

**Dr. Patrick Honohan**  
**Governor**  
**Central Bank of Ireland**  
**Dame Street**  
**Dublin 2**

56-59 St. Stephen's Green  
Dublin 2

Telephone 01 669 5000  
info@permanenttsb.ie  
www.permanenttsb.ie

8<sup>th</sup> December 2014

**RE: MACRO-PRUDENTIAL POLICY FOR RESIDENTIAL MORTGAGE LENDING – CONSULTATION PAPER 87**

Dear Governor,

Permanent tsb Group fully supports the objectives set out by the Central Bank of Ireland (CBI) in CP87 of:

- ▶ Increasing the resilience of the banking and household sectors to financial shocks (primary objective); and,
- ▶ Dampening the pro-cyclical dynamics between property lending and housing prices (secondary objective).

We agree that there is a need to discourage asset price driven activity in the housing market and focus credit provision on both a balance of supply / demand for housing consistent with economic recovery and prudent underwriting (based on affordability). The purpose of this paper is to set out our position in relation to the specific proposals outlined in CP87. We have provided responses in Appendix 1 below to the individual questions posed by the consultation paper. However, on the basis that the Irish housing and mortgage markets are complex systems, intertwined with a multiplicity of broader social and economic drivers, we have prefaced our detailed comments with broader perspectives for consideration in relation to the specific measures proposed in CP87.

It is in the shared interests of Ireland's citizens, its financial sector and the CBI that financial stability is maintained and future property bubbles avoided. CP87 sets out substantive and decisive policy measures aimed at increasing financial resilience throughout the economy and dampening hyperinflation in the housing market. The proposals are to be commended in terms of their clarity of objective and their likely substantive impact.

However, we are concerned regarding the manner and extent to which the current proposals are likely to impact our customers. In their current form, the proposed macro-prudential controls will

form an obstacle to home-ownership for a considerable segment of the market. In particular, we are concerned that many prospective first time buyers, whose long term net disposable income (NDI) or debt-servicing-to-income (DSTI) would otherwise merit a favourable lending decision based on credit-worthiness, would not be in a position to buy their own home.

We are a dedicated domestic retail bank with a long history of supporting home ownership across a broad section of Irish society, including middle-income families, who, in our view will be most affected by the proposals in their current form. While we support the overall objective of CP87, we feel that modifications to the proposals set out in the consultation paper are both necessary and appropriate with a view to:

- ▶ Successfully achieving the Central Bank's stated objectives;
- ▶ Recognising the complex nature of the housing and lending markets, including the nature and extent of market factors which drive house prices and lending levels;
- ▶ Recognising and reinforcing other recent, ongoing and planned regulatory initiatives;
- ▶ Balancing broader policy imperatives including access to credit and home-ownership; and,
- ▶ Mitigating unintended consequences.

In the first instance, we support the industry response submitted by the BPF; in particular, we do not agree with the LTV caps unless required by the triggers of CBI led macro-economic tests/ KPIs.

#### Contextual considerations

In considering the appropriateness and timing of the measures set out in CP87, it is imperative that other relevant market matters, including a number of related implemented and in-flight regulatory measures, be considered:

---

#### Existing regulatory initiatives:

- ▶ The AQR and stress-testing of banks conducted as a precursor to the establishment of the SSM is significantly influenced by house prices. Various research articles referenced in GP87 note the corollary between LTV restrictions and house prices. A number of commentators have, in recent weeks, highlighted the potential impact on the recovering housing market of the proposals in CP87. Further falls or stagnation in Irish house prices will impact on banks provisioning and regulatory capital requirements.
  - ▶ Recent assessments have clarified available capital for future lending. Downward pressure on currently illiquid property markets will curtail such funding a critical point in the market recovery.
  - ▶ The Mortgage Arrears Resolution Targets (MART) process established by the CBI in 2013, alongside the CBI's Code of Conduct on Mortgage Arrears (CCMA) have established new market practices in relation to lending assessment, with large proportions of banks' outstanding loans effectively being re-underwritten. The 'standard financial statement' (SFS) provided for under the CCMA establishes a basis for a detailed understanding of sustained affordability or DSTI which in our view, reflects a more important basis for loan assessment than LTI (or LTV). The Central Bank will receive a further report on MART compliance in late 2014 / early 2015 and has flagged its intention to perform CCMA themed inspections in the coming months. The outputs of both these reviews will provide further relevant information for the CBI regarding the functioning of the mortgage and property markets, in what is a particularly critical phase of the MART process, as the overall target for the resolution of mortgage arrears across the market moves towards 50%.
-

