Macro-prudential policy for residential mortgage lending (CP87) –

Response from Genworth

Genworth welcomes the opportunity to offer its comments in response to the Central Bank of Ireland's Consultation Paper CP87 on Macro-Prudential policy for residential mortgage lending.

In view of our experience in the provision of mortgage insurance, we feel that it would be appropriate for us to provide some comments on the Consultation Paper on Macro-prudential policy for residential lending. To this end, our response focuses on the following:

A. Genworth experience
B. The case for mortgage insurance
C. Genworth proposals and conclusion
D. Response to the Consultation Paper questions

A. Genworth experience

Genworth is the largest globally active private sector provider of mortgage insurance, with a leading position in the US, Canadian, Australian, Mexican, and European markets and, with our joint venture partners, the Indian market. In Europe, Genworth underwrites mortgage insurance in the United Kingdom, Ireland, Spain, Italy, Portugal, Sweden, Finland, and Germany. Our global reach across a range of jurisdictions and over a number of different housing cycles gives us a particular insight on how mortgage insurance can operate under different conditions. Our US headquarters are in Richmond, Virginia and our European headquarters are in London. Genworth Mortgage Insurance Europe ("Genworth") is headquartered in London with a UK registered entity that is regulated by the Financial Conduct Authority and Prudential Regulation Authority and will be under the Solvency II regulatory framework once it is implemented.

Genworth has a substantial presence in Ireland. Late last month, the Taoiseach opened our new International Business Centre in Shannon where over 400 colleagues service Genworth's Irish and international operations. We have been in Shannon since 1997. Additionally, we have provided mortgage insurance to lenders for 70,000 mortgages in Ireland since early 2000 and have paid more than €70m in advanced claims to lenders during this time to support their borrower forbearance programmes and avoid foreclosures. We have also been very active in the consultation process in developing the Keane Report mortgage arrears solutions, Personal Insolvency Act and Mortgage Arrears Resolution Targets.

B. The case for mortgage insurance

Genworth welcomes the general approach taken by the Central Bank to introduce measures to ensure sustainable lending practices in residential mortgage lending in Ireland. In particular we are supportive of the LTI caps and believe that some high LTV caps are also necessary. However, we believe that these objectives can be met without the unintended consequence of excluding creditworthy borrowers with small deposits, particularly first time buyers, being locked out of the property market. Under the Central Bank's proposals some potential borrowers in this category would be excluded from home ownership.

In light of this, Genworth's response to CP87 is focused to a large extent on how mortgage insurance can be effectively utilised within the LTV proposals to achieve the Central Bank's macro-prudential policy objectives.

Mortgage insurance provides protection to lenders against losses arising from borrower default on high LTV residential mortgage loans. Whilst it is typically paid for by lenders, the cost is usually passed on to the borrower, however this amount is usually not significant as the lender is typically able to benefit from lower regulatory capital charges, lower expected losses and lower funding costs in taking out mortgage insurance. Claims are usually paid upon repossession, however in light of repossession issues in Ireland in recent years advanced claims payments have been made to lenders upon permanent resolution strategies being imposed under the Mortgage Arrears Resolution Process.

Various international bodies (for example, the Joint Forum, the Financial Stability Board and the International Monetary Fund) have recommended the use of mortgage insurance as a risk mitigation tool in relation to high LTV mortgages. Various Governments and Regulators around the world also see the benefits of mortgage insurance and have incorporated the use of mortgage insurance extensively in their housing policy and regulatory toolkits.

These Governments, Regulators and international bodies all agree that mortgage insurance can be used as a useful macro prudential tool to bring the following benefits to the housing market:

- **Lending prudence**: Mortgage insurers perform independent audits on mortgage lenders, ensuring the strong underwriting standards are maintained. In effect, this discipline acts as a natural form of regulatory oversight and can be used by lenders as an efficient means of improving its underwriting and collections standards, on both its insured portfolio and non insured portfolio. The evidence of this can be seen in the performance of our insured high LTV portfolios in Ireland, which have performed 30% better in terms of loan delinquencies than non insured low LTV portfolios.

- **Risk transfer & diversification**: Mortgage insurance allows credit risk associated with high LTV lending (over 80% LTV) to be transferred from the banking industry to the balance sheet of a mortgage insurer (often reinsured). Mortgage insurers are better suited to bear such risk, as mortgage insurers pool mortgage risk across different jurisdictions, lenders and economic cycles, and are specialist insurance companies which are highly regulated with specific balance sheet structures and very strong capital requirements.

- **Arrears management effectiveness**: Mortgage insurers work with lenders to address borrowers who are in arrears, working through various mortgage arrears resolution structures aimed at keeping borrowers in their homes in a sustainable way. Mortgage insurers could assist in the Central Bank's regulatory oversight of the Mortgage Arrears Resolution Targets by building these targets within the agreed arrears management processes going forward. Genworth has been working in collaboration with lenders in Ireland on more than 15,000 loan modifications over the past decade to ensure sustainable solutions are put in place with borrowers. More than 77% of these 15,000 loans have remained performing 12 months later. We have also paid over €70m to Irish lenders in advanced claims over this period.

- **Facilitates housing supply**: A hard LTV limit (i.e., one that applies a restriction on the LTV at loan level that cannot be overcome by using credit risk mitigation) would negatively impact house builders who require certainty that an adequate supply of credit will be available for borrowers to purchase these properties. Uncertainty over the supply of credit makes the construction planning cycle very unpredictable. A hard LTV cap at 80% at loan level, or quotas at portfolio level would be detrimental to the future flow of housing stock, would alter the supply/demand dynamics and cause disproportionate volatility in house prices. Permitting the use of mortgage insurance in the proposals, in particular for first time buyers, would give builders the confidence to continue building new homes, improve the supply/demand dynamic and ensure more economically sustainable house prices. We can see the benefits of this in the UK Help to Buy scheme where house building activity has increased by 25% in the first year of its existence, during which time house prices have also stabilised.

- **Reduced volatility of the mortgage market**: If all first time buyer mortgages over 80% LTV are required to have mortgage insurance, the Central Bank could adjust the mortgage insurance eligibility requirements (upper LTV limit, loan term, property value limits etc.) giving it a very powerful macro-prudential tool that could be used to control the lending behaviours for high LTV mortgages across the economic cycle. This was used very effectively in Canada and Hong Kong through the crisis to control volatility in the housing market.

- **Creditworthy borrowers not locked out of the market**: By transferring the top slice of mortgage risk, lenders are more willing to lend at higher LTV which means credit worthy borrowers are not locked out of the market and their access to credit is related to their credit profile and not an arbitrary 15% quota.

- **International Recognition**: Investors' confidence in the quality of the underlying mortgages would be improved as a third party's capital would be at risk providing an additional layer of protection. The use of mortgage insurance in an LTV cap regime is already widely used internationally and acknowledged as a prudent layer of risk protection. The Central Bank should look to this international best practice when considering mortgage insurance as an exemption to the LTV cap proposals.

C. Genworth proposals and conclusion

Genworth believes that ensuring specific high LTV risks are protected whilst allowing provision for mortgage insurance within the LTV limit proposals merits serious consideration and has the real potential to increase the resilience of the banking and housing sectors, and at the same time make a positive contribution to the housing, mortgage and construction market in Ireland.

The Irish economy and housing market is at a pivotal stage in its recovery and we believe that this recovery would be an ideal platform for the introduction of an exemption for mortgage insurance from the proposed LTV restrictions to ensure that the risk diversification benefits and prudency in underwriting standards is instilled at the right time in the cycle.

We believe the framework we have laid out below ensures that credit worthy first time buyers, with strong ability to repay but with a small deposit, are not excluded from becoming a homeowner. Genworth believes that the proposals as they relate to LTV caps should allow for the following:

1. **Any mortgage to a first time buyer that exceeds 80% LTV <u>must have</u> mortgage insurance in place**

2. **Any mortgage to any non first time buyer that exceeds 80% LTV <u>may</u> have mortgage insurance in place.**

3. **No mortgage shall exceed 90-95% LTV, whether it has mortgage insurance in place or not. The Central Bank might be minded to adjust this threshold up or down within the 90-95% threshold depending on market conditions.**

4. **If mortgage insurance is in place for any mortgage (whether to a first time buyer or otherwise) over 80% LTV, the 15% portfolio restriction should not apply in respect of that loan and would not count towards the total value of mortgages in scope or the percentage limit (and so would be excluded from both the numerator and denominator in calculating compliance with the proportionate cap).**

D. Response to the Consultation Paper questions

Question 1: Which of the tools or combination of tools available to the Central Bank would, in your opinion, best meet the objective of increasing resilience of the banking and household sectors to shocks in the Irish property market and why?

