Banking & Payments Federation Ireland

BPFI Response Consultation Paper 98

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www.bpfi.ie

1. Introduction

Banking & Payments Federation Ireland (BPFI) represents over seventy domestic and international institutions. We welcome the opportunity to respond to the Central Bank of Ireland Consultation on Increased Protections for Variable Rate Mortgage Holders (CP 98).

We note the proposals from the Central Bank of Ireland (CBI), contained in the consultation document, which have been reviewed by our Members. We believe that transparency in relation to interest rates is welcome and that there are appropriate ways to provide consumer access to critical information while also maintaining a balance in publishing relevant and timely materials.

However, we recommend that a cautious and prudent approach is taken to the content of the Statement. This approach should take account of the following:

- the varied funding, capital and cost structures of Mortgage Lenders operating in the Irish market
- issues identified in relation to potential anti-competitive impacts, due to the publication of commercially sensitive information, are addressed
- factors that are outside a regulated entity's control which it could not be aware of at the time the variable rate summary statement was published
- the provision of information that it is relevant, sufficient and digestible by consumers.

We have included an example of a Statement which our Members believe would provide relevant information for Consumers in support of the consultation. We have also drawn on the experience of other jurisdictions in reviewing the proposals. On that basis, we believe that our proposed statement meets the requirements for an industry standard.

We would welcome the opportunity to discuss our response in more detail and to engage further with once the Central Bank representatives have had time to review all the inputs to the Consultation.

2. Response to the Consultation

1. What are your views on the proposals outlined above?

We are supportive in principle of the proposal to introduce a variable rate policy statement for mortgages. In the interests of transparency, we agree with the inclusion of such a statement through the regulated entity's website. It should also be feasible to provide this information directly to the consumer so that they would be notified of any changes by way of their annual statement. We believe that a Mortgage Lenders' Website is the most appropriate place for such content as it can be updated within reasonable timeframes and provides the consumer with easy access to relevant information. The inclusion in the annual update provides a further direct communication to consumers on mortgage related matters.

We do not agree with the proposal that the statement should be included in the Letter of Offer (LOO). As the LOO is a legal document we believe that it is not appropriate to include specific text, which with the introduction of changes to legislation and regulation after the contract issues could alter the original understanding and interpretation of the intended objectives. We propose that it is not possible to 'future proof' the content of the statement to address this issue. As an example, the requirements for additional capital buffers are adjusted in accordance with international developments which are beyond the scope of local mortgage lenders. We therefore believe that it is prudent to provide more transparency to consumers through the most appropriate methods, in this case websites and annual updates.

We suggest the following amendments to the proposed "Disclosure – Information provided on an ongoing basis" provisions in the Appendix: "*Where a regulated entity makes a change to its summary statement produced in accordance with provision X it must notify affected consumers on paper or on another durable medium of the change* ***on an annual basis*** *and make available an updated summary of its policy* ***as soon as possible on their website***."

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?

(i) **Factors:** There are a number of factors which may result in a change to a variable rate and these could certainly be clearly and unambiguously listed in the statement for the consumer. The varied funding, capital and cost structures of Mortgage Lenders operating in the Irish market will drive the variable rate pricing strategies undertaken by each entity and direct comparisons may be challenging. Also, to disclose any further detail on these factors would mean that commercially sensitive information would be in the public

domain from all regulated entities. This could prove to be anti-competitive as pricing between regulated entities could potentially be aligned. Ultimately, over time, we consider this would not benefit the consumer.

This issue has been identified in other jurisdictions and as an example the OECD has considered the potential implications in their paper ***'Unilateral Disclosure of Information with Anticompetitive Effects'*.** As a result, we recommend that a cautious approach to the level of details included in the Statement would be the most appropriate for the industry.

