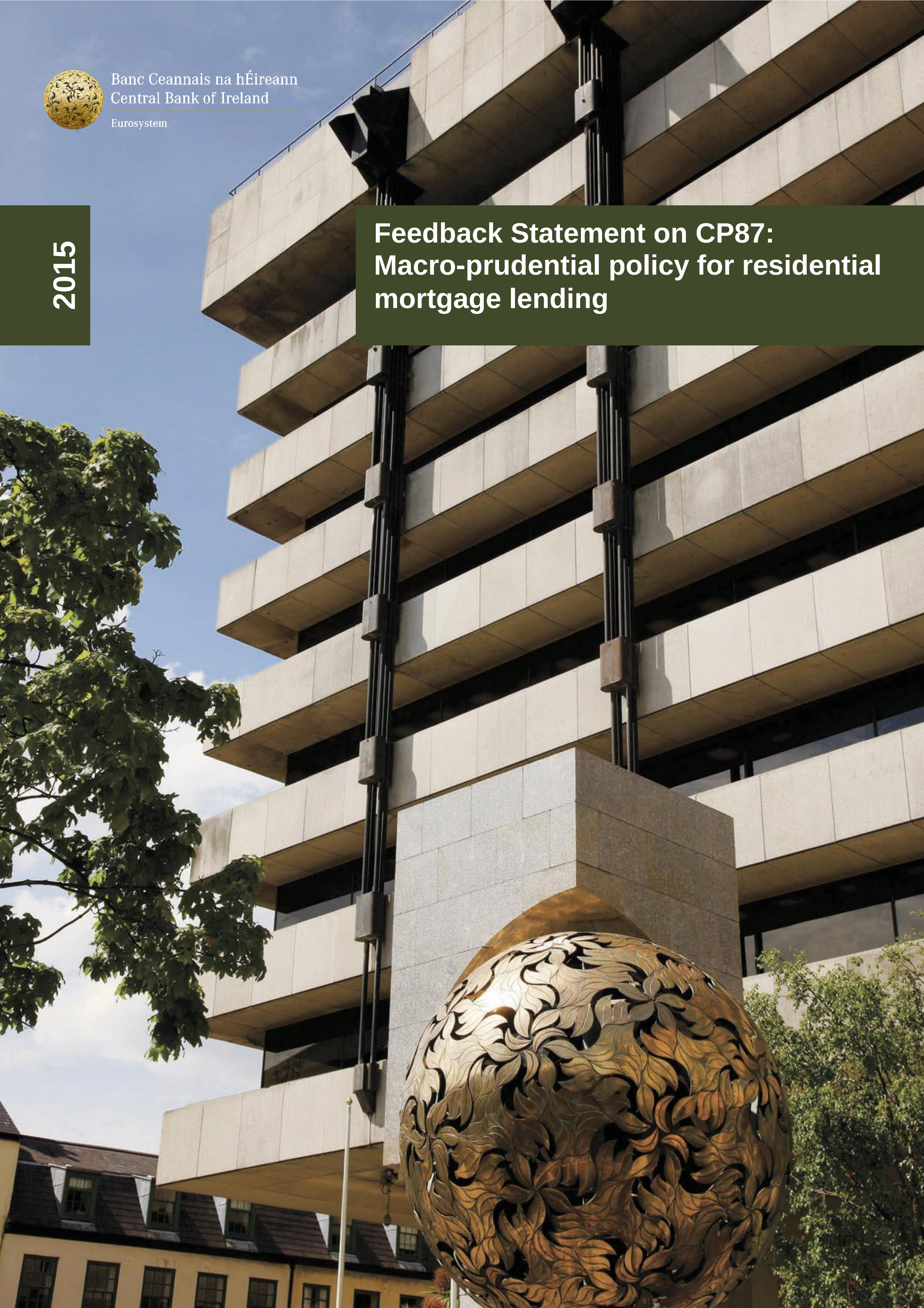

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Feedback Statement on CP87: Macro-prudential policy for residential mortgage lending

Contents

Introduction

On 7 October 2014 the Central Bank published a Consultation paper on Macro-prudential policy for residential mortgage lending ('CP87').[1]

CP87 consulted on proposals to:

- Restrict new lending for principal dwelling houses (PDHs) above 80 per cent LTV to no more than 15 per cent of the value of all new PDH loans;
- Restrict new lending for PDHs above 3.5 times LTI to no more than 20 per cent of the value of all new PDH loans; and
- Restrict new lending to buy-to-let above 70 per cent LTV to no more than 10 per cent of the value of all housing loans for investment purposes.

CP87 invited all stakeholders to provide comments on the draft Regulations which formed part of the Document and on the questions raised in the Consultation Paper.

Objectives of the measure

Key to the objectives of the Regulations and in accordance with the proper and effective regulation of financial services providers is to:

- Increase the resilience of the banking and household sectors to financial shocks;
- Dampen the pro-cyclical dynamics between property lending and housing prices.

Both of these aims are key priorities of the Central Bank in its dual mission to *'Safeguard Stability and Protect Consumers'*.

Macro-prudential policy aims to mitigate systemic risk and maintain financial stability and, as such, focuses on the financial system as a whole.[2] These policies are complementary to micro-prudential regulation and to

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[1]For more information on the proposed measures as well as rationale for policy intervention see CP87: Macro-prudential Policy for Residential Mortgage Lending

[2] The Central Bank has published a Macro-prudential Policy Framework for Ireland which outlines the Central Bank's macro-prudential policy strategy, covering the objectives, the instruments and the decision making process involved.

lenders' own risk management practices. These policies are also complementary to the existing consumer protection regime in force in Ireland. Box 1 outlines the consumer protection measures currently in place around mortgage lending.