Capital based instruments or loan terms based instruments?

Genworth agrees with the Central Bank that LTV and LTI ratios are more appropriate instruments for the Central Bank to achieve its macro prudential policy objectives for Ireland at this time. While increasing risk weights for high LTV residential mortgages is an effective means for regulator's to achieve their prudential policy objectives of moderating lending volumes, we agree with the Central Bank that this is not appropriate for Ireland in today's economic environment.

Typically a high LTV mortgage attracts up to 3-4 times the capital of a low LTV mortgage for a lender adopting the Internal Ratings Based approach, and up to 2.1 times for a standardised lender. Lenders are required by regulators to hold larger amounts of capital against high LTV mortgages as a result of the additional risk that such loans carry. Risk being measured by the advanced internal risk models under the Basel Framework is the combination of two main elements: (i) the probability for any given borrower to stop repaying the loan (probability of default 'PD'); and (ii) the amount of loss the lender would suffer should the borrower default (loss given default 'LGD').

While the LGD calculation is a highly correlated to LTV (the higher the LTV, the higher the potential loss for the lender should that loan default), the PD is partially related to actual borrower's ability and willingness to repay the loan. Mortgage insurance is an effective way to address the LGD as it acts as a natural risk mitigant for high LTV lending by taking a first loss position ahead of the lender for the high LTV portion of the loan. Successful mortgage systems reduce the high probability of non-payment by defining the underwriting parameters of high quality mortgages, and compensate for high severity with a specific risk mitigant in the form of mortgage insurance. When coupled with an LTI cap as being proposed by the Central Bank, the PD is further reduced.

It is important to note that the provision of high LTV loans does not, of itself, encourage imprudent lending or borrowing. In fact, the increased risk and severity of losses for this asset class should incentivise just the opposite. The problem arises when underwriting is undermined by the expectation of a continual increase in property prices compensating for poor borrower quality, as happened to an extent in Ireland during the boom. This was an important cause of the "sub-prime" crisis caused as a result of increasing property prices and increased competition over the last 20 years, which caused lenders to lower their underwriting standards in pursuit of volume. For example, standards were lowered in areas such as:

- borrower self certification of income;
- low documentation requirements;
- causal or non declared income in the affordability calculation;
- light underwriting based on credit score;

- high proportion o temporary or contract workers;
- non nationals with short residency history;
- adverse credit history; and
- previous mortgage arrears.

It is important to appreciate that underwriting standards for high LTV need to be stronger than low LTV. Given that mortgage insurers specialise in taking this type of risk, they ensure that strong lending criteria, strong contractual terms and deep auditing processes are embedded to enforce a high level of discipline and good market practices. As such, a model where mortgage insurance is built within the regulatory framework can help ensure with proper supervision that lenders do not devolve to the standards mentioned above. In fact, this was the primary conclusion of the Joint Forum of the Basel Committee, International Association of Insurance Supervisors and The International Organisation of Securities Commissions (IOSCO)'s 2013 report titled *Mortgage insurance: market structure, underwriting cycle and policy implications*.

The Consultation Paper indicates on page 8 that negative equity is a well documented cause of mortgage defaults. Whilst we agree there is correlation between the two, we do not believe negative equity is primarily the cause of mortgage defaults. Negative equity tends to happen at times of intense economic stress or in locations where the local employment fundamentals have faltered. Even the borrower with the strongest ability to repay and utter willingness will eventually run out of options if there are no jobs available. Whilst we agree that the loss given default for a high LTV loan is generally more severe than a low LTV loan, a high LTV loan does not necessarily increase the probability of default as this is driven by both the borrower's ability and willingness to pay if there is still some borrower equity at the time of origination. Hence, a high LTV loan underwritten at low loan-to-income multiple may have a lower probability of default than a low LTV loan granted at high loan-to-income multiple and neither is directly attributable to negative equity.

<u>How can mortgage insurance increase the resilience of the banking and household sectors to financial shocks?</u>

Whilst Genworth agree that "*LTV limits make lenders less vulnerable in the event of property prices falling by reducing the losses in the event of a default*", we believe that there are other more effective ways of achieving this same outcome which do not create the same socio-economic problems that a hard LTV limit does. The use of mortgage insurance removes the high LTV risk from the lenders balance sheet and transfers this to well capitalised insurers who typically hold capital to a 1 in 200 year event, i.e., an extremely remote event. Allowing provision for mortgage insurance for lenders to exceed the LTV limit also ensures that credit worthy borrowers, with strong income at the time of the loan origination, are not excluded from the housing ladder altogether. This removes an additional pressure point from the private rental market.

The use of mortgage insurance is also an effective tool in ensuring strong lending standards are maintained throughout the cycle. As mortgage insurers take a first loss position, sitting ahead of the lender in the event of a borrower default, they require lenders to ensure that loans are prudently underwritten. Mortgage insurers will also typically conduct regular audits throughout the year to ensure that lenders' processes are working correctly and that the lending standards and servicing standards are being maintained. As an additional layer of oversight reinsurers are typically involved in ensuring mortgage insurers undertake their obligations diligently.

Mortgage insurers also work very closely with lenders when borrowers go into arrears to help keep those borrowers from losing their home where an affordable and sustainable solution can be found. Mortgage insurers are experienced in restructuring mortgage debt into a more affordable repayment arrangement for the borrower, to avoid repossession, which is not in the interests of the lender or the mortgage insurer. Genworth has been working in collaboration with lenders in Ireland, even before the MARP process was introduced in the market, on more than 15,000 loan modifications over the past decade to ensure sustainable solutions are put in place with borrowers. More than 77% of these 15,000 loans have exited the modification arrangement and remained performing after 12 months. Genworth have also been proactive in working with lenders to ensure their compliance with the Central Bank's Mortgage Arrears Resolution Targets, and have agreed early claim payments to these lenders ahead of our contractual liability to pay such claims.

Genworth estimate that the additional oversight mortgage insurers bring to the mortgage process could have improved borrower loan delinquency rates by as much as 30% in Ireland during the crisis, which equates to approximately €275 million in savings to lenders.[1] In fact, Genworth estimate that lenders' losses on high LTV mortgages could have been reduced by a further €350 million in the form of claims payments if mortgage insurance was used on all high LTV lending (over 75% LTV) in Ireland through the crisis.[2]

The above savings represent claims paid and savings made from reduced delinquency rates between 2009 and 2014. However, in addition, we also estimate that if all high LTV residential mortgages existing in Ireland that originated during the property boom up to 2007 had mortgage insurance in place, and assuming that 1 in 3 of all high LTV borrowers that are delinquent today default at some point in the future, mortgage insurance could reduce losses by a further €1.7 billion over the lifetime of those mortgages.[3]

How can mortgage insurance assist with dampening the pro-cyclical dynamics between property lending and housing prices?

Central to any well functioning financial system is a macro prudential framework that also allows Governments and Central Banks to address the inherent pro-cyclicality of the lending market which creates boom/bust cycles. The most effective way to counterbalance this pro-cyclical lending behaviour is to introduce macro prudential measures aimed at mitigating the build up of systemic risks in the financial market.

A hard LTV limit is a blunt macro prudential instrument that has the very undesirable effect of excluding creditworthy first-time buyers from entering the housing ladder. It is also unproven that a hard cap is guaranteed to stem house price increases, for example, in Sweden where the 85% LTV cap introduced 4 years ago has failed to stem prices growing by approximately 13% over the last 4 years from an already overheated position.

We are not suggesting mortgage insurance is the panacea to the undersupply of housing in Ireland, or the silver bullet in the Central Bank's macro prudential toolkit, but for the following reasons we would contend that mortgage insurance has a clear role to play in dampening the pro-cyclical dynamics between property lending and housing prices:

[1] Source: Assumes 40% LGD on all defaulted high LTV loans between 2009 and 2014, and Genworth's own data on improved performance of delinquency on insured versus non insured portfolios.

