8 December 2014

Allied Irish Banks, p.l.c. ("**AIB**") response to questions included in the Central Bank of Ireland's Consultation on Macro-Prudential Policy for Residential Mortgage Lending (**"CP 87"**)

Question Number	CP 87 Question	AIB Response
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?	AIB believes, in principle, that the macro-prudential tools described in CP87 are appropriate for meeting CBI's objective of increasing resilience of the banking and household sectors to shocks in the Irish property market, where suitably applied with appropriate thresholds and levels of exceptions. In AIB, affordability metrics (including the use of Net Disposable Income, Mortgage Service Ratio and Loan to Income ("**LTI**") limits) are the fundamental criteria in determining a customer's ability to repay their mortgage and minimising the probability of any customer default. In addition, Loan to Value ("**LTV**") criteria are applied to measure the customer's ability to repay the mortgage based on the property value in the event of a customer defaulting and to minimise the Loss Given Default. AIB believes such tools must be applied in the appropriate manner whilst taking into account the broader social and economic consequences of implementation. Following a detailed review of the macro-prudential proposal as outlined in CP 87, AIB has the following observations: • The proposed LTI limit of 3.5 times with a level of exceptions is considered appropriate. • The proposed LTV limit for buy-to-let ("**BTL**") of 70% is also considered appropriate. • The proposed LTV limit for principal dwelling houses of 80% is not considered appropriate given the potential social and economic impacts. In this regard, AIB would respectfully request that CBI consider further direct consultation with the industry to establish an appropriate LTV threshold which takes account of the aims of the macro-prudential proposals, the resulting impacts and the operational complexities with regard to the allowable exceptions. • The current housing market environment is still in a recovery phase and AIB believes the change in macro-prudential criteria should be applied in a balanced way, potentially using a phased approach to mitigate potential unintended consequences, whilst supporting the CBI objective of preventing re-inflation of asset prices to unsustainable levels. Therefore, an appropriate implementation period in respect of the application of any proposed change would be required to allow the continued and sustainable recovery of the housing market (residential, buy-to-lets, rental) to reach a 'normalised' state.

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		In particular, AIB would strongly encourage the CBI to consider further direct consultation with the industry with regard to timing. • The use of Mortgage Insurance Guarantees ("**MIGs**") in support of higher LTVs does not offer a solution to the macro-prudential issues identified, given that it transfers the lending risk to a third party as opposed to determining the correct level of LTV. In addition, MIGs have proven problematic in the past in relation to the realisation of the guarantee and the cost of the guarantee. The insurer may also still have recourse to the borrower even after the sale of the property, thereby diluting any real benefit to the customer.
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)?	AIB supports the view that the measures should be applied to all lending secured by residential property provided it is made available through branches of regulated entities within Ireland (as opposed to other jurisdictions where additional regulations may apply).
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?	AIB broadly supports the exemptions set out in CP87. With regard to the negative equity mortgage exemption, AIB would suggest that rather than exempting the residual debt as outlined in CP87, it would be more appropriate to facilitate a customer moving to a new property so long as the overall mortgage debt and LTV does not increase following completion of the transaction.
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	AIB advocates the adoption of an implementation period of six months after the publication by the CBI of any changes to be implemented. AIB will have to address (amongst other things) the following: • managing the pipeline of existing applicants who have approval for six months but have yet to be drawn down; • redeveloping documentation and system applications to accommodate any proposed changes; • editing and communicating terms and conditions;

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	same.	• training of staff; and • communicating the requirements for both existing and potential customers on the applicability of the new limits and their implications.
5	Should some adequately insured mortgages with higher LTVs be exempted from the measures and if so what should be the criteria for exemption?	AIB is of the view that the use of MIGs in support of higher LTVs does not offer a solution to the macro-prudential issues identified, given that it transfers the lending risk to a third party as opposed to determining the correct level of LTV. In addition, MIGs have proven problematic in the past in relation to the realisation of the guarantee and the cost of the guarantee. The insurer may also still have recourse to the borrower even after the sale of the property, thereby diluting any real benefit to the customer.
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)?	AIB supports the view that the measures should be applied to all lending secured by residential property provided it is made available through branches of regulated entities within Ireland (as opposed to other jurisdictions where additional regulations may apply).
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?	AIB supports the exemptions set out in the consultation document.
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?	AIB supports the CBI's view (set out in CP87) that LTI ratios are a less relevant metric for BTL lending and does not support the introduction of an LTI limit on BTL mortgages. The proposed LTV limit is considered appropriate and a more significant limiting factor for BTL lending, mitigating price re-inflation risk.