Box 1: Consumer Protection measures for mortgage lending in Ireland

This Box provides detail on the consumer protection measures currently in force in the Consumer Protection Code in terms of assessing the affordability of a mortgage for an individual borrower.

Given the significant financial commitment attached to a mortgage, it is of particular importance that the personal and financial circumstances of consumers who are applying for a mortgage are thoroughly assessed to ensure that they are only offered a mortgage that they will be able to maintain over the long term. With this in mind, the Central Bank enhanced the 'know the consumer' and 'suitability' provisions of the 2012 Consumer Protection Code ('the Code') to improve the process of offering and recommending financial products, including mortgages, to consumers. Additional provisions were included aimed at promoting a greater level of responsible lending, which focus on assessing the consumer's ability to repay borrowings and include a requirement that a regulated entity must assess the impact of a 2 per cent interest rate increase, at a minimum, on the consumer's ability to repay credit. The enhanced provisions of the Code include the following:

- before offering, arranging or recommending credit, a regulated entity must fully assess the consumer's ability to service the repayments (Chapter 5, Provision 9);

- a regulated entity must, when assessing the consumer's ability to repay, calculate and consider the impact on the repayment amount of a 2% interest rate increase above the interest rate offered to the consumer. Where the lender offers an introductory interest rate, the calculation must be based on the variable interest rate to be applied after the introductory period, or on the current variable interest rate if the variable interest rate to be applied at the end of the period is not yet know. (Chapter 5, Provision 9 b);

- regulated entities are prohibited from accepting a self-certified declaration of income from a consumer as evidence of his/her ability to repay a mortgage (Chapter 5, Provision 6);

- regulated entities must be satisfied with the reasonableness of the information contained in and the authenticity of the documentation submitted by a consumer in support of a mortgage application (Chapter 5, Provision 7);
- in the case of interest-only mortgages, a regulated entity must be satisfied that the consumer will be able to repay the principal at the end of the mortgage term (Chapter 5, Provision 11); and
- where a mortgage is interest-only for a limited duration, a regulated entity must be satisfied that the consumer will be able to meet the increased mortgage repayments at the end of the interest-only period (Chapter 5, Provision 12).

It is important to note that the introduction of the macro-prudential policy for residential mortgage lending does not obviate lenders responsibilities to assess affordability and to lend responsibly on a case-by-case basis under the Consumer Protection Code.

Consultation Process

The deadline for receipt of submissions to the consultation process was 8 December 2014. In total, one hundred and fifty seven submissions were received. One hundred and ten of these submissions were received from individual members of the public. The Central Bank would like to thank everyone who provided us with a response to inform this process.

The aim of the consultation was to have a structured engagement with interested parties. The consultation process also aimed to build consensus, where possible, between all interested and affected parties on issues related to the measures, as outlined in the Consultation Paper. Feedback received as part of the consultation process has been carefully considered.

More details on the revised measures and implementation details can be found in the Information Note and Regulations which have now been published.

All submissions received are available on the Central Bank website. References to the submissions in this document mostly relate to the forty seven submissions received from institutions; responses from individuals are summarised under question 1 (combination of tools) and question 10 (unintended consequences).

The purpose of this Feedback Statement is to outline how significant comments received as part of this consultation process have been dealt with in the revised Regulations.

The following section outlines the submissions' response to each of the 13 questions posed in CP87 and the Central Bank response to the feedback received for each question. The final section of the paper discusses specific issues arising from the consultation process. These issues are:

1. Phasing in of measures
2. Wider housing policy issues
3. Central Credit Register
4. Impact Assessment

Feedback on questions posed in CP87

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?

Submissions

Every submission addresses this question. There is widespread agreement with the objective of the measures and the introduction of some form of macro-prudential measures for the mortgage. No submission suggests that the use of LTV and/or LTI limits could not achieve the stated objectives of the measure. There is, however, a wide range of views regarding the level of the caps and the appropriateness and timing of the measures.

The main point of disagreement with the proposed measures relates to the LTV cap and specifically the 80 per cent level for PDHs. There is far less disagreement with the LTI proposal and the LTV limit for buy-to-let lending.

Submissions from lenders all agree with the proposals regarding the LTI limit and the LTV limit for buy-to-let lending. They are unanimous in their disagreement with the LTV limits for PDHs. The limit of 80 per cent is said to be too restrictive.

Consumer groups who responded to CP87 are in agreement that a policy that will prevent another housing bubble is to be welcomed. They state that the Central Bank is right to impose limits on mortgage lending as borrowers and lenders cannot be relied upon to behave in a prudent manner. Most of these submissions express concern about the LTV limit, particularly the effect that this may have on first time buyers (FTBs). The LTI limit is not questioned by these submissions but it is noted that a debt to income (DTI) measure may be more appropriate to assess affordability.

Mortgage brokers and advisors are broadly in disagreement with the measures and particularly question the appropriateness of the LTV measure given that supply issues are the primary cause of recent house price inflation.

Seven submissions were received from the property and construction industry. The majority of these submissions agree with the objective of the measure but contend that the proposals are too restrictive, particularly with respect to the LTV cap.

