Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Gobharnóir / Governor

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Dear Deputy Doherty,

Re: Queries with respect to mortgages held by non-bank non-lenders

Thank you for your letter of 21 June in which you set out a series of questions on the subject of borrowers whose mortgages are held by non-bank non-lenders (NBNLs) regulated by the Central Bank of Ireland. Responses to your questions are set out in the attached annex. The rest of this letter sets out some broader context and our ongoing work.

Persistent high inflation

The rising cost of living poses challenges to all households and businesses across the country, and affects those with least means the most. Euro area inflation reached 10.6 per cent in October 2022, before moderating somewhat to 6.1 per cent in May this year, still well above the ECB's medium term target of 2 per cent. Irish headline inflation has followed a similar trajectory, reaching 9.6 per cent in July 2022 and falling to 5.4 per cent in May.

Interest rates are the main tool to fight inflation and the ECB's Governing Council has been increasing rates from historically low levels in order to stem the increasing cost of basic household goods and services. As monetary policy transmits through to the economy, households and businesses are facing higher interest rates than they did in the recent past. We recognise, of course, that higher interest rates pose challenges for borrowers. But, if inflation were to become entrenched across the economy, everyone would be worse off. And the eventual increases in interest rates needed to return inflation back to target would be even larger. The societal costs of a high and unstable rate of inflation are large and underpin the importance of taking policy action to bring inflation back to target.

Protecting consumers

Being live to the impact of rising costs of living on consumers, we set about a programme of work last year that continues today. This includes considering the impact of both rising interest rates and the rising cost of living more generally. It has included, for example, our work to raise awareness of the risk of underinsurance in housing, where (in 2022) we took steps to require firms to be more proactive in supporting consumers to identify and deal with this risk.

As part of this system-wide work, we issued a Dear CEO Letter last November reminding firms to follow-through on expectations outlined in the Consumer Protection Outlook Report issued in March 2022. Those expectations included the need to identify emerging risks for customers proactively, assess the consumer impact of commercial decisions, and ensure operational and customer capacity during a challenging period. The letter was directed at firms across the whole of the financial system, including mortgage lenders and NBNL firms, building on the strong regulatory framework already in place to protect consumers.

In the field of mortgage interest rates specifically, we have organised our work in phases. The first phase was aimed at gaining assurance across the system that the regulatory framework[1] was working across the topics of arrears, switching and interest rate increases. We published a note on this work on 26 April[2] where we detailed our work to ensure that:

- Firms enhance the supports available to borrowers in or facing arrears. Building on the Code of Conduct on Mortgage Arrears (CCMA) requirements in respect of pre-arrears, this includes enhancing early warning indicators to identify those borrowers who may require additional support as rates increase;

- Firms have sufficient operational capacity in place to manage applications by borrowers to switch their mortgage or mortgage provider, and that there is no discrimination

[1] Macro-prudential mortgage measures, the Consumer Protection Code 2012 (**CPC**) and the Code of Conduct on Mortgage Arrears (**CCMA**) comprise the bedrock of the protections in the framework

[2] 'Protecting Consumers in a changing economic landscape'

against borrowers based on where they currently hold their mortgage; and

- Increases in mortgage interest rates are in line with mortgage terms and conditions, firms' published variable rate policy statements and the regulatory framework for which the Central Bank is responsible.

The first phase of our work established that, properly applied, the regulatory framework is well-positioned to deliver for consumers in this context. We have seen firms introduce additional supports for borrowers and increase operational capacity, including proactive contact with vulnerable borrowers and continued provision of supports, including alternative repayment arrangements to borrowers at risk of arrears. While some degree of switching was taking place from non-lending firms to mortgage lending firms (including retail banks), the numbers are small. However, from our review, we saw no evidence of discrimination based on the firm the switching application was coming from.

Having concluded the first phase, we are now focused on Phase 2 which involves looking more closely at how the framework is delivering for consumers as rate increases begin to have an effect.

