Consumer Protection Code Review

Submission from Brendan Burgess 24th March 2023

Summary

- When a consumer is taking out a mortgage or an insurance policy, the absolutely key issue is the price of that product
- Yet the Central Bank has been reluctant to take any action on the issue of pricing.
- The Central Bank will devote considerable resources to discussing vulnerability and financial literacy. The reality is that almost all mortgage customers are vulnerable and financially illiterate. The Central Bank should protect all customers and not just focus on minority groups.
- This actual Review itself is a good example of the Central Bank's washing its hand of the issue. In 9 hours of round tables on the review, it allocated "the 15 minutes left before the coffee break" to deal with pricing issues.
- Bizarrely, the only time the Central Bank has intervened to prohibit unfair pricing practices has been on insurance while ignoring the much more significant issue of mortgage pricing.

Recommendations for changes to the Consumer Protection Code

- Financial Services providers should be prohibited from charging existing customers higher prices than they charge new customers with the same characteristics
- Mortgage providers should be prohibited from offering cashback to new customers
- Financial services providers should be prohibited from incorporating artificial features into their products whose sole purpose is to trick customers into making poor choices through ignorance or inertia.

I will focus my submission on the issue of mortgage pricing. But the same principles apply to insurance and other areas.

Mortgage pricing is the most important consumer issue yet the Central Bank has been reluctant to make any meaningful intervention

In the 64- page discussion paper on the review of the Consumer Protection Code, 2 pages are allocated to pricing matters. In 9 hours of round table consultations on the review– 15 minutes were allocated to "get pricing out of the way before the coffee break". Pricing is a key issue, but the Central Bank, for whatever reason, wants to have as little as possible to do with it.

- 600,000 people have mortgages on their homes
- For many of these people, it's the biggest element in their family budget
- For most of the past ten years we have had the highest rates for new business in the eurozone
- Existing borrowers (other than tracker mortgage holders) are particularly vulnerable because Irish lenders charge them much higher rates
- Some borrowers can't switch lenders and must pay whatever rates their lender charges
- High mortgage rates lead directly to higher levels of mortgage arrears which result in misery for the borrower and leads them to be trapped with their lender unable to switch

- High arrears lead to NPLs for the lenders resulting in them selling these mortgages to vulture funds

Why has the Central Bank been reluctant to intervene on mortgage rates?

Frankly, it does not understand the tricks the lenders use to hoodwink borrowers and so sees no reason to intervene.

Ideologically, it believes that it has no role in setting prices. I would agree with this ideology but only in a free and fair competitive market where lenders don't abuse the ignorance, inertia and captive status of many borrowers as happens in the Irish mortgage market. 3

The Central Bank allows itself to be distracted by minority issues such as vulnerability and financial literacy. And these are important issues. But the reality is that almost all mortgage customers are vulnerable and financially illiterate. The Central Bank should protect all customers and not just focus on minority groups.

Where the Central Bank has intervened, it has had little or no effect.

- Requiring banks to produce a Variable Rate Policy Statement – read a few of them to see how vague and meaningless they are
- Anyway, to the extent that lenders compete, they compete on fixed rates, yet there is no requirement to produce a Fixed Rate Policy Statement
- Requiring banks to write to borrowers once a year informing them of their mortgage options has had no effect.
- The Central Bank conducts academic studies on switching in preference to taking any real action.

These are meaningless initiatives. They are costly to the lenders and have absolutely no benefit for the borrower. They should be scrapped. At the end of the day, the cost of regulation is passed on to the consumer. When regulation is pointless, the consumer incurs higher prices for nothing.

Irish mortgage rates for *new* customers have been twice as high as the eurozone average

Irish new business rates have been higher than the rest of the eurozone for most of the last ten years. Only a small part of this is justified by the requirement to hold extra capital.

Take the Central Bank Retail Interest Rates Statistical Release from November 2019 as an example:

Weighted average interest rate on all new mortgages in Ireland	2.9%
Weighted average on all new mortgages in the eurozone	1.37%

So Irish new business rates were over twice as high as the eurozone average. For most of the last ten years, Ireland had the highest mortgage rates in the eurozone.

But rates were much higher again for *existing* customers who did not have tracker rates.

Lenders use a variety of methods and tricks which result in existing customers paying a much higher rate than the new business rate.

