] IMF Country Report No. 16/369, Finland, Nov 2016
[126] Davy Stockbrokers, Banks Monthly, December 2016
[127] Rates for October 2016, Davy Stockbrokers, Banks Monthly, December 2016
[128] See Financial Supervisory Authority of Finland website
http://www.finanssivalvonta.fi/en/Pages/default.aspx

made up of all collaterals used, which would include other collateral than the house purchased[129].

4.68 According a recent statement by the IMF [130] the immediate financial stability risks in Finland appear limited and the level of nonperforming loans is low. However, it noted that the Finnish banking system is large relative to the economy, highly concentrated, and closely interlinked with that of Nordic neighbours. In addition, banks' low risk weights for mortgages may exaggerate the robustness of their regulatory capital ratios (a view earlier expressed by the OECD[131]). Banks are also relatively reliant on wholesale funding, which creates funding liquidity risks.

4.69 According to the EMF during 2015, the Finnish FSA issued regulations and guidelines for the maximum LTV ratio. Banks are to abstain from financing home purchases for own use involving a higher than 90% LTV ratio as of July 2016. An exception to this is the amount of a loan taken out for the purchase of one's first home, which may be at most 95% of the current value of the collateral posted at the time of loan approval.

4.70 A 2017 Bank of Finland bulletin[132] noted that in addition to the LTV limits, preparations were underway to impose minimum risk weights on housing loans granted by banks. On top of these, to curb borrowing, the bulletin commented that it would be advisable to consider the adoption of tools, such as found in Ireland, that take household income into account, i.e. loan-to-income caps.

4.71 The growth rate in housing loans referred to above was maintained by the widespread use of interest-only periods on housing loans. The 'interest-only' offer was a widespread campaign from different banks whereby households renegotiated €12.8bn worth of their housing loan agreements during 2015. In 2015, outstanding residential loans in Finland were approximately €92bn, and renegotiations in the year amounted to 14% of these residential loans. According to the IMF[133], by way of explanation for this level of renegotiation a large mortgage lender launched a campaign to grant one-year grace periods from making payments on the principal, provided the borrowers met certain risk criteria. The biggest competitors followed suit, either with their own equivalent offerings, or granting grace periods on equivalent terms upon request. Following

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[129] Examples cited include: Primary housing pledge (shares in a housing corporation, mortgage deed of real estate, capital value of a right of occupancy agreement, capital value of a partial ownership agreement), other housing pledges, including leisure time residences deposit collateral, other real collateral (e.g. equity shares, investment fund units), third-party pledges. See http://www.finanssivalvonta.fi/en/Financial_customer/Financial_products/Loans/Housing/Pages/Default.aspx

[130] IMF review under the Financial Sector Assessment Program, October 2016

[131] It was noted that although the tier 1 capital ratio is high, the overall equity-to-asset ratio in Finland is one of the lowest in the OECD, reflecting the large share of mortgages with low risk weights in bank balance sheets. See OECD Economic Surveys Finland January 2016

[132] "How can we dampen the build-up of housing price bubbles?", Bank Of Finland Bulletin 2/2017, May 2017

[133] IMF Country Report No. 17/3, Finland, Jan 2017.

the termination of these amortization holidays, in early 2017, interest-only mortgages accounted for less than 4% of the total.

4.72 We are uncertain whether the market characteristics and the regulatory environment in Ireland would permit the same type of switching offers as seen in the Finish market. In addition, the Finish market may have efficient switching mechanisms in place, making the response to 'interest only' offers highly pronounced.

France

4.73 According to the EMF, in 2015, a total of 404 credit institutions (including banks, mutual banks, municipal credit banks and special credit institutions) were licenced as entities that could issue mortgage loans by the French supervisory authority (ACPR). The three main categories of credit institutions involved in property lending in France are as follows:

- Full service banks whose market share increased in 2015 (40.1% vs 37.3% in 2014)
- Mutual and cooperative banks with a slightly declining market share (54.5% vs 56.4% in 2014)
- Specialised institutions which experienced a slight decline of their position (5.4% vs 6.2% in 2014).

4.74 A highly concentrated market is one where a small number of firms account for a high proportion of production. Given the number of lenders (over four hundred) and the high level of market shares by category of lender, we would consider that the market concentration in the French mortgage market is likely to be considerably lower than is the case in Ireland. Solely on this basis, one could expect that competition would be more intense than in Ireland.

4.75 As distinct from Ireland, in France the most commonly held mortgage loan is a fixed rate one. In the first quarter of 2016, 99.6% of the new credits were fixed rate loans (Ireland's short term fixed rate share of new loans was 39% for 3Q 2016).

4.76 The two main sources of funding real estate lending in France are the household and company deposits. Securitisation of loans remains marginal in France.

4.77 According to the EMF, loan production increased sharply throughout the year. Over one year to the end of December 2015, loan production amounted to €156bn, an increase of 30%. This was seen as an exceptional level of activity and was ascribed to the rise in loan renegotiations (in effect customers switching between products or mortgage lenders) throughout the year, totalling €76bn in 2015. This level of renegotiations was encouraged by extremely low interest rates and intense competition between lenders.

4.78 The French mortgage market has been strongly influenced by the rules applying to State-subsidised loans[134]. The real estate lending market was very active in 2015 since home loan interest rates remained very low, at an average of 2.2%. The Government has as its objective facilitating first-time home ownership, in particular for young people. Through the PTZ scheme[135] interest free loans (up to certain levels) are part of the mortgage market in France. According to Reuters[136] the French Government embarked on a programme to provide €2bn in tax relief to banks offering new zero-interest mortgages in late 2015. The measures aimed at widening the number of people eligible for the existing PTZ scheme, thereby boosting the depressed housing market. Under the new measures first-time buyers under a certain income threshold would get zero-interest financing for up to 40% of the cost of a new property, up from somewhere between 18 and 26%. In effect therefore a larger portion of the loan could be interest free.

4.79 79% of borrowers that took an interest-free loan since the start of 2015 were under 40. The proportion of young people among first-time home buyers has been rising steadily, such that buyers under 40 accounted for 61% of new home buyers in 2015. The EMF considered that the interest-free loan proved particularly successful for the purchase of new properties and only an insignificant portion of these loans was granted for existing homes. As such, it would appear that fiscal measures in France have in part facilitated a lower mortgage interest rate environment and a greater number of young people among first-time home buyers.

Italy

4.80 At the end of 2015, the default rate to 180 days fell to 1.6%, the lowest level since 2011. The default rate to 90 days shows a similar trend, although at higher levels (2.3% in December 2015, compared to 2.7% in 2014).

4.81 The typical LTV ratio on residential mortgage loans was 69.3% for 2015. The low LTV ratios are, in part, a result of strict housing credit regulations and prudent bank practices. According to the Housing Market Survey[137], LTV ratios on new mortgages declined from 69% at end-2008 to 56% in early 2013. As a result one would expect that the average interest rate on loans would be proportionately lower for the lower 56% LTV rate.

4.82 With interest rates at historic lows, many customers preferred not to expose themselves to the risk of future increases, choosing the certainty of a constant rate over the life of the contract. As a result long-term fixed (over 10Y initial rate fixation), accounted for just under 59% of new loans for 3Q 2016, while variable

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[134] Study On Mortgage Interest Rates In The EU, European Mortgage Federation, 2012.

[135] The PTZ is a state regulated, interest-free loan which is intended to help with the acquisition of a main residence.

[136] France introduces new measures to boost depressed housing market, Reuters, Business News Nov 9, 2015

[137] Bank of Italy, as reported by IMF (2013) p. 11

rate mortgages (up to 1Y initial rate fixation) represented just over 36% of new loans.

4.83 Homeowners in Italy can benefit from some fiscal advantages for "first home" purchases, which consist of smaller indirect taxes than would otherwise be the case.

4.84 In addition, in 2014 the "First Home Mortgage Guarantee Fund" entered into force (a public guarantee on residential loans for house purchases). According to the EU Commission[138] the fund, which had a three-year budget of €670m for 2014-2016, offers young families who are not creditworthy enough to qualify for a loan, a 50% state guarantee on their mortgage. The fund was allocated a total amount of €670m for the three-year period 2014-2016, and issues state guarantees up to a maximum of 50% of the value of the mortgage provided by the lender. The initiative allows lenders to access liquidity where a borrower is unable (under mitigating circumstances) to repay instalments on the loan. The facility provides liquidity for a period of up to three years and through this risk-sharing mechanism customers, who would ordinarily have had difficulty meeting lending criteria, are helped to obtain a mortgage. Ultimately, when in a position to do so the borrower reimburses the Ministry of Economy the amount that was advanced by the Fund to the bank plus interest.

4.85 The EU Commission notes that the scheme has proved to be very successful, with about 70% of Italian banks providing loans on this basis. As of February 2016, the value of issued mortgages guaranteed by the Fund amounted to €539m.

4.86 The scheme has generally been seen as an improvement when compared to the previous initiative. The previous scheme's lower level of success was reported to be mainly due to the low interest rates applied to the loans guaranteed by it, making them unprofitable and unattractive for the issuing banks. Under the First Home Mortgage Guarantee Fund Scheme banks are generally free to set their interest rates, as is the case for regular mortgages.

4.87 According to the EU Commission the initiative allows banks and other financial intermediaries to easily gain access to the available liquidity in case the borrower is unable to repay the instalments of the loan. As such it aims to reduce the credit risk (and hence the capital requirements) of lending to targeted borrowers.

4.88 We consider that, potentially, such a measure could be introduced in Ireland to reduce the risk of lending to lower income groups, this in turn could increase the availability of credit to such groups.

[138] European Construction Sector Observatory, March 2016.

Netherlands

4.89 The low interest rate environment has made long-term mortgages more affordable, and switching to mortgages with lower interest rates has been popular. In 2015, 68% of new contracts had a fixed term longer than 5 years, whereas in 2013 only 36% choose a contract with more than 5 years fixed.

4.90 According to the DNB[139], the statutory loan-to-value (LTV) limit for residential mortgage loans was introduced in the Netherlands in 2012.This LTV limit is being reduced by one percentage point per year, from 103% in 2015 to 100% in 2018. The Government has stated that a further reduction in the LTV limit is desirable in due course. This is in line with recommendations[140] advocating further reduction of the LTV limit to 80%.

4.91 The Netherlands operates with a guarantee fund, the Nationale Hypotheek Garantie[141] (NHG) for mortgages less than €265,000. According to the NHG itself, the scheme is unique in Europe. If the borrower is unable to make repayments due to circumstances beyond their control, the NHG can provide a safety net for the borrower and their mortgage lender.

4.92 According to the Q4 2016 quarterly report produced by the NHG[142], in 2016 the number of loss claims submitted under the scheme totalled 3,506, down 22% from 2015. The total value of the loss amounts under surety were €109m and €168m for 2016 and 2015, respectively. Setting these figures in the context of the overall scheme, the NHG had liabilities of €193bn as at year-end 2016. As such, we calculate that the 2016 loss amount of €109m represented less than 0.06% of scheme liabilities for the year. In addition, the report noted that mortgage lenders and the Homeownership Guarantee Fund have substantially intensified their joint efforts in respect of control mechanisms. Consumers are contacting their mortgage lenders at an earlier stage if they anticipate or are already facing difficulties paying the mortgage. This means that more sustainable solutions can be offered to help people keep their home or avoid a forced sale at a loss.

