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Dear Deputy Doherty,

Thank you for your letter of 2 February that focussed on issues relating to monetary policy, interest rates and their impact on mortgage borrowers. The current inflationary environment has high costs for the economy and society, with people's living standards being significantly eroded over the last year. High inflation can also lead to lower investment, harming our future growth and economic potential.

Therefore, it is critical that we take measures to bring inflation back to our 2 per cent medium term target. We know that lower-income households are the most impacted as they spend more of their income on energy and food. Bringing inflation back to target matters for the whole community, as well as for the economy.

How is the European Central Bank combating high inflation?
Since July 2022, the European Central Bank (the ECB) has increased its main policy rate by 300 basis points with the aim of lowering inflation. The change in the official interest rates affects money-market rates directly, and lending and deposit rates more indirectly. Bank funding costs are the first important element in the bank lending transmission channel and the overall impact on the cost of funds for banks and other lenders can vary (depending on their funding profile). Lenders generally pass these costs on to customers in the form of higher borrowing rates.

These changes in interest rates affect saving and investment decisions of households and firms. For example, everything else being equal, higher interest rates make it less attractive to take out loans for financing consumption or investment and more attractive to increase saving. This lowers demand in the economy, and therefore brings down inflation.

As a result of the interest rate increases since July last year, we have seen lenders and credit servicing firms increasing rates on their mortgages in recent months. Interest rates for savers are also rising, albeit from a very low level. In each case, the firms in question will have made their own commercial decision on the specific changes (if any) to make to their lending and/or deposit rates based on the terms and conditions of their products and their commercial pricing strategy and funding costs.

We have undertaken extensive work in recent years to build resilience in the financial system and protect mortgage borrowers at the time of taking out their loan (including through our macro-prudential measures), when looking to switch to another mortgage product or provider and when in or facing arrears. The Code of Conduct on Mortgage Arrears (CCMA), which applies to all lenders including 'non-bank' retail credit firms (RCFs) and credit servicing firms (CSFs), provides specific protections for borrowers facing a prospect of arrears (what the CCMA refers to as 'pre-arrears'), be that due to increasing cost of living, interest rate increases or otherwise. In these cases, a lender must draw up and implement procedures for dealing with borrowers in pre-arrears and those who fall under the resolution process of the Code. A lender must have in place management information systems to capture information on its handling of pre-arrears (and arrears), including all alternative repayment arrangements (ARAs) put in place to assist borrowers. This subject has been, and will continue to be, an area of focus for us in our supervision of the firms we regulate.

We continue to encourage any consumer who believes they are at risk of arrears (as a result of rising interest rates or otherwise) to contact their lender, who is obliged as described above to support them assessing their financial position and, where necessary, identifying an appropriate and sustainable solution to any arrears. Where a consumer (as defined in the Consumer Protection Code[1]) is not satisfied with how a regulated firm is dealing with them in the course of providing a service, they can also make a formal complaint directly to the regulated firm. If a consumer is not satisfied with how their formal complaint is dealt with, they have the option of making a complaint to the Financial Services and Pensions Ombudsman (FSPO), who has a broad remit to consider complaints from consumers by reference to the individual circumstances of their complaint. Further details can be found on the FSPO website.

In relation to variable rate mortgages, in 2017 we introduced specific requirements for lenders to explain to borrowers how their variable interest rates have been set, including in the event of an interest rate increase. Further measures were introduced in 2019 to help consumers make savings on their mortgage repayments, provide additional protections to consumers who are eligible to switch, and facilitate mortgage switching through enhancing the transparency of the mortgage framework. We engaged with lenders last year on operational capacity to ensure the resources were in place to manage any increase in the numbers switching mortgages in the context of rising rates.

This regulatory framework requires that lenders are transparent and fair in all their dealings with borrowers and that borrowers are protected from the beginning to the end of the mortgage life cycle – whether borrowing, switching or facing arrears.

Lenders can sell loans in line with mortgage terms and conditions and such sales of loans are not limited only to loans that are non-performing. Where any loan is sold or transferred to another

[1] This definition includes a potential consumer and extends beyond individuals to include enterprises of a limited size

regulated entity, the loans maintain the same regulatory protections, including under the various Central Bank statutory Codes of Conduct, such as the Consumer Protection Code 2012 and the Code of Conduct on Mortgage Arrears 2013 (CCMA).

