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Mr Robert Troy T.D.
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Dear Deputy Troy,

Thank you for your letter of 23 February in relation to the ability of mortgage holders to avail of fixed rate interest rates in a rising interest rate environment. We share your concerns for the interests of borrowers and ensuring that our mortgage system works as it should to protect the best interests of consumers now and into the future. I have therefore set out below some information on our approach to the inflationary environment more broadly and our work on mortgages specifically which I hope you will find useful.

Combatting Inflation

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. This is why 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.

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.

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.

Regulatory Framework

The challenges facing borrowers (and consumers more broadly seeking credit to meet their needs) is a key area of focus for us at this time. Our work is focused on protecting all borrowers across the system, in particular on how firms are supporting borrowers to manage the challenges of the current economic environment.

The 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. Where any loan is sold or transferred to another 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).

Around 30 per cent of Irish households have a mortgage secured on their home (from a total of approximately 716,284 loan accounts[1]). 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.

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.

Building on this work to enhance the framework for customers borrowing or switching their mortgage, 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.

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

While we do not have a role in prescribing or limiting pricing, and in this case interest rates, we are focused on ensuring that lenders consider the impact of interest rate increases on their borrowers, and where they increase interest rates that they have the supports in place for borrowers impacted. 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, retail credit firms and credit servicing firms (RCF/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 (to whom you refer in your letter). As these 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.

A key aspect of our work with this group of RCF/CSFs therefore includes 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 Alternative Repayment Arrangements

(ARAs). As you will know, ARAs arise as a consequence of providing a repayable solution for a borrower who has faced arrears on their mortgage. For borrowers 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 even if the rate increases – with the loan taking longer to repay). Some ARAs include a reduction to the interest rate applied, including for a fixed period. To take a further example, in the case of a borrower on a split mortgage ARA, 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. We have also seen cases of firms exempting borrowers from recent variable rate increases on affordability grounds.

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. This will include continued engagement with the regulated firms in question to ensure they meet the requirements of our regulatory framework and the expectations set in our letter of November 2022.

I hope the above is helpful in understanding the role of the Central Bank and the priority we are placing on our work 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