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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	AIB advocates the adoption of an implementation period of six months after the publication of any changes to be implemented. AIB will have to address (amongst other things) the following: • managing the pipeline of existing applicants who have approval for six months, but have yet to be drawn down; • redeveloping documentation and system applications to accommodate any proposed changes; • editing and communicating terms and conditions; • training of staff; and • communicating the requirements for both existing and potential customers on the applicability of the new limits and their implications.
10	What unintended consequences do you see from the proposed measures and how could these be avoided?	AIB fully supports the setting of marco-prudential tools to maintain resilient banking and household sectors by: (a) reducing the potential for shocks in the Irish Property market; and (b) reducing the impact of the shock if and when it happens. However, AIB is concerned with the scale and timing of the proposed macro-prudential regime may have unintended consequences as follows: The recovery in the national housing market is at an early stage, with the Dublin area in particular and the rental market significantly leading the process. Even in Dublin, house prices have risen by 40% from their trough level, but still remain significantly below their previous peak levels. In other areas of the country, prices are still generally recovering much more slowly (9% above their trough) and turnover is low. The proposed LTV measures could significantly impact on the recovery in non-Dublin house prices. New house building and mortgage lending are at approximately 10% of their levels at the peak of the cycle and, at a minimum, would need to double from current levels to reach a more normalized housing market of 25,000 new houses and a €7-10 billion mortgage market. A key problem is the current shortfall in supply, particularly in the capital. While home construction has expanded from an annual the level of about 8,000 to about 11,000 this year, this is less than half the normal levels referred to. The LTV proposals could impact negatively on this house building recovery, which is still in its infancy. On the one hand they create uncertainty for house builders about the outlook for future levels of house purchasing. On the other, house prices, other than in the urban pockets already identified, still need to rise further before it becomes economic to resume building houses again. After a fall of over 50% in prices, in many areas total construction costs barely exceed the attainable sale prices. Affordability models indicate that the current market is equivalent in affordability terms to the 1997/98

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period, supported by the fact that prices nationally are still 40% below peak levels, while interest rates are at historically low levels and are expected to remain so for the foreseeable future. It has been estimated that cash buyers in recent years represented up to 50% of all sales. The proposals as drafted would once again skew the market in favour of cash buyers compared to first-time buyers, who rely largely on mortgage finance.
The LTV proposals are not designed to dampen housing demand, rather the objective is to ensure financial sector stability. Nonetheless, if new home buyers are shut out of the mortgage market, they will be forced into the rental market or towards social housing. The unintended consequence of the proposals could lead to a sub-optimal equilibrium in the housing market where house prices may stabilise, but this is driven by suppressed demand and lower construction rates.
AIB believes that at the current stage in the cycle the extent of the change in LTV limits as advocated by the CBI,
is not considered appropriate, particularly with mortgage lending remaining at depressed levels. AIB advocates consideration of :

further direct consultation between the CBI and the industry to establish an appropriate LTV threshold which takes account of the impacts and the operational complexities with regard to the allowable exceptions; and
an appropriate implementation period in respect of the application of any proposed change.

This would help limit any potential negative impacts on the housing market and broader economy, while still preserving the effectiveness of the proposed macro-prudential regime in protecting the stability of the financial system.
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<tr><td>11</td><td>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.</td><td>The threshold is compatible with existing regulatory reporting requirements.</td></tr>
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12	Are there any *significant* obstacles to compliance by regulated financial services providers with the limits?	Some system redevelopment will be necessary to support monitoring and reporting which will require an appropriate implementation period.