Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Economic Letter

Room to improve: A review of switching activity in the Irish mortgage market

Shane Byrne, Kenneth Devine and Yvonne McCarthy

Vol. 2020, No. 12.

Room to improve: A review of switching activity in the Irish mortgage market

Shane Byrne, Kenneth Devine** and Yvonne McCarthy**[1,2]

In this *Letter*, we provide a detailed review of switching in the Irish mortgage market and identify the potential for savings among mortgage holders. Our estimates show that three in every five 'eligible' mortgages for principal dwelling homes stand to save over €1,000 within the first year if they switch, and more than €10,000 over their remaining term. We find that just 2.9 per cent of mortgages switched provider during H2 2019. Our analysis points to a range of explanations for mortgage switching inertia. A significant proportion of mortgage holders report a lack of knowledge or worry about the prospect of switching, in addition, gender, education, financial literacy and behavioural characteristics can help explain the degree of reported inhibition towards switching. This highlights the relevance of behavioural insights in informing consumer policy design.

1. Introduction

At the end of 2019, interest rates charged on new mortgage lending for principle dwelling homes (PDH) tended to be lower, on average, for fixed rate products relative to that for the standard variable rate (SVR) products (Figure 1). The average SVR on *new lending* across the market at end-2019 was 3.12 per cent while the lowest average rate for PDH lending at a fixed rate was 2.68 per cent (for 1 to 3 year fixation periods). In contrast, the average interest rate on the *outstanding stock* of PDH mortgages in Ireland at end-2019 was 3.48 per cent for loans

[1] * Macro-Financial Division and ** Statistics Division.

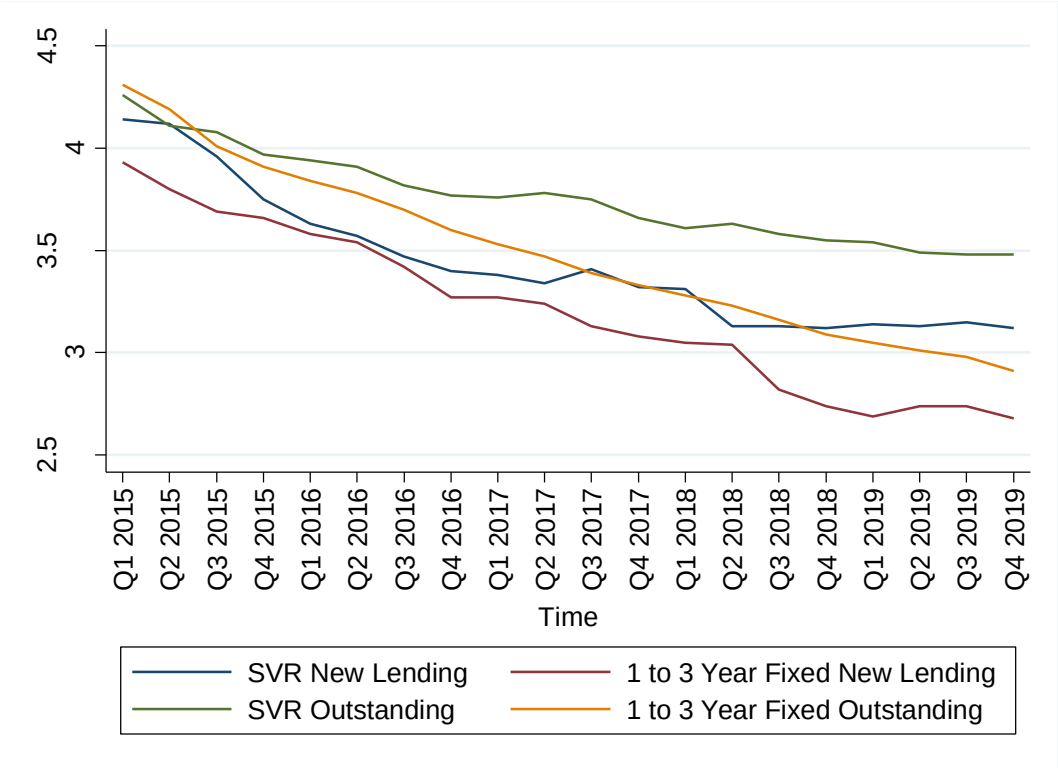
[2] The views expressed in this paper are those of the authors and do not necessarily reflect the views of the Central Bank of Ireland, the European Central Bank or the Eurosystem. Thanks to David Duignan, Edward Gaffney, Christina Kinghan, Fergal McCann, Rory McElligott, Caroline Mehigan, Samantha Myers, Paul Lyons, Vasileios Madouros, Reamonn Lydon, Gerard O'Reilly and colleagues for helpful advice and comments received.