4.93 The Netherlands has also engaged in fiscal measures to boost mortgage lending. Similar to the 2013 and 2014 regulations, the gift tax regulations have been relaxed in 2017, enabling one-off tax-free gifts for home purchases and mortgage repayments of up to €100,000[143].

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[139] The Dutch central bank, supervisory and resolution authority - "Effects of further reductions in the LTV limit" De Nederlandsche Bank n.v, www.dnb.nl, 2015

[140] IMF 2014 and Commissie Structuur Nederlandse Banken, also referred to as the Wijffels Commission

[141] The Dutch National Mortgage Guarantee - for English summary of the guarantee scheme see: https://www.nhg.nl/english-summary/Information-for-consumers/What-is-nhg

[142] NHG Fourth Quarter, 2016, Reference date: 2 January 2017

[143] DNB, 9 May 2017.

Denmark

4.94 In Denmark both retail banks and mortgage banks can issue mortgage loans. In 2015, mortgage banks issued 83% of residential mortgage loans, while retail banks issued the remainder. Mortgage loans issued by mortgage banks are solely funded by the issuance of covered bonds[144].

4.95 In Denmark there are three typical types of loans: loans with a fixed rate; interest reset loans[145]; and, loans with variable rate with and without cap[146].

4.96 Fixed rate mortgages (typically fixed for 30 years) accounted for 65% of gross lending in 2015, an increase of 11 percentage points compared to 2014. Adjustable-rate mortgages and interest-reset mortgages accounted for 34% and adjustable-rate mortgages with an interest rate cap accounted for 1% of gross lending in 2015.

4.97 For new loans for owner-occupied housing, LTVs are normally 80%, whereas, the LTVs for other new residential loans will normally be 60%.

4.98 Fixed rate mortgages increased in popularity in both 2014 and 2015. Several factors have been cited as being responsible for this development. One such reason is borrower expectations of a rise in interest rates.

4.99 Thanks to the Danish covered bond funding model[147], there is a direct match between the loan which a homeowner raises with the mortgage bank and the bonds which a mortgage bank issues to fund the loan. During the first half of 2015, interest rates on fixed rate mortgage loans sunk to a historically low level, but during the second half of the year interest rates rose again. However, the yearly average of interest rates on fixed rate loans in 2015 is still below the average of 2014. The interest rates on short-term loans fell to the extent that investors received negative yields on the underlying bonds with the short-term

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[144] Covered bonds are debt instruments secured by a cover pool of mortgage loans (property as collateral) or public-sector debt to which investors have a preferential claim in the event of default.

[145] We understand that an interest reset loan has a binding period, for example ranging from 6 months to 3 years. Thereafter the loan is either refinanced, or the interest rate is changed to the current interest rate then in force.

[146] For variable rate loans with interest rate caps we understand that the interest rate is fixed on the basis of benchmark rate (e.g. Copenhagen Interbank Offer) plus an interest rate spread. If this rate exceeds the interest rate cap, the interest rate of the loan will be fixed at this level. When the benchmark rate and the interest rate spread fall below this rate, the interest rate of the loan falls accordingly. The interest rate spread constitutes payment for the interest rate cap. The size of the spread depends on the size of the interest rate cap as well as the term of the cap. The longer the term and the lower the interest rate cap, the larger the interest rate spread. For more information see "Loan Guide" Nykredit, 2017, https://www.nykredit.dk/staticcontent/files/loan-guide.pdf

[147] See Annex relating to the Danish Mortgage market for further detail on the model.

interest rate to borrowers being on average 1.09% during 2015. For long-term 30-year fixed rate mortgages coupons were between 2.0-3.0% for the year.

5. Options

Introduction

5.1 In this chapter, we bring together the various strands of the discussion in chapters 2 to 4 and set out a number of options that could help to improve the level of competition in the Irish mortgage market and provide consumers with greater choice of product and provider.

5.2 The CCPC believes that is it important that there is a long-term strategy and shared vision for the mortgage market which would frame policy debate and give the context in which the CBI can make effective regulatory decisions. Such a vision should extend well into the future so as to avoid short term responses to long term structural challenges.

5.3 Without a clear stated vision the housing and mortgage markets could once again put the solvency of the banking system at risk and severely impact the economy.

5.4 A clearly stated and shared vision would set the context for policy choices that influence both demand (including the demand for mortgage credit) and supply in the market. It is essential that Ireland's policy-makers work together to develop this vision. The CCPC recommends that a suitable forum for a national debate be established and a national shared long-term vision be developed and articulated.

5.5 In the context of a highly distorted market, regrettably there are no quick fixes which will immediately create competition and therefore bring down mortgage interest rates in Ireland. There are, however, measures that should be considered by Government and policy-makers which would help make a better-functioning, more sustainable mortgage market. We have divided these options into those which are achievable in the short, medium and long term.

1. Short Term Options

1.1 Business Friendly Initiatives

5.6 To date the CBI has, given its mandate, been primarily concerned with ensuring financial stability, consumer protection and market integrity. While it does provide advice and assistance to firms on request and works actively with firms seeking authorisations it does not have a direct role in promoting competition, promoting entry (either by domestic or foreign institutions) or promoting new and innovative products and services. As a consequence, at an institutional level

the CBI is somewhat constrained with respect to the initiatives it can undertake to create an environment that will nurture increased competition.

5.7 By way of contrast the FCA in the UK has as part of its mandate a specific role for promoting effective competition in the financial services sector which requires it to adopt a more pro-competition approach to regulation. Under this guise the FCA has developed initiatives to:

i. help new competitors and entrants launch in the UK with a dedicated new start up unit, improved authorisation processes and reduced waiting periods for clearance and authorisation;

ii. foster innovation through the Innovation Hub which has a dedicated team and contact for innovator businesses, provides help for these businesses to understand the regulatory framework, assists businesses in preparing and making an application for authorisation, and provides a dedicated contact for up to a year after an innovator business is authorised. The Innovation Hub also facilitates the entry of innovative overseas firms into the UK and the expansion of UK-based innovative firms into overseas markets;

iii. allow business to test new and innovative products in a Regulatory Sandbox before bringing products to the mass market. The benefits of the sandbox approach include reduced time and cost in bringing products to the market, providing access to finance, designing consumer and regulation friendly products.

5.8 We believe that currently the regulatory framework is, on balance, business friendly. However, as the example of the FCA shows there are a number of initiatives that could be undertaken to improve performance in this area which would in turn encourage new entry into the market. A current and topical example where an initiative like the regulatory sandbox would be of great benefit is in relation to the potential for the credit union movement to scale up its mortgage offering. Another initiative that could help to promote foreign entry is the establishment of a dedicated international centre/advisory service which new entrants (specifically non-bank lenders) could approach to facilitate entry in to the Irish market.

ACTION: 1.1.1 CBI to develop a process for introducing new entrant/new product friendly initiatives such as those outlined.

ACTION: 1.1.2 Department of Finance should sponsor research to determine how authorisation periods and regulatory burdens vary between Ireland and other comparable jurisdictions.

1.2 Switching

5.9 Improving the ability to, and incidence of, switching is a key enabler to unlocking greater competition in the market. We discussed the findings of the CCPC B&A

research, the CCPC AR focus groups and the CBI research on switching in Chapter 2 and in Annex D and we note that the CBI intends to consult on a number of additional measures to facilitate mortgage switching later in 2017.

5.10 Much of the feedback from focus groups and the consultation process noted the 'hassle factor' involved in the mortgage switching process and that this amounted to a material barrier to switching. As such, making this process as efficient as possible should help promote switching, reduce barriers to entry by new lenders and secure the benefits of competition for the consumer in the mortgage lending market. The Law Society of Ireland (LSI) in its response to the public consultation noted the developments it has made in e-conveyancing and its plans to implement such a system. The LSI notes that its provisional timeline for implementation envisages rollout of the e-conveyancing system in 2019. At the moment much of the conveyancing process is based on the delivery of paper which is slow, inefficient and costly. E-conveyancing aims to make the interaction between solicitors, lenders and the Property Registration Authority electronic and thus reduce costs and improve timelines. We believe that the introduction of e-conveyancing would appear to be a materially positive development for promoting switching behaviour.

5.11 In addition to the measures outlined by the CBI we would advocate for the implementation of a pull based switching process whereby upon consent from the borrower the potential new lender is able to obtain the necessary documentation and information from the current lender within a specified time period. This will enable the new lender to complete all the required work without having to wait for the current lender to act and without having to ask the consumer to carry the burden of obtaining and assembling the documentation.

5.12 Given all the work that has been done to date to encourage consumers to engage in the switching process switching remains stubbornly but understandably low.[148] This is exacerbated by the prevalence of variable rates in the Irish market with the consequential difficulty for consumers to accurately forecast the expected gains from switching. Consideration should also be given to the introduction of a legislative process to encourage switching along the lines of the Bersani Decree[149] in Italy. This reform, enabled bank borrowers in Italy to prepay the loan at their current bank or change their loan provider without requiring authorisation from the initial lender and without any (or at significantly reduced) charges. Under this legislation borrowers are allowed to change the type of interest rate (fixed or variable) and the length of the mortgage term. There is no cost to the borrower (i.e. no switching fees, no valuation fees, no insurance fees, no tax and no notary cost). The process is to be completed within 30 days and the lenders involved are required to share information. Further research is

[148] See paragraph 2.10.

[149] The law, proposed by the minister Pier Luigi Bersani, applied to several sectors in Italy and was aimed at promoting consumer protection, enhancing competition, and increasing the overall level of economic activity.

required to determine the applicability of such a direct legislative approach in the Irish context and its likely effectiveness.

ACTION: 1.2.1 The CCPC should work with the Legal Services Regulatory Authority to facilitate the introduction of e-conveyancing.

ACTION: 1.2.2 The CBI, Department of Finance and the CCPC to establish a group to facilitate the development of automated switching processes, including legislative change where appropriate. In addition the CBI, Department of Finance and CCPC should share information from their respective switching campaigns to improve the effectiveness of information campaigns.

1.3 Re-building Trust: The Irish Mortgage Market is Functioning

5.13 The views of consumers expressed in the CCPC AR focus groups and the submissions by various stakeholders to the consultation all point to the erosion of trust following the financial crisis and highlight the central role that trust plays in a market such as the mortgage market where consumers are information poor compared to the sophisticated, expert and information rich lenders. Moreover, since consumers expressed a wariness and scepticism of new entrants given previous experiences, policies to attract new entrants will not achieve their potential if consumers are fearful of switching to those new entrants. Thus a lack of trust and confidence in the market will hold back the development of competition in the market. These are not newly held views - the roles of long-term relationships and trust in banking are firmly established.

5.14 In her comments to the 7th International Banking Conference Sabine Lautenschläger[150], noted that loss of trust in the banking sector:

- impairs the proper functioning of banks to reallocate resources;
- hampers growth;
- leads to instability and costly crises.