▶ The Central Bank has directed the auditors of major Irish banks to provide an audit report on 'new lending controls' under GL44. The reports will reflect the position in each bank as at 31 December 2014 and will be provided to the Central Bank in quarter 2 of 2015. CP87 repeatedly references deficiencies in lending standards as a key factor in the housing bubble. Boards' oversight of banks' lending standards are central to the reports required by the Central Bank. Continued Board focus, these reports under GL44 and continued attention to lending standards by banking supervisors should continually represent the most important mitigant to any future deterioration of lending standards.

- ▶ The continued absence of a comprehensive Central Credit Register (which has a current expected delivery date of 2016) has significant implications for the effectiveness of the proposed LTV limits – particularly given the scope, in the intervening period, for prospective borrowers to attempt to meet deposit requirements through unregistered borrowings – which would run counter to the CBI's objectives and have negative implications for lenders and borrowers alike.
- ▶ The establishment of a Central Credit Register must remain a priority policy initiative. However, overall sustainable affordability (and NDI or DSTI) remain the most important factors in credit assessment, regardless of the absence of a Central Credit Register. As noted above, considerable progress has been made in the context of MART and the CCMA in relation to the development of a more rigorous and consistent approach to the assessment of sustained affordability – regardless of the availability of a Central Credit Register.

---

All of the Central Bank initiatives that are already in progress are key to an orderly workout of the substantial arrears issue, while enabling suitable funding of property market activity by first time buyers in particular and without flooding the property market through excessive repossessions.

---

**Broader market considerations:**

▶ CP87 notes that there is no evidence that recent house price growth in Dublin is credit driven. The drivers of recent house price inflation include a shortage of appropriate supply – specifically in and around Dublin – and investor led demand (as investors seek greater yield in an artificially low interest rate environment) with a significant proportion of transactions being cash based.

- ▶ CP87 states:  
*“The overall impact of a proportionate LTV cap on the amount of new lending will depend on how borrowers react: what proportion of borrowers will be able to meet the additional deposit, what proportion will buy a cheaper property, and how many will delay purchase.”*
- ▶ As stated above, the impact of the proposed measures must be considered in the broader context of how customers will be impacted. CP87 does not contain any further analysis in relation to the questions posited above. There is also little analysis regarding the likelihood that prospective borrowers will try to meet the deposit requirement through un-secured debt. We believe that a more thorough understanding of customer impact is required considering CBI's additional remit in relation to consumer protection and broader societal questions regarding access to credit, home-ownership and indebtedness.

- ▶ As noted above, housing and mortgage markets are complex systems with a multiplicity of drivers. As such, there are a broad array of other relevant policy matters which must be considered in relation to financial resilience, property lending and housing prices. Certain areas which are outside the direct control of the CBI cannot be ignored. These include:
  - The impact of NAMA asset disposals on housing supply;
  - The effect of the current residential property market bidding process (for example, as opposed to a 'sealed bid' process) on house prices;
  - Planning rules and build quality; and,
  - Taxation on houses (including CGT, rental reliefs, etc).
- ▶ The interaction of these issues with the Central Bank's proposals must be considered more broadly by policy makers if the desired outcome of properly functioning housing and credit markets are to be achieved.

In 12 months-time, there will be considerably more information available regarding the normalisation of the mortgage and credit markets including the impact of recent and continuing regulatory initiatives. As such, we believe that the end of 2015 would be a more appropriate time to consider the impact of macro-prudential measures.