at a standard variable rate (excluding tracker mortgages), and 2.91 per cent for loans that were fixed for 1 to 3 years.[3]

In many cases, existing customers are eligible to switch their mortgage to a lower interest rate option either by refinancing with their current provider or by switching to another provider, once they meet certain eligibility criteria. In recent years, there has been an increase in switching activity among PDH borrowers (Figure 2), particularly when expressed as a proportion of new lending. In H2 2019, roughly 12 per cent of new PDH lending was accounted for by borrowers switching mortgage provider, compared to 6 per cent in H1 2015, (green line in Figure 2). However, when switching activity is instead considered relative to the outstanding stock of eligible switchers (PDH borrowers that are on a standard variable rate (excluding trackers) or a fixed rate with less than 1 year remaining on its term), the figure is much lower, at just 2.9 per cent in H2 2019 (red line in Figure 2). The latter is a more representative measure than the new lending proportion because it locates switching activity within the wider population of mortgage holders that could choose to engage.[4] In summary, mortgage customers in Ireland have not engaged to any large extent with the option to switch their mortgage in recent years, despite downward movements in interest rates, and policy initiatives to improve the switching process. For instance, the Central Bank of Ireland made changes to the Consumer Protection Code 2012, effective from 1 January 2019, to help consumers make savings on their mortgage repayments, to provide additional protections to consumers who are eligible to switch, and to facilitate mortgage switching through enhancing the transparency of the mortgage framework.

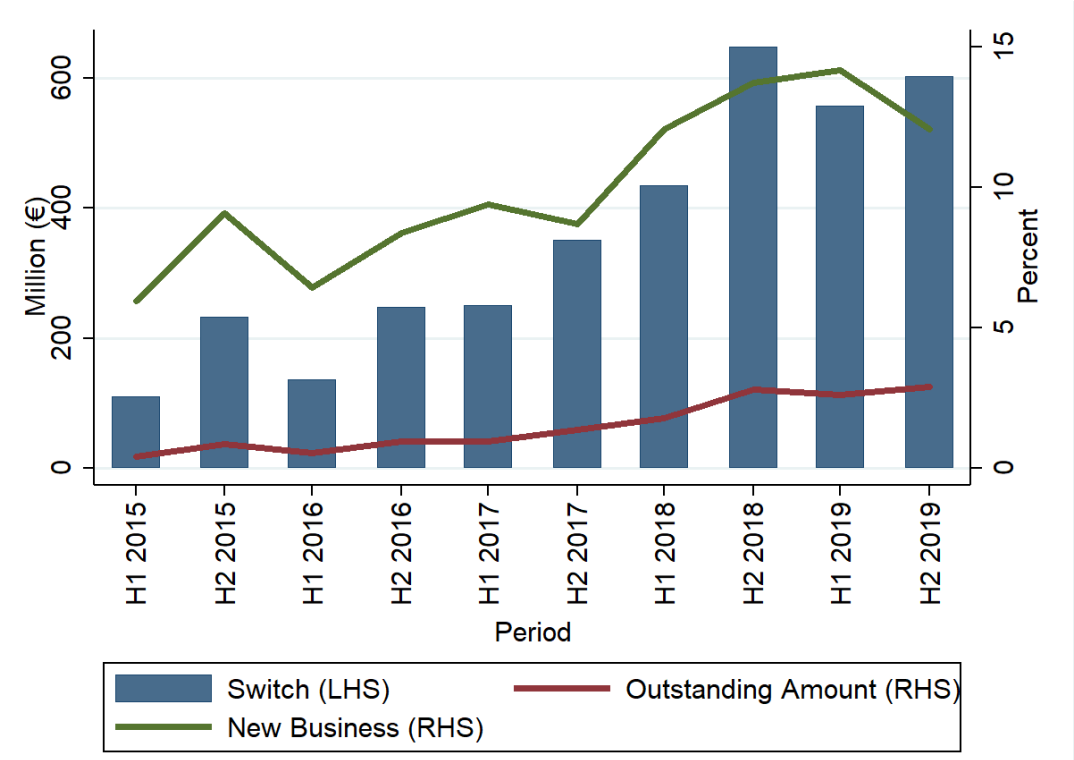
[3] Central Bank of Ireland Table B3.1 Retail Interest Rates – Mortgage Rates.
[4] It is possible that customers choose instead to refinance their mortgage with their existing provider, which could result in savings if their existing provider were willing to match an offer from an external institution, or if their existing provider had reduced interest rates on products that current customers are eligible to apply for. Unfortunately, a clean time series of internal refinancing activity for PDH borrowers does not exist.

