Banking & Payments Federation Ireland

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Industry Response to Consultation Paper

CP146 - Mortgage Measures Framework Review

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As outlined previously, Banking & Payments Federation Ireland (BPFI) and its members recognise the importance of ensuring the stability of the banking system and of protecting Irish households from the risk of over-indebtedness. The sector recognises the role that the Macro-prudential Rules (the mortgage measures) have played in ensuring more prudent lending, a reduction in the overall levels of consumer indebtedness and the establishment of reasonable and transparent requirements expected of customers seeking mortgage approval, and we continue to support the implementation of the mortgage measures for those reasons.

In addition, implementation of the mortgage measures has required significant effort by BPFI members to ensure they are understood and fully reflected in front-line staff training, IT system configuration, in the monitoring and reporting of exception usage and in the setting of credit policy criteria. A significant change in approach would require an equally significant process to roll out any revised measures, which we believe should only be the case where it is proven that the revised construct improves the delivery of the mortgage measures and their overarching objectives of financial stability and a reduction in consumer indebtedness.

BPFI now welcomes the opportunity to respond to the Central Bank of Ireland's (CBI) Consultation Paper CP 146 on the Mortgage Measures Framework Review.

Summary observations

At a summary level, the main position across BPFI membership includes:

- Support for the continued dual-instrument approach of both LTI and LTV, with LTI considered the most appropriate income-based instrument.
- The provision of allowances is a necessary component to ensure the mortgage measures can achieve their macro-objective, while still providing the flexibility for individual borrower considerations.
- Support to maintain the differential treatment currently afforded to FTBs in relation to LTV.

Consultation Paper Questions

1. ***Please provide any feedback on the channels of macroeconomic benefits and costs of the mortgage measures that the Central Bank proposes to consider within its updated framework.***

   BPFI members support the Central Bank's assessment of the broader macroeconomic and societal impact that the mortgage measures have had to date and acknowledge the challenge presented by a lack of sufficient data that would allow for an empirical assessment of these long-term effects.

   We agree with the macroeconomic benefit and cost channels detailed for consideration by the CBI within the updated framework and would add the following channels for consideration, which may be a subset of those already noted by the CBI:

   - Potential societal impact where citizens solvency to support their own housing costs or care costs post retirement may traditionally have been supported by the accumulation of wealth through homeownership.

- Evaluation of the net impact on home ownership accessibility and choice for FTBs through the shortening of the repayment window as a consequence of the additional time required to accumulate deposit requirements (and coupled with the general upward trend in prices observed over the long run), counterbalanced by the impact of lower house prices generally.
- Social justice considerations, whereby those FTBs with parents, guardians or family who can afford "gifts" that make homeownership more accessible for certain cohorts of society other things being equal. Or equally such social justice considerations on access to home ownership generally which is supported through lower prices.
- Assessment of the net impact on the ability of society to save for retirement. On one hand, buyers may be constrained in rental accommodation if home ownership is postponed to accumulate a deposit (also reducing the repayment window to retirement), while on the other hand lower prices generally support access to home ownership and wealth creation.
- Potential impact on the appropriateness of housing access/availability/suitability where family circumstances change e.g., FTB in an apartment but then starts a family - as a SSB the additional deposit requirement (20% v 10%) may make a house purchase unachievable. While on the flip side, lower prices generally, equity build up and mortgage pay-down should support flexibility as family circumstances change.
- Depending on the outcome of the above assessment, are there any social justice implications to consider?

Finally, we would highlight the potential impact of the mortgage measures on Foreign Direct Investment, in particular to what extent do housing or rental costs influence the final decision in boardrooms on the location of multi-national investment projects? Lower house prices will very likely bolster the attractiveness of Ireland as a destination, while housing supply constraints and high rental costs will lessen that attractiveness.

2. ***Please provide any feedback that you have on the proposed principles underpinning the refreshed objective statement of the mortgage measures.***

BPFI members support the principles underpinning the revised objective of the mortgage measures. We agree the measures should not be seen as a replacement for the maintenance of prudent lending standards and underwriting criteria, and it is noted that the use of complementary measures relating to LTV and affordability serve that objective.

We also agree with the principle that it is appropriate to consider the benefits and costs of the measures across the broader macroeconomic environment and society generally, as we concur that such impacts are not limited to those accessing mortgage finance.

We also welcome the Central Bank's underpinning principle to aim to weigh up the costs and benefits of the measures as they are experienced across the population and the commitment, as part of the new framework for the mortgage measures, to assess and communicate its judgements on the macroeconomic benefits of the mortgage measures against their macroeconomic costs.

One additional consideration for the proposed principles and objective statement may be how the rules could specifically support the broader ESG agenda. In particular, should the rules aim to support the development of additional “green” housing and the upgrade of existing housing stock to make it more efficient to run and contribute to Ireland’s reduced national carbon emissions targets?