We believe that further detail on these factors would also result in a conflict with the objective of these proposals i.e. increasing transparency and assisting a consumer to compare rates. Too much information would hinder the comparability of products for consumers when assessing their financial position and options. We believe there is a balance to be struck in the information provided so that it is both sufficient and digestible by consumers.

Additionally, we are of the view that the list of factors should not be too prescriptive as there may be factors which are outside a regulated entity's control which it could not be aware of at the time the variable rate summary statement was published. In the interests of transparency, consumers will need to be made aware, that any list of factors in their variable rate summary statement is subject to change. For the avoidance of doubt, we recommend that the summary statement is clear that the factors listed therein may potentially change over time due to internal / external factors which were not possible to be specifically identified at the time the summary statement was published.

As the consultation paper states, the format and content of this statement shall not interfere with the contractual relationship between the parties. As a result, we believe it is necessary to include the above explanation to ensure that a regulated entity is not contractually bound by a list of factors which were accurate at the time of their publication but which subsequently changed over time for reasons outside of its control. In those instances, the statement on the regulated entity's website would be updated as soon as possible and consumers notified in their annual statement.

We have set out a draft statement which is based on a review of current available information. This document is included in Appendix 1. We have also examined the type of information provided to consumers in the Swedish market where recently introduced measures have been implemented to improve the transparency of the mortgage interest rate margin. Mortgage Lenders in Sweden are required to include this information on their website and the content is, in our view, clear and concise. An example of the current content available on the Swedbank website Mortgage Interest Rate page is included here for ease of reference:

The table (above) shows our advertised mortgage rates that are set based on, among other things, current market, our capital costs and our administrative costs for mortgages. However, every client is unique, and the price for your mortgage depends on your financial circumstances. Other factors that can influence your individual interest rate include:

- *Property value*
- *Size of loan*
- *Your income relative to the size of the loan*
- *Amortization*
- *Your other transactions with Swedbank*

Source: www.SwedBank.se

(ii) **Criteria and Procedures:** We are in favour of the high-level disclosure of our criteria and procedures when setting a variable rate in the variable rate statement. Again, we believe that any further detail would not benefit the consumer in comparing rates.

(iii) **Different Approach:** We believe that it is unnecessary to differentiate between different cohorts of borrowers as the underlying approach to interest rate pricing is based on common factors.

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?

As indicated in our answers to questions 1 and 2 above, the level of detail required should be at a high level in order to: (a) avoid any potential anti-competitive behaviours in the industry, which might lead to the alignment of pricing of regulated entities to the ultimate detriment of the consumer; and (b) avoid over-complicating consumer choice with too many items in a comparison table, and thereby not achieving the aim of assisting the consumer in comparing rates across different regulated entities. It would also need to be 'future-proofed' by ensuring consumers are informed that the list of factors in the summary statement may change over time due to internal / external factors which were not possible to be specifically identified at the time the summary statement was published.

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?

This proposal is understood to be in the interest of the consumer and we are in agreement with the principle of the provision of such information in the interests of transparency. In doing so, Mortgage Lenders would not be providing financial advice to the consumer as to which product would offer savings. Instead, we would propose providing general information on all possible options available to mortgage holders each of which may, or may not, result in savings for the consumer. By giving a broad range of options we would not seek to influence an individual consumer's choice of product without the consumer discussing their options with an appropriately qualified regulated entity representative.

5. Do you have any views on the proposal to increase the notification period?

We are not in favour of extending the notification period for an interest rate increase. We believe that the current position of thirty days' notice is sufficient time for a consumer to plan ahead and assess any affordability issues. The notice period is also consistent with the timeframes in other business sectors.