The timing of the measures is mentioned in several submissions. It is noted that the current market is not normal, with low levels of mortgage transactions and a high proportion of cash purchases. Property prices are not currently being driven by credit and the appropriateness of the LTV measure in response to a supply shortage is questioned.

As previously mentioned, the LTI measure does not garner the same amount of criticism in the submissions as does the LTV measure. However, one submission states that LTI limits have no theoretical justification and that they do not take issues such as transport costs of borrowers forced to live far away from amenities and factors such as the running costs and energy efficiency of a property into account. As such, LTI limits can have consequences such as urban sprawl and can have different effects based on the location of the property. Another submission does not agree with the LTI cap as proposed as it may disadvantage low income households. The submission suggests that the LTI limit should take the progressive tax system and the implications this has on repayment burdens into account.

Suggestions for alternatives to the tools proposed in CP87 include:

- Increasing the LTV limit;
- Increasing the LTI limit;
- Using DTI rather than LTI;
- Phasing in the measures gradually;
- Linking the LTV and LTI measures (so that, for example, a low LTI loan could be granted at a higher LTV);
- Applying the LTV rule counter-cyclically;
- Imposing term limits on mortgages;
- Blended LTI which differentiates based on income levels and takes the tax burden into account.

The one hundred and ten submissions received from individual members of the public focus on providing answers to question 1. There is both agreement and disagreement with the choice of LTV and LTI limits and the proposed levels of these tools.

Individuals who are in agreement are more likely to agree in broad terms with the aim of the measure and are happy that the Central Bank is willing to act on this issue. There are twenty two submissions from FTBs voicing their agreement with the measures.

The level of the LTV cap attracts the most negative feedback and is singled out in a negative way in twenty seven of the individual submissions. Even in submissions which express broad dissatisfaction with both proposals, it is the LTV limit which is often singled out for criticism. Six submissions express agreement with the proposed level of the LTI cap.

Central Bank response:

The combination of LTV and LTI caps is still considered the most appropriate to fulfil the stated objectives of the measures.

We believe it is important these measures are introduced at this stage to ensure borrowers and lenders can withstand potential economic or property market shocks in the future. We believe that these measures are a standard part of a well regulated financial system and introducing these precautionary measures should contribute to a stable and well-functioning mortgage lending market.

The limits on LTI ratios will be introduced as proposed in the Consultation Paper. While a large majority of responses did not object to this limit, we note those responses that did and the objection to the blunt nature of the LTI tool. While LTI is indeed a blunt instrument, the calibration of the limit and the 20 per cent of new lending which is allowed above this limit gives sufficient flexibility to offset this issue in our view.

The limits on LTV for buy-to-let lending will be introduced as proposed in the Consultation Paper.

The objections to the level of the LTV cap have been noted and the final

Regulations have been amended to minimise the potential unintended consequences of the measure while maintaining the financial stability objectives of the proposals. These changes comprise of:

- differentiated limits for FTBs buying lower value properties;
- borrowers in negative equity (NEBs) are not in scope of the LTV limits.

These changes have been introduced to address the concerns raised in the submissions regarding fairness, access to mortgage finance and homeownership and have been informed by empirical research. For example, the finding that FTBs have a lower risk of default than second and subsequent buyers shows that a limited exemption for these buyers should not decrease the effectiveness of the Regulations in meeting the first objective (resilience) of the measures. In order to ensure that the second objective of these measures (dampen pro-cyclicality) is met, the higher LTV limit for FTBs is accompanied by a limit on the value of the property to which it applies. By limiting higher LTVs in this manner, this should help prevent a credit-fuelled property bubble from developing as it did in the recent past while at the same time not overly restricting access to credit to FTBs.

Alternative proposals which are not being adopted:

We agree that a **DTI limit** could be a more appropriate limit to put in place, given that it takes all of a borrower's debts into account. However, as noted in CP87, the Central Credit Register is not yet operational and we believe it would be premature to attempt to establish realistically-enforceable Regulations on total debt. In the meantime, lenders must nevertheless seek to inform themselves about total borrower indebtedness and limit their lending per their requirements under the 2012 Consumer Protection Code.

On the proposal for the **countercyclical application** of the LTV and LTI rules, we would note that these limits are not intended as static limits and may be varied according to economic, market, or other developments in due course. It is not possible to specify in the Regulations the precise conditions by which these will be varied. However, the Central Bank will monitor these limits and continually assess the appropriateness of their calibration.

We do not believe that it is appropriate to **link the LTV and LTI measures** as is suggested in several submissions. These measures address the different aspects of credit risk (namely the loss in the event of a default and the probability of default) and it would not be appropriate to connect them in this manner. In addition, this would add a further layer of complexity to the Regulations.

We note the suggestion to **limit the term on mortgages**. However, many of the aspects of prudent lending standards are better regulated through the micro-prudential assessment of credit standards and this is considered to be one of these.

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)?

Submissions

Seventeen submissions respond directly to question 2. There is broad agreement that the measures should apply to all lending secured by residential property within the State.

One submission notes that the Central Bank should monitor compliance with the measure and ensure that no competitive advantage could be gained by firms classifying loans in a certain fashion.

Submissions received from lenders disagree with including lending on properties outside of the State being within the scope of the proposed measure. The arguments against including lending outside the State include the fact that other jurisdictions apply their own measures based on conditions in their domestic market and that it could create a competitive disadvantage for lenders operating in other jurisdictions against lenders who are not subject to the same Regulations.

One submission notes that in order to maintain the stability of systemically important banks, the measure should apply to any lending that such banks undertake outside of the State.