Given the scale of the issues facing borrowers – and in addition to ongoing engagement with individual firms – we held a roundtable last month with all mortgage lenders and non-lending firms where we discussed areas where consumers could be better-supported, including where the information or options available could be enhanced. In the case of switching, the industry understands our expectations that:

- In the current environment, it is particularly important that borrowers who are eligible and want to switch mortgage provider are supported to do so, they can easily access information and the process is not unduly burdensome;

- Firms must ensure they have sufficient operational capacity to manage the flow of switching applications (and not create unnecessary frictions in the process) and that they facilitate switching through consistently applied credit assessments. There should be no discrimination based purely on where borrowers hold their mortgage;

- Subject to satisfying credit assessment, borrowers should be able to avail of any better-priced or more suitable products provided by their own lender or in the wider market.

We want to see the capacity in the system for more borrowers to switch (subject to credit underwriting criteria) utilised to the maximum possible extent.

I recognise that, as in any mortgage market, there will be borrowers who (for credit reasons) will not be in a position to switch mortgage and will require to be supported by their existing lender to ensure their repayments are affordable. Our work therefore continues to have a focus on the position for borrowers facing financial difficulties. We believe that more can be done by the industry to enhance the information available to borrowers to navigate the rising interest rate landscape and the options and support available to them.

Policy questions

Subject to satisfying a credit assessment, I agree that borrowers should be able to avail of any better-priced or more suitable products provided by their own lender or within the wider market. I also agree that more can be done by industry to support this (and welcome the Banking and Payments Federation's Dealing with Mortgage Debt campaign launched in conjunction with MABS).

Finally, the industry is aware of our view that a borrower's ability to participate in the mortgage market should not be influenced by who their lender is or has been in the past (i.e. for non-credit based reasons). I can confirm that we have not seen any evidence of discrimination against switching applicants coming from NBNLs.

Yours sincerely

Gabriel Makhlouf

ANNEX

1. Can the Central Bank clarify the number of Primary Dwelling Home mortgages held by…non-bank non-lenders?

At the end-March 2023, 113,856 Primary Dwelling Home (PDH) accounts were held by all non-banks, 80,032 accounts of which were held by NBNLs. This data is contained on page 3 of the Central Bank Statistical Release relating to Retail Interest Rates (March 2023), published on 10 May 2023.

2. Can the Central Bank provide the average weighted interest rate for this cohort of mortgages by decile?

Table 1 below highlights estimates of the changes in the mortgage interest rates on outstanding loans from March 2022 to March 2023. This was also explored in a recent Behind the Data published by the Central Bank.

It is clear that there are differences in the mortgage lending rate distributions between retail banks and non-bank firms, but also there are differences between non-bank lenders and NBNLs. As an example, in March 2023, 72 per cent of retail bank mortgages were at an interest rate of 4 per cent or lower, down from 93 per cent at the 4 per cent or lower rate 12 months prior. For non-banks lenders, 92 per cent of mortgages had rates of 4 per cent or lower in March 2023, down from 99 per cent 12 month prior, while for NBNLs, the rate at 4 per cent or lower fell to just 42 per cent in March 2023 from 78 per cent in March 2022.

Table 1: Estimates of the distribution of Interest Rates of Outstanding PDH Mortgages: March 2022 versus March 2023 ***(cumulative percentage of mortgages at each interest rate interval)****

End-March 2022

Interest Rate Intervals (%)	**Banks**	**Lending RCFs**	**Non-lending firms**
<= 0.5	2%	1%	14%
<= 1.0	16%	2%	36%
<= 1.5	31%	3%	55%
<= 2.0	32%	13%	57%
<= 2.5	42%	36%	60%
<= 3.0	66%	76%	64%
<= 3.5	82%	97%	68%
<= 4.0	93%	99%	78%
<= 4.5	99%	99%	94%
<= 5.0	100%	100%	96%
<= 5.5	100%	100%	98%
<= 6.0	100%	100%	99%
<= 6.5	100%	100%	99%
<= 7.0	100%	100%	100%
<= 7.5	100%	100%	100%
<= 8.0	100%	100%	100%
<= 8.5**	100%	100%	100%