[2] Source: Based on Genworth's share of the high LTV market of 20%, multiplied by paid claims of circa €70m.

[3] Source: The €1.7bn assumes: (1) Claims paid by mortgage insurers on one third of the current stock of non-performing high LTV mortgages which translate into ca €870m of saved losses; and (2) Improved delinquency rates of 30% on the current stock of high LTV non-performing mortgages which translates into ca €830m of saved losses

1. The first time buyer segment is not the primary cause of house price increases

Providing access to mortgages for first-time buyers is critical to stimulating growth in the housing industry and the construction sector. It unlocks the chain of property supply by allowing homeowners to move up the property ladder, releases housing stock for homebuilders and reactivates the construction activity, ultimately ensuring a more stable housing market. As high LTV lending is intrinsically linked with first time buyers, and first time buyers pose additional systematic risk to the housing market given the higher LGD associated with such mortgages, these mortgages should be protected with insurance. Further, given that first time buyers are critical to a well functioning housing market, they should be enabled to buy properties if they can afford to service a mortgage rather than be confined to renting indefinitely. Given this, mortgage insurance facilitates a type of lending to first time buyers that can ultimately be regulated by the Central Bank to control potential risks to the system, such as house price appreciation fuelled by oversupply of credit.

The UK's Help to Buy Guarantee Scheme is a good example of this, where 78% of all mortgages guaranteed in the first year of the scheme have been to first time buyers with an average price of £155,759, well below the national average of £273,000. Over 80% of these mortgages have also been to borrowers outside of London and the South East of England (with 95% being outside of London), where house price increases have been most prevalent. The regions where private mortgage insurance providers and Help to Buy are mainly concentrated are the East and North of the UK which, over the last year, have been experiencing the least house price appreciation in the country (circa 2-3%)[4]. This would appear to support the view that high LTV mortgages are not causing house price appreciation in the UK, as the areas where prices are rising the fastest have the fewest concentration of high LTV guaranteed mortgages. This is despite the fact that Help to Buy allowed for a maximum house price of £600,000 within the scheme, which has proven to be an excessive limit.

2. House prices are more closely linked with housing supply/demand, rather than credit supply/demand

Whilst more credit in the system might create more demand for housing, it is also true that it will create more supply of housing as predictable transaction patters will enhance the confidence level of builders, who can secure funding to increase building activity, certain that credit will be available to first time buyers to buy new properties.

As an example, market indicators in the UK following the Help to Buys scheme launch demonstrate that house building activity increased by 25% in the past year, the steepest increase in new housing starts for around 40 years.

On the contrary, the house price appreciation in Dublin over the previous 12 months cannot be said to be caused by an oversupply of credit to the first time buyer segment.

3. Mortgage insurance can be used as a macro prudential tool by for the Central Bank

The Consultation Paper suggests that mortgage insurance would "*weaken the effectiveness of the macro prudential measure as a tool to dampen the pro-cyclical credit-price dynamics*". Genworth

[4] Source: Help to Buy: mortgage guarantee scheme Quarterly Statistics: (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380651/help_to_buy_mortgage_guarantee_statistics_nov_2014.pdf)

would argue that mortgage insurance can in fact be used as a more dynamic macro prudential tool for the Central Bank than a static 'hard' LTV cap.

By requiring mortgage insurance on all first-time buyer high LTV loans, the Central Bank can effectively control the build up of systematic risk in a key segment of the housing market. It can do this by setting minimum underwriting standards (such as loan term, maximum LTV and DTI, maximum property price, borrower age, loan documentation etc.) that mortgages need to comply with in order to be eligible for the mortgage insurance under such a scheme. By tightening or loosening this criteria as and when needed across the economic cycle, the Central Bank can effectively control the flow of credit for high LTV mortgage to first time buyers, which has a significant impact on the overall housing market. Besides generating more structural stability, this would also enhance the resilience of the financial system, as mortgage insurers would add an additional layer of loss absorbing capital during the downturns.

This was an effective tool used by the Department of Finance in Canada throughout the financial crisis to successfully prevent the build up of systematic risk in the Canadian housing market. By way of example, the following measures were taken by the Department of Finance throughout the crisis to reduce mortgage insurers' (including the Canada Mortgage and Housing Corporation (CMHC), the State provider of mortgage insurance in Canada) exposure to more risky lending:

- **Loan term** - Maximum loan term lowered from 40 to 35 years in 2008, to 30 years in 2011 and to 25 years in 2012
- **Maximum LTV** - was reduced from 100% to 95% in 2008 for new mortgages, and for insured refinanced mortgages from 95% to 90% in 2010, to 85% in 2011 and to 80% in 2012.
- **Maximum total DTI** – Set at 45% in 2008, reduced to 44% in 2012.
- **Eligibility criteria** – Various changes made such as:
    - Loan documentation standards strengthened in 2008;
    - More stringent eligibility criteria were introduced in 2010 (all borrowers are required to meet the standards for a five-year fixed-rate mortgage, even if they choose a mortgage with a variable interest rate and shorter term);
    - Cap introduced in 2013 to limit the guarantee amount per lender to $350 million under the National Housing Act Mortgage-Backed Securities (NHA MBS) program until annual allocations could be better apportioned; and
    - More stringent eligibility criteria were introduced (Government-backed insurance is no longer available on second homes and self-employed borrowers without traditional proof of income).

The effect of these changes has had on CMHC's insured portfolio is clear, with CMHC insuring 27,869 housing units during Q1 2014 for borrowers who had a down-payment of less than 20%, which is 39% lower than in the final quarter of 2013, and 6.6% lower than the same time last year. Similarly, Genworth Canada's percentage of housing units insured during 2013 was 17% lower than in 2012.

<u>International recognition of mortgage insurance</u>

Various international bodies have also recommended the use of mortgage insurance as a risk mitigant in relation to high LTV mortgages:

- The Joint Forum recommended in its January 2010 Review of the Differentiated Nature and Scope of Financial Regulation: *"Mortgage insurance provides additional financing flexibility for lenders and consumers, and supervisors should consider how to use such coverage effectively in conjunction with LTV requirements to meet housing goals and needs in their respective markets.*

Supervisors should explore both public and private options (including creditworthiness and reserve requirements), and should take steps to require adequate mortgage insurance in instances of high LTV lending (e.g. greater than 80% LTV)."

- The Joint Forum's report on mortgage insurance (August 2013) notes that: *"Government policymakers should consider whether mortgage insurance can be used prudently in conjunction with LTV requirements to meet housing goals and needs in their respective markets. … Through this institutional arrangement [Canadian government's use of MI underwriting standards per item 3 above], the government influences sound mortgage underwriting practices for the industry."*

- The International Monetary Fund echoes the Joint Forum recommendation in its April 2011 Report on Housing Finance by stating that *"mortgage insurance … can be an important tool for reconciling the policy goals of widening access to homeownership while mitigating the risks of such lending."*

- The EU Mortgage Credit Directive also urges Member States to consider a variety of policy tools in relation to riskier mortgages such as high LTV loans. These tools might include *"products to insure or hedge the risks."*

Box 2: International experience of LTV and LTI ratios

Whilst the Consultation Paper draws on similar international examples of imposing LTV and LTI ratios, we would point out that what is being proposed in Ireland is unique and untested internationally, as it seeks to impose a hard 80% LTV cap in conjunction with a 15% portfolio restriction (for LTV ratios).

It is worth noting that none of the successful international examples where LTV limits have been introduced, such as Canada and Finland, which are referenced in the Consultation Paper, have been based on a hard LTV limit per loan, or on a quota system per entity. The only example where some form of hard cap on high LTV was imposed is Sweden, and the experience to date in that market shows that it had led to unintended consequences in form of additional unsecured top up loans to bridge the gap between the deposit required for the low LTV mortgage offered and the borrowers' savings. The Swedish experiment has also been relatively unable to moderate home price inflation in an already overheated market with prices growing by circa 13% over the last 4 years, since the cap has been imposed.