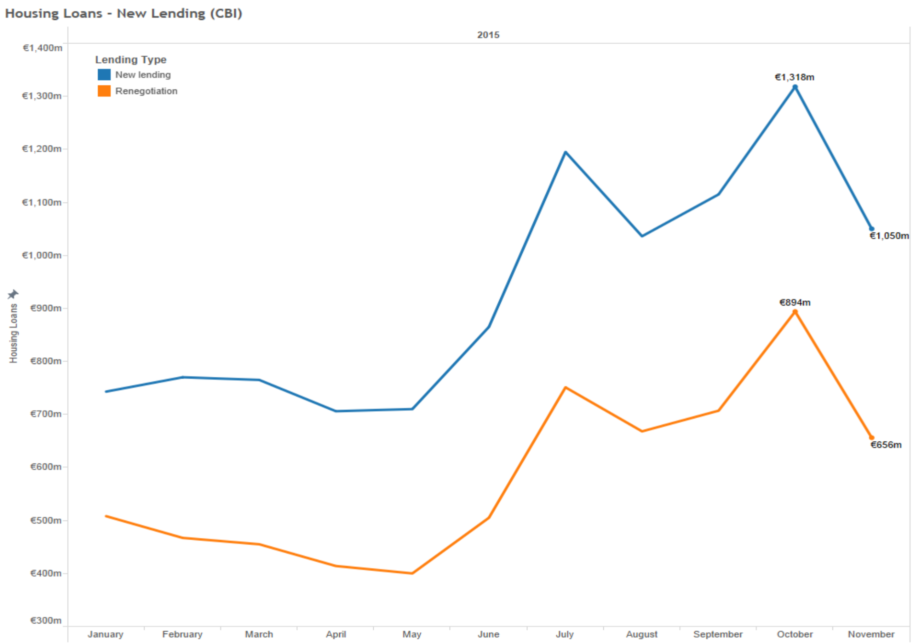
We are of the view that, a balance needs to be struck between giving sufficient time for a consumer to plan ahead and assess any affordability on the one hand, and on the other hand from the point of view of the regulated entity, what is practicable to react to market fluctuations and external pressures. The current position of thirty days achieves this.

The suggestion of extending the notification period also seems to presuppose that other lenders will not change their rates and that consumers are making decisions in a steady, stable interest rate environment. In an open competitive market, lenders will adjust their interest rates at different times and in different ways. This means that borrowers should regularly review available products and changes in pricing.

BPFI would encourage borrowers to review their mortgages and alternative products on a regular basis and consider switching rate types, products and or lenders where this could produce savings and fits the borrower's risk appetite, current situation and outlook.

CBI and ECB data suggest that Irish mortgage customers actively renegotiate their mortgage terms including switching between fixed and variable rates. As the chart below illustrates, renegotiations, which include switches between variable and fixed rates, and vice versa, accounted for the bulk of new mortgage lending reported by the CBI in 2015.

