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Bríd Dunne
Clerk to the Committee
Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach
Leinster House
Dublin 2
D02 XR20

29 March 2019

Re: Detailed Scrutiny - No Consent, No Sale Bill 2019 – Request for Written Submission

Dear Ms. Dunne

We refer to your letter of 28 February 2019 requesting the views of the Central Bank of Ireland ('Central Bank') on the No Consent, No Sale Bill 2019 (the 'Bill') and welcome the opportunity to provide a written submission on this matter to the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach.

The Central Bank's mission is to serve the public interest by safeguarding monetary and financial stability and ensure that the financial system operates in the best interests of consumers and the wider economy. We have considered the Bill in the context of our mission.

Overall, and as outlined in our recent correspondence with the Department of Finance (attached as Appendices 1 and 2 to this letter), the Central Bank has significant concerns regarding the terms of the Bill.

Consumer Protection

A strong consumer protection framework is in place for borrowers of mortgage loans, providing rules with which regulated firms operating in Ireland must comply by law. In the context of this

Bill, the Central Bank advocated for a legislative regime whereby customers would be protected regardless of whether their loan was held by a bank or a non-bank. This is now the case, following the introduction of the retail credit firm and credit servicing firm regimes. In the case of all statutory Codes in place, including the Consumer Protection Code and the Code of Conduct for Mortgage Arrears ('CCMA'), the Central Bank has reviewed, advocated for and strengthened, where necessary, these rules in order to ensure that the regulatory framework remains fit for purpose and continues to ensure the protection of consumers in their dealings with regulated firms.

From a consumer protection regulatory perspective, the enactment of this Bill will not offer new or existing borrowers any additional consumer protections and it could result in consumer detriment arising from an increase in interest rates and/or a decline in mortgage availability.

The policy intention of the Bill is to place the voluntary Central Bank Code of Practice on the Transfer of Mortgages (the Code of Practice) (issued in 1991) on a statutory footing and to require borrowers' consent to their mortgage being transferred to another party.

The Code of Practice was issued as a voluntary Code (as opposed to other Central Bank Codes of Conduct issued under Section 117 of the Central Bank 1989). Consequently, the Central Bank's regulatory powers, including the use of its Administrative Sanctions powers, do not apply to the Code of Practice.

The Central Bank is of the view that the voluntary Code of Practice is not relevant or appropriate in the current regulatory and financial environment. The Central Bank therefore considers the Code of Practice to be redundant and intends to revoke it. All relevant participants in the market are now subject to regulation by the Central Bank, including compliance with relevant statutory Codes in place.

Most loan agreements include a clause that allows the original lender to sell the loan on to another firm. It follows that the Bill is in conflict with contractual rights or the lender or loan owner, while not strengthening the consumer protection regulatory framework.

Financial Stability

Resilient banks are essential for a properly functioning economy

The recent crisis serves as a stark reminder of the severe costs of financial instability to society. While there has been significant progress towards repairing the banking system in recent years, legacy vulnerabilities from the crisis remain. It is the Central Bank's judgement that the

restrictions imposed by the Bill in its current form would be costly, both by hindering the continued recovery of the banking system and, most importantly, by reducing the ability of the banking system to absorb adverse shocks in the future. Ultimately, these costs will be faced by households and businesses in Ireland.

Implications for balance sheets when adverse shocks hit

Restricting the ability of banks to address non-performing loans (NPLs) effectively will have an adverse impact on the health of their balance sheets, especially in future times of stress. While there are various methods through which banks can deal with NPLs, the option to sell portfolios of loans – undertaken alongside strong consumer protection rules – is important.

- Looking back, loan sales have been part of the toolkit used by the banking system to deal with non-performing loans. Since the 2013 peak, the stock of NPLs held by the retail banks (across all loan portfolios) has declined by €67 billion. Around 12 percent of that reduction was achieved through residential loan portfolio sales (including Buy to Let ('BTL') and Primary Dwelling Home ('PDH') loans).

- Looking forward, while NPLs have declined in the Irish banking system, the level is still above the average across European banks. As part of the Single Supervisory Mechanism ('SSM'), the Central Bank requires Irish banks to reduce NPLs in a sustainable way. In this context, Irish retail banks have submitted updated NPL reduction strategies, which include both planned workouts and potential sales.

It is the Central Bank's view that the introduction of this Bill will significantly constrain the ability of banks to engage in portfolio sales (whether of performing or non-performing loans) and, so, limit their ability to deal with outstanding vulnerabilities from the crisis. These constraints will hinder the continued post-crisis recovery of the banking system. And, crucially, they will reduce the ability of the banking system to deal with any future macroeconomic downturn and the accompanying deterioration in asset quality.

Implications for funding costs

Actual, or even perceived, constraints on the ability of banks to deal effectively with NPLs can have adverse implications for their cost of funding, especially in times of stress. Creditors typically require higher interest rates to fund banks with riskier balance sheets, for example because of elevated NPLs. The relationship between the ability of banks to deal with NPLs and their funding costs is likely to be particularly acute in future times of stress. If – in a future downturn – investors perceive that Irish banks' ability to deal with rising NPLs effectively is

constrained, they are likely to require higher interest rates to fund banks. Invariably, this higher cost of funds will be passed on to consumers.

