The Irish Mortgage Market

Public Consultation

20 February 2017

Coimisiún um Iomaíocht agus Cosaint Tomhaltóirí
Competition and Consumer Protection Commission

We are asking for submissions to this public consultation by 20 March 2016.

Please send your responses to:

By email: harryorahilly@ccpc.ie

By post: FAO Harry O'Rahilly, Mortgage Market Study, CCPC, PO Box 12585, Dublin 1, Ireland.

We intend to publish all responses to this consultation on our website unless a respondent specifically requests otherwise. Please highlight specific parts of your submission which you want to be redacted from the public version.

In the event that we are asked to disclose confidential information under the Freedom of Information Act, 2014 we will consult with you before we make our decision to provide this information.

You can download this public consultation from our website: www.ccpc.ie

For any queries please contact Harry O'Rahilly:

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1. Introduction

1.1 The mission of the Competition and Consumer Protection Commission (CCPC) is to make markets work better for consumers and businesses. Our vision is for open and competitive markets where consumers are protected and empowered and businesses actively compete.

1.2 To achieve this, the CCPC has committed to:

- Promoting the benefits of competition and consumer protection through our advocacy and public awareness activities;
- Empowering and equipping consumers to make informed choices and assert their rights.

1.3 Our ultimate aim is to ensure that markets are competitive and play a role in making Ireland a better place to do business and to be a consumer.

1.4 Mortgage credit plays a vital role in the Irish economy, affects the lives of hundreds of thousands of consumers, and has far reaching impacts on many areas of the economic and social fabric of the State. Furthermore, a house purchase is the largest and most important financial transaction that most consumers will enter into during their lifetime.

Ministerial Request

1.5 In May 2016, the Government published its "Programme for a Partnership Government"[1].

1.6 The document stated that the Government would request the Competition and Consumer Protection Commission (CCPC) to work with the Central Bank to set out the options for the Government in terms of market structure, legislation and regulation to lower the cost of secured mortgage lending and improve the degree of competition and consumer protection.

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

1.7 On 25 October 2016, the Minister for Finance, Michael Noonan, TD, wrote to the Minister at the Department for Jobs Enterprise and Innovation (DJEI), Mary Mitchell-O'Connor, TD, requesting that the CCPC set out options in respect of mortgage lending as described in the programme for government.

1.8 The programme for government requires completion of this exercise within year one of the programme.

1.9 For the purpose of this study, the CCPC will focus on mortgages secured on a property, which includes Principal Dwelling Homes (**PDH**) and Buy to Lets (**BTL**).

Terms of Reference

1.10 In line with section 10 of the Competition and Consumer Protection Act 2014 the CCPC will undertake an exercise that will involve:

(a) Setting out how competition in the mortgage market operates in terms of interest rates and mortgage approvals with a focus on outcomes in comparator jurisdictions;

(b) Setting out what consumers want and expect in a properly functioning mortgage market;

(c) Identifying gaps where competition or consumer protection is inadequate, including a survey of potential new entrants (both traditional and non-traditional providers) on barriers to entry into the Irish mortgage market;

(d) Outlining of options, including their likely benefits and costs, to reduce the cost of secured mortgage lending and to improve competition and consumer protection in terms of market structure, legislation and regulation.

Context to this Options Paper

1.11 The CCPC has already carried out a series of interviews and meetings with stakeholders across the market including consumer representatives, focus groups conducted with consumers, industry representatives, individual banks and mortgage lenders both domestic and in other jurisdictions, independent financial advisers, new entrants to the Irish market, potential entrants, academics (including the ESRI) and regulatory bodies, both domestic and foreign. During this process a wide range of important issues were raised with regard to the structure and operation of the Irish mortgage market for lending. These issues need to be explored in more detail.

1.12 For the individual consumer a mortgage is likely the largest transaction they will ever undertake; furthermore the repayment schedule can last for up to 35 years. From a macro perspective, mortgage lending is an integral part of the banking system with significant knock-on effects for the wider economy.

