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Consumer Protection: Policy & Authorisations Division C
entral Bank of Ireland
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Increased Protections for Variable Rate Mortgage Holders Consultation Paper CP98

Dear Sir / Madam

I welcome the opportunity to respond to this consultation and encourage the Central Bank to continue to include the public in their decision making process in order to increase transparency and accountability.

As a variable rate mortgage customer and from my limited (one house purchase, one mortgage) but far from atypical experience as a consumer I can only draw as a conclusion the following principles in response to your consultation

1. **The high interest variable interest rates are a drag on our economy and a threat to recovery.** Our recovery is presently is dependent on international companies and increased competitiveness. The failure of this to trickle down to the general population is a risk to our recovery. There are over 300,000[1] variable rate mortgage holders who do not have the option to switch and thus cannot access better rates. If each of these mortgage holders is overpaying interest by €1,000 per annum, that represents €300m taken out of circulation in the local economy every year - €3bln over ten years.
2. **The Variable Mortgage Rates in Ireland have to be index linked with a regulated margin.** The Irish 'captive' variable rate customer is paying 4-5% in interest at the same time negative interest is being applied to loans in the Danish market[2]. I welcome the Central Bank's initiative to compel the banks to outline the inputs into the variable rate in their rate policy, however I have little faith in it having any impact on the interest rates being paid by the variable rate customer. This is market gouging by a group of protected companies acting as a de facto cartel. The idea that a bank, in a long term contract has the unlimited discretion to adjust interest rates - thus alter the price

[1] https://www.centralbank.ie/publications/Documents/EL_2015_8.pdf
[2] http://www.ft.com/cms/s/0/7f4e2f4c-dde3-11e4-9d29-00144feab7de.html#axzz3zz90gSfy

of the contract as often and by as much as they wish seems ludicrous. The regulator needs to intervene on behalf of the customer.

3. **Switching is not a credible threat as most of the variable rate customers cannot switch - regulation is required.** The Central Bank's intention to increase transparency and thus 'facilitate customer choices' can only be effective where competition exists. According to 'Switch and Save' by Kenneth Devine, Sarah Frost and Rory McElligot, the number of mortgage holders ineligible for switching is over 300,000, effectively over 50% of the 522,407 principal dwelling homes mortgage holders. Banks are applying penal interest rates without the facility to switch due to poor credits scores, negative equity or arrears, exactly the cohort who need lower interest rates in order to maintain their loans. Without the credible threat of switching there is no incentive to provide a better rate, au contraire, it is in the bank's interest to extract as much interest as possible from the borrower.
4. **A fixed rate long term standard mortgage product should be mandatory for all lenders.** The variable rate product itself, when available in the United States might be referred to as an adjustable sub-prime mortgage given the fact that its rate is fully adjustable at the discretion of the lender and the rate is an opaque multiple of the base rate.
   Nevertheless, there are substantial savings available to a significant cohort of borrowers, and yet switching activity to date has been extremely low. Research from behavioural economics indicates that this may be due to the complexity of information and the inability of mortgage holders to differentiate between products. [3]
   A standard fixed rate long term product should be mandatory for all licensed lenders to provide at whatever rate they choose. The customer would at least be able to compare products on a like by like basis, e.g. Fixed Rate, 25 year mortgage - where the rate is fixed for the full duration. As with the recommendations by Barr, Mullainthan and Shafr,[4] a default simple product that has to be offered to the customer, at whatever rate the bank decides, would act as a ex post test to any riskier bespoke product, i.e. the customer was offered both products and decided to take the riskier of the two, whereas now the customer has little or no information on the different products or their potential long term values.
5. **Banking overhead should be regulated as part of a regulated price control - particularly for the mortgage activities.** The banks are presently over recovering costs from the market. In the area of overhead, I fail to understand how it is acceptable that the CEO of a state owned bank that failed and required significant intervention at a very high personal and financial cost to the citizens of Ireland should earn more than the Taoiseach. In my mind, the only evidence we have is that bankers pay is not correlated to performance given that pay grew through the boom and delivered a financial meltdown. Salaries should be reset to match civil service rates, given that many of the banks are in public control. The general terms of employment contracts of staff should be published for an open view as to whether there is legal scope for change. Anyone not willing to sign a new contract is free leave. It seems ironic, given the fact that the banks have the discretion to increase the variable interest rate to cover costs such as personal pension top-ups, salary increases and corporate entertaining, that owners/shareholders have none of this discretion with their employment contracts. This could, I imagine, provide savings that could be transferred to the customer in rate reductions.

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[3] http://www.centralbank.ie/publications/Documents/EL_2015_8.pdf

[4] http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1028&context=other

6. **Cross subsidisation should be restricted.** Cross subsidisation is being employed to gain new customers at the expense of the old. I obtained my mortgage in advance of the availability of tracker loans. I was never offered a tracker loan from any institution and I cannot now switch to a cheaper rate with another bank. Thus my bank subsidised and continue to subsidise new customers by charging me a higher rate of interest. Any rates being offered to new customers should automatically be available to existing customers.
7. **Further transparency and disclosure is required.** As per Barr, Mullainthan and Shafr,[5] the banks have created a situation where systematic asymmetric information occurs. The banks know more about a customer's credit score or eligibility than they do. They also know what products the customer would qualify for and may choose not to share this with the customer. It should be mandatory for a customer to have visibility of the scoring criteria for a loan and their score in the assessment. It should also be mandatory for any products to which they would qualify to be disclosed. Imagine the CAO, where the College knew what points a student got in the leaving cert but the student didn't. The college could offer the student a course which may not be optimum for student but which attracted subsidies or benefits for the college. E.g. A student who wanted to do Medicine, may have qualified for Medicine but if went through a Science degree first may attract more income to the University in fees.