Central Bank response:
The Central Bank has reviewed all submissions in detail and following a thorough assessment of the issue, the Central Bank has amended the Regulations with the effect that the LTV restrictions being implemented as part of this macro-prudential measure will only apply to residential mortgage lending secured by residential property in the Irish State. This amendment is in line with the broad agreement in the responses received to the consultation.

Question 3: Do you agree with the [LTV] 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?

Submissions
Eighteen submissions directly address this question. Of these, the majority are either in favour of the exemptions, as laid out in CP87, or suggest some minor adjustments.

One submission notes that exemptions are a sensible approach to protect vulnerable borrowers and housing market mobility. Two submissions disagree with the exemptions on the grounds that they would be too operationally difficult and would involve a large administrative burden. One submission asks for clarity to be provided on the definition of a switcher mortgage for the purposes of the exemption.

There are suggestions for further exemptions from the LTV limit in the submissions; these include exemptions for adequately insured mortgages, for new properties and for FTBs. However, one submission does not consider further exemptions appropriate as the more exemptions there are in place the greater the scope for circumvention of the measures.

On the issue of an exemption for NEBs, submissions from lenders state that the measures should not curtail these borrowers' ability to move. It is suggested that it may be more appropriate to facilitate a customer in negative equity moving to a new property so long as the overall mortgage debt and the LTV position of the borrower does not deteriorate further following the completion of the transaction.

Central Bank response:

We are committed to implementing Regulations which can achieve their financial stability objectives while being fair and proportionate. Therefore, we agree that some exemptions to the LTV limits could be consistent with achieving the macro-prudential goals of the measures. We have considered the exemptions carefully in light of the increased complexity that they bring to the measures.

It should also be noted that the LTV limit is proportionate, with 15 per cent of the value of lending allowed in excess of the limits. This allows for flexibility for creditworthy cases, with decisions on this portion of lending subject to the banks' internal affordability and assessment criteria.

We take on board the feedback that the exemption for NEBs as proposed in CP87 may restrict the mobility of some of these borrowers. With this in mind, we have, for the time being, decided that NEBs are outside of the scope of the LTV limits. We note that the current levels of transactions of this type are low. If unintended consequences or adverse behaviour is observed as a consequence of this decision, the Central Bank reserves the right to amend the treatment of NEBs accordingly. The Regulations do not preclude banks from applying higher deposit requirements on NEBs, or any other borrowers, in accordance with their own risk management and risk appetite.

Calls for exemptions for FTBs are motivated by concerns regarding the fairness of the measure. While an exemption for these borrowers has not been the policy option chosen, the differentiated LTV limits for FTBs are designed with these concerns in mind.

Clarity has been provided on the definition of a switcher mortgage. This clarification specifies that the new housing loan which is replacing another existing housing loan is on the same property and that the amount of the housing loan is the outstanding monetary balance at the date of the switch rather than at origination.

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

Submissions

Operational difficulties identified by lenders include managing the pipeline of existing applicants who have been approved but have yet to draw down loans, updating internal systems and processes, staff training and editing and drafting changes to terms and conditions.

Mortgage insurance firms suggest that, if mortgage insurance is included as an exemption, lenders will need to include in their business plans the extent to which they use mortgage insurance. They note that it takes 3 to 6 months to put a mortgage insurance scheme in place.

Managing the proportionate limits, particularly the portion of lending which exceeds the LTV and/or LTI limits, is highlighted as an operational difficulty in several submissions. One submission notes that the introduction of proportionate limits on LTV and LTI together may pose difficulty as there is uncertainty as to how, operationally, they will work together.

Lenders request an implementation period to overcome these difficulties. It is also suggested that compliance should be demonstrated over a 12 month window to reduce complexity. It is also suggested that the Central Bank should engage further with lenders to ensure the measures put in place are effective and do not cause undue compliance difficulties.

Central Bank response:

The Central Bank has reviewed all submissions relating to Question 4 in detail and notes the consultation responses in respect of the varying operational difficulties which may occur due to the implementation of the Regulations. To assist relevant stakeholders in meeting such operational difficulties the compliance period has been extended from the original period of 6 months to an annual compliance period. Compliance with the limits will be measured on an annual basis at year end, 31 December. An interim monitoring template is also required as at 30 June.

The Central Bank will also engage further with the banks regarding the implementation of the Regulations and the data template requirements.

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?

Submissions

Almost thirty of the submissions comment on mortgage insurance, with similar numbers agreeing and disagreeing with the question of whether adequately insured mortgages should be exempted from the LTV measure.

The submissions which agree with exempting insured mortgages emphasise that mortgage insurance could help to provide prudent lending for FTBs who are creditworthy but who are unable to save for a large deposit. Other benefits of mortgage insurance which are mentioned in the submissions relate to how the introduction of insurance would: increase the resilience of the banking sector to property shocks by providing additional capital to absorb losses in a stressed scenario; improve underwriting standards as the insurance company would provide feedback to the banking sector on changes to its standards; reduce mortgage rates, as banks would not have to hold expensive capital; and diversify risk, as insurers have a capital base which is diversified from that of the banking sector.

Those who disagree with exemptions for insured mortgages note that mortgage insurance does not eliminate risk but rather transfers it from banks to insurers. Concerns are also raised in the submissions that mortgage insurance does not protect borrowers and that the costs would be borne by the consumer, thereby increasing the cost of servicing a mortgage. It is also noted that mortgage insurance schemes have had varying degrees of success in other countries and are often backed by a government guarantee.