Chart 1

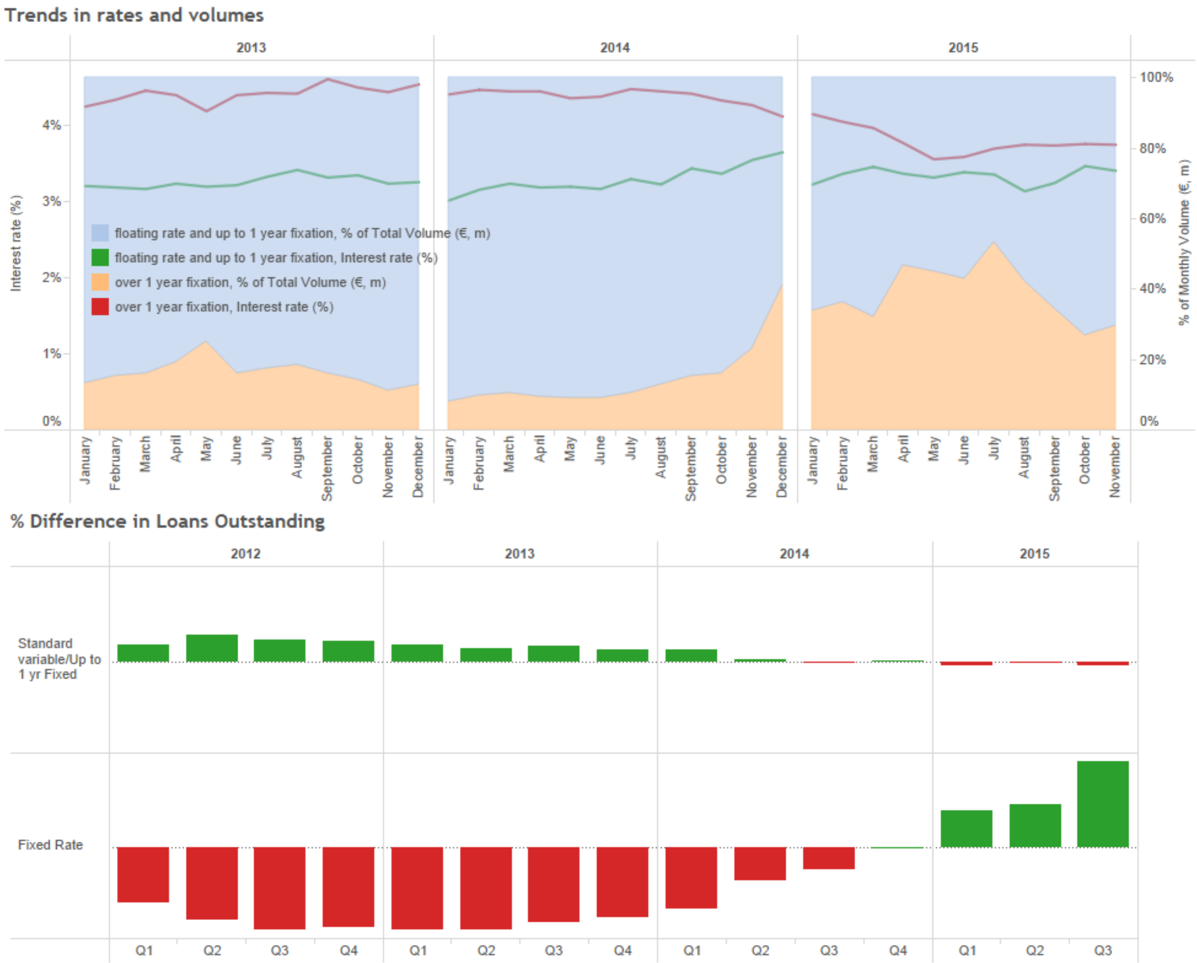


Source: Central Bank of Ireland

CBI and ECB data analysis suggests that borrowers respond to interest rate changes. The charts below show the share of new lending on fixed rates increases as the gap between variable (including up to one-year fixed rates) rates and fixed rates narrows. This was evident in data from the last quarter of 2014. This shift has had a significant impact on outstanding loans with the value of outstanding loans on fixed rates (greater than one year) increasing in the first three quarters of 2015.

In its *Retail Interest Rates* report in November 2015, the CBI noted: “In December 2014, 61 per cent of all new business mortgages were variable interest rate products. However, from June 2015 onwards, this ratio has shifted to approximately 50-50, as mortgage customers opt for cheaper fixed rate alternatives.”

<u>Chart 2</u>



Source: Central Bank of Ireland

Where banks increase interest rates outside the central bank rate setting cycle, borrowers should review their options as they would with any service such as energy or telecommunications charges. In these sectors 30 days’ notice of a change in pricing is standard.

In terms of budgeting for increases, banks stress test borrowers to two percentage points above agreed rates at mortgage origination, providing an affordability buffer for new borrowers. Borrowers who envisage payment difficulties are encouraged to contact their lender to discuss their situation.

The proposal to increase the notification period would restrict a regulated entity's flexibility on variable rates and would impact negatively on the industry as regulated entities need the ability to respond quickly to market changes in order to function effectively. Extending the notification period would have pricing implications, raising costs for all stakeholders, and negatively impacting consumers. Bearing all this in mind, we do not believe that the proposal to extend such a period would achieve the CBI aim of removing non-financial barriers to switching.