In the jurisdictions where some form of cap or limit has been successfully imposed, this has been imposed at individual loan level and has been accompanied by the introduction of exemptions to that loan level cap where additional protection is taken out by lenders, such as mortgage insurance. International examples, like Canada, that prevent any unprotected high LTV, but permit high LTV with mortgage insurance, have weathered the financial crisis far better than most other markets with significantly fewer mortgage defaults. Additionally, these markets have continued lending in the high LTV segment through the crisis, enabling those creditworthy borrowers with small deposits onto the housing ladder.

We would point out the following additional features in respect of each of the markets mentioned in the Consultation Paper:

- Canada has an LTV cap in place, but there is an exemption available at a loan level where the loan is protected with mortgage insurance allowing up to 95% LTV. The existence of mortgage insurance allows lenders, in turn, to achieve significant capital relief, incentivising lenders to prudently lend to the first-time buyer segment.

- In Finland, the LTV cap legislation passed earlier in the year requires any mortgage loan over 75% LTV to have a guarantee or collateral for the portion over 75% LTV. Mortgage insurance is an eligible guarantee and is used extensively in the market today. There will be a further hard cap at 95% for first-time buyers and 90% for all other borrower types, but the Finnish regulator has been given the power to reduce these limits by as much as 10% (down to 85% and 80% respectively).

- In Sweden, a hard LTV cap of 85% was introduced in 2010. The unintended consequence of such a cap has led to a widespread use of unsecured loans to “top-up” the mortgage loan. The cap has also restricted access to the housing market for first-time buyers with strong affordability but with small deposits. The very recently elected (Sep ’14) majority party has recognised this and is considering removing the hard LTV cap.

Question 2: Do you agree that the measures should apply to all lending secured by residential property (which will include lending on property outside the State)?

Genworth agrees with this proposal.

Question 3: Do you agree with the exemptions set out? Are there any additional exemptions which you consider appropriate, taking into account the objectives of the proposal and the balance between the benefit of any exemptions and the resulting increase in potential for unintended consequences?

Genworth agrees with the exemptions as presented, but believe that a further exemption should be added for any mortgage over 80% LTV that is insured with mortgage insurance. We have elaborated further on how this exemption should work in Question 5.

We also believe that clarity is needed on the ‘switcher mortgages’ exemption, to make it clear whether the phrase “*no increase in principal*” means no increase in principal above the outstanding principal remaining at the time of the re-mortgage, or above the original principal amount at loan origination. We also think this exemption should state whether the re-mortgage applies to the same lender the original mortgage was with, or a new lender.

Question 4: If there are any *significant* operational difficulties envisaged by regulated financial services providers in complying with the measures as outlined above and in the draft Regulations (Annex 1) and the proposed exemptions, please submit brief details of same.

If mortgage insurance is included as an exemption to the LTV limit proposal, in line with our suggestions in our response to Question 5, lenders would need to think carefully when and to what extent they intend to use mortgage insurance in their business plans.

<u>How long does it take to put a mortgage insurance policy in place?</u>

In our experience, it usually takes between 3-6 months to put a mortgage insurance arrangement in place. Below is a rough timeline of the steps involved and the time needed for each step. Not all these steps need to occur consecutively, i.e., that can take place concurrently. The steps are as follows:

Step 1: Understand lenders requirements / strategy / insurance options (1 month);
Step 2: Agree pricing, lending criteria, arrears procedures and other key terms (1-2 months);
Step 3: Legal documentation (up to 1 month);
Step 4: Training, implement operational processes and data reporting (1-3 months).

It is not critical that a lender enter into a mortgage insurance relationship before the effective start date of the proposals in the consultation paper. There are three main reasons for this:

1. Mortgage insurers will typically provide mortgage insurance on loans that have already originated, so mortgage insurance cover can be retrospectively put in place (assuming the loan is not in arrears or defaulted at the point that insurance is put in place).
2. The lender could still choose to count these mortgages within the 15% limit assuming they were not to first time buyers, which under our proposals would require mortgage insurance.
3. The lender could choose not to offer any mortgages over 80% LTV until such time they put in place a mortgage insurance relationship.

<u>Which mortgages would count towards the 15% portfolio restriction?</u>

Mortgage insurers typically require a lender to agree up front upon signing the insurance policy what loans are required to be insured. The most common approach is for the lender to insure all mortgages over 80% LTV that satisfy the pre-agreed underwriting criteria. The reason mortgage insurers require this is to avoid being anti selected against, that is, lenders choosing to insure the worse risks and self insuring the better risks.

The proposals recommended by Genworth in our response below contemplate lenders being permitted to write up to 15% of the non first time buyer portfolio over 80% LTV without mortgage insurance being in place. As such, lenders would need to agree with their mortgage insurer when negotiating the policy how to factor in the 15% portfolio limit.

To overcome this potential operational difficulty, Genworth would recommend that the Central Bank provide an incentive to lenders to take out mortgage insurance on all loans over 80% LTV. In Australia for example, in the securitisation context APRA has recommended that the pool have the same characteristics of the lender's overall portfolio. Similarly in Italy, high LTV loans are required to have a form of credit risk mitigation in place to qualify under the *Credito Fondiario* regime. We would not advocate that this be imposed by the Central Bank, but rather, a commercial negotiation between the lender and the mortgage insurer and supported by the Central Bank as a prudent step. This would be a simpler approach for the lender and add additional prudency to their entire high LTV portfolio.

Question 5: Should some adequately insured mortgages with higher LTVs be exempted from the measures and if so what should be the criteria for exemption?

Given the importance of the first time buyer segment in the market, Genworth believe that it is critical that any regulatory intervention in the mortgage market does not exclude these first time buyers from the market altogether. Given their importance, and the size of the first time buyer market in Ireland and the additional risk such mortgages add to the system, Genworth believe that protection in the form of mortgage insurance should be in place on all such mortgages over 80% LTV to protect lenders against the increased exposure and add stability to the banking and housing sectors.

Genworth believe the following criteria should apply for such an exemption:

1. **Any mortgage to a first time buyer[5] that exceeds 80% LTV must have mortgage insurance in place.**

2. **Any mortgage to any non first time buyer that exceeds 80% LTV may have mortgage insurance in place.**

3. **No mortgage shall exceed 90-95% LTV, whether it has mortgage insurance in place or not. The Central Bank might be minded to adjust this threshold up or down within the 90-95% threshold depending on market conditions.**

4. **If mortgage insurance is in place for any mortgage (whether to a first time buyer or otherwise) over 80% LTV, it is exempt from the 15% portfolio restriction and would not count towards the total value of mortgages in scope or the percentage limit (and so would be excluded from both the numerator and denominator in calculating compliance with the proportionate cap).**

The table below sets out the suggested criteria.

	Mortgage insurance required where LTV less than 80%	Mortgage insurance required where LTV more than 80%	Maximum LTV permitted where mortgage insurance in place	Exemption from 15% portfolio restriction where mortgage insurance in place
First time buyers	No	Yes	90-95% LTV	Yes
All other borrowers	No	No	90% LTV	Yes

Why require all first time buyer mortgages over 80% LTV to have mortgage insurance?

Providing finance for first-time buyers is a major challenge, that is permanent in nature rather than temporary, which needs to be addressed. Not only are first-time buyers unable to access the deposit necessary to bridge the gap between the maximum loan being offered by financial institutions (e.g. 80% LTV) and the purchase price of a house, but as a compounding problem not all financial institutions are willing to lend high LTV loans because they carry more risk and are more expensive from a capital perspective. In the current environment, regulators are increasing capital requirements for lenders, who in turn are responding by severely reducing availability of high LTV mortgages.

Reducing first time buyer lending increases, by definition, buy-to-let lending (you cannot restrict first time buyer numbers and buy-to-let as people need to live somewhere). We believe there is a greater need from a policy perspective to favour owner occupier first time buyers than the buy-to-let rental sector.

First time buyers are critical in driving property transactions leading to the activity in the rest of the housing market. First time buyers account for 51.7% of house purchases as per IBF statistics for Q3 2014. This in turn is an important catalyst in stimulating wider economic recovery, not only through private residential investment but also via spending on housing services.