Submissions from the banking industry do not view the mortgage insurance proposals positively, and none put forward a case for exempting adequately insured higher LTV mortgages. Two submissions from political parties strongly disagree with the idea of a government mortgage guarantee scheme.

Mortgage insurance firms all strongly agree with the exemption for adequately insured mortgages. The main rationale given is that mortgage insurance can be used to ensure that creditworthy FTBs are not excluded from the mortgage market. The submissions from these firms differ in their opinions as to how the mortgage insurance market should be structured.

Central Bank response:

We do not consider an exemption for suitably-insured mortgages to be an effective practical amendment at this point in time. While mortgage insurance may play a role in increasing the resilience of the banking sector by insuring the first portion of any loss on a property, it does not remove the risk of these losses but transfers it to the insurer. This leaves insurers vulnerable in the event of widespread falls in housing prices, as happened in Ireland during the last crisis. There are also consumer protection implications for a mortgage insurance scheme, as this insurance does not protect the borrower but the cost is generally passed on to the borrower, either directly or through higher interest rates.

We believe that the issue of access to credit of creditworthy FTBs is better addressed by the introduction of a higher LTV cap for FTBs of lower-valued properties. Evidence that these borrowers have a lower risk of default shows that it is not necessary for the higher LTV loans of these borrowers to be insured, with the additional cost that this entails.

In addition, an exemption for suitably-insured mortgages would require an extensive micro-prudential framework which would take some time to put in place.

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

Submissions

Fifteen submissions directly respond to question 6. Of these, there is broad support that the measure should apply to all lending secured by residential property within the State.

The arguments put forward with respect to including lending in jurisdictions outside the State are the same as those described under question 2.

Central Bank response:

The Central Bank has reviewed all submissions in detail and following a thorough assessment of the issue, the Central Bank has amended the Regulations with the effect that the LTI restrictions being implemented as part of this macro-prudential measure will only apply to residential mortgage lending secured by residential property in the Irish State. This amendment is in line with the broad agreement seen in the responses to the consultation.

Question 7: Do you agree with the [LTI] 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?

Submissions

The majority of submissions do not directly address question 7. Eleven submissions are in agreement with the proposed exemptions from the LTI measure.

One submission does not consider further exemptions appropriate as the more exemptions there are in place the greater the scope for circumvention of the measures.

Suggestions for additional exemptions from the LTI limit include differential treatment of FTBs and lower value mortgages and temporarily lower restrictions on mortgages for new properties in locations where demand significantly exceeds supply.

Central Bank response:
We are committed to implementing Regulations which can achieve their financial stability objectives while being fair and proportionate. In that respect, we believe that the exemptions to the LTI limits already set out in CP87 are warranted. We have considered such exemptions carefully in light of the increased complexity that they bring to the measures.

We will not be making any amendments to the LTI measure; therefore, the exemptions stated in CP87 will not be changed. The changes to the LTV limits with respect to FTBs are, we believe, sufficient to address the concerns raised in the submissions.

It should also be noted that the LTI limit is proportionate, with 20 per cent of the value of lending allowed in excess of the limits. This allows for flexibility for creditworthy cases, with decisions on this portion of lending subject to the banks' internal affordability and assessment criteria.

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?

Submissions
Of the eighteen submissions which directly addressed question 8, eleven agreed that LTI was not a suitable metric for assessing the affordability of buy-to-let mortgages. They note that rental income, rather than borrower income, is a more important consideration for this type of lending. A number of submissions also note that other factors, such as the overall portfolio of the investor, should be considered by a lender. These

submissions consider LTV to be a more appropriate criterion for buy-to-let loans.

Five submissions believe that LTI may be suitable for buy-to-let lending under certain circumstances. Several of these comment that distinctions could be made on the basis of the type of buy-to-let investor; for example, on the basis of the number of properties owned by an individual. LTI ratios may be appropriate for smaller-scale investors in the property market. One consumer group suggests that where a buy-to-let loan is advanced to a non-incorporated entity it should be subject to an LTI limit. The purpose of this would be to protect consumers who intend to purchase an investment property as an alternative to a pension.

Central Bank response:

Given the different considerations taken into account in the decision to grant a buy-to-let mortgage we do not consider LTI to be an appropriate metric of affordability.

We do not feel that differentiating between buy-to-let investors on the basis of the size of their property portfolio, or any other means, is necessary. This would add undue complexity to the measure.

The stricter LTV limit on this type of lending is sufficient to achieve the macro-prudential objectives and we feel that this is adequate to address the concerns raised in the submissions.

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

Submissions

The operational difficulties identified for the LTI limit in response to this question are the same as those for the LTV limit. See the responses to question 4 above.

Central Bank response:
The Central Bank has reviewed all submissions relating to Question 9 in detail and notes the consultation responses in respect of the varying operational difficulties, which may occur due to the implementation of the LTI restrictions. To assist relevant stakeholders in meeting such operational difficulties the compliance period has been extended from the original period of 6 months to an annual compliance period. Compliance with the limits will be measured on an annual basis at year end, 31 December. An interim monitoring template is also required as at 30 June.

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

Submissions
The potential for unintended consequences associated with the introduction of these measures features strongly across the submissions. In most cases the unintended consequences are used as a basis for the respondents' opposition to the proposed measures or as rationale for suggested changes to the proposals outlined in CP87. A brief summary of the main unintended consequences is given below.