1.13 In Q2 2016 total outstanding PDH house purchase credit amounted to €87.2bn, BTL loans to €20.6bn and holiday or second home loans to €0.9bn[2]. In 2016 alone the total number of mortgages drawn down was valued at €5.66 billion, covering some 29,498 transactions[3].

1.14 Consequently, it is important that the mortgage lending market is functioning effectively. This requires both open and fair competition between the incumbent lenders and ease of entry into the market for new lenders and challenger banks.

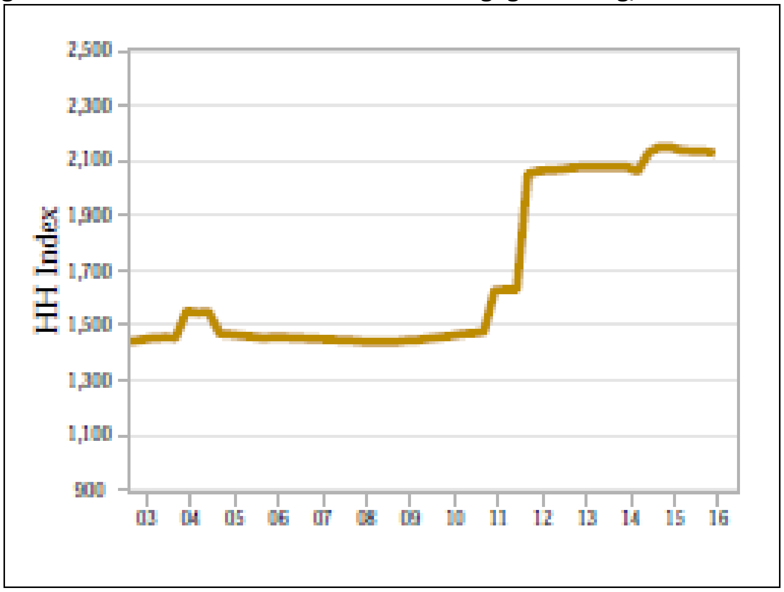
1.15 Currently, by any measure, the structure of the market for mortgage lending in Ireland is highly concentrated, i.e. there is a limited amount of competition and this may be leading to poor outcomes for consumers.

1.16 The Central Bank estimates that by 2015 the combined market share of the top three banks stood at over 80%. Subsequent data for the Irish mortgage lending market in 2016 also indicates a highly concentrated market context. One way of determining the level and trend in concentration in a market is to use the 'Herfindahl-Hirschman Index', otherwise known as HHI[4].

[2] Central Bank of Ireland, Household Credit Market Report, H2 2016
[3] BPFI, Q4 2016, Mortgage Drawdowns Report
[4] This sums up the squares of the individual market shares of all the competitors in a market: the higher the total, the more concentrated the market.

1.17 A HHI score over 1,800 is indicative of a highly concentrated market. The HHI for the mortgage lending market in Ireland at the end of Q1, 2016 was over 2,100.[5]

Figure 1: Concentration Index for Irish Mortgage Lending, Q1 1998 - Q1 2016



Source: Central Bank of Ireland, Household Credit Market Report, H2 2016

1.18 A market with a high level of concentration may lead to direct or tacit coordination. Even where there is little likelihood of coordination, such a market structure can, in itself, result in a significant impediment to competition[6]. Based on the concentration levels and survey data compiled by the Central Bank, it has been argued by some market commentators that Irish consumers are not enjoying the benefits of a highly competitive mortgage lending market, which would comprise lower prices, innovative products, and wider choice.

1.19 Market commentators have also claimed that the relatively weak level of competition in the Irish mortgage lending market is manifest in the interest rates charged to borrowers, particularly the relatively high Standard Variable Rates (see Figure 2) which have provoked much debate, including proposed legislation to empower the Irish Central Bank to cap banks' lending rates[7].