#### **Preface to responses to questions set out in CP87:**

In light of the contextual points listed above, our responses to the specific questions set out in the consultation paper are informed by the following over-arching position:

- ▶ We believe that the proposals in CP87 place an undue emphasis on LTV and LTI rather than sustainable affordability / credit-worthiness (including DSTI), and that the contextual factors referred to above (including other actions currently being taken by the Central Bank such as MART and the establishment of a Central Credit Register) raise questions as to whether the proposals are merited in their current form and / or whether they are timely;
- ▶ As set out in CP87, the proposed LTV limits will have a significantly greater impact on current market dynamics than the proposed LTI limits (on the basis that a greater proportion of recent mortgage lending would be impacted by the LTV limits than LTI limits). In our view, placing such primacy on collateral value over affordability is counter-intuitive. A significant shortcoming of lending standards in the period prior to 2008 was the emphasis on collateral value rather than credit-worthiness and sustainable affordability. Relying on the value of the collateral as the basis for recovering a loan should always represent the last resort for a lender;
- ▶ We would encourage the CBI to bring its considerable influence to bear, as and when appropriate, in relation to the broader policy matters which are influencing the housing market and demand for credit, including those noted above (for example, in relation to housing market taxation policy and other policy matters effecting housing supply);
- ▶ While certain of the various policy considerations relevant to the housing and mortgage markets in Ireland are beyond the specific remit of the CBI, there are other areas, extraneous to residential mortgage lending, which were contributors to the financial crisis, to which the CBI could apply macro-prudential controls, such as development finance lending and wholesale funding;

- ▶ There is also a case to be made for establishing greater LTV limits for investor lending on the basis that that segment is focused primarily on return (including asset appreciation) as opposed to owner-occupied property where the primary purpose of the property is as a residence rather than an investment;
- ▶ We should reiterate that we do not agree with LTV caps unless triggered by CBI macro-economic tests. However, should measures be adopted along the lines set out in the consultation paper, we consider the following amendments to the proposals to be necessary:
  - Implementation of LTV limits should be phased (perhaps in 1% increments over a number of years) so as to mitigate the short term impact on house prices and assist borrowers and lenders in adjusting to the new levels of deposits required.
  - First time buyers require separate consideration. As noted above, first time buyers are likely to be the most effected by the proposed LTV limitations on the basis of the challenges presented in saving for a deposit for 20% of purchase price. This limitation does not, of itself, equate to a longer term credit risk. As noted in CP87, there is recent international precedent for applying a different approach to first time buyers, with Finland applying a 95% limit for first time buyers and a 90% limit for other borrowers. We believe that such a differentiation is appropriate in Ireland subject of course to continuing robust credit assessment for such borrowers. We would propose an LTV limit of 90% for first time buyers (without a proportionate limit).
  - With regard to the role of mortgage insurance, it is our view that a higher LTV limit for first time buyers should be considered regardless of the presence of mortgage insurance. The extent to which such a differentiation would maintain an unwelcome level of risk across the banking sector would be mitigated by:
    - The overall dampening effect on the market of the broader LTV and LTI limits;
    - The limited size of a more normalised first time buyer segment as a proportion of the overall mortgage market; and,
    - The continued application of stringent underwriting and affordability requirements (for all market segments, including first time buyers).

**Conclusion:**

In summary, therefore, we are of the view that:

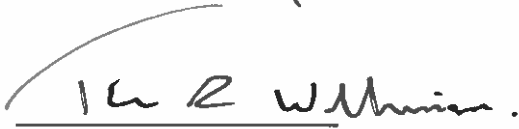
- ▶ We support the BPFJ submission
- ▶ There are a considerable number of initiatives underway at present in relation to the restructuring and renewal of the mortgage market (including Central Bank-led initiatives);
- ▶ At this point, the housing and mortgage markets remain fragile;
- ▶ The proposed macro-prudential measures, in their current form, will create a disproportionate obstacle to home-ownership;
- ▶ Therefore, further analysis is needed in 2015 to determine what macro-prudential measures are required in order to achieve the Central Bank's stated objectives.

Our responses to the individual questions set out in CP87 are detailed in Appendix 1 below and should be read in the context of our over-arching views as set out above.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Ger Mitchell", written over a horizontal line.

**Ger Mitchell, Mortgage & Consumer Finance Director**

A handwritten signature in black ink, appearing to read "Jerold Williamson", written over a horizontal line.

**Jerold Williamson, Chief Risk Officer**

---

## Appendix 1:

### Responses to specific questions set out 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?***

#### **Answer 1:**

In 2011 the CBI conducted a review of banks First Time Buyer mortgage origination process and criteria that led to recommendations that improved the affordability assessment of borrowers thereby protecting customers and banks. The updated CPC and the inclusion of the Stress Test (+2%) ensure the borrower has the ability to make mortgage repayments even when rates increase.