The enactment of the Bill in its current form will also hamper the ability of banks to tap market-based sources of financing using mortgages as collateral, such as securitisations and covered bonds. Access to such forms of finance helps diversify the funding base and achieve lower funding costs, relative to issuing unsecured bonds. Constraints on banks' ability to mobilise (typically performing) mortgages as collateral to raise funding through these market-based channels has the potential to limit the availability, or increase the cost, of mortgage credit.

Constraints on access to central bank funding

The enactment of the Bill in its current form will also constrain access to central bank funding using mortgage-related securities as collateral. Central banks provide credit to banks backed by collateral and Irish retail banks rely to a significant extent on mortgage-related collateral, given their business models. Indeed, during the financial crisis, the ability of Irish banks to post securitisations and covered bonds as collateral was crucial to allow them to borrow from the eurosystem to meet their acute liquidity needs. Total liquidity provided to Irish-domiciled institutions in monetary policy operations by the Central Bank, on behalf of the eurosystem, rose to a high of €140 billion towards the end of 2010, around 40% of which was backed by mortgage-related collateral.

The Bill would render the type of asset transfers required to use these financial instruments effectively impossible for Irish retail banks. It would also seem likely that the eurosystem, as a taker of collateral, would have concerns about the realisation of such collateral in the event of a counterparty default. This, in turn, has the potential to restrict the capacity of Irish banks to access central bank funding.

Overall impact on financial stability

The above factors mean that the enactment of the Bill in its current form has the potential to hinder the continued post-crisis recovery of the banking system. The high share of NPLs on the balance sheets of domestic banks has contributed to higher interest rates on lending to households and businesses relative to European norms. High NPL levels require additional regulatory capital and impose both direct and indirect costs on financial institutions (time, monetary and diversion of management focus). Together with the potential implications on banks' funding costs and access to central bank funding, these factors – everything else equal – are likely to translate into a higher cost of credit for households and businesses.

Most importantly, the enactment of the Bill in its current form will reduce the resilience of the system to potential future adverse shocks. The ability to restructure balance sheets and, crucially, to tap central bank liquidity is essential to be able to absorb shocks. It is, therefore, our judgement that the enactment of the Bill in its current form will mean that the banking system will be more likely to become impaired in future times of stress and less capable of providing credit to households and businesses, amplifying – rather than absorbing – shocks.

Other Comments

Appendix 3 to this letter contains certain additional comments, including our preliminary technical comments on the Bill.

We understand that the ECB has been consulted on this Bill and its Opinion will be considered as part of the Committee's scrutiny of this Bill. Consideration should also be given to the requirement to consult the Single Resolution Board on this Bill.

The Central Bank shares the concerns of the Committee that borrowers must be treated fairly. However, it is incumbent on us, in accordance with our mandate, to set out the potential unintended consequences of the Bill in its current form. Our concerns centre on the adverse impact this Bill would have on the ability of Irish banks to deal with non-performing loans in a sustainable way, their overall funding and liquidity resilience and, in turn, the potential adverse impact on existing and future borrowers, especially in times of stress. Overall, the Bill has the potential to impact negatively on financial stability and the Irish economy, without enhancing the consumer protection framework. Given that, consideration should be given to conducting a thorough impact assessment of the costs and benefits of the Bill.

Yours sincerely

Gráinne McEvoy
Director Consumer Protection

Vasileios Madouros
Director Financial Stability

Appendix 3 – Other Comments

Constitutionality of the provisions

While the constitutionality (or otherwise) of the Bill is a matter for the Attorney General's office, the Central Bank's view, as set out in our attached correspondence with the Department of Finance, is that the enactment of the Bill would appear to result in an interference with the legitimate property rights of the lender or loan owner without an appropriate consumer protection justification.

Articles 40.3.1 and 40.3.2 of the Constitution provide as follows:

1. *The State guarantees in its laws to respect, and, as far as practicable, by its laws to defend and vindicate the personal rights of the citizen.*
2. *The State shall, in particular, by its laws protect as best it may from unjust attack and, in the case of injustice done, vindicate the life, person, good name, and property rights of every citizen.*

Article 43.2 also provides that "[*t*]*he State … guarantees to pass no law attempting to abolish the right of private ownership or the general right to transfer, bequeath, and inherit property*".

The property right in question is the contractual entitlement of the lender/loan owner under the terms of a mortgage agreement to transfer the loan without the requirement for any further consent from the borrower. It appears that the intention of the Bill is to seek to interfere with these property rights with retrospective effect.

It is the Central Bank's view that the potential encroachment on the property rights enjoyed by the lender/loan owner under a mortgage contract would not appear to be proportionate to the policy intention of the Bill, namely the protection of consumers whose loans are or have been sold. On this particular point, we have suggested to the Department of Finance that the Attorney General's office consider whether legislative interference purporting to unilaterally vary contractual agreements in this way would constitute an "unjust attack" on the property rights of the lender/loan owner and in light of the established legal position that retrospective measures are, prima facie, an unjust attack on such property rights.