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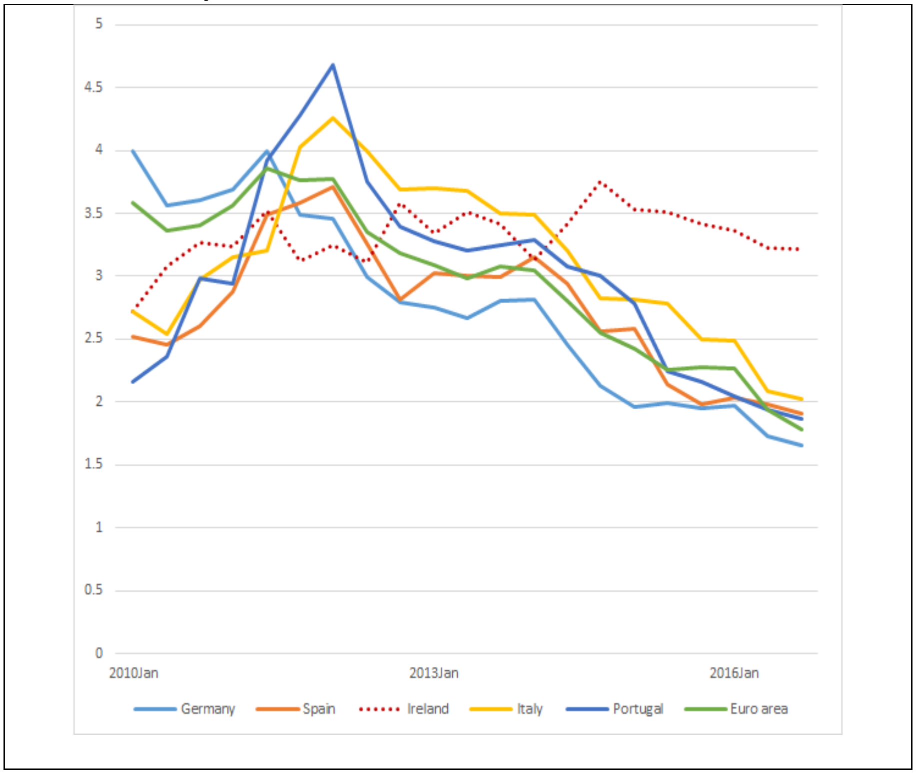
[5] Central Bank of Ireland, Household Credit Market Report, H2 2016
[6] EU Merger Guidelines, para 25, See also CCPC Guidelines for Merger Analysis, 2014
[7] Central Bank (Variable Rate Mortgages) [Private Members] Bill 2016

Figure 2: Representative Interest Rate on New Residential Loans for Selected Countries, January 2010 to December 2016



Source: European Central Bank Statistics for Lending for house purchase excluding revolving loans and overdrafts, convenience and extended credit card debt, Annualised agreed rate (AAR) / Narrowly defined effective rate (NDER), New business.

1.20 In addition margins on new lending, defined as the spread between the average deposit rate and the average lending rate for new business, have been shown to be higher in Ireland when compared to elsewhere in Europe[8].

1.21 It has been highlighted to us that another specific feature of the Irish mortgage market is the financial difficulties facing mortgage borrowers since the onset of the financial crisis, which in turn could have an impact on the decisions of new lenders to enter the Irish Market .In absolute terms, it has been reported that by late 2016 total Non-Performing Loans (**NPLs**) represented 17.3% of all outstanding loans and that retail mortgages remain, by far, the largest component of these

[8] Influences on Standard Variable Mortgage Pricing in Ireland, Central Bank of Ireland, May 2015

total NPLs, accounting for 57%[9]. In terms of arrears the Central Bank reports that at the end of Quarter 2, 2016[10]:

- The value of PDH mortgages in arrears:
    - for more than 2 years was approximately €7.8 billion;
    - for more than 90 days was approximately €3.8 billion;
- The value of BTL mortgages in arrears:
    - for more than 2 years was approximately €4.4 billion;
    - for more than 90 days was approximately €1.7 billion.