5.15 In terms of rebuilding trust and confidence in the Irish mortgage market it is important to recognise that much has already been achieved through the policy choices of the Minister of Finance.

5.16 Moves to bolster the independence of the CBI have been crucial. The rebuilding of consumer confidence that the market will from now on operate with tight controls on lending to reduce the likelihood of speculative bubbles emerging was well reflected in the consumer focus groups for this Paper. Consumers are assured that the CBI will work assiduously to maintain market stability and are not subject to the same political pressures of the legislature. The independence

[150] Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the Single Supervisory Mechanism, Bocconi University, Milan, 28 September 2015.

of the CBI is also critical to the views of international investors and potential new entrants.

5.17 The clear policy position as regards the sale of the State's shareholdings in Irish banks has also given a large degree of confidence to international investors and potential new entrants who might otherwise have viewed this as a real barrier to entry. Despite a prior suspicion that this would be a major barrier to entry it was not viewed as such by market players which goes to the amount of credibility that they place on the stated policy.

5.18 All of this points to the central importance of the Minister and Department of Finance in setting the policy context which all the other actors then take as a given.

5.19 It is vital, for the market to work effectively for consumers, that trust is rebuilt and relationships are restored. Achieving this outcome will be challenging and it is submitted that it can only be developed incrementally. The discussion above has highlighted a number of areas where policy development would be helpful not only in restoring trust but as a by-product also encouraging increased switching by consumers:

- Lack of knowledge, confidence and expertise on the part of consumers could be mitigated by the increased use of Independent Financial Advisers/brokers. A great deal of work has been done by the CBI since the financial crisis to regulate and develop the IFA sector and the sector is now better regulated than before. However, the results of these efforts have not been widely promoted. While we note that there is still some reticence among consumers regarding commission payments and the incentives of brokers to promote switching this is being addressed by CBI as part of its ongoing review of commission payments to intermediaries[151];

ACTION: 1.3.1 Similar to its campaign to encourage switching behaviour in general the Department of Finance should give consideration to running a promotion campaign encouraging consumers to make use of independent brokers when applying for mortgage credit.

- Chapter 2 highlighted the growing significance of cashback payments and loyalty discounts introduced by lenders in the Irish market as incentives to encourage switching. On one level this can be seen as proactive competitive behaviour by lenders to differentiate their product offering from those of competitors. At another level it could be argued they represent a sophisticated attempt to manipulate consumer behaviour. The work of PRICELAB detailed in the analysis earlier shows that consumers cannot properly assess these type of loan products and often make poor choices and both the Fair Mortgages Campaign and

[151] See https://www.centralbank.ie/news/article/responses-to-discussion-paper-on-the-payment-of-commission-to-intermediaries for more detail.

Fianna Fáil in their responses to the public consultation have called for cash incentives to be banned. It is difficult to see: (a) how lenders could be prevented from offering these incentives without primary legislation and; (b) whether this type legislation would be capable of being implemented at all. Alternative efforts to help consumers could include:

- requiring lenders to accurately inform consumers of the full implications of the products offered in terms of monthly repayments and the total interest payments associated with these products along with direct comparisons to the products they are currently on. This should take place on an individualised basis rather than using generalised examples;

- promoting the work of PRICELAB to further develop policy responses to these types of market developments;

- ensuring that financial education and consumer protection measures evolve to deal with these issues.

ACTION: 1.3.2 The CCPC and the CBI should establish a joint working group to examine the findings from PRICELAB and to develop a set of policy recommendations for implementation.

5.20 All respondents to the public consultation and indeed all of those we met during our discussions with stakeholders cited legacy issues as an impediment to the investment decisions not just by new lending entities but also by the underlying funders. There is still a widespread perception that, despite the work of the CBI and the Department of Finance, the Irish banking sector (and by extension the Irish mortgage market) is not functioning as it should.

5.21 This perception requires tackling on two fronts.

5.22 First policy-makers need to continue to design and implement a series of credible policies to deal with NPLs, to develop best practise repossession processes and procedures, to prevent a return to widespread property speculation, to ease the regulatory burden on new entrants, to inject scale into the market by providing increased housing supply, to adopt new/innovative business friendly initiatives, and to encourage switching and customer mobility.

5.23 Second policy-makers have to set out in detail to the international finance community (funder and lenders) the measures already implemented and the proposed actions still to be undertaken with a clear and unambiguous commitment to achieving these. There are a number of immediate opportunities available to policy makers to signal these policy developments which include:

- The imminent sale of part of the Government's shareholding of AIB represents a timely opportunity to sell this message to the international community and together with a strong public rejection of legislative

attempts to control interest rates would act as a useful signal of the Government's intentions;

- Drop all references to and use of the term "Pillar Banks" – terms like this simply re-inforce the stereotype of a banking sector that is not functioning.

5.24 The implementation of various macro-prudential measures has stabilised the financial sector in Ireland. The dividend of this stability will be a more robust financial sector, appropriate lending standards, and greater certainty. Thanks to the work of the CBI, this will help establish a more attractive market profile for potential new entrants and expansion by existing lending firms.

5.25 The creation and preservation of such an environment can only be achieved in the presence of an independent and effective financial regulator.

Therefore, notwithstanding prudent oversight mechanisms, interference in the policies and operations of the regulator threaten the stability needed for the financial sector and the economy as a whole and should therefore be avoided. Indeed, stakeholder acknowledgement of the independence of the CBI would help in further stabilising the sector.

New entrants to a market improve choice, lower prices and stimulate innovation. For effective entry consumers must feel assured that the protections they enjoy in dealing with existing firms will be matched by any new firm.

While we are certain that any new firm in Ireland will be regulated in the same manner as an existing firm, conveying this fact to consumers is essential, as this will increase the prospect of switching and the likelihood of entry.

ACTION: 1.3.3 Consideration should therefore be given by the Department of Finance and the CBI to ascertain and understand consumer concerns in respect of new entrants and to formulate measures to address these.

ACTION: 1.3.4 Consideration should be given for the Department of Finance and the Department of Jobs, Enterprise and Innovation to undertake an international campaign (similar to that undertaken in the private sector when firms are seeking additional equity or pursuing mergers and acquisitions) to encourage new entrants and international funders to consider the Irish mortgage market as a commercial opportunity.

2. Medium Term Options

2.1 Repossession Policy

5.26 We are mindful that repossession policy needs to be carefully considered in a wider societal context. However it must be considered as the current system adds significant uncertainty to both consumers in arrears and to lenders. In our

view the current system could be improved and be more appropriate, considered, and predictable.

5.27 As shown earlier, data indicates that many of the countries in Europe have more predictable practices when dealing with loans in arrears. While Ireland's late-stage arrears profile has improved significantly in recent years, and is projected to decline through 2017 and 2018[152] the scale of the arrears will still be sizeable over this period, remaining well in excess of the experience in the UK, Germany and the Netherlands.

5.28 The scale of arrears and their duration increases the risk profile for mortgage lending in Ireland. The sovereign issuer default ratings and the bank system indicators as published by Fitch[153] illustrate the augmented risk of writing loans in Ireland. Thanks in large part to the added risk of lending, the risk weighting of mortgage assets in Ireland has been shown to be substantially higher than many other European markets[154]. This means that more bank capital is needed to write a mortgage in Ireland, and as a result a loan is more costly[155].

5.29 Clearly by adopting decidedly different standards in respect of loans and foreclosure, Ireland is setting itself apart in a European context. Given the relatively small size of the market in Ireland, potential entrants will be even more reluctant to invest in such a market where materially different mortgage lending policies exist. Rather, one could expect that Irish interest rates could be persistently higher than in Eurozone countries with effective repossession regimes.

5.30 While arrears and defaults are part of a normally functioning market this is predicated on the assumption that with appropriate lending rules, these will be minimised. Under such circumstances there is scope to put in place (in conjunction with appropriate and robust consumer protections, e.g. mortgage to rent schemes) policies and practices that are more aligned to European norms, where the process of effecting repossession is more efficient and has more certainty.

5.31 Separately, from an investment perspective alone, it would seem reasonable that investors would be more reluctant to invest in a market where there is a problematic issue that has been identified but left unaddressed, or where there is the risk to the legislative or judicial predictability in repossession procedures. If this where to happen in Ireland and policy makers failed to adequately address the current NPL issue through the introduction of a predictable, transparent and rules based process for resolving mortgage NPLs then it is conceivable that the

[152] Fitch Global Housing and Mortgage Outlook – 2017.
[153] Fitch Global Housing and Mortgage Outlook – 2017.
[154] Davy Research, Banks Monthly, December 16, 2016.
[155] "… capital is costly. Holding too much of it can force banks to raise their lending costs. This, in turn, would raise borrowing costs for companies and may act as a brake on investment and economic growth." Speech by Danièle Nouy, Chair of the Supervisory Board of the ECB, at the Austrian Chamber of Commerce, Vienna, 2 May 2017

additional risk perceived by investors could lead to permanently higher capital costs for Irish lenders and as result interest rates would also be correspondingly higher.

Specialist Court and/or Case Management Process

5.32 The ECB has stated[156] that in order to resolve the NPL issue member states could: (i) make judicial systems more efficient; (ii) create fast out-of-court procedures; (iii) increase access to collateral; and, (iv) adopt measures to align the fiscal incentives of borrowers and lenders.

5.33 We understand that while there are advisory services available to borrowers, there is no formalised out-of-court procedure in practice in Ireland. Rather it is for the courts to make, grant or dismiss orders to repossess mortgage properties. Therefore in a jurisdiction where the court has the ultimate competence in these matters consideration should be given to improving the court process. The manner in which applications for possession orders are initiated and processed in the courts was examined in detail by the Expert Group on Repossessions[157] and the recommendations of that group were due to be raised with the Court Rules Committees who determine the practices and procedures applicable to proceedings coming before the courts. Before any future work is undertaken it would be beneficial to examine whether and how court procedures have changed following this review.

Additionally, there is good precedence for the establishment of specialist courts and case management procedures in the Irish courts. For example Order 63A of the Rules of the Superior Courts established the Commercial List (which is widely regarded as a successful measure for quickly and efficiently disposing of commercial cases) and the procedures to be followed in these cases including case management deadlines, pre-hearing conferences, the production of documentation prior to hearings etc. Order 5B of the Circuit Courts (Actions for Possession and Well-charging Reliefs) could likewise be amended by Statutory Instrument to introduce elements along these lines. In addition for transparency for potential new lenders and policy formulation the provision of detailed case management statistics from the courts services would be beneficial.

One action point under the programme for government was the establishment of a dedicated court to handle mortgage arrears. We understand that development of this continues to be examined by the Department of Justice[158]. We also note the activities of the Abhaile Service (the Mortgage Arrears Resolution Service) which was set up last year to help homeowners find a

[156] Danièle Nouy, Chair of the ECB's Supervisory Board, and Sabine Lautenschläger, Vice-Chair of the ECB's Supervisory Board, Frankfurt am Main, 23 March 2016

[157] The Expert Group on Repossessions was established in September 2013 in response to a commitment to the Troika contained in the 9th review of the Memorandum of Economic and Financial Policies (MEFP) to examine the repossession system, identify any shortcomings and to make recommendations before the end of 2013. The report is available at http://www.justice.ie/en/JELR/ExpGroupReportFinal.pdf/Files/ExpGroupReportFinal.pdf

[158] Tánaiste and Minister for Justice and Equality (Deputy Frances Fitzgerald), re Mortgage Arrears Proposals. Written answer 122, Tuesday, 28 February 2017,

resolution to home mortgage arrears. A review of the efficacy of the Abhaile service is therefore likely before further substantive development of dedicated mortgage courts.