[5] First time buyers would be defined by age limits, property value limits and homeownership status (buyer must buy a property for the first time to be used as a residential home)

A hard 80% LTV cap, even with a 15% portfolio allowance, would therefore have a very damaging effect on the overall housing market as it would exclude a vast number of credit worthy borrowers.

It is important to stress that requiring mortgage insurance on all first time buyer mortgages over 80% should not be seen as discriminating against first time buyers. Rather, it should be viewed as a means of enabling this segment access to high LTV mortgages when it would otherwise be unavailable under a hard 80% LTV cap as currently proposed by the Central Bank.

<u>What should the upper LTV limit be set at where mortgage insurance is in place?</u>

As pointed out in the Consultation Paper, choosing an appropriate LTV limit is not an exact science but we agree with the Central Bank's suggestion that an LTV cap of 80% is appropriate and broadly in line with other international examples. Whilst it does not protect lenders from the full downside potential (as recent experience in Ireland demonstrates), it does ensure that lenders keep some skin in the game.

Should the Central Bank agree to allow an exemption for mortgage insurance, it would also need to set an upper LTV cap and Genworth believes the most appropriate limit is somewhere between 90-95% LTV, which is in line with lenders' current appetite and ensures sufficient 'skin in the game' from the borrower's perspective. Genworth believe it is critical for borrowers to have some 'skin in the game' so setting the upper limit at or above 100% LTV drastically reduces borrowers' willingness to pay, especially in a downturn market where property prices are falling.

We would advocate that the Central Bank use its powers to increase or decrease this upper limit between 90-95% LTV, depending on market conditions prevailing at the time, as an effective tool to dampen the pro-cyclical credit-price dynamics. This is precisely the tool the Finnish regulator introduced in Finland at the start of 2014 (although the range in Finland was set at 85-95% for first time buyers and 80-90% for all other borrowers).

There are three main reasons Genworth feel these upper limits are appropriate:

1. The difference between finding a 10% deposit and a 5% deposit can often be years of additional saving. Taking the average house price in Dublin for example, this is the difference between finding a €25,000 deposit and a €12,500 deposit, which for the average consumer can often mean years of additional savings before they are able to enter the housing ladder. This issue is compounded further if rental prices surge higher as a result of greater demand for rental properties. If the Central Bank were able to increase or decrease this limit between 90-95% LTV, it would gain some control over the amount of credit available in the market for first time buyers and indirectly have more control over house price appreciation.

2. By requiring mortgage insurance on all first time buyer mortgages over 80%, as opposed to it being optional for the lender, creates a more diversified pool of risks which enables mortgage insurers to insure higher up the risk curve. It also maximises the effectiveness for the Central Bank to use it as a macro prudential tool.

3. As regards non first time buyers, Genworth generally feels that in a properly functioning market (noting that this may not be true for Ireland today in light of the severe negative equity faced by many households) the upper LTV cap should be set lower for non first time buyers as these borrowers would in most cases have paid down a portion of their existing mortgage already,

meaning that a 10% deposit should be far more manageable. Further, these 'second steppers' aren't as critical to the housing market as first time buyers.

Finally, we note that the Consultation Paper does not seem to propose an upper LTV limit in respect of those mortgages falling into the 15% portfolio cap. If provision for mortgage insurance is to be allowed by the Central Bank, it should consider imposing an upper LTV limit for those loans not insured with mortgage insurance, which we believe should also be set at 90%, to avoid a situation where an uninsured high LTV loan has a higher LTV than an insured high LTV loan.

What other measures should be considered in allowing provision for mortgage insurance?

The Central Bank has rightly suggested that if mortgage insurance is to be recognised as a mitigant in the LTV cap proposals, it is imperative that the insurers providing the guarantee are robust and capable of meeting their obligations under their policies provided. This can be achieved in the following ways:

1. Pre approval of eligible mortgage insurers by the Central Bank

Genworth agrees that it would be imprudent for the Central Bank to accommodate mortgage insurance in the LTV cap proposals if the end result would be to transfer the credit risk outside the banking industry to a less well suited industry. However, it is important to recognise that mortgage insurers are better suited to take high LTV mortgage risk than banks, for the following reasons:

- Mortgage insurers typically have much higher equity (lower gearing/leverage) as a percentage of total assets than a bank;
- Mortgage insurers operating in highly regulated jurisdictions are typically required hold a minimum level of capital to withstand a 1 in 200 year event (at the 99.5th percentile), which is closely monitored by regulators and required to be remediated if the capital levels drop below a certain buffer (usually set at around 120% of the regulatory capital requirement);
- By virtue of the nature of a bank's business model, its assets comprise primarily of loan receivables and deposits that can be withdrawn. On the contrary, insurers are required to invest in much more liquid and higher quality assets as prescribed by regulatory bodies;
- Banks lend long term (eg. mortgages with 25-30 year duration) while borrowing short term (5 year deposits, 3-5 year asset backed securities, 0-3 years money market lines). Insurers on the other hand, do not have any asset liability mismatch as the business model is liability driven rather than asset, which is the exact opposite of the banking model;
- Mortgage insurers benefit from diversification of risk, by mutualising it across lenders, segments and jurisdictions;
- Insurers add more capacity to the system so that credit flow is maintained through the cycle. In addition to providing structural stability, insurers also add more capital to the system, providing more capacity for good quality lending; and
- Insurers re-enforce market discipline, by acting as a "second-pair of eyes" and re-enforce strict underwriting discipline due to mortgage insurer's first loss position and thus "skin in the game".

It would be important for the Central Bank to undertake a thorough due diligence of any mortgage insurer that wants to insure Irish residential mortgage risk, and a licence be provided to such mortgage insurer which can be revoked at any time if the Central Bank feels the prudential standards of such insurer have dropped below a minimum prescribed level. This is similar to the system that has recently been adopted in India, where the Reserve Bank of India both regulates the product and licences the providers. It is also similar to Australia, Canada and New Zealand, where the supervisor must approve the company writing mortgage insurance there.

In addition, Genworth suggests certain high level principles be established for mortgage insurers to adhere to as a condition of their licence to write mortgage insurance in Ireland. As a start, Genworth would propose that the mortgage insurer:

- be authorised and regulated by a regulatory body within the EU;
- have at least 10 years of experience underwriting mortgage insurance, or if this experience is not present, satisfy the Central Bank that is has the requisite systems and controls, management structure, underwriting and arrears expertise and processes, capital and pricing models;
- have in place an effective risk diversification strategy, through reinsurance or some other means;
- be required to invest in low risk, highly liquid assets;
- be required to notify the Central Bank of any matter that might reasonably affect the ability of the mortgage insurer to meets its liabilities in Ireland; and
- be required to submit to the Central Bank quarterly regulatory accounts indicating its capital position and a formal declaration that it has sufficient capital to withstand 12 months of losses in a severe stress scenario. The Central Bank should be given the power to revoke such licence if the insurer's available capital falls below a certain pre-agreed level.

Genworth believe these additional measures would provide the Central Bank with an accurate and reliable means of ensuring the financial soundness and claims paying ability of the mortgage insurer. It would also remove the need for the Central Bank to rely on an external rating agency financial strength rating, which can typically be volatile and unrelated to the claims paying ability of the insurer. It would also be in line with a growing international trend for regulators to place less reliance on rating agencies following the financial crisis.

2. Pre approval by Central Bank of the mortgage insurance policy

To address the Bank's requirements that that mortgage insurance be of high quality and payable on first demand, we would advocate for the Central Bank to pre-approve all mortgage insurance policies prior to the lender entering into such policy with the mortgage insurer. This way, the Central Bank has control over the effectiveness of the guarantee. As a starting point, we would suggest that the mortgage insurance policy fulfil the requirements of Article 213 and 215 of the Capital Requirements Regulation. These requirements are summarised below:

- The mortgage insurance policy should be direct, clearly defined and incontrovertible;
- The mortgage insurance policy should not contain any clause, the fulfilment of which is outside the direct control of the lender, that:
  - would allow the mortgage insurer to cancel the protection unilaterally;
  - would increase the effective cost of protection as a result of a deterioration in the credit quality of the insured mortgage portfolio;
  - could prevent the mortgage insurer from being obliged to pay out in a timely manner in the event that the borrower fails to make any payments due; and
  - could allow the maturity of the mortgage insurance to be reduced by the mortgage insurer;
- The mortgage insurance policy is legally effective and enforceable at the time of the conclusion of the credit agreement; and
- On the qualifying default of or non-payment by the borrower, the lending institution has the right to pursue, in a timely manner (ie, within 24 months), the mortgage insurer for any monies due under the claim in respect of which the protection is provided and the payment by the mortgage insurer shall not be subject to the lending institution first having to pursue the borrower.