1.22 From a lender's perspective, the scale of mortgage distress may mean that mortgage lending is perceived as inherently riskier in Ireland than other EU member states. In addition, aside from default, market commentators have also said that the ability to effect loan security is perceived as more challenging in Ireland.

1.23 The issues briefly described, and in particular the perceived relationships between market concentration, entry by new lenders, relatively high standard variable rates and the risk of default and arrears, demonstrate a need to examine the functioning of the mortgage lending market in detail.

1.24 The purpose of this consultation is to collect more information and to hear from stakeholders. In the next section we set out a series of questions designed to capture this.

[9] Introductory statement by Philip R. Lane, Governor of the Central Bank of Ireland before the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, 20 December 2016
[10] Central Bank of Ireland, Household Credit Market Report, H2 2016

2. Public Consultation Questions

We ask respondents, where possible, to answer each of the questions fully, providing specific examples and evidence to support the answers provided.

Current Level of Competition

2.1 The market concentration levels and the net interest margin levels set out in Section 1 would suggest that competition in the mortgage market in Ireland is limited.

(a) What is your general view of the current level of competition in the mortgage market in Ireland? Please support your views with relevant data, analysis or experience.

(b) What would be, in your opinion, the characteristics of a properly functioning competitive mortgage market in the Irish context (e.g. number of players, market shares, margin levels, levels of switching, length of approvals process, prevalence of online/digitised systems, etc.)?

(c) In your view, do the incumbent lenders actively monitor and react to new products/prices offered by their competitors? Please provide evidence to support your view.

(d) Do you have any knowledge or experience of current and/or recent plans (approved or not) for entry into the Irish mortgage market. What are the key decision making criteria for deciding whether or not to enter the market?

(e) What role could you see building societies fulfilling in Irish mortgage lending? What restrictions, if any, are there to their formation?

(f) Is the highly concentrated nature of the Irish Mortgage market[11] acting as a deterrent to potential new entrants? Please explain your answer.

Standard Variable Rate – the Appropriate Comparison?

2.2 The Irish mortgage market is dominated by the prevalence of variable rate mortgage lending. There are two forms of variable rate mortgages: "trackers" which are contractually linked to the ECB policy rate and standard variable rate mortgages ("SVR") which are not linked to any underlying rate and can be changed by individual lenders at will. Before the financial crisis in 2007 there was less divergence between trackers and SVRs. In recent years the underlying ECB policy rate has fallen to historically low levels and while tracker mortgages have followed suit, SVRs have not fallen as sharply or as quickly[12] despite reductions in the cost of funds. This divergence between the policy rate and SVRs and comparisons with the trends in other jurisdictions has stimulated the debate about the nature of competition in the Irish mortgage market.

2.3 How would you explain the recent divergence between the cost of funds and the cost of SVRs in the State compared to other jurisdictions? Please support your views with relevant data, analysis or experience.

2.4 Given that mortgage products in other jurisdictions may be significantly different to those offered in the State, is comparing SVRs across countries a valid comparison? For example in other jurisdictions mortgage lenders offer teaser rates for an initial term, or longer-term fixed rates, or tie borrowers to other products such as life assurance. Please support your views with relevant data, analysis or experience.

2.5 What other measures of mortgage lending rates might be considered more appropriate when comparing Ireland with other jurisdictions? Please support your views with relevant data, analysis or experience.

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[11] Central Bank (2016). "Household Credit Market Report H2, 2016". Central Bank of Ireland, 2016, p.22.

[12] McQuinn, K. & Morley, C. (2015). "Standard Variable Rate (SVR) Pass-Through in the Irish Mortgage Market: An Updated Assessment". *QEC Research Note*. ESRI, June 2015

Operational Barriers to Entry

2.6 Each jurisdiction has its own unique features, which must be assessed and addressed by any potential new lender before entering the market. These market characteristics include for example, the preferred sales channel for first time buyers (e.g. the preference for independent financial advisers or direct interaction with lenders), the legal processes involved in property transactions etc.