Notwithstanding the resolutions achieved through the Abhaile service, the length of time involved in mortgage arrears cases, and the number of outstanding proceedings speak of a courts system that could work better[159].

Suspended Possession Orders

5.34 Many of the respondents to the consultation noted the prolonged nature of obtaining judgement in repossession proceedings in Ireland (these views are also supported by the data discussed in Chapter 3). By way of example several respondents noted the difference between the Irish proceedings and those in the UK. During our engagement phase, one stakeholder noted the benefits of the use of the 'suspended' possession order to speeding up the process in the UK. It was noted that the suspended possession order incentivises the borrower to engage with the process and also allows the court to set what it considers appropriate conditions for repayment as part of the suspension.

5.35 Under the Land and Conveyancing Law Reform Act 2009[160] (the 2009 Act), a lender must get a court order to take possession of a mortgaged property. According to the Courts Service in Ireland a judge/county registrar may[161]:

- grant the order for possession;
- strike out or dismiss the case; or,
- adjourn the case to allow time for both the borrower and the lender reach an agreement.

5.36 In Ireland there is provision within Section 101, of the 2009 Act to allow for the suspension of an order. In addition, an adjournment, stay, postponement or suspension may be made subject to such terms and conditions with regard to payment by the borrower of any sum secured by the mortgage or remedying of any breach of obligation as the court thinks fit.

5.37 By way of comparison, in the case of repossession proceedings in the UK[162] the court can make the adjournment, stay, suspension or postponement subject to payment conditions by the borrower of any sum secured by the mortgage or the remedying of any default as the court thinks appropriate. Therefore under the UK system the courts appear to have an option similar to that in Ireland of

[159] In this context we would also note the review announced by the Tánaiste and Minister for Justice and Equality, Frances Fitzgerald TD, the aim of which is to deliver a more efficient and effective Irish legal system in regard to the area of civil justice. 22 March 2017
[160] Section 97 (1)
[161] Guide To Possession in the Circuit Court, October 2015.
[162] Section 36, Administration of Justice Act, 1970,

suspending a repossession order subject to the borrower making some form of payment.

5.38 Our understanding is that the current practice in Ireland appears to be that the court generally seeks to adjourn proceedings in the expectation that the borrower and lender agree to some form of settlement – rather than reaching a court mandated solution as part of a suspension. In the UK we understand that suspended possession orders tend to be issued at an early stage.

5.39 If suspended possession orders were used more widely in Ireland at the initial stages of proceedings this could reduce delays by avoiding the need to have repeated adjournments to allow the borrower and the lender reach an agreement under the provisions in Ireland set out above.

5.40 A benefit of greater use of suspended possession orders would also be that the arrangements made under a suspension order would be an order of court, as such with the associated transparency this could lead to greater standardisation in settlements and terms of orders, and more predictability.

ACTION: 2.1.1 We would therefore consider that the greater use of suspended possession orders by the court would be worth exploring further as a measure to bring about a more transparent and predictable process that is aligned to European norms.

The complexity of the options described above, in conjunction with considering the long term desired structure of the mortgage market, requires the establishment of an Interdepartmental working group or Joint Oireachtas Committee to examine the design and implementation of the processes described building on the commitment in the Programme for a Partnership Government.[163]

2.2 Restricting the Use of Properties Subject to PDH Mortgages as Investment Collateral

5.41 The Celtic Tiger economy and the associated property bubble in the mid-2000s led to a situation whereby homeowners on seeing the 'value' of their homes increase were encouraged to use that increased value to leverage additional mortgage finance for the purchase of additional properties for investment purposes. Almost a national obsession at the time this led to a large number of people engaging in risky borrowing and over extending their credit. When the financial crisis hit and the inevitable crash came this cohort was left stranded with declining asset values, falling income streams, large outstanding debts and the emergence of the NPL issue discussed in Chapter 3.

[163] The establishment of a dedicated court to handle mortgage arrears. Programme for a Partnership Government, 2016, p. 30.

5.42 While we note that the prudential measures implemented by the CBI are helping protect consumers from inappropriate borrowing some consideration could be given to further deepening this type of consumer protection. For example one option could be the withdrawal of the "family home" protections from borrowers who leveraged their PDH property to obtain BTL mortgage(s). In this scenario the borrower could be asked to formally acknowledge, in writing, that their primary residence may be repossessed in a fast tracked commercial process if they default on the BTL mortgage.

5.43 A more interventionist approach that might be considered further is to prevent consumers from using properties purchased using PDH mortgage credit as collateral to purchase additional properties with BTL mortgage credit where the PDH property is still subject to the mortgage.

5.44 In addition to protecting consumers measures like this would also act as a signal to potential new entrants and international funders that the reckless speculative mortgage borrowing of the past will not be repeated. The implications of introducing measures like these would need careful consideration to avoid any negative unintended consequences.

ACTION: 2.2.1 The option to withdraw the "family home" protections from borrowers who leveraged their PDH property to obtain BTL mortgage(s) should be explored in more detail by the CBI as part of its rolling review of the macro-prudential mortgage market regulations. The implications of preventing consumers from using properties purchased using PDH mortgage credit as collateral needs to be examined in greater detail because of its potential implications on other areas of the banking and credit sectors.

2.3 Review Implementation of Section 149 of the Consumer Credit Act

5.45 Section 149 of the Consumer Credit Act 1995 came into effect in 1996 and currently requires that credit institutions, prescribed credit institutions and bureaux de change must make a submission to the CBI if they wish to introduce any new customer charges or increase any existing customer charges in respect of certain services. Section 149 does not cover interest rates; it applies to fees and commissions only. We understand that examples of such direct price intervention in the EU banking sector are very limited.

5.46 As a result of section 149 there are regulatory constraints applied to credit institutions in their ability to generate non-interest income. The Department of Finance Report of the Review of Regulation of Bank Charges in Ireland[164] (with the input of the then Competition Authority) in 2013 concluded that it would not be appropriate to repeal section 149 at that point in time. The lack of competition in the banking sector meant that the removal of section 149 would give unconstrained price setting power to the incumbent banks. It further noted

[164] Department of Finance (2013).

that this issue should be revisited when competition in the banking sector had improved significantly.

5.47 In the event that there are restrictions on generating non-interest income, lenders will seek to generate adequate returns from interest earning assets. Separately, this has an impact on comparing variable rate mortgages relative to European peers who have no such pricing restrictions and, consequently, a higher level of non-interest income against which to recover cost. In effect therefore the customer cohort with high debt levels could be subsidising the bank activities of other customer groups.

5.48 Given the restrictions on pricing and the necessary timelines involved in the approvals process, it could be argued that this reduces investment and the rate of innovation in non-interest income lines of business. Furthermore, since the restrictions apply to credit institutions, firms that offer deposit taking only do not face the same restrictions, which could place credit institutions at a disadvantage.

5.49 Removing this provision from the statute book would have a number of effects. On the one hand lenders would have more flexibility in balancing their sources of income and with this flexibility would be better able to innovate. On the other hand giving the large incumbent lenders pricing freedom could adversely affect new entrants and increase the potential for consumer harm.

ACTION: 2.3.1 The Department of Finance in conjunction with the CBI and the CCPC should commit to regularly reviewing the appropriateness and implementation of Section 149.

3. Longer Term Options

3.1 Promote the Move to Longer Term Fixed Rates

5.50 In Ireland retail deposits is the predominant method of funding mortgage loan books. As shown in Figure 5.1, with the increase in mortgage lending during the economic boom lenders needed to secure ever more deposits to fund expanding loan books.

5.51 Because deposits are typically short term and therefore mobile, depositors were able to seek out better rates from lenders who were competing against each other for deposits to lend as mortgages. Competition for deposits can destabilise a banking industry, due in part to the asymmetry of information between the lender and the depositor[165]. Competition for deposits may also increase the incentives to take risk and correspondingly the probability of failure of banks[166]. In addition this can increase instability by exacerbating the coordination problem

[165] *"Because of asymmetric information, depositors are unable to tell whether their bank is a good bank or [not]"* Mishkin, F. S. (2001).

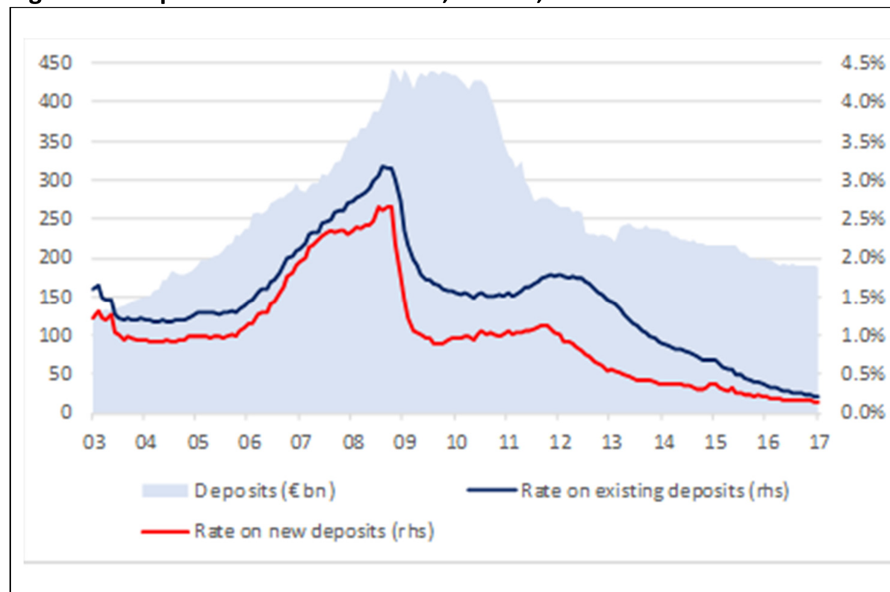
[166] Competition and Stability in Banking, Vives X, 2016, p 106

of depositors/investors, and consequently fostering runs, which may become systemic[167].

5.52 According to the CBI, systemic liquidity risk materialises when banks' normal funding channels fail. A reliance on volatile sources of funding [such as short-term deposits] and a high degree of maturity mismatch [e.g. where short-term deposits fund long-term mortgages] increases this risk[168].

5.53 The reliance of banks on short-term funding to finance the expansion of their balance sheets in the run-up to the crisis, together with excessive leverage, have been highlighted as key factors in the build-up of systemic risks[169]. Therefore, long-term funding of mortgage loans can help mitigate the risks that are involved in short-term, mobile deposits.