Figure 1 | Average Interest Rate, New Lending & Outstanding Stock



Source: Central Bank of Ireland Table B3.1 Retail Interest Rates – Mortgage Rates.

Figure 2 | Value of Mortgage Switching from H1 2015 – H2 2019



Source: Central Bank of Ireland Table B3.1 Retail Interest Rates – Mortgage Rates and Monitoring Templates.

Switching may be low if the perceived or actual gain from switching is insufficient to outweigh the costs of the process. A number of other non-financial barriers have also been identified, including the time and cognitive costs. Attention has focused on the role of behavioural characteristics in explaining relatively low switching levels. Some of the most commonly cited behavioural barriers include a tendency towards procrastination, a preference for immediate or near-term rather than future payoffs (present bias) and inattention.

This *Letter* sheds light on the potential barriers to mortgage switching in Ireland. First, we calculate the potential savings to mortgage customers from switching their mortgage, to assess if the financial gains are likely to outweigh the financial costs. We find evidence of significant potential savings. Three in five PDH mortgages which are eligible to switch their mortgage stand to save at least €1,000 within the first 12 months of a switch, and the same proportion could save over €10,000 over the remaining term ('lifetime') of their mortgage by moving to the best available rate in the market, given their loan characteristics. Cumulatively, these estimates amount to potential unclaimed savings of approximately €236 million over a one-year horizon.

Second, we provide a descriptive comparison of the characteristics of borrowers who have switched mortgage provider in recent years in Ireland to those who have not. We find evidence of statistically significant differences between the two groups.

Using survey data, we explore the barriers to switching in further detail and find that a significant portion of mortgage holders report a lack of knowledge about the prospect of switching their mortgage. The data shows tentative evidence of a link between behavioural characteristics and an aversion to mortgage switching. The latter results are supportive of the use of behavioural insights in consumer policy design.

The remainder of the *Letter* is structured as follows: In Section 2 we explore the international evidence on barriers to mortgage switching and highlight how these barriers differ across customer groups. Section 3 presents an overview of potential savings available to eligible mortgage customers who could switch their mortgage. In Section 4, we examine the characteristics of borrowers who have switched their mortgage in recent years, and we compare them to non-switchers, to assess if switching appears more prevalent among customers with specific characteristics. Section 5 explores survey responses of mortgage

holders in Ireland to questions about mortgage switching, to shed light on the perceived barriers in an Irish setting. Finally, Section 6 concludes.[5]

2. International literature

A large literature explores the reasons for borrower inaction on mortgage switching. Across these studies, commonly cited barriers include financial and non-financial factors, such as perceptions of the monetary, time, and cognitive costs involved. The Australian Competition and Consumer Commission (2018), found that less than 4 per cent of variable rate mortgages and just 2 per cent of fixed rate mortgages switched to another lender over a 6-month period. In the UK, where switching activity is considered to occur more frequently, the Financial Conduct Authority (2019) still found that 800,000, or 10 per cent, of mortgage holders who could switch and would benefit from doing so did not engage in the activity.

Focusing on the Danish mortgage market, Andersen et al. (2015) document a widespread failure to switch a mortgage even when the potential savings are sizeable. The authors argue that inaction is also associated with 'psychological costs' and present bias, which discourages households from incurring time and financial costs today for benefits that would only be realised in the future. The authors also show that older households, those with lower education, income and wealth are less likely to consider switching or refinancing.