(a) Are there any particular features that are unique to the Irish context that make entry less attractive?

(b) What measures do you think would be beneficial to attract and facilitate entry into and operation within the Irish mortgage lending market? Please explain your answer.

Other Potential Barriers to Entry

Government interest in Allied Irish Banks and Permanent TSB

2.7 The Irish Government is the main shareholder in both AIB and Permanent TSB. However, we acknowledge that the Government is committed to selling its shareholdings in both entities at the earliest possible opportunity. As at end-June 2016 AIB had approximately €36bn of gross loans to residential mortgage customers and provided new mortgage lending of approximately €800m in the first half of 2016[13]. Permanent TSB on the other hand reported new lending of €211 million of the first half of 2016. To set these figures in context according to the Banking and Payments Federation of Ireland, the value of mortgage drawdowns for Q1 and Q2 of 2016 was approximately €2.3bn[14].

(a) In your opinion do you think that a new entrant might view these ownership arrangements as a barrier to entry? Please explain your answer.

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[13] Half-Yearly Financial Report Allied Irish Banks, p.l.c. For the six months ended 30 June 2016.
[14] BPFI Mortgage Drawdowns Q2 2016.

(b) Will the sale of the Government shareholding in AIB and/or Permanent TSB have an impact on encouraging competition in the market? Please explain you answer.

Default, Credit Risk and Repossessions

2.8 Banks leverage their capital bases to extend credit to borrowers. Where even limited borrower defaults or arrears occur, because of this leveraged nature, bank solvency can be significantly impacted. Because of this, depositors or other providers of funding may have concerns that their funds are at risk.

(a) Do you think the arrears profile and the related levels of default in Ireland are acting as a barrier to entry or expansion into the mortgage lending market? Please explain you answer with supporting evidence, data or experience.

(b) Do you think the repossession policies and practices in Ireland are acting as a barrier to entry or expansion into the mortgage lending market? Please explain your answer with supporting evidence, data or experience.

(c) How do repossession policies and practices differ in Ireland compared to other jurisdictions?

2.9 We understand that the arrears profile for Small Medium Enterprise (SME) mortgage customers has improved at a faster rate than that of the Principal Dwelling Home (PDH) segment. We understand that SME engagement with lenders has been one of the principal reasons behind the relative improvement in arrears.

(a) What in your view is inhibiting the current engagement process between lenders and borrowers from the PDH segment that are in arrears? Please explain you answer.

(b) Could this process be amended or improved? Please explain how.

Legislative Options

2.10 In response to the current environment there are legislative proposals to cap mortgage rates.

(a) What impact do you think interest rate controls would have on market entry? If possible please draw on experience internationally.

(b) In your opinion what would be the impact if such controls were to be introduced?

Regulatory Environment

2.11 While we recognise that the regulatory framework has been designed and implemented, to a large extent, at a European level there may be specific features of the regulatory environment that are unique to the Irish market.

(c) While a credit institution that is regulated in another EU state could enter the Irish mortgage market without having to undergo a full regulatory assessment process in Ireland, do you consider that regulatory policies and practices in Ireland are more or less onerous than those in other comparator countries? Please explain your answer.

(d) What, if any, changes to the regulatory regime would be necessary to increase the potential for new entry into the mortgage lending market by a new domestic start-up lender, or another credit institution operating in the State? Please explain your answer.

(e) Please provide your views on the mortgage lending regulatory environment in Ireland. What, if any, changes to the regulatory regime would in your view be appropriate? Please explain your answer.

Scale of Opportunity in Irish Mortgage Lending

2.13 While the economy is improving in Ireland, a number of stakeholders have expressed the view that the overall scale of the market might be seen as offering limited opportunity to a new entrant. For example, many borrowers are on attractively priced tracker mortgages, others are nearing the end of their mortgage term, while others are unable to switch because of high loan-to-value (**LTV**) ratios (so called 'mortgage prisoners'). As such, these borrowers might not be in a position or wish to switch to an alternative lender.