We are of the view that sustained affordability / credit-worthiness remain the most relevant criteria and that, therefore, DSTI is a more appropriate measure than LTV.

We do not object to the LTI limit as currently proposed.

#### **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)?***

#### **Answer 2:**

The measures must be applied equally for bank branches operating within the State and who are regulated by the CBI.

However, should macro-prudential measures be introduced, we believe there is a case for applying the measures differently to first time buyers, other owner occupiers and investors.

#### **Question 3:**

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

#### **Answer 3:**

The application of the exemptions will give rise to operational challenges. As noted above, we believe that there is a case for taking a differentiated approach to first time buyers, other owner occupiers and investors.

#### **Question 4:**

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

#### **Answer 4:**

Managing proportion limits and exemptions will be extremely challenging from an operational perspective which must be considered in the timing and oversight of any measures introduced. Market competition often results in multiple approvals being sought by individual applicants. Accordingly, it will not be possible to accurately forecast ultimate pipeline take up performance. Thus the introduction of exemption levels for LTV and LTI criteria will provide significant operational challenges.

In addition, managing exemptions whilst ensuring compliance within the requirements of the Consumer Protection regulation framework will be challenging.

#### **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?***

**Answer 5:**

As noted above, we believe that consideration should be given to permitting higher LTVs for certain market segments (specifically first time buyers).

We do not believe that there is sufficient information available at present to support the use of mortgage insurance as a basis for higher LTV loans.

**Question 6:**

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

**Answer 6:**

Yes - see answer 2, above. We do not perceive the same extent of challenges in relation to the proposed LTI limits as the proposed LTV limits.

**Question 7:**

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

**Answer 7:**

We do not have any comments regarding the proposed exemptions from LTI limits.

**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?***

**Answer 8:**

We agree with the view set out in the Consultation Paper that LTI is not a suitable measure for buy-to-let mortgages.

**Question 9:**

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

**Answer 9:**

Managing exemption limits will be extremely challenging from an operational perspective. In addition, market competition often results in multiple approvals being sought by individual applicants. Accordingly, it will not be possible to accurately forecast ultimate pipeline take up performance. Thus the introduction of exemption levels for LTV and LTI criteria will provide significant operational challenges.

**Question 10:**

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

**Answer 10:**

We welcome the objective to ensure the banking, housing and consumer lending markets are resilient and capable of coping with future cycles. However, as set out above, we believe that the timing of the intervention by the CBI is too early in terms of the economic cycle and will have significant impact on the potential recovery to a more stable housing market – particularly in light of other initiatives (including CBI initiatives) currently underway and the relevance of broader policy issues to the CBI's overall objectives. We believe that the introduction of caps / limitations should be considered, in conjunction with relevant stakeholders towards the end of 2015, in order to better address the Central Bank's stated objectives in CP87.



---

Banks have strengthened the underwriting process to ensure credit is only advanced to customers who are credit worthy. Consumer affordability is the key to determining the amount of any new loan sanctioned and we recommend that this should be the critical measure for policy assessment. As a result we recommend that a more blended approach to the tabled measures is considered by the CBI.

The European Banking Authority (EBA) will notably issue guidelines in support of the Mortgage Credit Directive (MCD) by March 2016. A period of consultation on these guidelines is due to commence by the end 2014 in order to leave enough time for the national competent authorities (NCAs) and the industry to comply with the requirements. We believe that it is vital that National initiatives are aligned with the expected EU requirements and given sufficient lead time for their respective implementation.

In summary, we believe that any measures should be implemented on a phased basis with regular review / checkpoints in place in order to assess the impact and any potential unintended consequences. The objectives of macro prudential policy should be aligned with the consumer protection principles/ requirements of suitability and 'treating customers fairly' as set out in CPC.

**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*

**Answer 11:**

Thresholds will be extremely difficult to manage as outlined above and treating customers fairly will be a challenge.

**Question 12:**

*Are there any significant obstacles to compliance by regulated financial services providers with the limits.*

**Answer 12:**

Thresholds will be extremely difficult to manage as outlined above and treating customers fairly will be a challenge.

---