The effect the measure will have on the housing market is mentioned in over twenty of the submissions received from institutions. The main consequence identified is that decreased demand for housing and lower house prices will have a negative effect on the viability of new construction. The potential for these measures to threaten the nascent recovery in the construction industry and the effect this would have on employment and housing supply is also a strong feature in these submissions.

Another consequence of the measure which features strongly in the submissions is the effect on the rental market. Increased pressure on the rental market and the potential for rents to increase as a result of these proposals is mentioned in over fifteen submissions. It is noted that rents are already increasing and the prospect of further rent increases, coupled with an increased savings requirement for a deposit, is said to be unfair, particularly for FTBs. Creditworthy borrowers could potentially be unable to access mortgage finance as a result of the measure. Another submission notes that if rents increase as a result of the measure, social housing tenants could be disadvantaged as the gap between rent subsidy caps and market rents will widen.

A large number of submissions note that the measures will negatively affect people's ability to move house. Issues of decreased opportunity for mobility are mentioned in the context of FTBs and NEBs specifically. Three submissions comment that cash buyers and investors should not crowd out borrowers who do not have such easy access to funds.

Over twenty submissions highlight that the increased deposit requirement may have unintended consequences with respect to unsecured lending and/or social equality. The submissions note that the new measures may potentially force mortgage applicants to seek funds from other banks, credit unions, moneylenders and family, which will increase the debt burden on borrowers in the early years of mortgage payments.

The potential of the measure to impact on society is also mentioned in around twenty submissions. These submissions cover a wide range of issues such as the potential to increase demand for social housing and negative effects on foreign direct investment, competiveness, employment and economic growth. The issue of regional inequality, given differences in property prices across the country, is also mentioned in some of these submissions.

Many submissions note that several of the potential unintended consequences of the measure would require policy actions which are outside the remit and control of the Central Bank. However, the potential unintended consequences are the rationale for some changes or additions to the proposed measures. Suggested changes include phasing in the measures over time, performing a detailed impact assessment and periodic review of the measures when introduced and having different requirements for cohorts such as FTBs.

The responses received from individuals also make reference to the potential for unintended consequences as a result of the measure. In most cases the unintended consequences are mentioned in submissions from individuals who are not in favour of the measures. The main unintended consequences highlighted in these submissions are very similar to those raised in the submissions from institutions. The main consequences mentioned are that the measures will make homeownership unattainable; will have an impact on the rental market in the form of increased rents; will not address the issue of the lack of supply and will lead to increased inequality.

Central Bank response:
We believe that the benefits of the improved lending standards and the fulfilment of the measures' stated financial stability objectives outweigh any potential negative consequences.

Effect on housing market: The Central Bank notes these concerns and has tried to address these concerns through further research into this area. Forthcoming research models the economic effects of the proposed measures. Precise quantification of such effects is not possible, but the indications from such macroeconometric modelling as has been carried out are that macroeconomic side effects would be sufficiently limited in relation to the aimed-for reduction in macro-prudential risk.

The proposed measures are not designed to target house prices. There is little indication at present of bank credit being an important driver of the recent increase in property prices, with the volume of new lending still very low. However, the introduction of precautionary measures will help ensure that the recovery of the property market is not destabilised by the re-emergence of a dangerous credit-driven price dynamic.

Effect on homeownership rates: On the issue of the impact these measures will have on the attainability of homeownership, we feel that the amendments made to the measures with respect to FTBs address these concerns. There is a social benefit to allowing FTBs (buying lower value properties) access to credit at higher LTVs. Given the research which shows that FTBs have a lower default rate than second and subsequent buyers,[3] this social benefit can be realised without significantly increasing the risk to financial stability.

Effect on the rental market: The potential effects on the rental market have been considered by the Central Bank: the net effect will be the result of a number of offsetting factors. The higher LTV caps for FTBs buying lower valued properties should also reduce the impact that the measures would have on the rental market, as fewer FTBs will be restricted by the measures

[3] Kelly, R., O'Malley, T. & O'Toole, C. (2014), "Do first time buyers default less? Implications for macro-prudential policy", Central Bank of Ireland, Economic Letter Vol.2014, No.14.

compared to their current circumstances.

Effect on mobility for certain cohorts of buyers: The issue of the measures restricting mobility are also addressed by the changes which have been made to the measures. The different level of the LTV cap for FTBs ensures that this cohort is not unduly disadvantaged. The decision that NEBs are not within the scope of the LTV limits, also addresses the issue that the measures could restrict mobility.

Other policies: Many of the potential unintended consequences require policy remedies which are outside of the remit and control of the Central Bank. A forthcoming economic letter from the Central Bank discusses potential side effects of the measures and reviews possible complementary policy options to address them.[4]

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.

Submissions

As this question relates specifically to operationalising the measure many submissions did not address this question, with some submissions simply stating that this is a matter for discussion with lenders.

Of the eight submissions that dealt directly with this question, the majority were from banks. One bank agreed with the question as it is compatible with existing regulatory-reporting requirements. Five submissions received from the banking industry disagree with the threshold and time period for reporting requirements. The main rationale for disagreement was that the measures would be operationally difficult to implement. One issue which

[4] Cf. Kennedy and Stuart, forthcoming Economic Letter.

was highlighted was challenges associated with the conversion rate of loan approvals to drawdowns. A lead in time, of at least six months, was requested to deal with these operational issues and to limit the initial customer impact of the measures.