(a) To what degree have these, and/or other factors which affect the scale of the Irish market, inhibited entry into the mortgage market.

Lending Criteria

2.14 Lenders are required to operate within the framework set out in the Mortgage Credit Directive and the Consumer Protection Code, 2012. As part of this, lenders must adopt new EU-wide standards to assess the credit worthiness of mortgage applicants so as to ensure that borrowers can meet their repayment obligations. They must also act in the best interests of consumers and, in particular, disclose material information to consumers to enable them to make informed decisions. Furthermore, lenders may apply their own additional criteria to achieve their individual business goals.

(a) Do you consider that there are segments of the market that are not being adequately served since the implementation of these standards? Please explain your answer.

Information Available to Lenders

2.15 Information on a customer's income and credit history can assist a lender to extend credit to that customer. In this regard, we note the imminent introduction of the Central Credit Register in 2017.

(a) What additional measures or additional credit information do you think would be beneficial to facilitate a potential new entrant in making credit and risk assessments in Ireland? Please explain your answer.

Mortgage Switching

2.16 Mortgages are sizeable long-term financial commitments. As a result, switching to a different mortgage rate, even if only marginally lower, can result in a significant reduction in cost over the life-time of a mortgage. According to the Central Bank the vast majority of standard variable rate borrowers both in positive and negative equity could benefit from either switching to another provider or to another product with the same provider[15].

2.17 The Central Bank has stated that the level of switching of mortgages in Ireland is low[16]. Some consumers may not wish to switch for a variety of reasons, for example, they may already have a low interest mortgage. On the other hand consumers might consider that the expense (e.g. conveyancing and valuation fees), cost (time involved and inconvenience), difficulty in understanding competing offerings, and the uncertainty of the medium and longer term benefit from switching make the prospect of changing provider or product unattractive.

(a) In your view, are there significant barriers to switching in the mortgage market for consumers? Do you consider each of these to be equivalent? Please explain your answer.

(b) Do you think that legal costs (whether perceived or real) incurred by consumers are a barrier to switching in the market? If so, how could these be reduced? Are there any practises in other jurisdictions which could be adopted? Please explain your answer.

(c) Do you think that customer apathy inertia or the ‘hassle factor’ is a reason why there is limited switching in the market? Please explain your answer.

(d) Do you consider that Irish customers would be reticent to get a mortgage from a new entrant or switch mortgage to a new entrant? Please explain your answer.

(e) Is ‘trust’ an important issue for existing and/or new borrowers? Please explain your answer.

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

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

(f) Are the products on offer attractive and secure enough for consumers to switch?

(g) In reference to your responses above, please describe what measures could reduce these barriers, or in general would facilitate consumers to switch their mortgage (e.g. better independent advice, more clarity on savings, increased use of technology to streamline legal processes e.g. e-conveyancing, online land registry, better access to information, focussed trigger points for consumers, etc.).

2.18 More generally, with advances in technology, lending processes can become more streamlined, while lenders can evaluate risk more accurately.

(a) What measures do you think would facilitate the emergence of technological innovations to streamline processes and improve the level of switching?

(b) What measures, if any, should be introduced to facilitate the implementation of new technology-led lending models? Please explain your answer.

Independent Financial Advisors

2.19 Independent Financial Advisors (IFAs) may be qualified to act as brokers to give mortgage advice to customers. We understand that a significant proportion of new mortgage lending arises through this channel.

2.20 With an established independent broker network a new lender has the opportunity to enter a market without having to set up a dedicated distribution network.

(a) Do you consider that there is an adequate independent broker network in the State to facilitate the entry of new mortgage lenders? If not, what measures would be necessary to remedy this? Please explain your answer.

2.21 We understand that payments to brokers for mortgage transactions can come from the customer through a direct payment or from the lender through commissions.