3. ***The Central Bank proposes to maintain a dual-instrument approach with both a collateral-based and income-based instrument in place. In your opinion, is this dual-instrument approach appropriate? Please provide additional information to support your view.***

BPFI members support the Central Bank’s view that maintaining a dual instrument approach (collateral complemented by income-based instruments) continues to be appropriate within the mortgage measures framework.

We agree that LTI, suitably calibrated and used in conjunction with a lender’s own prudent underwriting criteria, is a suitable framework for assessing affordability for the borrower and one which can be applied consistently across all mortgage lenders; is readily understood by borrowers; and maintains a clear connection to the measures’ objectives. In addition, LTI is transparent and provides a simple basis for historical and jurisdictional comparison. Such characteristics are clearly features of value that should be retained to support preservation of public trust and confidence in the measures.

We agree that the complementary measure of LTV displays similar characteristics of simplicity, understanding by borrowers, transparency, connectedness to the objective of the mortgage measures, and a simple basis of comparison etc. A complementary LTV measure can also be applied consistently across the industry and can effectively address the scale of potential loss to borrowers and lenders in the event of default among a group of borrowers no longer able to service their mortgage and as such, supports the resilience of borrowers, lenders and the broader economy.

However, we also note the views of respondents to the CBIs listening exercises; in particular those in relation to customers who sit outside the existing rules on LTI but who have demonstrated repayment capacity (through regular rental payments) over many months at a level in excess of the requested mortgage repayment and/or stressed mortgage repayment. Given the demonstrated mortgage affordability in such instances, evidencing a willingness and competency to prioritise certain spending, and should the evaluation of the costs and benefits of the rules warrant it, any measures that could bring such customers within the rules, without recourse to the limited volume of exemptions may enhance the existing framework, perhaps removing the potential anomaly that some contributors to the listening exercises perceived, whilst continuing to ensure sustainable lending standards are maintained.

4. ***Taking both the proposed objective statement for the mortgage measures and the pros and cons of different income-based instruments into account, what are your views on the Central Bank's proposal that LTI remains the most appropriate income based instrument? Please provide additional information to support your response.***

   From the arguments presented in the consultation paper in addition to the challenges we would note in relation to the complexity of calculating a consistent DSTI ratio across the industry and the appropriateness of a single DSTI limit across all income levels, we would support the view that maintaining the LTI measure, complemented by the LTV measure, is preferable to introducing a new DSTI, DTI or LTNI based metric. We believe that LTI limits continue to provide a buffer against the effects of income and employment shocks, thereby increasing the resilience of borrowers and assisting in a reduction of the probability of default for these borrowings, thereby meeting the objectives of the measures.

   The observation that all consumer credit agreements would need to come within the scope of the measures in order to guard against over indebtedness in the mortgage stock through time is particularly important and applicable to the DTI and DSTI measures. This also highlights the importance of the emphasis and regulatory expectation placed on lenders own prudent underwriting criteria, on both mortgages and all other credit agreements, in providing a suitable mechanism for ensuring debt serviceability is maintained at an appropriate standard for both individual borrowers and lenders' portfolios generally.

   Also of note, in relation to a Debt Service measure is that some industry feedback has been provided to the EU Mortgage Credit Directive (MCD) consultation process on the current calculation methodology for APRC which risks not always lending itself to fair and transparent comparison of mortgage offerings within the Irish mortgage market, as the calculation itself is based on an assumption regarding the customer's selection of a future interest rate. A similar situation regarding fair and transparent comparison could also potentially arise in the context of setting a Debt Service metric.

   Regarding the alternative measure of LTNI, we would also support the CBI's view that there would be substantial challenges, complexities and risks associated with a move from LTI to LTNI, including exposure to tax policy and the potential for pro-cyclicality that this would introduce, employer deductions, as well as the interaction with lenders' own credit risk assessments.

   As noted earlier, LTI displays a number of features over and above other affordability-based measures such as DTI, DSTI and LNTI. It can be applied consistently across all mortgage lenders, is readily understood by borrowers and maintains a clear connection to the measures' objectives. In addition, LTI is transparent and provides a simple basis for historical and jurisdictional comparison. Such features will support the continuation of public trust and confidence in the measures.

5. ***What is your opinion on the role of allowances as part of the mortgage measures? Do you agree that allowances are important to maintain flexibility within the framework?***

   The provision of allowances to complement the dual instrument is a necessary component to ensure the mortgage measures can achieve their macro-objective, while still providing the flexibility for individual borrower considerations.

   Further, as outlined in the paper, the allowances can provide a mechanism for dealing with demographic and geographic factors which influence the typical loan to income ratio and may also reduce the need for more frequent recalibration in response to slow-moving structural factors such as those relating to interest rates and housing supply constraints - maintaining two policy instruments allows for the capacity to change one instrument while leaving the other instrument stable, responding to specific sources of risk and providing additional policy flexibility in a rapidly evolving environment.

   It is important that while the overall criteria remain simple and transparent, and achieve the desired objectives from a financial stability perspective, that there remains some level of ability for individual circumstances to be catered for on a selective basis, with lenders retaining the ability to make their own assessments on their appetite to utilise exception capacity for specific individual cases.