Figure 5.1 Deposit Volumes and Rates, Ireland, 2003 to 2017



Source: CBI

5.54 A reasonable question therefore is whether short-term funding of mortgage loans is the optimum model for lenders.

5.55 From the borrowers perspective the CCPC AR focus groups found that consumers are somewhat reluctant to acquire long-term fixed rate loans: consumers want to maintain the ability to switch to a lower rate should such a rate become available. However, since the incidence of switching in Ireland is comparatively low, despite there being opportunities to save significant sums over the lifetime

[167] ibid

[168] A Macro -Prudential Policy Framework for Ireland, Central Bank of Ireland, 2014

[169] Bank Funding Structures and Risk: Evidence from the Global Financial Crisis, IMF working paper, WP/12/29, 2012

of the loan[170] it is reasonable to question whether consumers would want to maintain the ability to switch where the benefits of fixed rates were clearly demonstrated:

I. a fixed term for the product naturally creates a trigger point on the calendar where a consumer can plan, perhaps in conjunction with suitable independent mortgage advice, to reassess their mortgage loan (this is borne out in the experience in Denmark[171]).

II. A fixed rate loan provides stability for household cash flow and budgeting.

III. Due to its simplicity, and the fixed nature of the mortgage repayments over the lifetime of the contract a standard fixed rate product makes comparisons between products easier for consumers. (Recall from Chapter 2 that consumers' are mainly exercised by the level of the monthly repayment and are unaware of the interest rate). Being on a long term fixed rate will help a consumer assess competing offers so that they can achieve the ultimate result they want, lower monthly repayments.

IV. Based on discussions with the FCA in the UK, introductory short term fixed teaser rates work well for lenders. Many borrowers are drawn into the attractive initial rates and for a variety of reasons do not switch after the promotional period ends and higher interest rates kick in. By selecting a longer term fixed rate product the consumer can also avoid teaser rate offers comprising high and long-tail interest rates.

5.56 Therefore, from both the perspective of the borrower and the lender, a shift towards longer term fixed rates could comprise several benefits, notably increased transparency and stability for borrowers and more reliable, stable funding sources for lenders.

ACTION: 3.1.1 The Department of Finance and the CBI should examine ways to promote and secure greater long-term funding of loan books coupled with long-term fixed mortgage rates.

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

[171] According to the Association of Danish Mortgage Banks Customers switch mortgage banks especially when remortgaging [where remortgaging occurs when a fixed rate mortgage deal comes to an end].

3.2 Pilot Alternative Funding Models

The Danish Covered Bond Model

5.57 The use of deposit funding has risks for the mortgage consumer and the lender alike, with the lender accommodating changes to its funding costs by passing these variations on to the customer. Under the Danish system there is a direct match between the loan which a homeowner raises with the 'mortgage bank' and the bonds which a mortgage bank issues to fund the loan. Match-funding means that the loan book is mirrored by the funding side of the balance sheet. This system minimises market risk for the mortgage bank, while on-balance sheet loans ensure a prudent credit policy.

5.58 A Danish mortgage bank does not operate as a universal bank, which may take deposits or raise funding with other banks for lending purposes. When a mortgage bank grants a customer a loan for the purchase of real property, it must first raise the funds by issuing covered bonds. The mortgage bank will issue and sell covered bonds to investors, which then fund the loans. During the loan terms, borrowers make principal and interest payments to mortgage banks, which transfer the amounts to covered bond investors.

5.59 The current Danish mortgage model has a number of attractive properties, not only to borrowers and bond investors, but also for the Danish economy:

(a) Borrowers are ensured low and transparent loan rates and unique prepayment terms.

(b) Investors who buy the issued bonds do not incur any default risk in practice.

(c) The mortgage model has a stabilising effect on the Danish economy and helps sustain financial stability.

5.60 In the Danish system borrowers have a full overview of all loan costs. Total costs consist of interest and principal payments relating to the bonds funding the loan as well as a margin charged by mortgage banks. The margin covers the costs of loan administration, expected future losses, requirements for returns on the capital needed to grant loans and capital requirements.

5.61 In general, better transparency increases a customer's ability to assess whether there are better deals available. Increasing customer mobility imposes market discipline on lenders with the result that these lenders have to compete on lower fees and improved services and products. The incidence of switching in Denmark is relatively high in a European context – over 25%.

5.62 The Danish mortgage market has shown great resilience over its 200 year history. A loan matches a specific covered bond, all the loan features are embedded in the covered bonds[172], and as such there is much greater transparency available

[172] Association of Danish Mortgage Banks, Danish Mortgage Market, presentation 31 Jan 2017.

for funders than would be otherwise be the case with deposits or other forms of wholesale funding. This enables funders to have a much clearer picture of the loans that they are funding. Therefore funders can exercise more discretion on the loans (and their risk profile) that lenders advance.

5.63 Furthermore, the Danish system structurally separates commercial activities from house purchases. This again simplifies the nature of the institution and provides transparency for funders on the activities of the lender. To note however, the Association of Danish Mortgage Banks[173] [ADMB] has stated that new international capital requirements, liquidity rules and special rules for systemically important financial institutions as well as consumer protection requirements pose challenges to the Danish mortgage model. This is because the technical and complex regulations include features which do not accommodate the Danish mortgage model.

5.64 On balance, we consider that the stability and transparency benefits brought about by the Danish model would merit further consideration. Potentially, should the EU regulatory requirements fully accommodate such a system, the Danish model, or a variation thereof, could be a highly beneficial development in the mortgages market in Ireland.

Non-recourse lending

5.65 In a recourse mortgage the lender can foreclose the secured asset and also has recourse to the borrower themselves, which means that the lender can also collect the debt from the borrower's unsecured personal assets and from their future income. In a non-recourse mortgage the lender is confined to the secured asset. They can foreclose, repossess the house, sell and collect the proceeds, but have no recourse to the personal assets of the borrower, or to the borrower's future income.

5.66 According to research carried out by the Centre for Economic Studies in 2015[174] ten to fifteen US states, including several with particularly high rates of foreclosure in the post-2007 housing crisis, are considered non-recourse States, whereas generally speaking mortgage loans in Europe are recourse loans. Spanish mortgage law explicitly allows for non-recourse mortgages; however, they also state that these mortgages are rare in practice.

5.67 In the case of homeowners, the object of the non-recourse feature is to protect borrowers from financial collapse. The deal is predicated on the assumption that borrowers will be very reluctant to give up their primary residence, which means uprooting their family from familiar surroundings, incurring significant moving costs, and in all likelihood having to change neighbourhoods. These factors make lenders confident that the non-recourse feature will be exploited only in cases of severe financial distress. If this assumption is fulfilled, the expected number

[173] The traditional Danish mortgage & covered bond model, Association of Danish Mortgage Banks, 2016.

[174] Centre for Economic Studies (2015).

of non-recourse foreclosures will be small and, as a result, the cost premium of non-recourse loans will be minimal.

5.68 In the US borrowers in non-recourse states typically give up on their homes not when the home value is slightly below the amount of the outstanding loan ("under water"), but only when the shortfall is quite large. Because there is no recourse to the borrower, the cost of the loan is greater. However, in the event of default a consumer is not encumbered into the long-term with a shortfall resulting from sale.

5.69 Risk is transferred to financial institutions such as banks and insurance companies, which are typically far less risk-averse than individual homeowners; furthermore, their ability to foresee, manage and hedge the risk are greater due to greater financial sophistication and large economies of scale in risk management.

5.70 Nevertheless there are drawbacks to non-recourse lending such as:

- Moral hazard of the borrower - the customer takes on a larger mortgage than is suitable;
- Financial stability - a significant number of accounts with high levels of negative equity are foreclosed and the burden is placed on the lenders;
- Downward spiral of house prices - encouraging widespread foreclosure can in turn encourage lower home values which encourages yet lower house prices.

5.71 Notwithstanding these drawbacks, by limiting the exposure of the borrower, we consider that they would be in a better position to get a home loan in the future, or other forms of credit, albeit with a negative consequence for their credit rating. This could also assist in speeding up the process of resolution in a market where possession practices are protracted. The authors of the CESifo DICE Report noted that *"Non-recourse mortgages could be a constructive step for countries with high levels of home ownership, and insolvency regimes that are currently undeveloped and for which comprehensive reform is, for whatever reason, politically impractical."*

ACTION: 3.2.1 The Danish Model (either in whole or in part) has been exported to and used in other countries (e.g. Mexico)[175]. The CBI should examine the appropriateness and the potential costs and benefits associated with piloting the Danish model (or some variant of it) in the Irish mortgage market.

[175] For example, Mexican pension funds, insurance companies and other local investors own most of the country's mortgage-backed debt. In many European countries long-term covered bonds account for a large proportion of mortgage lending. See, Mexico's Infonavit attracts foreigners to debt sale, Reuters, Market News, Sep 29, 2009 and "Dual nature in the Balance sheet: as a Social Mortgage lender (assets) and as a Pension Fund (liabilities)" INFONAVIT Presentation 2013.

5.72 The mortgage market is characterised by a number of highly interconnected moving parts and a complex set of relationships between these parts, with numerous links to the wider economy which it both affects and is affected by. Likewise the options set out here are interconnected to such an extent that it is not possible to simply implement one option believing that this will have a transformative effect on the market. The options need to be considered, planned and implemented in the round with close attention to the sequencing of that implementation. Otherwise the risk of unintended and potentially harmful consequences is high.

A. Focus Group Results

Mortgage Switching

A report for the Competition and Consumer Protection Commission

February 2017

MMCL/SR

S17-029

A Presentation Prepared For:

Report Structure

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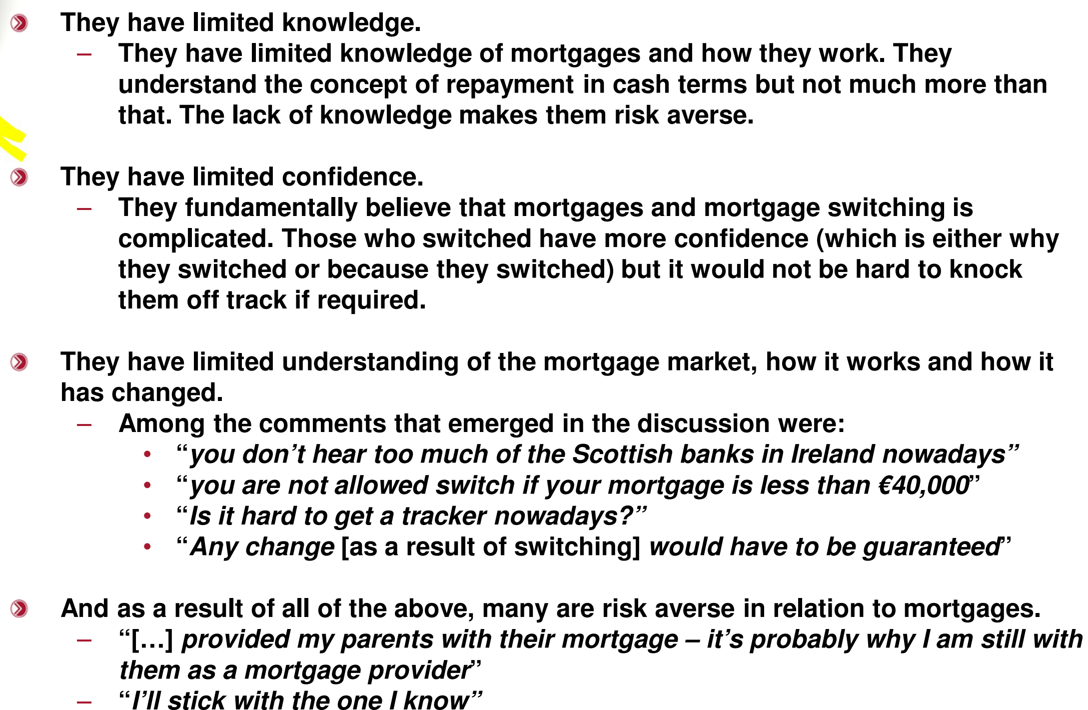
2

