75 BLIAIN AG FREASTAL AR AN BPOBAL
YEARS OF PUBLIC SERVICE

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Philip R. Lane *Gobharnóir/Governor*

T +353 (0)1 224 6001

Bosca PO 559
Baile Átha Cliath 1

PO Box 559
Dublin 1

www.centralbank.ie

Deputy Michael McGrath, TD
Main Street
Carrigaline
Cork

4 May 2018

Dear Deputy McGrath

Thank you for your correspondence of 5 April 2018 regarding interest-only terms on Dilosk's buy-to-let mortgages.

Buy-to-let (BTL) mortgages as a share of overall market

Despite the relatively large size of the BTL market in the outstanding stock of mortgage debt and its disproportionate share of defaults on loans originated, the share in new lending activity is low.

Banking and Payments Federation of Ireland data report that 3 per cent of new mortgages issued in each quarter in recent years have been to the BTL sector. In both 2015 and 2016, 98.5% and 98.6% of BTL loans were amortizing (paying both capital and interest). Figures for 2017 show similar percentages.

Analysis of loan level data on new lending since the introduction of the borrower based macroprudential measures in 2015 suggests that, in the last three years, average loan sizes, originating loan-to-value (LTV) ratios, loan terms, interest rates and the geographic spread have been stable. Given the rapid house price growth experienced in that timeframe, this stability highlights the importance of a robust macroprudential framework in the sector, with origination LTVs capped at 70%. The minimum of 30% deposit in relation to BTL mortgages also mitigates the potential risk of a fall in house prices.

Regulatory Requirements

The sale of such products is subject to a number of regulatory requirements including the Central Bank's Consumer Protection Code and the European Banking Authority Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products, in addition to the Mortgage Lending Requirements (which require a maximum 70% LTV). Appendix 1 of this letter provides further detail in regard to the regulatory requirements.

You raised a number of points in your letter. While I do not comment on the specific product or firm, I trust that the broader responses below address the questions you raised.

Typically after interest-only periods expire, both interest and capital payments are made. In the case where there is interest-only for the full term of the loan, the full amount of the capital is due for repayment at the end of the term.

The ability for the borrower to repay the capital should be assessed when the loan is underwritten. Where the borrower is a personal consumer (i.e. acting outside his or her business, trade or profession), the affordability provisions of the Consumer Protection Code apply. In the case of an interest-only mortgage, the lender must also carry out an assessment to ascertain the personal consumer's likely ability to repay the principal at the end of the mortgage term.

The Central Bank's macro prudential rules require a maximum loan to value of 70%[1] which reduces the risk of residual debt.

The General Principles of the Consumer Protection Code (the 'Code') also apply, including that lenders must act honestly, fairly and professionally in the best interests of their customers and the integrity of the market. Lenders are also subject to specific requirements in relation to personal consumers, including that lenders must seek to agree an approach that will assist a personal consumer in resolving his/ her arrears and a requirement that all communications with personal consumers are clear.

More generally, the Central Bank has taken a number of measures to reduce levels of systemic risk through the introduction of macro-prudential mortgage measures. The macro-prudential mortgage measures are reviewed annually. This is to ensure that they continue to meet the objectives of increasing bank and borrower resilience. Reviewing the measures annually allows the Central Bank to respond to emerging joint risks in the credit and housing markets and to adjust the measures accordingly to promote the long-term sustainability of Irish mortgage lending and safeguard wider financial stability. On-going developments in the mortgage market are considered in this process.

Yours sincerely

Philip Lane

[1] 10% of mortgages can be above this cap. H1 2017 showed 11 loans with a total value of €2m were above this cap. Table F1 in Central Bank of Ireland Review of residential mortgage lending requirements – Mortgage Measures 2017.