   We welcome the introduction of the “carryover approach” which enables lenders to better manage the current level of permitted exemptions which, as noted earlier, are required to provide the flexibility within the rules to address the demographic, geographic and slow-moving structural factors. Any curtailment of the allowances would reduce this flexibility and in so doing would hamper efforts to alleviate some of the public perceptions noted in the paper on which borrower cohorts receive exemptions.

6. ***What is your view on the proposal that the Central Bank reconsider the balance between the calibration of the limits and the level of the allowances?***

   We welcome the Central Bank’s commitment to assess the costs and benefits of the measures as they are experienced across the population and the commitment to assess and communicate its judgements on the macroeconomic benefits of the mortgage measures against their macroeconomic costs. The output of these considerations should be the basis for determining the most appropriate calibration of the limits and level of allowances.

   Absent the outcome of the above, we are of the view that the current flexibility would appear to strike the right balance between the aim of the measures to ensure sustainable lending standards in the mortgage market and prevent the emergence of an unsustainable relationship between credit and house prices, and the preference for flexibility for individual circumstances, demographic and geographic factors which influence the typical loan to income ratio and reduce the need for more frequent recalibration in response to slow-moving structural factors, such as those relating to interest rates and housing supply constraints. Furthermore, the flexibility afforded by the allowances and the carryover approach should serve to alleviate some of the public perceptions noted in the paper on which borrower cohorts receive exemptions.

We would also suggest that the exemption levels help alleviate some of the economic and societal costs associated with the measures as detailed earlier. Evaluation of the extent of those costs and benefits may also inform whether further exemption capacity would, on balance, benefit society and the economy.

Finally, we note the regulatory expectation placed on all lenders to maintain prudent underwriting criteria, on both mortgages and other credit agreements, and this should provide an appropriate mechanism for ensuring debt serviceability is maintained at an appropriate standard for both individual borrowers and lenders' portfolios generally, independent of an exemption being utilised.

7. ***The differential treatment for FTBs reflects their different risk profile and the challenges for FTBs in accessing mortgage finance, including paying rents while saving for a deposit. Would you agree that differential treatment across borrower groups remains suitable, given their different characteristics and the different roles they play in the housing cycle?***

We are supportive of maintaining the differential treatment currently afforded to FTBs in relation to LTV, and in terms of allowances in the complementary LTI measure, to reflect the different risk profile of that customer cohort but in particular, to reflect the challenges they face in accessing mortgage finance, including paying rent while saving for a deposit, and as a consequence home ownership. Once initial homeownership is achieved then subsequent home purchases in terms of LTV requirements would already benefit from either house price growth, mortgage paydown or both, which would not be a feature of the experience of FTBs. The potential pro-cyclicality considerations of extending the favourable LTV treatment afforded to FTB to SSB is also noted.

However, as previously referenced, the appropriateness of the current calibration of the SSB LTI and LTV measures and any allowances (and indeed the FTB measures and any allowances) is best informed by the planned assessment of the economic costs and benefits of the measures.

8. ***If so, what would you consider to be the most appropriate option for the choice and design of implementing differential treatment across borrower groups?***

Again, this question is best addressed by determining the most appropriate calibration of the measures given the impact assessment of the macro-economic and societal costs and benefits of the measures.

Absent the outcome of the above, the current preferential treatment afforded to FTBs over SSBs would appear to strike the right balance between maintaining sustainable lending standards in the mortgage market and being sympathetic to the particular challenges of the FTB cohort.

9. ***The Central Bank proposes that any future calibration changes of the mortgage measures would primarily reflect slower-moving, structural factors rather than responding too frequently to cyclical developments. Do you agree or disagree with this view? Please provide additional information to support your response.***

   This may depend on the outcome of the assessment of the costs and benefits of the measures, but in principle the adaptation only for slower moving structural changes would be preferable to provide customers certainty regarding their "mortgage readiness" through time so that they can plan appropriately. Similarly, the certainty this provides to other industry stakeholders is also likely to be welcomed, including in relation to providing policy certainty with regard to the housing supply pipeline.

10. ***Taking into account the balance between the need to regularly review the measures while not inadvertently disrupting the market with overly-frequent expectations of changes to the measures, should the annual reviews of the measures be replaced by regular assessment of the functioning of the measures in the context of the mortgage market, combined with periodic overarching framework reviews, for example, every 3-5 years? Please provide further information to support your view.***

    Again, this may be best informed by the outcome of the assessment of the measures' costs and benefits, but in principle the adaptation only for slower moving structural changes would be preferable to provide customers certainty around being "mortgage ready" so that they can plan appropriately. However, should the Framework Review involve any significant changes to the calibration of the measures and applicable allowances, then it may be preferable to delay any change to the current review schedule until those changes have been embedded and the revised costs and benefits assessed. Generally, we believe that the measures used should be consistent over time and remain relatively simple and transparent to the market.