Net Interest Income of Irish Banks on Deposits (Question 1)

According to the ECB, as of December 2022, Irish resident banks held just over €5.6bn in current account balances and just under €97bn euro in deposit facility balances at the Central Bank of Ireland. This includes balances for all resident banks, and not just the Irish retail banks. The rate on the deposit facility now stands at 2.50 per cent, having been raised numerous times since July 2022 and, most recently, in early February 2023. The rates returned on the required reserve balances also currently stand at 2.50 per cent, with any amounts held in this account above the required reserves remunerated at zero per cent, or the deposit facility rate, whichever is lower.

Interest rates paid by Irish banks on household overnight deposits in Ireland stood at 0.03 per cent in December 2022. The euro area equivalent was 0.07 per cent in December 2022. In Ireland, interest rates on new household deposits with agreed maturity rose to 0.63 per cent in December 2022 (0.48 per cent in November 2022) and (0.13 per cent in December 2021) in Ireland. The equivalent rate in the euro area was 1.44 per cent.

As at end-December 2022, €148.6bn was held on deposit by Irish households with Irish resident banks and credit unions, of which €139.1bn was in overnight deposits and €9.4bn was on deposit with agreed maturity or redeemable at notice. The difference between interest rates on term deposits (0.63 per cent) and overnight deposits (0.03 per cent) is typical of rate hiking periods, and implies an increased opportunity cost of holding overnight deposits. Reflecting this rate differential, we would expect to see some flow from overnight to term deposits over time. Increasing competition to attract these relatively stable sources of funding could also contribute to a greater pass-through of policy rates into deposit rates over time.

Deposits rates thus far have been sluggish in response to rising policy rates, in both the euro area and Ireland. This is a trend evident across the euro area now and also historically, where the adjustment in the rates on deposits – which are a stable funding source for banks - has contributed to containing the increase in bank funding costs so far. Given the typical lags in the transmission of monetary policy, this is something we will continue to monitor with incoming data.

It is also worth noting that this differential is taking place against the backdrop of Irish banks' commercial decisions on mortgage interest rates, the dynamic of which will also affect the financial outcome for Irish banks. It remains important that monetary policy transmits effectively through the economy to ensure inflation is returned to its target of 2 per cent.

Understanding the impact of rate increases on mortgage borrowers (Questions 2 to 4)

Around 30 per cent of Irish households have a mortgage secured on their home (from a total of approximately 716,284 loan accounts[2]). The table below indicates how this is split by different mortgage lenders and service providers.

Mortgage types (private homes)

	Total	**Banks**	**Non-banks**
Total mortgage accounts	716,284	602,596 (84%)	113,688 (16%)
% of accounts by type*			
Tracker	35%	35%	33%
Variable	26%	23%	40%
Fixed**	39%	41%	27%

*Estimates based on Central Credit Register data
**Fixed rate includes accounts on a mixed rate

The weighted average interest rate on outstanding Irish mortgage agreements with banks at end December 2022 was 2.88 per cent, an increase of 43 basis points compared to December 2021. The equivalent rate across the euro area increased by 26 basis points to 1.89 per cent reflecting the high share of long term fixed rate mortgages in the some euro area countries. For households with an existing mortgage, those with ECB tracker mortgages (35 per cent of outstanding mortgage loans) will have seen interest rates increase in line with changes in the ECB policy rate. Some lenders have also increased interest rates on other variable mortgages in line with or less than ECB rate increases to date. The weighted average interest rate on new mortgage agreements with Irish banks was 2.69 per cent, a similar rate to end-2021. In the same period, the equivalent euro area average rose by 166 basis points to 2.95 per cent. As a result, the new business mortgages rates are now below euro area average, a reversal in the position in recent years.

We are in the process of compiling and preparing to publish further data on the interest rates from non-bank firms, as the current dataset is based on a coordinated pan European statistical gathering approach. This new information will include data from those Retail Credit Firms and Credit Servicing Firms (RCF/CSFs) who do not originate loans. Our initial analysis of this data indicates that the weighted average interest rates in these firms align with the figures that have been quoted publicly by some firms.