End-March 2023

Interest Rate Intervals (%)	**Banks**	**Lending RCFs**	**Non-lending firms**
<= 0.5	1%	0%	11%
<= 1.0	1%	0%	12%
<= 1.5	1%	0%	12%
<= 2.0	1%	17%	13%
<= 2.5	16%	46%	14%
<= 3.0	37%	77%	16%
<= 3.5	57%	90%	21%
<= 4.0	72%	92%	42%
<= 4.5	93%	93%	65%
<= 5.0	98%	96%	74%
<= 5.5	99%	97%	79%
<= 6.0	100%	98%	81%
<= 6.5	100%	99%	91%
<= 7.0	100%	100%	93%
<= 7.5	100%	100%	98%
<= 8.0	100%	100%	99%
<= 8.5**	100%	100%	100%

**Estimates based on CCR data. These are not official Central Bank Statistics.*
***A small number of mortgages are held at interest rates above 8.5% - approximately sub 800. At end-March 2022, 0.05% of the mortgages with Banks were above 8.5% and remained unchanged at 0.05% by end-March 2023. For Lending RCFs, 0.004% of mortgages were at a rate higher than 8.5% at end-March 2022, while there were no mortgages with Lending RCFs above that rate at end-March 2023. Meanwhile, for Non-Lending Firms, at end-March 2022, 0.03% of these mortgages were at a rate higher than 8.5%, and this has increased to 0.43% of Non-Lending Firms' mortgages at end-March 2023.*

Some key findings of the Central Bank's analysis[3] of interest rates in the non-bank sector are as follows:

- Generally, non-banks have a greater reliance on wholesale funding (often tied to EURIBOR) than retail banks as they are not authorised to accept deposits. As such, the

[3] Outlined in greater detail in the Governor's letter to the Minister for Finance of 6 June 2023

pass through of rising interest rates is more strongly linked to their funding model and tends to happen quicker.

- Most of the mortgages serviced by NBNLs are assets in securitised portfolios owned by investors who are not regulated by the Central Bank. NBNLs are paid on a fee basis which do not rise in line with interest rate increases. A typical securitisation will contain terms and conditions for the bonds within the structure that will dictate the return the NBNL is expected/contractually required to provide to the investor(s). Usually, this is EURIBOR plus somewhere between 1.4 and 4 percentage points.
- NBNLs are broadly increasing rates for variable rate loans as the ECB rates and wholesale market rates have trended higher. We have also seen that not all increases have been passed on to the fullest extent possible (in terms of increases in ECB or wholesale funding rates). In some cases, firms have exempted certain borrowers on affordability grounds.
- We have not seen rate increases that are contrary to customers' terms and conditions or increases beyond what the underlying securitisation structures would envisage.

3. Can the Central Bank provide a breakdown of the number of Primary Dwelling Home mortgages held by [NBNLs] with respect to mortgage loans which are performing, performing and restructured (disaggregated by restructure type) and in arrears?

Mortgage arrears data are published quarterly for two different categories of mortgage only: (i) banks and (ii) non-banks (where lending and non-lending non-banks are combined).
The latest available data set is for Q1 2023 is available here.

Of the total 716,560 PDH accounts (across banks and non-banks), 113,835 are held by non-banks.

Of those accounts held by non-banks 26,413 were in some form of arrears as at end of March 2023.

This means that a total of 87,422 accounts held by non-banks (non-bank lender and NBNLs combined[4]) are either (i) performing without a prior restructure or (ii) restructured and performing.

4. **Can the Central Bank provide the number of Primary Dwelling Home mortgages held by [NBNLs] which they assess are in a position to switch to a bank or non-bank lender?**

Each individual lending institution has their own credit standards and process that they apply to any application from a borrower to switch mortgage provider. These assessments cover a range of underwriting criteria about the applicant including credit history, affordability test, loan-to-value (LTV), outstanding balance on existing mortgage, other borrowings etc. Every borrower (and mortgage application) is unique and contains a wide range of data points which may influence the willingness or otherwise of a particular lender to extend credit in the form of a mortgage.

Our ongoing work will seek to achieve a greater degree of assurance that participants in the mortgage market are taking steps themselves and as a coordinated group to ensure that those borrowers who can be expected to be in a position to switch are supported to do so.