Genworth also believe the mortgage insurance policy should be tailored in a way that takes into consideration the unique arrears management and foreclosure processes that exist in Ireland today. Under most mortgage insurance policies, a claim is not payable until after the borrower has defaulted on their mortgage, and the property has been sold following a foreclosure process. In recognition of the requirements imposed on most Irish lenders to adhere to the Central Bank's Mortgage Arrears Resolutions Targets, we would advocate for the claims triggers and payment amounts be tailored to allow for the lender and mortgage insurer to pre agree a claim payment in cases where the property is voluntarily surrendered by the borrower, a borrower short sale takes place or a split mortgage is put in place. The development of regulation in this regard would need to be carefully considered to avoid any unintended consequences.

3. Capital relief and CRR recognition

The Capital Requirements Regulation already provides lenders with the ability to obtain capital relief where an eligible form of credit risk mitigation is in place. The rationale for this is clear: if the risk of the high LTV portion of the mortgage is transferred to a financially sound insurer, the lender should be entitled to hold less capital against that risk.

Lenders need to be incentivised with appropriate capital relief on the high LTV portion of the loan if they are to be required to take out mortgage insurance for first time buyer mortgages over 80% LTV. Without capital relief, there is less incentive for lenders to engage in high LTV lending, and so borrowers with strong affordability but who cannot get a sufficient deposit in place, will continue to be prevented from getting on to the property ladder. The cost of borrowing to borrowers would also be much higher if lenders weren't able to avail of capital relief.

Lenders will need a clear and predictable treatment of capital relief and the Central Bank should give thought to issuing guidelines on the regulatory treatment of loans insured with mortgage insurance, similar to what the PRA did with Help to Buy and the private mortgage insurance industry in the UK. Within these guidelines, we believe that the eligibility of mortgage insurers to provide lenders with such capital relief, and the amount of capital relief available should be linked with the prudential assessment and ongoing oversight undertaken by the Central Bank in granting and maintaining the licence (in accordance with point 1 above).

4. Lender paid

Mortgage insurance in Europe is typically on a lender paid model (rather than borrower paid model), with a single up front premium paid by the lender to the mortgage insurer upon completion of the loan. This is often the more simple structure to adopt given that the mortgage insurance policy is strictly between the insurer and lender (i.e., the borrower is not a party to the insurance contract). We would recommend a similar structure for Ireland.

Most lenders will bear the premium cost of the insurance themselves, build the cost into the interest rate charged to the borrower or add it as a line item in the cost of the mortgage as a high LTV lending charge. We would estimate that if all mortgages to first time buyers over 80% LTV are required to have mortgage insurance in place, the gross premium a lender would need to bear to pay for mortgage insurance would range between 0.5% and 2.5% of the loan amount (depending on the type of cover, depth of cover and LTV of the loan).

But this is not to say that the underlying mortgage interest rate charged to the borrower will necessarily be higher than without mortgage insurance in place. In most well functioning mortgage markets where mortgage insurance is used, mortgage insurance reduces the cost of providing the loan for the lender by:

- lowering regulatory capital charges (see point above for more details);
- lowering expected losses - as the mortgage insurer will cover the loss from the LTV attachment point (assume 80% LTV, to the LTV at origination, say 95%); and
- lowering funding cost – mortgage insurance is a form of credit enhancement which can be factored into the rating agencies methodology when the loan is securitised.

This can be seen in the UK for example, which shows that interest rates on offer for loans with mortgage insurance (either Help to Buy or private mortgage insurance) are just as competitive as those loans that are not insured, and in some LTV bands they are actually cheaper.

5. Full disclosure to the borrower where mortgage insurance is being paid for

Genworth would advocate for full borrower transparency where mortgage insurance is taken out for a mortgage. We would suggest that all lenders be required to clearly state in the mortgage documentation whether mortgage insurance has been bought in respect of the mortgage, what the premium cost for that insurance is and how the lender has effectively paid for it.

6. A direct lender to mortgage insurer relationship

Genworth would advocate a direct lender to mortgage insurer relationship, rather than a broker led model that cedes the risk across a consortia of mortgage insurers. There are a number of reasons why Genworth feels this is the most appropriate model:

- It is the tried and tested model in most markets where mortgage insurance is utilised;
- It is the simplest structure, and avoids complicated broking arrangements that requires additional legal relationships between the lender, mortgage insurer and broker and avoids constant renewal programs and commission structures to brokers;
- With only a handful of lenders making up the majority of the market in Ireland, and only a handful of specialist mortgage insurers able to underwrite the risk, there is no need for a broker led structure; and
- A direct lender to mortgage insurer model will force more ‘arms length’ arrangements to be put in place and maintained, arguably driving down the cost of the insurance, benefiting the consumer.

Question 6: Do you agree that the measures should apply to all lending secured by residential property (which will include lending on property outside the State)?

Genworth agrees that the measures should apply to all lending secured by residential property, subject to the three exemptions currently contemplated in the Consultation Paper.

Question 7: Do you agree with the exemptions set out? Are there any additional exemptions which you consider appropriate, taking in to account the objectives of the proposal and the balance between the benefit of any exemptions and the resulting increase in potential for unintended consequences?

Genworth agrees with the exemptions as set out.

Question 8: Do you consider restrictions on loan-to-income ratios as suitable for buy-to-let mortgages? What impact would a restriction on such loan-to-income ratios have on buy-to-let lending in the State?

Whilst Genworth agrees that buy-to-let mortgages should be excluded from the 20% portfolio restriction, we do not necessarily agree that loan to income ratios are unsuitable for buy-to-let properties. Whilst we agree that the borrower's income is less of a concern to lenders than the rental income from the property, it is nevertheless an important consideration, particularly where the borrower has multiple properties with varying degrees of leverage and rental income. Coupled with the LTV limit restriction that would be imposed on buy-to-let properties, we think the exemption for buy-to-let properties is appropriate.

Question 9: If there are any *significant* operational difficulties envisaged by regulated financial services providers in complying with the measures as outlined above and in the draft Regulations (Annex 1) and the proposed exemptions, please submit brief details of same.

Genworth has no comment on this question.

Question 10: What unintended consequences do you see from the proposed measures and how could these be avoided?

Genworth believes there are a number of significant unintended consequences inherent in the introduction of a hard LTV cap.

1. <u>Strict loan to value limits create inequality and limit social mobility</u>

The Central Bank has rightly recognised that loans at higher LTV and LTI ratios can be appropriate in certain circumstances and that those two combined risk factors should not coincide in mortgages condoned by the regulator. In particular, the recognition of the different risk characteristics of high LTV lending is factually correct, in that they are higher risk because of the higher losses to a lender after default and the borrower has less equity in the home.

The Central Bank is proposing that the maximum unprotected risk retained by banks be set as 15% of new originations. If extrapolated from the peak years of originations, that would mean that the Central Bank would be comfortable with circa €3.5bn of new high LTV mortgages being originated per annum in Ireland without additional protection. If we are to assume Ireland suffers a similar housing crisis in the future to the one it is currently coming out of, there would be roughly €1.3bn of unprotected negative equity accumulated for each year of origination.

Limiting unprotected high LTV to an arbitrary percentage of total new originations is not an effective instrument for a sustainable housing policy and would also negatively affect a large number of creditworthy potential borrowers.

As we indicated in our response above, first time buyers and high LTV are intrinsically associated, as very few first time buyers .will be able to provide for a 20%+ down payment. In effect the Central Bank's proposed measure severely limits the percentage of creditworthy first time buyers that will have access to mortgage finance to a small percentage of the total potential borrowers. In Ireland, as in any normal mortgage market, it is estimated that between 30% and 40% of buyers will be first time buyers, significantly more than the 15% proposed by the Central Bank.