Appendix 1 – Additional Information

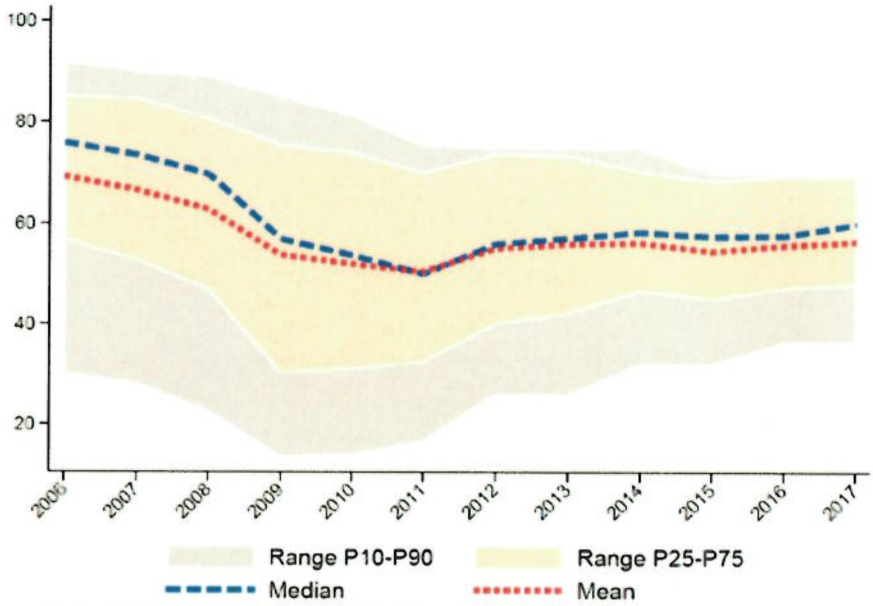
Introduction

The most recent Central Bank statistics report shows that there is €21.9 billion of BTL debt outstanding in Ireland as at end-2017, compared to €98.5 billion in the Primary Dwelling House (PDH) segment (a BTL share of 18.1 per cent). It is true that loan performance in the BTL segment has been particularly poor. At the end of 2017, 14.9 per cent of loans, or 22.7 per cent when weighted by balance, were in arrears of more than 90 days past due; the analogous figures among PDH loans were 6.6 and 9.8 per cent. However, despite the relatively large size of the BTL market in the outstanding stock of mortgage debt, its share of new lending activity is much lower. This has been driven by a combination of the impact of the Central Bank's macroprudential measures, changing risk appetite among lenders to the sector, and changing attitudes among borrowers to the accumulation of leveraged positions in the property market.

Impact of Macroprudential Measures

The chart below shows current lending activity in a longer-term historical context. From the chart, you can clearly see the impact of the macroprudential measures. Currently, both the 75th and 90th percentiles of the BTL LTV distribution are at 70 per cent, reflecting the bunching of a large share of borrowers at the regulated maximum. This contrasts sharply with the 2006-2007 period, when the 90th percentile BTL loan received a 90 percent LTV mortgage, and close to half of mortgages received an LTV above 80 percent. Such high-LTV originations, combined with a high share of interest-only products, left insufficient buffers in place for these mortgages to withstand property price falls.

Chart 1: Distribution of Originating LTV on BTL loans in a historic context



Source MTD and LLD In-Scope loans only from 2015-2017

Product Oversight and Governance

The European Banking Authority Guidelines on Product Oversight and Governance Arrangements for Retail Banking Products provide that the manufacturer should, having first identified the target market, ensure that the product is deemed appropriate for the interests, objectives and characteristics of the identified target market(s). Once the product is brought to market, the manufacturer is ultimately responsible for product monitoring and should monitor the product on an ongoing basis to ensure that the interests, objectives and characteristics of consumers continue to be appropriately taken into account.

The Consumer Protection Code

The General Principles of the Consumer Protection Code 2012 (the Code) include that a regulated entity must ensure that in all its dealings with customers and within the context of its authorisation it:

- acts honestly, fairly and professionally in the best interests of its customers and the integrity of the market;
- acts with due skill, care and diligence in the best interests of its customers;
- does not recklessly, negligently or deliberately mislead a customer as to the real or perceived advantages or disadvantages of any product or service;
- seeks from its customers information relevant to the product or service requested.

Where the borrower is a personal consumer (i.e. acting outside his or her business trade or profession), the affordability provisions of the Code also apply. This means that prior to offering, recommending, arranging or providing a credit product to a personal consumer, a lender must carry out an assessment of affordability to ascertain the personal consumer's likely ability to repay the debt, over the duration of the agreement. An affordability assessment must include consideration of the information gathered under "Knowing the Consumer'' requirements and, in the case of all mortgage products provided to personal consumers, the consumer's ability to repay the instalments on the basis of a 2% interest rate increase.

In the case of an interest-only mortgage, the lender must also carry out an assessment to ascertain the personal consumer's likely ability to repay the principal at the end of the mortgage term.

In the case of a mortgage provided on an interest-only basis for a duration less than the term of the mortgage, a lender must carry out an assessment to ascertain the personal consumer's likely ability to repay the capital and interest instalment amount that will apply at the end of the interest-only period. This assessment must be on the basis of a 2% interest rate increase, at a minimum, above the interest rate that will apply at the end of the interest-only period, if known at the time of the offer of the interest-only mortgage, or on the current variable interest rate if the variable interest rate to be applied after the ending of the interest-only period is not yet known.