- Perceptions of the Mortgage Market
- Switching Scenarios in general
- Switching mortgages – why and why not
- Reaction to suggested changes in the switching process
- The role of Brokers
- Assessing possible mortgage products
- Methodology

KEY FINDINGS



Some core themes emerged which need to be highlighted at the outset
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They have limited knowledge.
– They have limited knowledge of mortgages and how they work. They understand the concept of repayment in cash terms but not much more than that. The lack of knowledge makes them risk averse.
They have limited confidence.
– They fundamentally believe that mortgages and mortgage switching is complicated. Those who switched have more confidence (which is either why they switched or because they switched) but it would not be hard to knock them off track if required.
They have limited understanding of the mortgage market, how it works and how it has changed.
– Among the comments that emerged in the discussion were:
• "you don't hear too much of the Scottish banks in Ireland nowadays"
• "you are not allowed switch if your mortgage is less than €40,000"
• "Is it hard to get a tracker nowadays?"
• "Any change [as a result of switching] would have to be guaranteed"
And as a result of all of the above, many are risk averse in relation to mortgages.
– "[…] provided my parents with their mortgage – it's probably why I am still with them as a mortgage provider"
– "I'll stick with the one I know"

They will Happily Switch Every Other Product or Service

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- In all of the groups they switch service providers with considerable enthusiasm. What they switch varies from person to person, but they do all consider it to be a core part of financial management. The areas for review include:
  – Broadband; mobile; landline; electricity; gas; health insurance; car insurance; household insurance; main grocery store; current accounts; credit cards etc. etc.
- The 'Switchers' believe that they switch more than the people around them – and that they have often persuaded people about the benefit of switching. The rationale for switching includes the obvious benefits of financial impact and savings, but also includes a sense of control, empowerment and engagement.

Switching is a Core Part of Financial Management …

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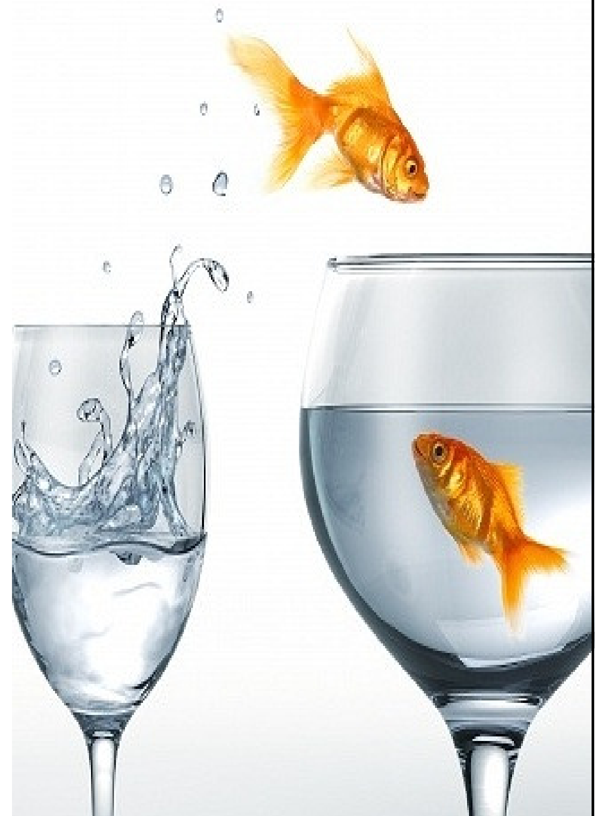
- What they save varies from service to service. But typically they believe that they save about €500 in total per annum as a consequence of their switching behaviour.
- While the driver is cost savings, they also initiate the switching process because they do not believe that providers have their interests at heart. They believe that they have to push for the best price and switching is the lever to give it. This is particularly true in the case of car and household insurance.
- They believe that if they stay loyal and quiet they will be taken advantage of.

" Loyalty is shafted – its expensive to be loyal"



And What they Switch is often Complex …

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- They switch service providers in purchase areas that if it went wrong could have a core and significant impact on their lives.
  - Health insurance.
  - Car insurance.
  - Home insurance.
- They also switch in service areas that also run the risk that if the move does not go smoothly it could have a disruptive impact on their lives. Broadband for example.
- They switch in areas that are inherently complex – the most extreme of which is health insurance, where the policy and choice complexities surely outweigh those of the mortgage market.

But it comes down to a confident mindset

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- There is a contradiction between the non mortgage switching behaviour and the switching behaviour.
- There are many reasons why non switchers shy away from the mortgage switching process. They include:
  - *"I'd have to take a day off work"*
  - *"I'll stick with what I have"*
  - *"In Vegas the house always wins, with mortgages, the bank always wins"*
  - *"It's a mountain of paper work"*
  - *"You don't want to be looked at under a microscope again"*
  - *"It's a lot more hassle to switch a mortgage"*
  - *"The man in the street doesn't know what he is doing"*
- One of the factors that needs to be considered is their lack of understanding of their own power as consumers in the process. They don't engage with the fact that the lender needs them as much as they need the lender, they don't understand how mortgages work and they seem to believe that the involvement of other players in the process, other than the borrower and lender creates an impenetrable complexity.
- And few seem to recognise that even if you get an offer you don't have to take it.

Whereas the Switchers are More Confident

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9

- **They believe that the service level provided by banks is declining.**
- **All are glad that they switched.**
- **Some did not switch by choice, but seem sanguine about it. They are marked by low loan to value and no-one appeared to be in financial distress.**
- **They all have an economic view of the banks – it is a transactional relationship rather than a personal one. The banks they were leaving rarely if ever got in touch to keep the business – "*they couldn't care less*" which served to underline their belief that they themselves were best to act in their own interest.**
- **The process was difficult – and "*you would need to be resilient*"**

Perspectives on the Mortgage Market

They take a relatively positive view on the mortgage market …

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11

- **They are aware of the different players in the market**
  - **But have no real sense of who is actually lending currently or not.**
  - **Of those who borrowed or switched in the past few years, […] has established a presence and offers an active alternative.**
  - **There was no sense of lenders who might have changed criteria or dialled back their engagement with the market – there was mention that they had not heard much from the Scottish banks!**
- **They believe that the application process has become much harder than before but:**

"You've got to play the game, but if you jump through the hoops you'll get it"

- **They believe that there is enough competition in a small market.**
  - **They have a preference for the established indigenous players**
  - **They do not crave alternatives – *"alternative finance providers have a desperate reputation"* and are *"bottom feeders"***

… And take a broadly positive view of the Central Bank rule changes of 2015.

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- They believe that loose lending in the market in the period before the crash was a key contributory factor in the crash.
- A minority were suffering from negative equity – and were of the view that they were restricted in their options in the market.
- Those who expressed negative views on CBoI's 2015 intervention felt that it was more likely to penalise the second time buyer – who may suffer from a combination of negative equity and the requirement to have 20% of the purchase price as a deposit.

"I will never have 20% of the value of a property saved in my lifetime"

- They are fearful that lending decisions in lending institutions now run the risk of over centralisation and automation.
- They do not want to see the flexibility of individual lending officers reduced to complete mechanisation and a process.

In Truth they are More Bothered about Bank Behaviour …

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13

- They believe that personal service in banks is a thing of the past.
- They object to major purchase decisions (which is what a mortgage is for them) being forced online

"to some office in Dublin where there is someone looking at a screen saying yes or no"

- Their interaction with banks appears functional rather than relationship based. They do not believe that track record or history counts for much. They are sceptical of promotional rates for new business in the mortgage space while existing customers pay more.
- They also believe that the pendulum has swung from lax lending to very intense scrutiny. Several cited examples of scrutiny line by line of current account transactions for switching credit cards and a number of non-switchers believed that they would be subject to an invasion of privacy if they attempted to move.

"Banks don't give a damn – they are very cold"

- It was very striking throughout that no-one could provide evidence of a relationship with an individual or branch of a financial institution. In the past there was a sense of a different relationship locally with a financial institution with a lower regard for the 'national brand'. This is no longer the case.

… and Believe that the Illusion of Complexity Suits the Banks

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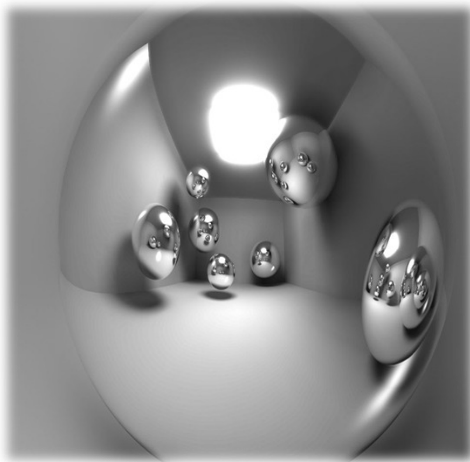

- There is a fundamentally different perception of the understanding of the complexity of switching mortgages to the complexity of switching other products.
- In an absence of trust or control, they believe that banks rely on jargon; that they won't act in the customer's best interest (and the customer doesn't know what that best interest is) and that they will engineer pitfalls.
  - *"The man in the street doesn't know what he is doing"*
  - *"Why do they make switching so difficult?"*
  - *"You are supposed to know all the terminology"*
  - *"I wouldn't be able for the stress of it"*
- And finally the evidence from the switching groups is that no bank that was being left, put up any resistance to the borrower's departure.