- Having separate lower rates for new customers, which existing customers can't avail of

- Charging artificially high variable rates which many customers default to when the fixed rate is up
- Keeping new business rates high but attracting new business with cashback

Some examples of lenders charging existing customers higher rates than new customers

- Bank of Ireland's lowest rate today is 2.9% for a High Value Mortgage fixed for 4 years which qualifies for the 0.3% Green Mortgage discount, but it is only available to new customers and there is no cashback. When the 4 years is up, the borrower ends up paying the much higher existing customer rates – up to 4.5%.
- Bank of Ireland gives new customers a 0.3% reduction if they have a high energy rating but this is not available to existing customers. When the new customer's fixed rate is up, they don't qualify any longer for the green mortgage discount. I doubt that Bank of Ireland customers are aware of this.
- For much of the last ten years, permanent tsb offered fixed rates to new customers, but did not allow existing customers to fix at any rate, so these customers were stuck paying variable rates of 3.9% to 4.25%.
- When ptsb did introduce fixed rates for existing customers, they were much higher than the rates available to new customers

While ptsb has not made any public statement on this issue, they seem to have recently stopped charging existing customers different rates. However, their website has different sections for new and for existing customers, although the rates appear to be the same.

There is absolutely no justification or rationale for charging existing customers higher rates than new customers and the Central Bank should prohibit such discrimination

The only reason some banks charge existing customers higher rates is because they know that they can exploit the ignorance and inertia of their customers.

This pricing is artificial. It is not in any way related to the cost of the product. Such artificial pricing whose sole purpose is to gouge customers should be prohibited.

Most customers are too busy shop around. Even if customers are not too busy, they are too ignorant to evaluate the different mortgage offers. They do not understand mortgage interest rates. And even if a borrower is informed enough and empowered enough to switch to another lender, many customers cannot switch.

Most customers don't switch lenders to get a lower rate, and many can't switch lenders.

A customer must be well-informed, must make a lot of effort and must incur a lot of expense to switch lenders. And they are never sure that the new lender will be cheaper over the long term. So, most customers don't switch.

But there are reasons why many customers simply can't switch lenders and are stuck on the high rates:

- They are in arrears
- Although they are no longer in arrears, their mortgage has been restructured
- Their income has fallen since taking out the mortgage, often because one parent takes time off to mind children
- A couple has split up and are no longer cooperating on such matters

- They have switched from employment to self-employment
- There are defects in the property e.g. mica

And in some cases, although there is a lower rate available from another lender, it does not make financial sense to switch:

- The break fee is too high or the mortgage-holder does not have the cash to pay it up front
- The remaining balance is too low so that any saving in interest would not recover the costs of switching
- The remaining term is too low so that any saving in interest would not recover the costs of switching

Keeping new business rates high but attracting new business with cashback

(For a fuller discussion see the Appendix)

In any discussion I have had with Central Bank staff about cashback, they argued that availability, choice, product innovation are good for consumers. In fact, this is repeated in the discussion paper for this review. This is a purely ideological position divorced from the reality of Irish mortgage lending. The Central Bank argued that cashback suited some customers who were free to avail of this or go to another lender for a cheaper non-cashback deal.

But that is the wrong way to look at it. Step back and take a wider view. Why did Bank of Ireland introduce cashback? It was not some magnanimous gesture to give customers choice. It was so that they could maintain artificially high rates for their back book of existing customers.

If Bank of Ireland charged new customers 3% when AIB was charging 2.5%, then Bank of Ireland would get no new business. So, they would have to reduce their rates to 2.5%. They did not want to reduce the rate to 2.5% to compete with AIB because they would come under pressure to offer this rate to existing customers. So, giving cashback enabled them to charge higher rates to new customers, but more importantly, it allowed them to keep the rates higher for existing customers.

If the Consumer Protection Code is amended to specifically prohibit cashbacks , then lenders would be forced to compete on rates, and rates alone.

It would also be necessary to ban discrimination between new and existing customers, or else Bank of Ireland and ptsb could continue with their practice of attracting new customers with special rates while not allowing existing customers to avail of them.

Why has the Central Bank taken action on insurance pricing but not on mortgage pricing?

While the action taken on insurance pricing is welcome, taking action on mortgage pricing is far more important.

- The lenders' mortgage pricing tricks are far more devious and complicated than the tricks of the insurance companies. (While the Central Bank copped on to the tricks of the insurance companies, they don't seem to have copped on to the tricks of the mortgage lenders.)
- The mortgage payment is usually a far higher proportion of a person's income than their insurance premia.
- Insurance is a one-year product whereas a mortgage can be up to 30 years.