In the case of borrowers on split mortgages where interest is not paid on the warehoused amount, the actual rate of interest applied will be correspondingly reduced. For example, if a headline rate is 6 per cent but this is only charged on 50 per cent of the outstanding loan, the current rate being applied to that loan is effectively 3 per cent. Similarly, for borrowers in arrears on an ARA, the current rate being paid on a monthly basis will depend on the terms of their ARA. For example, some ARAs include fixed monthly repayment amounts (so the monthly repayment amount stays the same

[2] Central Bank of Ireland Mortgage Arrears Statistics as at September 2022

even if the rate increases – with the loan then taking longer to repay). We have also seen cases of firms exempting borrowers from recent variable interest rate increases on affordability grounds. A key aspect of our work at this time is, therefore, to interrogate how announced interest rate increases are in fact transmitting into the loan books in question, including in particular those loan books comprising a variety of ARAs.

Availability of Alternative Repayment Arrangements (Questions 5 and 6)

In the period 2021-2022, we placed considerable focus on requiring firms to enhance their engagement strategies, improve their resourcing and widen their suite of options to resolve arrears. The progress made in this regard is evident in our analysis published in November 2022. The data showed the extent to which long term mortgage arrears (LTMA) had been reduced. By end-September 2022, LTMA had fallen to less than 24,000 accounts[3] for the first time since the Central Bank started its data collection on mortgage arrears, and this figure continues to fall. This is significant in terms of indicating the systemic capacity to resolve arrears since LTMA are typically some of the most difficult arrears cases to resolve.

The overall reduction in LTMA accounts between 2020 and 2021 was mostly driven by accounts held by RCF/CSFs. When the impact of loan sales by retail banks is controlled for, banks and RCF/CSFs recorded a reduction in LTMA of around 3 and 14 per cent in 2021 respectively. The analysis also highlighted that over half of accounts in LTMA made no repayment towards their mortgage in 2020 and 2021. RCF/CSFs held 75 per cent of accounts that made no repayment towards their mortgage in 2021, up from 58 per cent in 2020, mainly due to transfer of loans from retail banks.

The data indicates that solutions can be found, even in cases where historic repayment is low. Supervisory analysis indicates that meaningful engagement between borrowers and lenders to enable assessment of individual circumstances to agree a solution was a key driver in reducing LTMA. It also indicates that, where this engagement is there on both sides, the suite of options available provides solutions. We continue to see this suite being broadened by providers as they learn from their experience of dealing with LTMA, most particularly by the RCF/CSF population of firms.

On this basis, the evidence does not suggest any disadvantage for a borrower being with a non-bank (RCF/CSF) in terms of the suite of ARA options available or being deployed. Nor does it indicate a significant gap in this suite acting as a bar to the resolution of arrears cases. In fact, insofar as it shows a differential, the data indicates that greater progress is being made by non-bank (RCF/CSF) entities in resolving arrears, but recognising that much depends on the individual circumstances of each case.

[3] An account which records a loan to an individual for house or apartment purchase, renovation, improvement or own construction of housing, which is fully or completely secured by a mortgage on the residential property. The mortgage arrears statistics are presented at account level, rather than property level or customer level.

While recognising the progress that has been made, LTMA remains at elevated levels. There is still more that all firms can do to continue to enhance how they engage with borrowers and to go deeper into the suite of options available to reach an agreed resolution with a borrower. We will therefore continue our work to scrutinise lenders' progress against their plans and targets for the reduction of LTMA.

Our Supervisory Strategy (Question 7)
We describe above the work we have done in recent years to enhance the framework for customers borrowing or switching their mortgage, and the supports in place for borrowers in or facing arrears. Building on this work in the current context, in November 2022, we issued a Dear CEO letter to all regulated firms, to set our expectations for how firms support their customers in the face of current cost of living challenges. Ensuring all regulated financial service providers meet these expectations will be a key area of focus for us in 2023.

With respect to mortgages, we are especially focused at this time on ensuring that firms:

- Have the resources and arrangements in place to assess applications from existing and new or switching borrowers in a manner that is timely and based on prudent lending standards applied consistently across all applicants;
- Have fit-for-purpose arrangements in place to anticipate and deal with customers in or facing arrears. This includes cases where consumers may face arrears due to an increase in the interest rate on their mortgage, while recognising that with increasing costs of living driven by inflation, this is just one factor currently affecting people's repayment capacity; and
- Proactively assess the risks and consumer impact that commercial decisions, including rising interest rates, may pose to borrowers and have an action plan in place to mitigate such risks.