If you consider that there were roughly 15,000 mortgages provided in 2013, of which roughly 7,500 were for first time buyers (and lets also assume for the purposes of this calculation that all were high LTV), a 15% cap would have meant that 6,200 first time buyers would be excluded from entering the property market last year (and that assumes that all these borrowers would have satisfied the LTI requirements). Whilst this may not seem like a lot, one needs to remember that lending volumes in 2013 remain significantly under the long term average. Assuming a normalised market would probably see between 40,000 and 50,000 total mortgages issued per year, the cap would mean a maximum of 6,000 – 7,500 high LTV mortgages. Assuming the high LTV percentage remains at circa 50% of overall lending that would mean 14,000 – 17,500 high LTV borrowers would be excluded. When you consider that most first time buyers are high LTV borrowers, that is a significant number of first time buyers being excluded from the market.

Imposing a limit expressed as a percentage of new originations also assumes that the market will be deep enough to allow for a large number of buyers with access to very large deposits to make up 85% of the new lending, so that 15% of first time buyers is significant in absolute numbers. That is not the case today in Ireland and will result in significant social exclusion and a generation of perpetual renters.

This will likely also impact on housing availability as properties remain attractive for buy to let investment in an artificially buoyant rental market. This point is illustrated below which shows that the 'average' consumer would need to save for an additional 6 years to accumulate a 20% deposit compared to a 10% deposit. [6]

National Averages (Monthly)	**One Income Household**
Average Gross Earnings (€)	2,920
Average Net Earnings (€)	2,250
Average Rent (€)	940
Reasonable Living Expenses (€)	1,045
Remaining Surplus Income (€)	265
Average House Price (€)	195,000
20% Deposit Required (€)	**39,000**
Years To Save Deposit	**12.2**
10% Deposit Required	**19,500**
Years To Save Deposit	**6.1**

2. 'Top up loans' replace high loan to value lending, making LTV limits inefficient in managing indebtedness and macro-prudential risk

One of the consequences of hard LTV limits in other jurisdictions has been an increase in unsecured top-up loans to bridge the gap between LTV limits and property prices. Top up loans as a replacement for high LTV lending can result in significant negative consequences, particularly since the unsecured debt will be at higher interest rates. This stretches a borrower's resources, leading to higher levels of debt to income at origination (i.e. higher monthly debt payments as a proportion of the borrowers' income.)

High LTV lending is considerably preferable to top up loans, particularly when combined with mortgage insurance. This combination of high LTV and mortgage insurance results in far higher

[6] Sources : CSO, Daft.ie, Insolvency Service of Ireland, Genworth estimates

standards of underwriting. As the debt is really used for the purchase of a long-term asset (a home), a shorter term unsecured loan is unnecessarily onerous. Compared with unsecured lending/'top up' loans, secured lending is generally at lower interest rates (since the lending is secured), and the repayments of capital are spread over a far longer term. All of which facilitate affordability, as opposed to over-indebtedness, when compared with 'top up' loans.

It is important that the relevant underwriting takes into account the impact of mortgage rate increases, to ensure that the borrower can afford interest rate increases. This kind of prudent underwriting, taking into account future affordability, is more likely to happen with high LTV lending, particularly where mortgage insurance is in place, than when lower LTV lending is combined with a top up loan (as demonstrated in Case Study 2 below).

The Central Bank has acknowledged this concern in the Consultation Paper and has proposed setting up a Central Credit Register to monitor borrower indebtedness and restrict unsecured lending. Whilst we think this is a positive development, we are concerned as to the effectiveness of these measures as it requires strict adherence by lenders and will not capture all alternative forms of unsecured lending, including for example loans from friends and relatives or parental pledges.

Case study 1 - Sweden: LTV limits have led to a rise in unsecured lending

The country's Financial Stability Report (2012:1) refers to the challenge of rising unsecured loans.

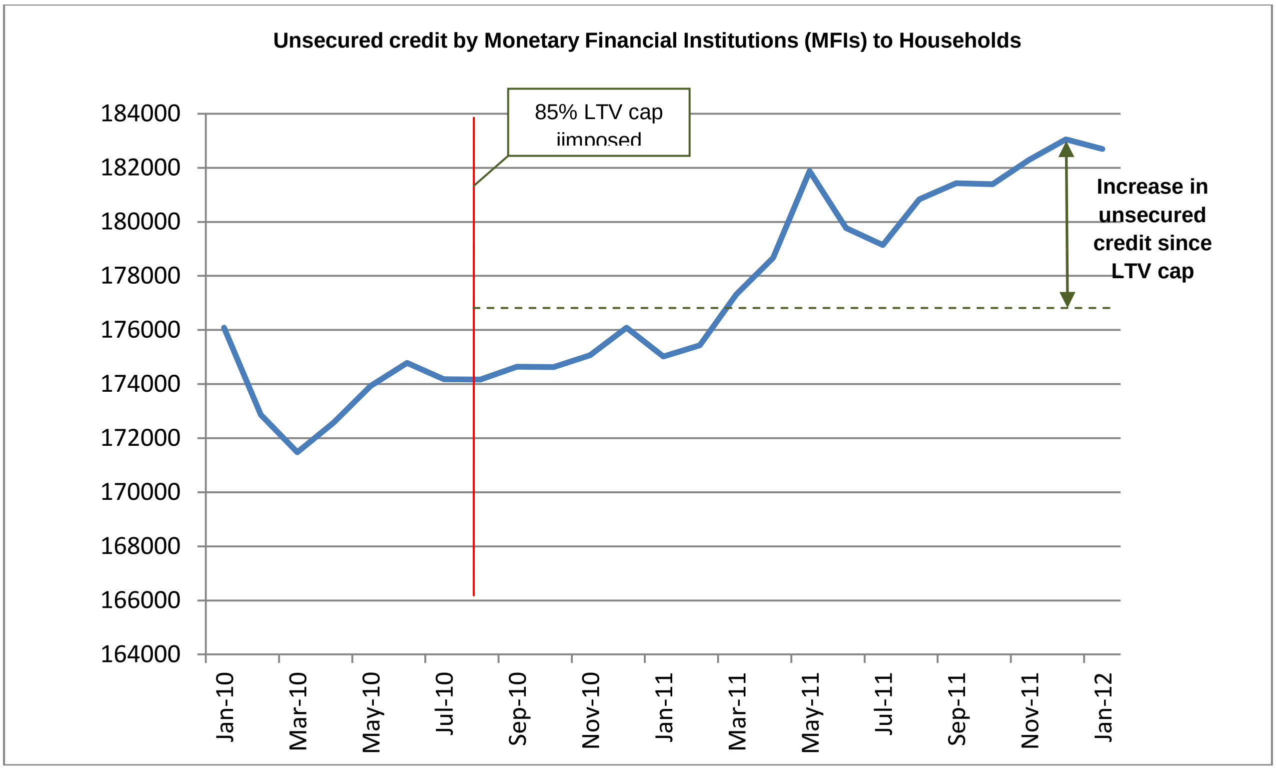
"The use of unsecured loans has increased somewhat following the introduction of the mortgage cap, although from low levels."

Below is an excerpt from 'The Swedish mortgage market, March 2011, Finansinspektionen':

"*Some banks offer their customers unsecured loans in conjunction with mortgages. The majority of the banks still divide their mortgages into "top loans" and "bottom loans". They allow the bottom loan to be fully collateralised by the home for up to between 75 and 85 per cent of the market value….* ***Most, but not all, of the banks offer unsecured loans for the portion of the loan-to-value ratio that exceeds 85 per cent****. A normal method for funding loans above 85 per cent is to collateralise an object belonging to the borrower's parents or another close relation. The banks report that borrowers must meet very high requirements if they are to be granted a loan exceeding 85 per cent of the loan-to-value ratio and that the maximum granted loan-to-value has gone down.* ***The majority of the banks that offer unsecured financing for housing purposes state that it is somewhat more common to grant an unsecured loan today than it was before the mortgage cap****. This is confirmed by the aggregate data"*

The graph below, based on data from 'Statistics Sweden' (www.scb.se) demonstrates the growth in unsecured credit to households, post the LTV cap.