The most common suggestion for alternatives to the threshold proposed in question 11 was a €100 million threshold over 4 quarters. One submission agreed with the €50 million threshold but suggested that the time period be extended to 4 quarters. Another submission suggested a phased approach, with an initial threshold of €150 million decreasing to €50 million after two years.

Central Bank response:
Where a regulated financial service provider advances €50 million or more in residential housing loans over a six monthly period it will be required to submit data via data monitoring templates on a six monthly basis or any other period that the Central Bank may specify in writing. Compliance with the measures will be determined on an annual basis.

Regulated financial service providers will not be required to complete data-monitoring templates if they advance less than €50 million in residential housing loans over a six monthly period.

All regulated financial service providers advancing less than €50 million in residential housing loans over 2 consecutive quarters will be required to advise the Central Bank in writing of the total value of housing loans it advanced over a six monthly period within 10 working days of end of each reporting period.

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

Submissions
Question 12 was not addressed in many submissions as this question relates specifically to compliance with the measures. Submissions which directly

address this question were received from banks and the industry body representing the banking industry.

All submissions note that the measures will represent a significant operational challenge. One bank commented that the use of two proportionate limits would present difficulties in terms of implementation and on-going management. It was suggested an implementation period would be required to implement the necessary system changes to facilitate monitoring, reporting and compliance with the limits and the exemptions. Six months was the most commonly suggested implementation period.

Central Bank response:
We do not consider the proposals to pose any significant obstacles to compliance by lenders. The period for determining compliance with the Regulations has been increased to one year. This will provide regulated financial service providers with ample time to demonstrate compliance with the Regulations.

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

Submissions
Thirty nine submissions did not directly address this question.

Four submissions state that the Regulations, as proposed in CP87, should be changed. Of these, two submissions ask that provisions are made for FTBs. Two submissions request a more balanced approach and that the Regulations should consider risks to economic recovery.

Two submissions mention that the Central Bank should be mindful of the provisions of the new European Mortgage Credit Directive (MCD) before imposing legally binding criteria for mortgage lending.

One submission notes that the role of the appraiser in the mortgage market is often overlooked and adds that the Regulations should make reference to the valuation process. Another submission suggests that details of a mortgage insurance scheme could be added to the Regulations.

Central Bank response:

The final version of the Regulations has been published and reflects the comments and feedback received as part of the consultation process.

The changes to the Regulations reflect the concerns raised in the submissions regarding potential unintended consequences of the measures.

The valuation process and the role of the appraiser in this process are not the focus of these Regulations. As explained in the response to question 5, we do not consider an exemption for suitably insured mortgages to be a suitable amendment at this point in time.

The interaction of these macro-prudential measures and the MCD was highlighted in two submissions. The Central Bank has been mindful of existing and forthcoming legislation (including the MCD) in framing these macro-prudential requirements. It should be noted again however that these macro-prudential limits are separate from existing and forthcoming obligations on regulated lenders to properly assess the creditworthiness of the borrower, and that (along with the other requirements of the MCD referred to) regulated lenders must continue to comply with those creditworthiness obligations in addition to complying with these macro-prudential limits.

Other issues raised by respondents

The feedback received has been detailed and comprehensive and we thank all respondents for their input. There were some issues raised in numerous submissions which did not specifically relate to questions in the consultation paper. The purpose of this section is to provide detail of these other issues raised in the submissions and to provide our response to them.

Phasing in of limits

The suggestion that the measures should be phased in is mentioned in nineteen of the submissions received. There were numerous suggestions as to the timing and levels of the phasing in of the measures. It is also suggested that the phasing in could be done on either the levels of the caps or on the size of the proportions of lending allowed above the caps.

Submissions received by banks are in favour of delaying or phasing in the measure. The idea is also featured in submissions from individuals (mostly FTBs), the construction industry, mortgage brokers and advisors and political and governmental organisations.

One submission says that, given the international evidence and the wider social and economic and consequences of such measures, a more "nuanced and graduated approach" may be warranted. Such an approach would allow for the impact of the measures to be monitored and the measures could be "fine-tuned" in light of actual developments.

Central Bank response:

Given the amendments we have made to the Regulations in relation to the monitoring and compliance period, the LTV limit for FTBs and the fact that NEBs are out of scope of the LTV limit, we believe that many of the concerns raised by the submissions which suggest phasing in the measures have been addressed.

We believe it is important that we take action at this stage to avoid fuelling housing demand in a way that drives up house prices beyond what can be sustained. This is a precautionary measure which we believe will help ensure that the recovery of the property market is not destabilised by the re-emergence of a dangerous credit–driven price dynamic.

Furthermore, phasing the measure in over time may cause increased uncertainty in the market and incentivise frontloading of mortgage applications in order to gain a loan at higher LTV ratios. Therefore, we have decided to implement the amended Regulations at once.

Need for changes to policies outside the remit of the Central Bank

Many submissions advocate for a more collaborative approach to housing market policy, with all stakeholders and policymakers involved. One submission suggests the creation of a Property Council and a dedicated Minister for Housing and Construction.

While there is agreement that a macro-prudential policy is required, there is concern that this is being rolled out in isolation and that a root and branch examination of housing policy in Ireland is required.

All the submissions received from political parties emphasise that the Central Bank is acting within its remit with these proposals but that there are other important facets to the housing market. Policies such as rental regulation, planning laws, social housing provision and the need for a coherent construction strategy are mentioned in the submissions. Closer engagement with Government to formulate a coherent and comprehensive housing policy is also mentioned.