***Question 1**: What are your views on the proposals outlined above?*

Provide transparency facilitate choice. One has to ask what choice the central bank expects the consumer to make. Only the few with perfect credit scores and sizeable equity will have the option to switch mortgages. This may have the perverse effect of allowing those who least need it the ability to achieve a lower rate while leaving the rest who do not have the option to switch to bear again the brunt of costs and rate increases, whether more transparent or not.

The requirement to publish a variable rate policy is of itself no use to the consumer. The mechanics of the development of the rate should be clearly and concisely detailed and included as a contract condition.

Any commercial contract that includes a mechanism for price/cost adjustment is clearly outlined within the contract and can be transparently calculated by either party. Anything else is a variation and is subject to negotiation and agreement of both parties. The fact that this is not a requirement in a mortgage contract is a glaring omission and boon for the mortgage provider who may adjust their rate at any time thus effectively increasing the price of the contract at any time.

The main reasons for this are:

- The power imbalance in the relationship - large listed corporation vs. individual
- The consumer is seeking approval from the institution for the loan
- The consumer has little or no formal legal representation or education

[5] http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1028&context=other

- The consumer is generally in the early years of their professional career and has neither the experience or competence to negotiate with a corporation
- It is probably the only time in their lives when the consumer will be required to go through this process and they are at the mercy of companies who have trained personnel, processes and systems to maximise their returns.
- The scale of the transaction is probably the largest personal transaction they will make and may consume more than 30% of their net income for over thirty years.

Question 2: *Do you have any suggestions in relation to the format of the summary statement or the level of detail which should be contained in the statement?*

As with many of the conditions enacted through the Truth In Lending Act - Regulation Z from the United States, I would recommend the following:

1. A clear and unambiguous mechanism for the calculation of the interest rate should be a mandatory inclusion in the documents. The rate should be derived from a published index rate and the only additional costs allowed should be a regulated overhead and profit allowance to be consulted on and published, much like a utility price control. This would allow the consumer a transparent mechanism to to anticipate the likely impact of any change in the underlying index. Any policy that would allow the lender to set their own rate of return should be resisted this will allow the lender to over recover from a specific cohort of customers, I.e. The variable interest mortgage holder who, due to poor credit history or negative equity is unable to switch lenders. As the mortgage market has failed and there is no real competition, tighter price regulation is appropriate.
2. Worked examples of the potential impact of interest rate changes given the amount of the loan should be included in the loan document;
3. Any charges not related directly to the interest rate but specific to the loan should be listed with details and amounts. These would include items such as commissions, brokerage fees, administration and set up charges;
4. A maximum interest rate should be stated in the loan document. Under no circumstances should the lender be permitted to exceed this rate;
5. No quibble mandatory financial penalties should be applied to the lender if any of the conditions of the guidelines are not adhered to;

Question 3*: Do you have any views on the proposal that the Central Bank would prescribe the format and content of the information to be provided in the summary statement?*

The central bank should prescribe the format as if the lender is given any discretion, they will develop a template specific to their institution which will act to confuse the borrower and make it difficult to compare one institutions offering from another. They will also 'interpret' guidelines to their benefit again negating the intended benefits to the consumer.

Moreover the mortgage contract itself should be standardised. As a contract is a risk pricing document, the only way to protect a naive and trusting consumer from a predatory lender is to provide the market with a standard mortgage agreement much like a Works contract template that the national procurement agency makes available to the market for the purpose of having a common legal reference for construction projects.

As stated above also - a standard fixed rate 30 year mortgage should be mandatory from every lender. The rate could be at the discretion of the lender but the borrower would be able to compare products on a like by like basis.

Question 4: *Do you have any views on the proposals that the lender will be required to give variable rate mortgage holders information on alternative options?*

Without doubt they should and the basis for identifying the assessment of alternative options should also be prescribed, I.e. The loan which would attract the lowest interest payable over the lifetime of the loan.

Question 5: *Do you have any views on the proposal to increase the notification period?*

The notification period is only significant if the borrower is in a position to question the rate adjustment and somehow effect change. This in turn will only be possible in the case of a transparent rate calculation mechanism. If the only thing happening is that the borrower is being dictated to then it is immaterial as the borrower will simply be compelled to adjust her payments in line with the notice.

Question 6: *If you agree that the notification period should be increased, what do you consider to be an appropriate notice period in order to achieve the objectives set out above?*

As with question 5, this is dependent on the borrower having the power to achieve something other than just following instruction to increase payments.

Again I commend the Central Bank for consulting on this topic and hope that this is only the beginning of long overdue consumer protection improvements in an area that directly affects the quality of life of over 1m people in Ireland. I hope you can appreciate from the fact that I, along with many others I would imagine, have taken considerable time and energy in order to contribute in a constructive and meaningful way to this consultation.

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Domnall - A variable rate mortgage holder