Figure 1. Unsecured credit by Monetary Financial Institutions (MFIs) to Households



This issue has been raised in Ireland before in a speech on Housing markets and financial stability at the National University of Ireland, Galway, 20 April 2012, Mr Stefan Gerlach, Deputy Governor of the Central Bank of Ireland, who noted:

*"However, **the narrow focus may enable borrowers and lenders to seek to circumvent the restrictions**. For instance, Crowe et al. (2011a) report that, in Korea lower LTV limits were implemented for loans of less than 3 years substantially increasing the popularity of loans of three years and one day. Furthermore, **LTV limits have been circumvented by taking out a personal loan to cover a portion of the house price**."*

Case study 2 – Bank of Canada Data Shows High Rate of External Funding

In a study recently published by the Bank of International Settlements reviewing a "policy model to analyse macro prudential regulations and monetary policy," researchers from the Bank of Canada also noted some real world data that was not incorporated in the model. Specifically, they noted that according to Bank of Canada survey data, over 40% of first time homebuyers, who on average were near the regulatory maximum of 95%, also borrowed part of their down payments, which were not reflected in the Bank of Canada LTV limits.

3. Delay/reduction in housing development projects due to limited high LTV credit availability

Availability of high LTV mortgages is a key driver for builders in their decision to acquire land and commence construction of residential premises. Introducing the LTV restrictions as proposed would reduce the availability of high LTV lending, which in turn would reduce the level of residential construction.

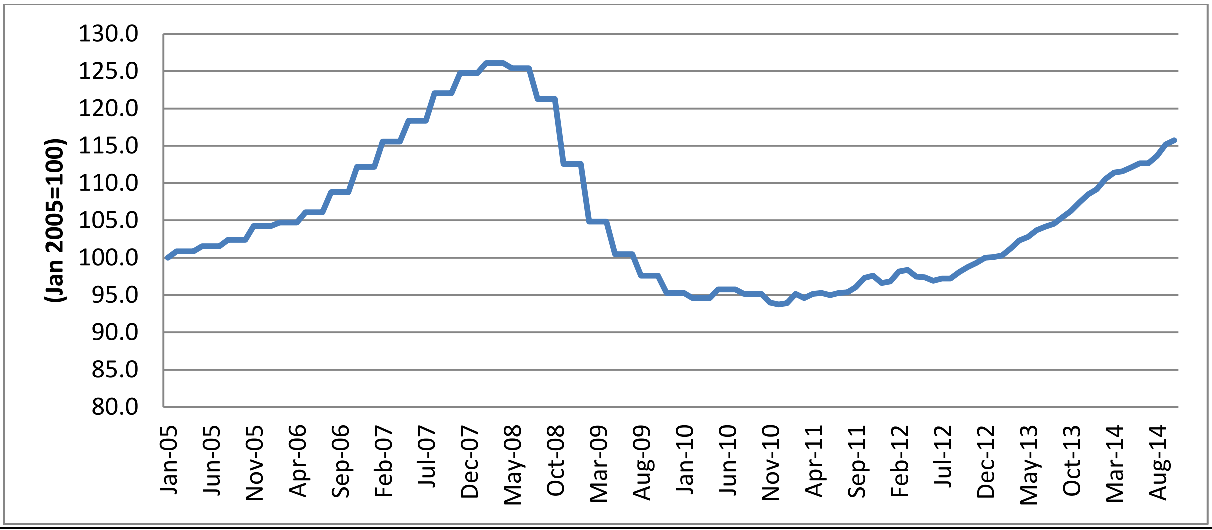
4. Inconsistent treatment between borrowers wanting high LTV mortgages

The Central Bank's proposals to limit lending over 80% LTV to just 15% of a lenders' total lending would mean that lenders will need to be very selective in choosing which borrowers should be granted mortgages over 80% LTV making up the 15% pool. Given that most lenders have standardised lending criteria that determines which borrowers are eligible for high LTV loans, it will be very challenging for lenders to arbitrarily determine which of those borrowers that satisfy the criteria should and shouldn't be eligible to receive a high LTV loan.

It is unclear yet how lenders will decide to fill the 15% quota, but it is very likely that unless lenders fundamentally change the selection criteria for borrowers, it will become a case of 'first come, first served', which would create volatility in the availability of high LTV mortgages and create a lot of uncertainty for borrowers. It is also likely that second steppers will be favoured over first time buyers in filling the 15% allowance as they will have a stronger track record of repayment history.

5. Increased competition for rental properties

After years of under-investment in house building, supply is limited. This lack of supply and emergence of pent-up demand is having a significant impact on the rental market. Private rents have increased by 8.9% in the year to October 2014 and rents are now 23.5% off the low achieved in December 2010.



Source: CSO

The Central Bank's proposals to limit lending over 80% LTV to just 15% of a lenders total lending will dramatically increase demand for rental properties. As mentioned earlier, had the measures been introduced in 2013 there would have been between 14,000 – 17,500 high LTV borrowers excluded from buying their own property. With demand for rental properties already on the rise, adding such a significant number of additional renters would drive up rental prices and make it even more difficult for aspiring homeowners to save a 20% deposit. For certain cohorts of consumers it is likely they may be permanently excluded from owning a home as the gap between their available income and rental prices remains constant.

Question 11: Is the threshold of €50 million over 2 quarters an appropriate threshold and time period for reporting requirements? If not, please indicate a threshold you believe to be appropriate and provide reasons why you believe this is the case.

Genworth agrees with the €50 million threshold, but considers the 2 quarter time period to be too short. Genworth would suggest an annual time period to minimise the operational burden imposed on lenders.

Question 12: Are there any *significant* obstacles to compliance by regulated financial services providers with the limits?

Genworth has no comment on this question as it is a mortgage insurer and is not required to comply with the limits.

Question 13: Please provide comments on the following draft Regulations.

Genworth suggest the following amendments to the draft Regulations.

1. Add a new sub-paragraph to paragraph 3 as follows:

   "3. In these Regulations:

   '**First time buyer'** means a **borrower** who is under the **maximum age**, who takes out a **housing loan** for the purpose of buying his or her first **residential property** in Ireland the value of which is under the **maximum property value**.

   '**Maximum age'** means [*for Central Bank to determine*] years.

   '**Maximum property value'** means [*for Central Bank to determine*].

   '**Mortgage insurance'** means a mortgage insurance policy entered into between a **lender** and a **mortgage insurer** for the purposes of protecting the **lender** against the default of the **borrower** under a **housing loan** and subsequent loss to the **lender** following the sale of the **residential property**;

   '**Mortgage insurer'** means a mortgage insurance provider approved by the **Bank** to underwrite **mortgage insurance** in Ireland;"

2. Add a new paragraph 5(iv) as follows:

   "5. These Regulations shall not apply to:

   iv. a **housing loan** which is protected by **mortgage insurance** provided by a **mortgage insurer**."

3. Add a new sub-paragraph to paragraph 7 as follows:

“**7. Housing Loan to Value**

(4) A **lender** shall ensure that it does not provide a **housing loan** to a **borrower** with a housing **loan to value** ratio in excess of 90 per cent, or such other **loan to value** ratio as prescribed by the **Bank** from time to time.

(5) The **Bank** shall be permitted to increase or decrease the **loan to value** ratio in paragraph (4) above, between a range of 90 per cent and 95 per cent, if it considers it necessary in order to increase the resilience of the banking and household sectors to financial shocks, or to dampen the pro-cyclical dynamics between property lending and house prices.

(6) If the **Bank** chooses to exercise its right in paragraph (5) above, it must provide at least three months notice to **lenders** and publish its reasons for increasing or decreasing the **loan to value** ratio on its website.”

4. Add a new paragraph 9 as follows:

“**9. First time buyers**

(1) A **lender** shall ensure that any **housing loan** it provides to a **first time buyer** with a housing **loan to value** ratio in excess of 80 per cent is insured with **mortgage insurance**.

(2) The Bank shall be permitted to increase or decrease the **maximum age** and **maximum property value**, if it considers it necessary in order to increase the resilience of the banking and household sectors to financial shocks, or to dampen the pro-cyclical dynamics between property lending and house prices.

(3) If the **Bank** chooses to exercise its right in paragraph (2) above, it must provide at least three months notice to **lenders** and publish its reasons for increasing or decreasing the **maximum age** and **maximum property value** on its website.”

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