- Insurance premiums are far simpler to understand and compare. If one insurer charges €500 and another insurance company charges me €600, it is usually easy to see the difference immediately and decide if any additional cover is worth the extra €100. A mortgage product is much more difficult to assess even for sophisticated borrowers:
    - Interest rates are expressed in percentages whereas insurance premiums are in cash amounts. Percentages are much more difficult for customers to understand which gives the lenders more scope for deception
    - They are complicated further by cashback
    - Customers have to compare fixed with variable rates
    - Mortgage lengths may be different, further complicating the comparison
    - It takes time to apply for, get approval and draw down a mortgage. The interest rate often changes during this period
- If a customer makes a mistake in choosing a bad mortgage product, it may be costly to extricate themselves from it, whereas with an insurance product, as it's just one year, the potential loss is limited.
- Customers, who have not had a recent claim, can switch insurers easily – they can go onto bonkers.ie or some other website and switch instantly to another insurer. Switching mortgage provider can take about 3 months, during which time, prices may well have changed.
- There is no cost to switching insurance. Switching mortgage provider costs around €1,500.
- It takes time to switch mortgage providers and during that time, the new lender may no longer be the cheapest and so the switch does not go ahead and the borrower has wasted their time and, in many cases, fees to a broker and solicitor.
- Many borrowers cannot switch lender as they have a restructured mortgage or their personal circumstances have changed since they drew down the mortgage so they are prisoners of their lender. While the claims history of some drivers might make their premium higher, they are rarely stuck with no choice.

Conclusion

The Central Bank must change its own culture and recognise that it must deal with pricing as the number one issue for consumers. If the Central Bank can get this right, it will dramatically improve outcomes for consumers.

- Financial Services providers should be prohibited from charging existing customers higher prices than they charge new customers with the same characteristics
- Mortgage providers should be prohibited from offering cashback to new customers
- Financial Services providers should be prohibited from incorporating artificial features into their products whose sole purpose is to trick customers into making poor choices through ignorance or inertia.

Appendix 1 Copy of note sent to Central Bank on 28 April 2021

Why cashbacks should be prohibited.

A note for Governor Makhlouf from Brendan Burgess

28th April 2021

The prevalence of cashbacks is one of the reasons why our mortgage rates are the highest in the eurozone.

The very high mortgage rates in Ireland are due to a number of factors including the difficulty in enforcing the security and the high capital requirements.

But by far the most significant factor is the lack of competition. Irish banks charge high mortgage rates because they can get away with it.

And cashbacks distort the market enabling lenders to compete for business on issues other than mortgage rates. Their removal would force lenders to compete on mortgage rates alone. It would not solve the problem of high mortgage rates in Ireland, but it would contribute to the solution.

The Central Bank is looking at this issue from the wrong direction – it is not about choice for new customers, it is about existing customers.

In all my discussions on the topic with the Central Bank, they speak about cashbacks being good for "customer choice".

If you look at it as a decision facing a single customer, you might conclude that cashbacks are ok. An informed customer should be free to make a choice between a non-cashback deal and a cashback deal.

While the Central Bank makes a virtue of engaging with stakeholders, the reality is that the "we know best" attitude of the Central Bank prevents the Bank from actually listening to people like me. This failure to really listen and to try to understand means that the Central Bank cannot see this issue from the correct vantage point.

This is not about a choice by an informed customer – it is about keeping the mortgage rates high for existing customers.

Table 1 Best rates available to existing customers

Non-cashback lenders		Cashback lenders	
Avant	1.95%	EBS:	2.9%
Ulster Bank	2.2%	Bank of Ireland	2.9%
KBC	2.25%	Permanent tsb	2.95%
AIB	2.35%		
Average rate:	2.2%	Average:	2.9%

The best rate an existing customer of permanent tsb can get is 2.95% whereas an Ulster Bank customer can avail of the 2.2% rate.

Likewise, a Bank of Ireland customer pays 2.9% compared to KBC's 2.25%

Bank of Ireland and permanent tsb face a choice when trying to attract new mortgage customers. They can bring their mortgage rates down to 2.2%. But if they do that, they will come under pressure to offer these rates to existing customers. So instead, they keep their rates high and give cashback to get new customers.

Cashback penalises existing customers of Bank of Ireland and permanent tsb very heavily.

If cashbacks were prohibited, Bank of Ireland and permanent tsb would be forced to bring down their mortgage rates or they would get no new customers.

The situation is now urgent with the forthcoming exit of the two cheapest lenders from Ireland.

KBC and Ulster Bank are currently the cheapest banks providing mortgages. Neither do they discriminate between new and existing customers.

Bank of Ireland and permanent tsb are the two most expensive lenders and they are the only lenders who discriminate between new and existing customers.