Central Bank Response:

The Central Bank acknowledges that mortgage lending is but one facet in a larger housing market and that policies related to mortgage lending affect many other areas and housing policies. Efforts have been made to limit the unintended consequences of these Regulations; however, some spillover effects to other areas of the housing market are unavoidable.

The Central Bank agrees that the macro-prudential tools that are part of its remit are only part of the overall range of policies needed to ensure the well-functioning of the housing market. The choice and timing of such other policy measures are not within the remit of the Central Bank, which must however ensure that the matters under its responsibility are acted on in a timely and effective manner. The Central Bank will contribute to public research and debate on issues relating to the housing market.

Central Credit Register

This issue was raised in eight submissions in the context of concerns that individuals would resort to unsecured borrowing, that may not be captured on a credit register, to fund their deposit. The introduction of a mandatory central credit register is seen as vitally important to mitigate this risk.

In the absence of a fully-functioning credit register, the proposed measures may simply have the effect of transferring borrowing to more risky short-term sources of finance. This would make the measures ineffective in achieving their stated objective and could arguably make the financial system more unstable.

It was suggested that when the credit register is fully operational the LTI measure should be changed to a DTI limit. DTI takes all debt obligations of a borrower into account and could be facilitated by a fully-functioning credit register. The DTI limit would be a better measure of affordability as it gives a more complete picture of the borrower's financial position.

Consumer protection issues were also raised on this issue. If, in the absence of a credit register, borrowers may look to source unsecured lending from banks or moneylenders to fund a deposit it may be more costly to them (as the interest rate charged for such borrowing is higher) and make them more indebted in the early years of their mortgage.

Central Bank response:

While we acknowledge that the creation of a mandatory central credit register would be a valuable resource when introducing these measures, we believe that the measures cannot be delayed until such a register is established.

It is only when the appropriate infrastructure, such as a central credit register, is in place will it be possible to consider a DTI rather than a LTI limit. We accept the comments received with respect to the risk that people may turn to other forms of lending to fund a deposit.

The Consumer Protection Code contains provisions in terms of how Irish lenders assess the affordability of a mortgage for an individual borrower. The Consumer Protection Code requires that the personal and financial circumstances of consumers who are applying for a mortgage must be thoroughly assessed to ensure that they are only offered a mortgage that they will be able to maintain over the long term. In addition, the Code contains provisions which are aimed at promoting a greater level of responsible lending, which focus on assessing the consumer's ability to repay borrowings before offering, arranging or recommending credit, a regulated entity must fully assess the consumer's ability to service the repayments. Irish credit institutions, as part of their mortgage credit underwriting process, currently verify the source of the borrower's deposit and any changes to this approach going forward will be reviewed by the Central Bank.

Impact assessment

Given the potential for several, wide-ranging unintended consequences associated with the introduction of these macro-prudential measures for residential mortgage lending, seven submissions suggest that the Central Bank conduct an impact assessment. Another issue which arises is the need for further consultation with both the banking industry and with government and other policymakers.

Response:

The Central Bank will monitor the impact and effectiveness of the measures in achieving its stated objectives in line with its policy cycle as laid out in the Macro-Prudential Framework document and having regard to any possible future implications of other macro-prudential provisions introduced by virtue of legislation at EU level.

The Central Bank has carried out a detailed assessment of the suitability of these measures for the Irish market. This research informed the original proposal and is outlined in CP87. A continuing research effort will evaluate macro-prudential policy to help ensure its optimal deployment. The Bank will continue to make publicly available reports on its research findings. Among recent relevant published papers are:

An Economic Letter[5], published in 2014, finds that there is a strong positive relationship between originating LTV and LTI ratios and subsequent

[5] Hallissey, N., Kelly, R. & O'Malley, T., (2014), "Macro-prudential tools and credit risk of property lending of Irish Banks", Central Bank of Ireland, Economic Letter Vol. 2014, No. 10.

defaults, with the strength of the relationship dependent on the point of the property cycle at which the loan was originated.

Another recent Economic Letter[6] examines the default risks of FTBs and second and subsequent buyers. The research finds that FTBs have lower default rates, controlling for borrower and loan characteristics. It concludes that “this research is consistent with differential regulatory treatment of FTBs with default risk remaining comparable to the remainder of mortgage lending”.

In forthcoming research[7], the potential side effects of the measure are discussed and policy options, outside the remit of the Central Bank, to address these effects are reviewed. The side effects identified are taken from numerous sources including the responses to the consultation paper, economic theory and the experiences of other countries in using such macro-prudential tools.

A further research note[8] assesses the link between the composition of buyers in the Irish housing market and price dynamics during the recent housing boom. The analysis suggests that periods of strong house price growth appear to be related more to the share of buy-to-let borrowers in the market than to the share of FTBs.

It may be necessary to adjust any or all of the parameters of the proportionate LTV and LTI ratios in response to economic, market, or other developments in due course. It is envisaged that such adjustments may be introduced without a lengthy period of prior consultation.

[6] Kelly, R., O'Malley, T. & O'Toole, C. (2014), “Do first time buyers default less? Implications for macro-prudential policy”, Central Bank of Ireland, Economic Letter Vol.2014, No.14.
[7] Cf. Kennedy and Stuart, forthcoming Economic Letter.
[8] Coates, D., Lydon, R., & McCarthy, Y., (forthcoming), “House price volatility: The role of different buyer types”, Central Bank of Ireland, Economic Letter Series.

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