(a) What is your view on the current system of broker incentives in Ireland and its impact on the ability of IFAs to service customers and provide the appropriate advice? Please explain your answer.

(b) What role, if any, should a broker have in promoting mortgage switching by customers?

(c) Do you have any further comments on the potential of IFAs to act as mortgage brokers?

Credit Union Activity in Mortgage Lending

2.22 According to the Irish League of Credit Unions[17], credit unions in Ireland had approximately €14.3bn in assets, and €4.3bn in loans in 2014. We understand that the Credit Unions in Ireland currently engage in limited forms of mortgage lending. Potentially, there is scope for credit unions to engage in mortgage lending to a greater degree.

(a) What role should credit unions have with respect to mortgage lending? Please explain your answer with reference, where possible, to increasing competition and consumer protection.

(b) What measures (including regulatory requirements) do you think are necessary to facilitate greater credit union involvement in mortgage lending? Please make reference, where possible, to the following and/or any other issues you consider relevant:

(i) pooling of loan funding between credit unions;

(ii) capital adequacy and solvency requirements;

(iii) underwriting and risk systems and expertise;

(iv) fulfilment of credit union social objectives.

[17] ILCU Factsheet 2014.

Product Innovation - Alternative Mortgage Lending Models

2.23 Irish mortgage lending has, to date, largely relied on deposit and wholesale funding. As a result of this short-term funding mix, lenders have generally offered short-term mortgage rates. In other countries[18] mortgages are facilitated by long-term pension funding arrangements and as a consequence longer-term fixed mortgage rates are more prevalent (e.g. 10, 20, or 30 year rates).

(a) Do you consider that alternative lending models should be considered in Ireland? Please explain why, please make reference where possible to the impact on competition and consumer welfare.

(b) Are there any barriers (i.e. language, legal and cultural barriers) to implementing alternative lending models in Ireland?

(c) What is your view of the long-term lending model described above?

2.24 Modified or new lending models have begun to emerge in the sector. For example, some new and small firms in the UK are offering consumers the opportunity to engage in securitised peer-to-peer lending to the buy-to-let segment.

(a) Do you think this form of lending by these types of lenders, has a place in the Irish mortgage market?

(b) In your view would the regulatory approvals process in Ireland enable the development of this type of lending? Please explain your answer.

(c) What measures if any should be introduced to facilitate the emergence of new lending models? Please explain your answer.

The Implications of Brexit

2.25 The prospect of Brexit may affect the Irish mortgage market in a number of ways. For example, while UK lenders may seek to open operations in Ireland in order to

[18] See Danish Lending Model: https://www.realkreditraadet.dk/sites/default/files/2016/08/Realkreditraadet_engelsk_2012_skaerm.pdf

retain an EU presence for regulatory purposes they may refrain from offering mortgage products in Ireland. Brexit may also reduce the potential for new market entrants, as it may be more difficult for their UK subsidiaries to locate here. More generally, the Irish economy may come under strain following Brexit, which could negatively impact domestic lending.

(a) Please comment on the potential impact, if any, of Brexit on the Irish Mortgage market.

(b) Please describe any suitable actions to mitigate possible negative effects of Brexit on the Irish Mortgage market.

Other Views

2.26 Mortgage lending forms part of the broader financial markets. As such, conditions within the mortgage lending market are affected by changes in international capital markets.

(a) In your view is the current structure of the Irish financial sector well equipped to react to changes in the international capital markets? Please explain your answer.

(b) In your view would Irish financial institutions be in a position to extend credit to a growing housing market under current and proposed regulatory and broader market conditions? Please explain your answer.

(c) What, if any, measures should be undertaken to address lending limitations, where such limitations might exist, while ensuring adherence to regulatory policies?

2.27 Please provide any further views you may have on mortgage lending in Ireland.

2.28 Please also share any views that, while out of scope for this exercise, may be of relevance to mortgage lending within the context of the broader Irish economy (e.g. finance for homebuilding, future housing demand and supply, lending to SMEs, etc.).

CCPC

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