It would be disastrous for customers of KBC and Ulster Bank if their mortgages are taken over by Bank of Ireland and permanent tsb while these banks continue to charge existing customers very high rates.

Table 2 Comparison of KBC and Bank of Ireland rates for existing customers

LTV	Fixed term	KBC	Bank of Ireland
<60%	2 year	2.25%	2.9%
	3 year	2.25%	3%
	5 year	2.4%	3%
	1 year	2.5%	2.9%
	10 year	2.85%	3.3%
<80%	2 year	2.25%	2.9%
	3year	2.3%	3%
	5 year	2.45%	3%
	1 year	2.5%	2.9%
	10 year	2.99%	3.3%
<90%	2 year	2.3%	2.9%
	3 year	2.35%	3%
	1 year	2.5%	3%
	5 year	2.5%	2.9%
	10 year	3.2%	3.3%

Table 3 Comparison of Ulster Bank and permanent tsb rates for existing customers

LTV	Fixed term	Ulster Bank	Permanent tsb
<60%	2 year	2.35%	3%
	5 year	2.2%	3.1%
	7 year	2.8%	3%
<80%	2 year	2.25%	3.1%
	5 year	2.45%	3%
	7 year	2.95%	3%
<90%	2 year	2.4%	3.1%
	5 year	2.55%	3%

	7 year	3.15%	3%

As well as prohibiting cashbacks, lenders must be prohibited from discriminating between new and existing customers.

The four non-cashback lenders allow their existing customers to avail of the rates on offer to new customers.

Bank of Ireland and permanent tsb have lower rates for new customers and don't allow existing customers to avail of them.

Table 4 Mortgage rates from cashback lenders who have a no cashback option.

	Bank of Ireland	Permanent tsb
Best rate existing customers	2.9%	2.95%
Best rate new customers – with no cashback	2.5%	2.25%
Difference	0.4%	0.7%

If cashbacks are banned, Bank of Ireland could reduce the rate for new customers and not offer it to existing customers, so this discrimination must be prohibited as well.

Cashbacks enable lenders and borrowers to get around the Central Bank limits.

If a borrower who has 8% of the price of a house, they can use the 2% cashback to get a mortgage of 90%. They may have to borrow the 2% from a family member and then repay it when they get the cashback.

Cashback should not be used in this way. The Central Bank rules serve a purpose and are carefully calibrated.

A ban on cashbacks would make international comparisons fairer.

While mortgage rates in Ireland are reported as being 1.5% higher than the rest of the eurozone, that does not take into account that some Irish banks give cashback.

With cashback prohibited, the comparisons would be fairer.

Cashbacks have been widely criticised as bad for consumers.

The main reason for prohibiting them is to promote competition. The Central Bank argues that they are good for consumers. But this is at odds with all the following commentary:

The ESRI highlighted this in their recent report: Do some financial product features negatively affect consumer decisions?: "Evidence suggests full disclosure of information is unlikely to be a sufficient remedy, as transparency does not eradicate consumer mistakes."

CCPC response to Central Bank's consultation paper on switching :

"1.17 In our recently published Mortgage Options paper we highlighted the growing significance of cashback payments and loyalty discounts introduced by lenders in the Irish market as incentives to encourage switching. On one level this can be seen as proactive competitive behaviour by lenders to differentiate their product offering from those of competitors. At another level it could be argued that they represent a sophisticated attempt to manipulate consumer behaviour and may result in consumers making decisions for short-term gains that over the medium or long-term are not in their best interest."

Academic Studies Conned by Cashback "the average cashback mortgage is €32,000 more expensive over 30 years." And "The evidence on the effectiveness of current mandatory disclosures is weak."

Mortgage broker representatives: Michael Dowling: "Banks are misleading customers with costly cashback mortgage incentives."

The Central Bank does have the moral power to ban cashbacks.

It has been argued that the Central Bank does not have the legal power to ban cashbacks. This is a specious argument. The Central Bank can use its moral suasion to end cashbacks and should do so.

Furthermore, they can advise the government that they would like to see legislation brought in to end cashbacks.

If it is the Central Bank's policy to maintain very high mortgage rates in Ireland, then you should say so!

The Central Bank has a disgraceful record in regard to mortgage rates. For many years, it disguised the true rates being charged by classifying rescheduled tracker mortgages as new business.

The Central Bank has opposed every effort to highlight the high mortgage rates and has done nothing to promote competition in the market.

I hope this is all accidental and not part of a strategy to promote high mortgage rates. But if the Central Bank's strategy is to maintain very high mortgage rates in Ireland, then you should be straight up about it and state it publicly.