As we have seen firms begin to increase interest rates, our work has included building a detailed understanding of what different firms are doing to assess the impact of increasing interest rate rises across their customer base. This work includes engaging with those firms on their plans to deal with that impact in line with their regulatory obligations and the expectations we set in the November 2022 Dear CEO letter with respect to those obligations.

We are taking a system wide approach to our work on this issue, across retail banks, RCFs and CSFs. We are particularly conscious that groups of borrowers in all regulated lenders and servicers may be challenged in the current economic climate. So, it is important that supports are available across the system for all borrowers as required by the CCMA. We have also required firms to be proactive in anticipating arrears. We have seen firms put early warning indicators in place and we will monitor emerging arrears trends closely.

This work also includes a specific focus on the position of borrowers with RCF/CSFs who do not originate loans. As your letter identifies, since such firms simply service an existing loan, they do not have generally available alternative mortgage options, although they do have alternative options available for a borrower facing challenges in meeting repayments under their existing loan. Consistent with our regulatory mandate, our focus in this case is to see that (i) those borrowers who choose to switch to another provider are supported to do so (including that applications are based on prudent lending standards applied consistently across all applicants); and (ii) the necessary supports are in place for borrowers facing challenges in meeting their monthly repayments. We will continue to monitor this aspect of the market closely in the period ahead, as we see the impact of rate rises on these borrowers and gain a better understanding of how announced rate increases are transmitting into those borrowers' monthly repayments.

Tracker Mortgage Examination (Questions 8 and 9)

The Tracker Mortgage Examination (TME) Framework required lenders to identify all borrowers affected by tracker related issues and compensate those affected borrowers for tracker related failings on a mortgage, in line with the Principles for Redress that formed part of the Framework. The Principles for Redress set out that lenders make redress and compensation offers that are fair and commensurate with the detriment suffered by affected borrowers. This included that redress would result in affected borrowers being returned to the position they would have been in had the lenders' failure regarding the customer's tracker mortgage not arisen. This includes that:

- Compensation is reasonable and must reflect the detriment involved arising from and/or associated with being on an incorrect rate (such compensation to reflect the specific circumstances of each impacted customer); and
- Impacted borrowers to revert to the appropriate Tracker Interest Rate or to be offered the option to revert to an appropriate Tracker Interest Rate, where relevant.

Resulting from TME c.42,000 borrowers received redress and compensation and were returned to the appropriate tracker rate as necessary.

Based on February 2023 figures supplied by lenders, c. 6K[4] loans impacted by TME were sold by the retail banks, of which c.40 per cent are in respect of recent loan sales as part of the banking consolidation underway. Of the remaining TME impacted loans that were sold, c. 50 per cent are Buy to Let loans.

The originating lender was responsible for ensuring that borrowers were put back in the positon they would have been if the tracker failing had not occurred. This included engaging with any new lender where necessary to ensure that the customer received redress and compensation and the appropriate tracker rate going forward.

Independent oversight of TME for lenders ensured that impacted borrowers were appropriately remediated and redressed. Where borrowers went into arrears or restructuring arrangements as a result of TME failures, when they were redressed and remediated, they would have been put back

[4] This figure does not include loans that received redress and compensation following read-across from an FSPO decision

on the appropriate tracker rate and continued on this rate with their new lender. As is the case for other borrowers, these customers can seek to switch to other lenders subject to the lending criteria, terms and conditions of the lender to whom they apply.

There are individual borrowers covered by the TME who would have been in arrears or a restructuring arrangement without the impact of the tracker failure. There may also be situations where a borrower's circumstances subsequently changed after tracker remediation leading to them moving to a different interest rate due to affordability issues. Accordingly, as for other borrowers, the position of a customer in this group at this point will depend on their individual circumstances, including whether or not they seek to switch to another lender's rate and whether they meet the credit criteria of that lender in order to switch. In these respects therefore, such a borrower should be in the same position as other borrowers. That said, if there are specific scenarios or experiences that you wish to highlight, we will of course consider them.

I hope the above is helpful in your work and the wider policy consideration of these matters. I hope it also serves to reassure you of the priority we are placing on our work to combat inflation and to ensure that the firms we regulate meet their regulatory obligations to support their customers to navigate this changing economic landscape.

Yours sincerely,

Colm Kincaid

Colm Kincaid
Director of Consumer Protection