However, internal Central Bank data shows that the number of accounts held by NBNLs that have been assessed as never having been in financial difficulties[5] was approximately 22,000 in March 2023. A further approximately 32,000 accounts were classified as having 'previously experienced[6]' financial difficulty. These figures represent the upper limit number of NBNL accounts who may be in a position to look for an alternative mortgage provider; however, the aforementioned criteria will be considered for any application to switch.*

5. **Can the Central Bank provide the number of Primary Dwelling Home mortgages held by [NBNLs] which they assess are performing but unable to**

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[4] Statistical confidentiality rules prevent publication of further disaggregation of lending/non-lending non-banks by arrears, restructuring activity (etc).

[5] Account has never been in arrears, as defined in the CCMA, and the customer has never sought, or been granted, an alternative repayment arrangement for the account.

[6] Account has at some point been in arrears or subject to an ARA.

* This paragraph was updated on 23 August 2023 to replace the word "borrowers" with the word "accounts".

switch due likely failure to meet affordability checks and stress testing by banks and non-bank lenders?

Please see above.

6. **If the Central Bank has views on allowing greater flexibility in affordability checks in the context of switching for the cohort of mortgage borrowers referenced in 5?**

First, any affordability text conducted by a lender in respect of a prospective borrower should be based on the financial and personal circumstances of that individual and not be influenced by the identify of their current mortgage provider.

The application of appropriate credit standards and affordability assessments by all lenders has been – and continues to be – a core supervisory focus of the Central Bank and the ECB[7]. This supervisory focus is informed by historical experiences during the financial crisis of weak credit underwriting including excessive credit policy deviations, an absence of credit risk management, and a lowering and relaxation of credit standards over time. For a number of reasons, including the historical context, a system-wide loosening of credit standards by lenders would not be prudent and would ultimately generate risks to borrowers and the wider economy.

We wrote to all lenders in November 2022 reminding them that all firms providing or advising on credit should pay particular attention to their obligations to ensure that credit is affordable in the context of a more challenging economic environment and how it may affect borrowers' expenses. This includes, in the case of mortgages, firms' specific obligations under Provision 5.9 of the Consumer Protection Code to assess affordability on the basis of a 2 per cent interest rate increase, at a minimum, above the interest rate offered to the personal consumer.

Well-structured and sound creditworthiness assessment procedures allow lenders to differentiate, in a timely and effective manner, and on a case-by-case basis, viable from non-viable borrowers. Prudent and consistently applied credit policies and procedures mitigate against the risks associated with imprudent lending, in particular against the emergence of non-

[7] The creation of the Single Supervisory Mechanism (**SSM**) in 2014 made the European Central Bank the competent authority for banking supervision in Ireland and the rest of the Euro area.

performing loans, which result in a reduction in lenders' ability to offer further lending to households and businesses. Central Bank and ECB supervisory expectations emphasise the importance of fair but robust credit lending practices, supported by strong governance and oversight, as well as effective risk identification, recognition and classification processes. Flexibility by firms in their own lending practices needs to carefully balance the need for prudent credit decisions, effective risk management, with the fair treatment and support of borrowers and that continues to be a focus of our ongoing engagement with all lenders.

To date, we see standard underwriting and scoring models being applied by lenders to assess all switching applications (as they are for new mortgage applications) including credit history, affordability test, LTV, outstanding balance on existing mortgage, other borrowings (etc.). These requirements and firms' own credit underwriting practices reflect the need to ensure lending remains responsible and that firms perform their proper purpose of assessing and managing credit risk.

This is done in a context of the evolving economic situation and outlook across all applicants for loans. We do not have a policy or practice of specifying or permitting an approach where borrowers are treated differently based on factors other than credit quality and affordability (e.g. who their current lender is or whether an existing loan was originated at that lender and/or later sold).