Attitudes towards new players in the market – I

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15

- **The presence of additional or alternative players in the market place is greeted with scepticism.**
- **They reflect on the experience of 'new players' in the past and how they believe that they performed during and after the crash.**
- **They wonder about the commitment of new players to the market and to their customers. They see how the previous new players' mortgages ended up with the vulture funds. Several attendees had taken mortgages with Bank of Scotland or Danske Bank and quite simply (and alarmingly) did not know where they had ended up. Money was leaving their account every month to an unknown destination……**
- **There is fear of the unknown.**
- **The one new potential player who received positive reaction was the credit union movement – but in a sense they aren't a new player**
  - **They are established and known.**
  - **They provide good customer service.**
  - **There is somewhere physical to visit.**

Attitudes towards new players in the market – II

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- **In truth their attitude to new players is further evidence of their lack of confidence in their own knowledge of the market. They don't buy a mortgage, they get one. They don't see themselves as a customer of a mortgages bank, more as a lucky supplicant. Because they don't understand the process, they don't understand whether they will or will not get a mortgage.**
- **And so the risk is, that what they seek will (a) not be provided or (b) will be amended in a way that they have not anticipated or is outside their control during the lifetime of the mortgage.**
- **They do not appear to sense that they have any power as a borrower. In a sense they appear to believe that they have some power or ability to influence in a face to face context more so than online – which may be the rationale for their comfort with face to face interaction and local players**

Brokers

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17

- For the minority who used brokers, they believed that brokers were on their side (more so than mortgage providers) and they believed that brokers had an expertise and insight that they personally lacked.
- But the majority did not think about brokers in the mortgage or switching context (even if they used brokers for insurance purchases).
- There was some discussion of conflict of interest (in that the broker derives income from the lender) and need to consider and be aware of this with the potential benefits of the availability of expertise.
- Those who used brokers believed that they took the pain of mortgage applications away from the borrower – they looked after the paperwork, they were able to deal with multiple applications to different financial institutions.
- The majority of the switching group had not used a broker formally in the switching process. They had used other sources of advice – principally family and friends and one where a family friend happened to be a broker – but there is a clear opportunity for brokers to act in this area.
- The purpose of these groups was not to examine the role and potential of brokers, but there is clearly consideration required of the role that brokers can play in highlighting and facilitating the switching process.

Fixed Rates and Extending Fixed Rate Terms

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18

- Many had used fixed rates as part of their mortgage management process. The fixed rates had provided certainty at the time of maximum financial vulnerability:
  - At the outset of the mortgage when debt exposure was high
  - At critically expensive times for their families – when children are small or when they are at school.
- While they like the certainty of fixed rates at specific times, they are more bothered about misreading market movements – so they are wary of being 'caught out' on a fixed rate that is materially different from the variable rate. There appears to be an emotional as well as a financial cost to getting this wrong – it underlines their sense of foolishness and ignorance.

- Some were on tracker rates – and so were not going to consider switching.
- There was no sense in any group that people were aware that rates currently were well below historic rates or of any consideration that rates might rise substantially in the future. What was present now was perceived as normal.
- They have no sense or opinion as to whether the fixed rates available at present represent good value in a 20 year context.
- The absence of this awareness of interest rate movements (other than those on a tracker) and the risk of rates rising means that there is little appetite for a fixed rate of a 15 year or 20 year horizon.
- They are also unsure of the impact of locking into a fixed rate on their flexibility in relation to home ownership – could they move house if they were locked into a fixed rate?
- They don't know enough to commit.

A desirable fixed rate product would have a fixed rate with variable flexibility

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19

- They like the idea of a fixed rate – but in reality they like the idea of a capped rate – so the mortgage holder couldn't lose. Among the items suggested were:
  - A fixed rate with an opt out if the variable rate dropped (with no penalty)
  - A fixed rate with the option of a review at a set point
- One attendee described how he had split his mortgage between fixed and variable – to give the benefits of both. Few had thought about this – but it gained traction in the group as an option. The fact that some time was spent in the Group explaining this option demonstrated once again how little intuitive feeling people have for their mortgages.
- Their limited understanding of mortgage products shines through here – for example, they believe that penalties for breaking fixed rates are simply banks making excessive profits.

For non switchers inertia and ignorance are key…

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- They switch everything else as a matter of routine and almost of honour.
- They provide numerous reasons as to why they won't switch mortgages
- The monthly mortgage repayment doesn't appear to cause them difficulty – this may be a function of the fact
- The reality is that they don't really know how much it will cost, how much they might save or what the process is. They are at sea.

- They need to know from the outset that they can complete the process without damage to themselves or their tenure in their home.
- In our groups, it appeared that the majority were not struggling financially with their mortgage – some seemed to be struggling with negative equity (and that acted as a barrier) and with the thought that they would have to lose their tracker mortgage if they moved.
- But fundamentally it comes down to risk and reward. They believe that there is significant risk in switching and relatively little reward. To be tempted to switch the figure of a saving of €100 a month was mentioned.

The rationale for switching has to be absorbed before other prompts will work

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21

- There is a macro requirement that people need to understand why they might even begin to consider changing-
  - There are savings
  - They can change the structure of their mortgage (term, fixed rate etc.)
  - It is straightforward – but requires resilience and follow through
  - Other people do it.
  - There are people who can support and assist.
  - And fundamentally they don't have to take any of the offers that they get – it isn't inevitable that they have no choice at the end.

- They need to understand their role as the consumer or service acquirer. They are paying all of the service providers, banks, assurance companies, solicitors and surveyors.

- The opportunity needs to be dialled up, and the fear needs to be dialled down.

Other People's Example is key…

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- In the same way as switchers appear to influence the people around them, the prompt for switching often comes from others. The role of the friend or family member as trusted advisor should not be underestimated. What they may lack in expertise is more than made up for in trust, support and advice.
- Examples cited included a sister-in-law; a neighbour who was an ex banker but now a broker (who provided impartial advice) and their own switching behaviour.

Repossession

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- In all the groups we sought to test the notion that a more streamlined shorter repossession process could result in making the market more attractive to newer players, increase competition and drive down the costs.
- There was not a visceral reaction to the idea of repossession. In all groups there was a recognised difference between those who were genuinely in trouble (who evoke huge sympathy), and a minority who were perceived to be gaming the system.
- The appetite for a truncated repossession process was limited – particularly in the case of family homes. In the case of Buy-to-Lets, there was a sense that these purchases were commercial transactions and should be treated differently. In some groups there was an awareness of the knock-on consequences for tenants of a more aggressive approach to commercial repossession.
- They are also unconvinced of the benefit of a streamlined process for the mortgage market:
  - They are sceptical as to whether the banks would pass any benefits to the consumer.
  - They are unsure of what the benefits would be (which again goes back to their lack of financial insight and savvy)
  - They fear the substantial risk of it going wrong in the downside
- The core rationale for the possible change – to attract competition and new players into the market – is not one that they share. They believe that there is sufficient competition currently – and they prefer the players that they know.

The Pre-Task Outcomes

Those who had not switched were presented with four theoretical mortgages

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- We cited four different providers
  - […]
- We asked the group to compare and contrast the different mortgages

So they choose the familiar

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- Of the 21 who expressed a preference
  - 9 went for the […]
  - 7 went for the […]
  - 4 went for […]
  - 1 went for […]
- Fundamentally they stuck with the brands and organisations that the know – and even though many were impressed by the simplicity of the […] offer, they were not fully persuaded in the end.
- In terms of term of mortgage, they split relatively evenly between 15 and 20 years

Insights and Implications

There is a real information gap at the heart of this issue…

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- **They know how to change most suppliers, but they don't know how to change mortgages.**
  - **They are unaware of the costs and benefits.**
  - **They have an exaggerated view of the risks**
  - **They do not know where to turn.**
- **They know how the process starts, but are unsure of what happens next.**
- **They lack real financial knowledge – and as a consequence confidence.**

… which create uncertainty and fear

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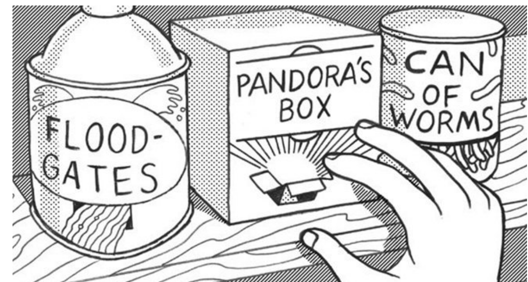
29

- The excuses that they trotted out for not switching are scarcely credible
  - We might not get it.
  - Better the devil you know.
- They are afraid of opening up a can of worms if they go back over the mortgage issue.



- They do not want people pouring over their finances.
- They don't have a sense of how the system works.
- They don't want to end up looking stupid or losing out.

Any strategy has to be consumer centric

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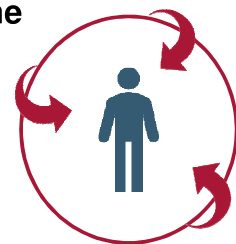
30

- There is a requirement for people to understand that it can be done – that people like them switch all of the time and live to tell the tale.
- It has to move away from a supplicant relationship to a peer to peer relationship.
- It has to describe the process end to end.
- It should estimate the costs and benefits of switching.
- It should focus on the language that can be understood (repayments per month).
- It needs to describe the costs, the personnel and the timeframe involved.
- It needs also to describe what is not involved.



… And built on existing players

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31

- They are all sceptical of new players in the market place. The reaction to the theoretical offer from […] was that they'd like it – but from someone else. The repeated downside was that they were an unknown quantity and the experience of unknown quantities in the past decade was not positive.
- In the pretask, the vast majority plumped for lenders that were familiar to them.

Methodology

Brief and Background

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- The CCPC commissioned Amárach to undertake qualitative research amongst mortgage holders.
- The research took the form of six focus groups (eight persons per group) of mortgage holders with three of the groups consisting of people who had previously switched their mortgage.
- The attendees were drawn from different age groups. There was an equal split of gender in all groups. The groups were held in Dublin, Galway and Cork.
- Amárach developed a core discussion guide with CCPC. There was two variations – one for those who had switched and one for those who had not.
- Each group lasted about 90 minutes and was moderated by Amárach staff with expertise in the area.

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B. List of Respondents to the Public Consultation

B.1 The full responses are available on the CCPC website. The CCPC received 20 responses to the consultation from a range of different stakeholders including:

- 5 industry representative bodies (The UK Council of Mortgage Lenders (CML), the Professional Insurance Brokers Association (PIBA), the Irish League of Credit Unions (ILCU), the Credit Union Development Association (CUDA) and the Law Society of Ireland);
- 4 lenders currently active in the market (Lender 1, Lender 2[176], BOI and PTSB);
- 3 individual mortgage consumers;
- 3 consumer representatives (MABS, the Public Banking Forum, the Fair Mortgage Rates Campaign);
- 1 academic (Dr. Ed Shinnick); 1 market commentator; 1 potential new entrant (The Frank Mortgage); 1 mortgage broker (IMB); and 1 political party (Fianna Fáil).

[176] Lender 1 and Lender 2 asked for their identities and submissions to be fully redacted.

C. Mortgage Arrears for those in Difficulty

Box C.1 MABS Submission – Mortgage Arrears in the Context of Total Household Debt for those in Difficulty

In its 2013 report - MABS Clients and Mortgage Arrears: A profile of MABS clients in mortgage difficulty and factors associated therewith – MABS found that over 80% of those in mortgage difficulty had other, unsecured, borrowing. Due to the nature of unsecured debts, the collections methods of lenders tend to place more pressure on borrowers than those who have security to rely on. For borrowers under pressure this can result in promises to pay which are unsustainable and which put priority payments at risk. In particular, in MABS experience, there is a strong inclination to make repayments to credit union debts. This is because having experienced a loss of income such borrowers need to rely on credit union borrowings in order to live. Most households require two incomes to service a mortgage and meet day-to-day living expenses. Where one income is lost, due for example to loss of employment or ongoing illness, both the capacity to meet the mortgage and meet routine living expenses become greatly impaired. In MABS experience households endeavour to prioritise the mortgage but, if the loss of income is sustained, they will rely on borrowings from the credit union to meet for example, insurance payments, car repairs, essential home repairs etc. and in effect credit union borrowings come to sustain a household in these circumstances. Logically, the longer the loss of income continues, the worse the situation becomes.