Bajo and Barbi (2018) investigate an Italian mortgage market reform that allowed borrowers to refinance at no cost. They document a limited uptake (only 4.1 per cent of fixed rate borrowers), and illustrate how the propensity to refinance correlates with key mortgage and socio-demographic characteristics. Perhaps unsurprisingly, with greater savings to realise, they find that larger loans and loans with a longer time to maturity are more likely to be refinanced. Those borrowers who are experienced with financial products, the more highly educated and men are also more likely to avail of refinancing opportunities. Immigrants, older and wealthier borrowers are less likely to do so. Notably, low financial literacy levels are associated with a reduced propensity to refinance a mortgage.[6]

Johnson et al. (2015) find low levels of take-up by US customers, even in a setting where borrowers are pre-approved to refinance their mortgage, with no upfront monetary costs, and

[5] For a recent review of switching activity in the Irish mortgage market, see the Central Bank of Ireland Macro-Financial Review, 2018:1, Box 4.
[6] Financial literacy has also been shown to be related to other household financial management decisions and outcomes, with less financially literate households having a lower propensity to save, plan for retirement, own stocks and having lower household wealth levels (Lusardi and Mitchell, 2007), (van Rooij et al., 2012).

the potential to reduce average monthly payments by the equivalent to 30 per cent of a household's reported annual income. The authors document how traditionally cited barriers to refinancing are less important in driving refinancing decisions, relative to behavioural factors such as a borrower's time preferences or their trust in financial institutions. They show that those borrowers who are more suspicious of the motives of financial institutions are less likely to engage in refinancing. Keys et al. (2016) similarly report a role for behavioural characteristics of borrowers, pointing to a tendency for procrastination or inattention to reduce the take-up of beneficial refinancing opportunities.

These findings are consistent with a wider literature that documents the role played by psychological and behavioural factors in undermining household financial management more generally. McCarthy (2011), for instance, shows that behavioural factors such as a lack of self-control and patience can increase the incidence of household financial distress. In an experimental setting, the UK Financial Conduct Authority demonstrates the significant effect of reminders in prompting action by households, pointing to the role of procrastination and inattention in shaping the course of a household's financial life (see for instance Adams and Hunt (2013); Adams et al. (2015, 2016)).[7] Reflecting this growing body of evidence, regulatory authorities are increasingly harnessing insights from behavioural economics to inform the design of effective policy interventions (see, for example, Kell (2016); Wheatley (2014); Bailey (2010).

3. How many mortgage holders could save money by switching their mortgage?

This *Letter* employs the same methodology as in previous Central Bank research (Devine et al., 2015) to calculate the potential savings available to borrowers if they were to switch their mortgage. We focus on mortgages for principal dwelling homes (PDH) in the Republic of Ireland. We define a customer as 'eligible' for mortgage switching if they hold a variable rate product (excluding tracker mortgages) or a fixed rate product with less than 12 months of fixation remaining. We further restrict our sample to those accounts with a current

[7] Also in an experimental setting, Timmons et al. (2020) find that in evaluating switching alternatives, mortgage holders place less weight on longer-term savings and show a greater orientation towards mortgages with high upfront cashback offers, illustrating the important role of time-discounting, with consumers often struggling to balance immediate rewards expressed as cash sums against benefits that accumulate over time.

outstanding balance of at least €30,000, a loan-to-value ratio below 90 per cent, with no outstanding mortgage arrears and classified as 'performing' in the dataset.[8]

Using our loan-level dataset of mortgages at the 5 main providers, we identify 182,272 'eligible switchers' for the purpose of our analysis, out of 674,176 PDH loans (Table 1). We first identify the lowest interest rate available in the market for that customer at end-December 2019, based on their current mortgage characteristics (i.e. loan-to-value ratio). Where a cheaper product is available, we use the lower interest rate to compute a new hypothetical mortgage repayment for the customer.[9] The difference between the actual and hypothetical repayment is our measure of potential savings. We do not incorporate any customer preference for fixed or variable rate products in this exercise, nor do we make any assumption about a customer's preference to remain with their current mortgage provider, if, in fact, the best rate available to them is indeed with an alternative provider. The purpose of this exercise is to highlight the potential savings available to customers in the event that these factors were not relevant. As such, our 'savings' estimate can be thought of as an upper bound on the true figure.

To estimate potential lifetime savings, we apply the same approach, but use a standard annuity formula to estimate the total cost of credit under the current and hypothetical repayment scenarios, with the difference representing the estimated lifetime saving. We assume that the alternative interest rate remains constant over the horizon of investigation. This assumption is in keeping with the approach of Devine et al. (2015).