7. **Can the Central Bank clarify the requirements under the Consumer Protection Code for [NBNLs] to inform mortgage borrowers whether they can switch to an alternative provider, and if the Central Bank has considered policy interventions to increase information requirements in this respect.**

In June 2018, the Central Bank introduced changes to the Code to help consumers identify opportunities to make savings on their mortgage repayments. The changes included requirements for lenders to provide customers with information on alternative mortgage options that are available from their provider. In particular, variable rate mortgage customers should be notified annually of these options as well as when the interest rate changes, and borrowers coming off a fixed rate should be notified 60 days prior to the expiry of the fixed rate period.

Historically, levels of switching in the mortgage market have been relatively modest. Over recent years, there have been several studies of refinancing activity in the Irish mortgage market. For example, a Central Bank study in 2020 reported that "mortgage customers in Ireland have not engaged to any large extent with the option to switch their mortgage, despite downward movements in interest rates, and policy initiatives to improve the switching process"[8]. The authors found that 3 in 5 mortgaged households in Ireland could save at least €1,000 within the first year, or €10,000 over their remaining term by switching to a lower interest rate. Another 2022 study showed that two-thirds of borrowers at an Irish retail bank did not take up a cost free refinancing offer from their financial institution, foregoing average savings of €5,400 over the remaining term of their mortgage[9].

As a result, the Central Bank undertook a piece of consumer behavioural-based research in the area. Our aim was to improve understanding of what would prompt greater consumer engagement with mortgage refinancing opportunities available from an existing lender. Partnering with a retail bank and working with a sample of approximately 12,000 variable rate mortgages, we tested the impact of a series of consumer-friendly enhancements – informed by behavioural economics – to the application of disclosure requirements under the Code. The findings, which we published in December 2022[10], show that small but targeted changes made to lender notifications can significantly increase customer engagement with the options presented to them.

Based on this research we have articulated our expectation that firms should consider their overall approach to communicating mortgage refinancing-related information, to make sure it supports customers to make effective, timely and informed decisions. In doing so, a firm's overall approach should be less about simply 'providing information' and more about 'seeking to support practical understanding' by the customer so that the customer is enabled to take

[8] https://www.centralbank.ie/docs/default-source/publications/economic-letters/economic-letter-12-mortgage-switching.pdf

[9] https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/refinancing-inertia-irish-mortgage-market.pdf?sfvrsn=80a1971d_11

[10] https://www.centralbank.ie/docs/default-source/publications/economic-letters/interrupting-inertia-evidence-from-a-mortgage-refinancing-field-trial.pdf?sfvrsn=35889b1d_6

action to enhance their own financial well-being[11]. This approach will be reflected in proposed regulatory changes as part of the current review of the Consumer Protection Code.

The Code does not currently include obligations for firms to inform their customers about alternative products provided by other firms. In an effectively-functioning market, firms are incentivised to attract new business through the provision of information to prospective customers on their product offering. The Code includes a number of provisions designed to ensure that such information is fair and accurate, including provisions on how incentives (including cashbacks) are described to consumers.

8. If the Central Bank has or is considering policy interventions to facilitate the reintegration of this cohort of mortgage borrowers with the mainstream mortgage market

As communicated in our note of 26 April, there should be no discrimination against borrowers based on where they currently hold their mortgage. At the industry roundtable last month, we articulated clear expectations in relation to mortgage switching (which is set out in the main body of this letter). We emphasised the need for ongoing access to switching for all performing borrowers irrespective of who their lender is currently or has been in the past.

We also emphasised the need for firms to take a system-wide view on mortgage switching and to ensure collectively that there is a co-ordinated industry approach to support borrowers to switch. Since not all borrowers will be in a position to switch, it is vital that we continue to see effective, high quality implementation of the CCMA and related protections for borrowers in or facing arrears. This includes such solutions being appropriate to the specific current context of rising interest rates and the need to have solutions for borrowers facing financial difficulties owing specifically to rising rates. For example, some NBNL firms offer fixed rate alternative repayment arrangement (ARA) options and we believe this is potentially a key development in appropriate cases. We will continue to engage with firms to further enhance their ARA offerings.

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[11] https://www.centralbank.ie/news-media/press-releases/remarks-by-gerry-cross-director-of-financial-regulation---policy-and-risk-to-the-irish-mortgage-market-council