The MABS process is to prioritise payments to accommodation, current utilities, childcare payments and anything which may result in a loss of liberty for the client to, where possible, ensure the client remains in their home. In MABS experience, most households cannot sustain a long-term loss of income without risk to the ongoing sustainability of their mortgage and other detriment to the household's financial situation.

In this context, rescheduling/restructuring the mortgage and other debt repayments on a basis that affords the household the opportunity to live at or above reasonable living expense thresholds is essential but this must happen at the earliest possible opportunity.

The difficulties currently being experienced by over-indebted borrowers need a more immediate response. The latest statistics on Mortgage Arrears published by the CBI saw a slight decrease in the use of short-term resolutions, such as interest only and reduced repayments but an increase the use of split mortgages. While split mortgages may provide a solution for some borrowers with future increased repayment capacity to meet the adjusted payments when the warehoused portion becomes due, for those with long-term income inadequacy split mortgages only serve to delay the inevitable to a future date. The exploration of new long-term solutions such as inter-generational mortgages, debt for equity swaps where equity permits and lifetime loans would greatly enhance the options available for those with long-term affordability issues.

The cost of homeownership (and rental costs in that market) as a percentage of household income will continue to place many Irish households in a financially vulnerable situation until such time as both social and commercial residential housing stock supply issues are substantially addressed with the overall aim of driving down accommodation costs.

There are currently 91,600 households on the waiting list for social housing , over 7,000 people experiencing homelessness (including over 2,000 children and dependents), and an estimated future net increase in household formation of between 16,000 and 33,000 per year. MABS view is that macro-economic policy encompassing regional development, employment creation outside of major urban centres and sufficient supply of appropriate housing stock are the key

elements in achieving a functioning property market. The recession imposed a serious lag in this regard and 'Rebuilding Ireland' recognises the array of actions that now need urgent progression.

Source: MABS CLG

D. Summary of CBI Mortgage Switching Research, April 2017

Box D.1 Central Bank Mortgage Switching Research

The most recent research undertaken by the Central Bank on this topic was published on 11 April 2017. The research was externally commissioned, involving focus groups and a quantitative survey of 2,003 mortgage holders. It was conducted to gain a better understanding of consumers' perceptions, attitudes and experience of mortgage switching in order to identify areas where further action by the Central Bank could assist borrowers who are considering switching their mortgage. While many consumers surveyed, who have switched their mortgage, reported a positive experience, others reported many aspects of the switching process that could be improved to better facilitate mortgage switching. In addition to the consumer research, the Central Bank also conducted research amongst lenders, mortgage intermediaries and law firms in order to gain insights into their views of the mortgage switching process.

The main findings from the Central Bank research can be summarized as follows:

Consumers see mortgage switching as a significant undertaking

- 44% of all mortgage holders surveyed felt that the switching process would be too complex.
- 38% of those surveyed who switched their mortgage reported that a reduction in the amount of paperwork/documentation required for the mortgage switching process would improve the process.

Consumers see mortgage switching as costly

- 37% of those surveyed who have switched their mortgage with the same lender said there were additional processing fees that they were unaware of.
- 33% of those surveyed who considered switching but did not, reported that a lower cost process would encourage them to switch.

Consumers who switched their mortgage had a positive experience

- 81% of mortgage holders surveyed who switched their mortgage agreed that they understood what was going on at each stage of the process.
- 27% of mortgage holders surveyed who switched mortgage lender reported no obstacles to switching their mortgage.

Consumers said that they might consider switching if they could be certain that they would make a saving over the lifetime of the mortgage

- 54% of all mortgage holders surveyed agreed that they might switch if there was a long-term guarantee of an interest rate saving. This figure rose to 77% amongst mortgage holders surveyed who considered switching but did not switch.
- 42% of mortgage holders surveyed who had never switched said that lower interest rates would encourage them to switch.

Easy comparison of mortgage products is a key step in the mortgage switching process

- 32% of mortgage holders surveyed who switched their mortgage disagreed that it was easy to compare mortgages from different lenders.

- 30% of those surveyed who have switched mortgages disagreed that mortgage products were simple to understand.
- 31% of mortgage holders surveyed said they were aware of the CCPC's consumer help website (www.consumerhelp.ie), but only 11% had visited this website and only 6% had used the mortgage comparison tool.

A single point of contact or a dedicated switching team would encourage and assist with the mortgage switching process

- 36% of those surveyed who switched their mortgage reported that they had to chase their lender to be kept informed during the mortgage switching process.
- Across all elements of the research, a single point of contact or dedicated switching teams who would assist consumers throughout the switching process, were highlighted as possible stimuli to switching.

Improvements to the specified timelines around the mortgage switching process are also needed

- 28% of mortgage holders surveyed who switched mortgage lender reported delays with the legal process as an obstacle in the switching process.
- 19% of those surveyed who switched mortgage lender reported delays with the new mortgage lender approving the mortgage application as an obstacle in the switching process.
- 28% of mortgage holders surveyed who considered switching but had not said that a less time consuming process would encourage them to switch.

The Central Bank now plans to progress its work in this area and will publish a consultation paper in Q3 2017 proposing additional measures to facilitate mortgage switching for those consumers minded to switch. Specific proposals to be explored will include:

- lenders providing greater clarity to consumers on the switching process itself, including as to timeframes and potential costs of switching;
- the benefits of lenders having dedicated switching contact points;
- further disclosure rules at trigger points in the mortgage life cycle e.g. end of a fixed interest-rate term; and
- the scope for increased co-operation amongst lenders during the mortgage switching process.

Previous research by the Central Bank showed that borrowers can save significant sums of money by switching their mortgage[177]. The recently published Mortgage Switching Research continues the Central Bank's work to maintain a strong consumer protection framework for mortgage borrowers and builds on new protections introduced by the Central Bank for variable rate mortgage holders which enhance transparency and facilitate consumer choice.

Source: CBI

[177] Devine, Frost & McElligott, 'Switch and Save in the Irish Mortgage Market' Vol 2015, No. 8, Central Bank of Ireland. https://www.centralbank.ie/docs/default-source/publications/economic-letters/economic-letter---vol-2015-no-8.pdf?sfvrsn=10

E. Repossession Process in Ireland

Box E.1 Repossession Practice in Ireland

In general, a lending institution may start the proceedings for repossession in either the Circuit Court or the High Court. However, if the mortgage was taken out on or after 1 December 2009, then a case for the repossession of the home arising from default on a housing mortgage loan must be first taken in the Circuit Court. The Land and Conveyancing Law Reform Act 2013 (described above), has extended this rule to housing loan mortgages taken out before 1 December 2009. A housing loan mortgage is the usual kind of mortgage that individuals take out in order to build, buy or improve a house. (Cases involving repossession for default on other kinds of mortgages may continue to be taken in either the Circuit or the High Court.)

The usual procedure is that the lending institution applies to the court for one or more orders – a possession order and/or a well-charging order. These orders may be granted in the same proceedings. Generally, it is the practice of the courts to allow you some time to make arrangements to repay the money owed before making any final orders.

If an order for possession or a well-charging order is made against you and you do not hand over possession or comply with other terms of the orders, the orders may be enforced by the Sheriff (in Dublin and Cork) or by the County Registrar in other areas.

Circuit Court procedure

The procedure in the Circuit Court is governed by the Rules of the Circuit Court as set out in the Circuit Court Rules (Actions for Possession and Wellcharging Relief) 2009. You may find this guide to possession proceedings (pdf) useful as you prepare to go to court.

The Circuit Court process starts when the mortgage provider issues you with a civil bill. This is usually accompanied by an affidavit setting out the claim that is being made against you. The civil bill has a return date – that is the date on which the matter will come before the County Registrar. The civil bill must be served on you at least 21 days before the return date.

The mortgage provider may apply for a possession order and/or a well-charging order (see below).

If you intend to fight the action taken by the mortgage provider to repossess your home, you must enter an appearance (there is a specific form for doing this) within 10 days of being served the civil bill. You must then file an affidavit replying to the mortgage provider's claim and serve that on the mortgage provider at least four days before the return date.

When your case comes before the County Registrar it will be decided on the basis of what is in the affidavits. Neither side has the right to give oral evidence except in specific circumstances. However, you do have the right to cross examine the person who swore the affidavit. In order to do this, you must have given notice that you require this person to be present.

The County Registrar has the power to make a number of orders, including adjournments, notice to third parties and more time to file affidavits.

Decisions by the County Registrar

The County Registrar may make an order for possession and/or a well-charging order if you have not entered an appearance.

The County Registrar can also make an order for possession, if you have entered an appearance and filed a replying affidavit, but your affidavit does not disclose a prima facie defence (this means that the affidavit does not show any obvious defence).

If you have entered an appearance and filed a replying affidavit which does disclose a prima facie defence, the case must be sent by the County Registrar for hearing by a judge.

Judge's decision
The judge may grant or refuse the order requested.

High Court
The procedures for getting well-charging and possession orders in the High Court are similar. The Master of the High Court has a similar (but not exactly the same) role as the County Registrar in the Circuit Court. The procedure is set out in Order 38 of the Rules of the Superior Courts.

The lender may apply to the High Court for a possession order and, if necessary, a well-charging order.

The process involves the lender issuing a special summons. This is first dealt with by the Master of the High Court. He sets a return date which may not be less than 7 days after the issuing of the summons. The summons must then be served on you at least four days before the return date. The lender must file an affidavit setting out the facts of the claim in the Central Office of the High Court. The hearing may be on affidavit only or oral evidence may be given.

The Master may grant or refuse the orders requested or may forward the case for hearing by a High Court judge.

Mortgage suit
A mortgage suit is a court procedure which is taken by the holder of a security on property (for example, your mortgage lender) to recover a debt by forcing a sale of that property. If a mortgage suit is successful, the court issues a well-charging order. A well-charging order usually includes:

A declaration by the court that the debt owing to the person or institution (together with any interest and costs) taking the case is “well charged” on the property in question
A direction that the property be sold (usually the court gives you time to pay the amount due before the order for sale becomes effective)
A direction that the Examiner’s Office take an account of all encumbrances and make an inquiry into their respective priorities. This can arise, for example, if you have more than one mortgage on a property or there is some arrangement whereby some of the proceeds of sale of the house must be used for other purposes
The arrangements for the sale are also generally agreed through the Examiner’s Office. The sale is usually by public auction. If the sale price is greater than the amount you owe, then the excess is paid over to you. If it is less, you are still liable to repay the shortfall.

If you manage to make a settlement with the lender and agree repayment terms, then the lender may apply to the court to discharge the well-charging order.

Executing the orders
If you do not comply with the terms of the court orders, they may be enforced by the sheriff or the County Registrar.

Source: http://www.citizensinformation.ie/en/housing/losing_your_home/home_repossession.html

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