Other technical comments on the Bill

As set out in the body of this letter, the Central Bank has significant concerns on all of the provisions of the Bill and its overall purpose and objective. In addition to these concerns, below are the Central Bank's preliminary technical observations on the specific terms of the Bill.

As an overall comment on the Bill, the Central Bank notes that it does not adequately address how consent might be given. For example, if no consent is given, for whatever reason, it is not clear whether the loan can be transferred or not or whether silence equates to consent after a certain period of time.

The Bill is also unclear on when precisely consent must be given. For example, it is not clear whether another consent is necessary in all cases including where consent has already been provided under an existing agreement.

- **Section 1 - Interpretation**

  a) Definition of "borrower" refers to "housing loan" which is not defined. It is not clear whether this is intended to refer to both residential and investment property.

  b) Definition of "lender" refers to "company, partnership, business or other entity engaged in the provision of, management or administration of dwelling house mortgage loans" – this definition is very broad and purports not only to regulate entities that are lenders but also entities that do not currently fall to be regulated.

- **Section 2 - Conditions for the transfer of residential mortgages**

  a) Section 2(1) – "residential property" is not defined.

  b) Section 2(2) – reference to "new borrower" – it is not clear why the concept of a new borrower is provided for given the intention of the Bill. Is the intention that only new borrowers must consent to the transfer of their mortgage loan in circumstances where an existing borrower has already consented in their loan agreement to such transfer?

  c) Section 2(3) purports to provide the Central Bank with a function that it would not typically have in terms of pre-approving the communications of a regulated entity with its customers, whether such communications are required under statute or otherwise. It is a matter for regulated financial service providers to comply with their obligations under relevant financial services legislation and it is important that they remain fully responsible in this regard. This function would also be resource intensive and likely lead to an increase in the levies imposed on firms.

  d) Section 2(4) – The requirement that each borrower would be approached individually would not be practical in the context of the sale of a large number of mortgage loans. This could effectively mean such loan sales could not occur given the practical implications of being able to approach each borrower individually. It is also unclear what is meant by "approached individually". The reference to "reasonable time" is too open to interpretation and is unlikely to be enforceable.

- **Section 3 – Lender to act as agent of the transferee**

  It is important to note that by reason of the Consumer Protection (Regulation of Credit Servicing Firms) Act 2018, each transferee will be required to be authorised by the Central Bank and it is the transferee who will be responsible for all relevant regulatory requirements rather than the original lender. In setting their own policies on the handling of arrears or the setting of mortgage interest rates, such transferees will be required to comply with all relevant regulatory requirements (including the Consumer Protection Code and CCMA) and their contractual obligations to borrowers.

- **Section 4 - Loss of control**

  The meaning and aim of this section is unclear. It is not clear if consent is only required in these circumstances or in all cases and why another consent is required when consent has already been provided.

- **Section 5 - Information to be provided by the lender**

  a) Section 5(v) – does this provision mean that the transfer cannot go ahead without a specific consent? The wording is not clear on this.

- **Section 6 - Terms of transfer agreement**

  a) Section 6(i) would appear to cut across existing EU legislation (for example the European Union (Consumer Mortgage Credit Agreements) Regulations 2016) which allows for a fee to be charged in certain circumstances when paying back a fixed rate mortgage loan early.

  b) Section 6(iv) – to the extent relevant, this provision will apply so there is no need to provide for this in this Bill.

  c) Section 6(v) – "relevant authorities" is not defined.

  d) Section 6(v) – "mortgage statistics" is not defined and it is not clear what is meant by this.

- **Section 7 - Exemptions**

  a) This section is out of date and does not reflect the significant developments on resolution legislation over the last decade. For example, this section purports to give the Central Bank broad powers to determine "serious business difficulties" without any regard to existing legislation that governs how the Central Bank and ECB should interact with failing banks eg. the European Union (Bank Recovery and Resolution) Regulations 2015. We would note that it is the ECB that is responsible for making any failing or likely to fail assessment for significant institutions rather than the Central Bank.

b) Section 7(iv) - this provision is not appropriate where there is now a European resolution framework in place for a situation where an institution is in "serious financial difficulties". The term "group" is used without definition or reference to the type of entity.

- **Section 8 - Powers of the Central Bank**

  The Central Bank already has information gathering powers and direction making powers, which it could use where appropriate in regulating the provisions of this Bill so this provision is not required. In order for these powers to be capable of being exercised by the Central Bank, the Bill would need to be prescribed as a "designated enactment" (see further below).

- **Section 9 - Enforcement**

  a) This is not the correct legal mechanism to give the Central Bank enforcement powers. To do so, the Bill would need to amend the Central Bank Act 1942 by adding the Bill, if enacted, to the list of designated enactments in Schedule 2, Part 1.

- **Section 10 - Regulations**

  a) Section 10 – this section refers to matters "required or permitted to be prescribed…" however the Bill does not prescribe anything so no regulations could be made by the Central Bank in this regard.