Regulated entities often absorb increases to a pricing factor for some time before changing interest rates. Were the notification period extended, regulated entities may be commercially impelled to commence the rate increase process more quickly than would currently be the case. We believe the proposal to extend the notification period goes against the nature of the variable interest rate. We are also of the view that there is a risk that rates would change more frequently across the industry due to the complex way in which a regulated entity's interest rates are calculated.

In terms of switching, any such process takes longer than thirty days and behavioural economic research[1] has highlighted that it is not the length of the notification period which affects a consumer switching, but rather other factors such as:

- "*potential switchers often struggle to absorb the complexity of information relating to mortgage options they replace in-depth analysis with biased techniques and rules of thumb such as sticking with the status quo*";
- "*lack of consistency in time preferences for savings now and in the future. Borrowers place a disproportionate weight on immediate savings*"; and
- "*if borrowers believe there is little differentiation between mortgages then they will make little effort to search and compare products*".

In addition, economic commentators have indicated that the current low levels of switching would suggest that an intensive information and marketing strategy may be required to convince mortgage holders of the potential savings to be made. We believe that this is a

[1] Devine, Kenneth, Frost, Sarah, McElligott, Rory, "*Switch and Save in the Irish Mortgage Market*", Vol 2015, No 8, Central Bank of Ireland, Economic Letter Series

more appropriate and effective manner to achieve the Central Bank's aim of promoting switching among consumers rather than increasing the interest rate notification period. We believe that the Competition and Consumer Protection Commission website www.consumerhelp.ie would be the most appropriate place to provide this type of information as it is the source for other helpful materials in terms of switching products and services.

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 indicated in our response to question 5 we would not be in favour of extending the notice period.

7. Do you have any views on the proposal to require the lender to include the reason for the change in the rate in the notification of an increase in a variable interest rate?

We are not in favour of disclosing a reason for a variable rate change. Firstly, this would be anti-competitive as regulated entities would effectively be disclosing to other regulated entities/other unregulated entities the specific reason for the interest rate movement. These reasons would then operate to constrain competition in the market to the detriment of the consumer.

In addition, there is generally unlikely to be a single reason for an interest rate change. Member Banks carry out an analysis internally on all contributing factors and would make a decision whether, based on all factors, an increase or a decrease in the consumer's rate is necessary. It is a complex analysis and is done on a regulated entity-wide basis.

It may also be confusing to the consumer if an increase is passed on in one circumstance due to, for example, a market change but then on another occasion it is not passed on. We are of the view that the provision of the variable rate statement detailing the factors which may affect a variable rate is sufficient information for the consumer from the perspectives of both comparability and transparency. A consumer will be cognisant where there is a rate increase that this is as a result of one of those factors set out in the summary statement.

Appendix

Variable Rate Summary Statement

This Summary Statement is relevant to you if you have or plan to obtain a mortgage variable interest rate with us. It contains details of the factors and procedures currently used to set our mortgage variable interest rates. It also contains details as to how those factors can change.

Factors

There are a number of factors which are used to set our mortgage variable interest rates and these currently include:-

1. Funding costs
2. Capital required by the Regulator to support the loan
3. Default risk i.e. estimated potential losses on loan
4. Operational costs including staff, infrastructure etc.

Variations in these factors could result in changes to our mortgage variable interest rates. This list may change over time due to reasons both within and outside of our control. If this happens we will notify you in your annual statement and the revised list of factors will be updated as soon as possible on our website.

Criteria and Procedures

One of our key commitments to you is to keep our mortgage variable interest rates under review and to manage the costs that could contribute to changes as efficiently as we can.

Changes to our mortgage variable interest rates can be due to one of, or a combination of, the above listed factors.