For the borrower, a euro gained today may be worth less than a euro gained tomorrow. This could be due to expected inflation, or perceived uncertainty around the realisation of savings over the remaining term of the mortgage. Similar to the approach used by Keys et al. (2016), we discount lifetime savings estimates using a 2 per cent and a 10 per cent per annum discount factor for illustrative purposes.

[8] Individual bank credit policies may vary in the definition of switching eligibility. The analysis in this Letter precedes the onset of the COVID-19 pandemic, and as such does not adjust for any arising impact on the Irish mortgage market.
[9] In all cases, this implies moving customers to a short-term fixed rate product.

Table 1 | Breakdown of mortgage population: Potential savings

	Fixed	Variable	Tracker	Total	% of ES
All mortgage accounts	171,105	259,276	243,795	674,176	
Eligible Switchers (ES)	29,082	153,190	NA	182,272	100
Of which can save:					
Undiscounted					
>€1,000 in Year 1	19,408	93,315	NA	112,723	62
>€2,000 in Year 1	7,863	37,257	NA	45,120	25
>€10,000 in remaining term	20,837	89,657	NA	110,494	61
>€30,000 in remaining term	8,076	28,499	NA	36,575	20
>€10,000 in remaining term*	18,402	79,857	NA	98,259	54
>€30,000 in remaining term*	8,076	28,499	NA	36,575	20
>10% of annual repayment cost	21,024	109,498	NA	130,522	72
>20% of annual repayment cost	5,134	38,026	NA	43.160	24
Discounted (2% per annum)					
>€10,000 in remaining term*	17,871	75,805	NA	93,676	51
>€30,000 in remaining term*	5,089	17,864	NA	22,953	13
Discounted (10% per annum)					
>€10,000 in remaining term*	9,544	39,500	NA	49,044	27
>€30,000 in remaining term*	423	1,528	NA	1,951	1

Note: Table provides a breakdown from the total mortgage population to eligible switchers, and reports the number of mortgages among eligible switchers that stand to save above certain threshold values.
* Who can in the first instance save over €1,000 in the first year after a switch.

Source: Central Bank of Ireland Loan-Level Dataset and Author calculations.

3.1 Distribution of potential savings

We explore the potential savings available to eligible switchers in Figure 3. This chart illustrates the distribution of possible savings in the first year after a switch to the lowest available market rate, expressed as a euro amount and as a percentage of the total repayment for the year. We see that the bulk of estimated savings are concentrated between €500 and €2,000, with 115,291 mortgages falling within this range. Given that there are financial costs associated with mortgage switching, some of these customers might conclude that the savings available in the short-term (over a 1-year horizon) are not sufficiently large to outweigh the costs of switching.[10] However, 112,723 loans (or roughly three in five eligible switchers) have potential savings above €1,000 in the 12 months following a switch and 45,120 (25 per cent) of these could save more than €2,000 over this period (Table 1). In other words, there is a substantial cohort of PDH borrowers who could save by switching their mortgage, even after accounting for the financial costs involved in the process. Expressed differently, we find that the number of mortgages whose potential savings exceed 10 per cent of their total repayment cost for the year is 130,522 (72 per cent of eligible switchers), and 43,160 (24 per cent of eligible switchers) stand to save over 20 per cent. Aggregating the potential savings of those mortgages that stand to save *at least* €1,000, we estimate one-year cumulative forgone savings among eligible switchers to amount to €236 million.[11]

[10] Switching a mortgage can involve legal fees, with most financial institutions suggesting a cost of approximately €1,200-1,500 for this service, in addition to a property valuation fee of approximately €150. In some instances, financial institutions advertise that they will cover the legal costs involved in switching a mortgage. Some mortgage products also offer cash incentives to switch (cashback mortgages) that could be used to offset the costs involved.
[11] We consider an alternative scenario: Eligible switchers do not opt for the lowest rate available to them at December-2019 (which is a fixed rate), but instead opt for the lowest available variable rate given their circumstances. In this case, a much lower 30 per cent of eligible switchers could save over €1,000 in the first year after a switch, and 25 per cent could save over €10,000 over the remaining term of their mortgage.

Figure 3 | Year 1 Savings

Note: Figure shows the distribution of potential savings available to eligible PDH switchers, over a 12-month horizon, following a switch to the lowest available market rate based on a borrower's current loan characteristics, expressed as a euro amount and a percentage of the borrower's total 12-month repayment amount.
Source: Author calculations based on Central Bank of Ireland Loan-Level Dataset.

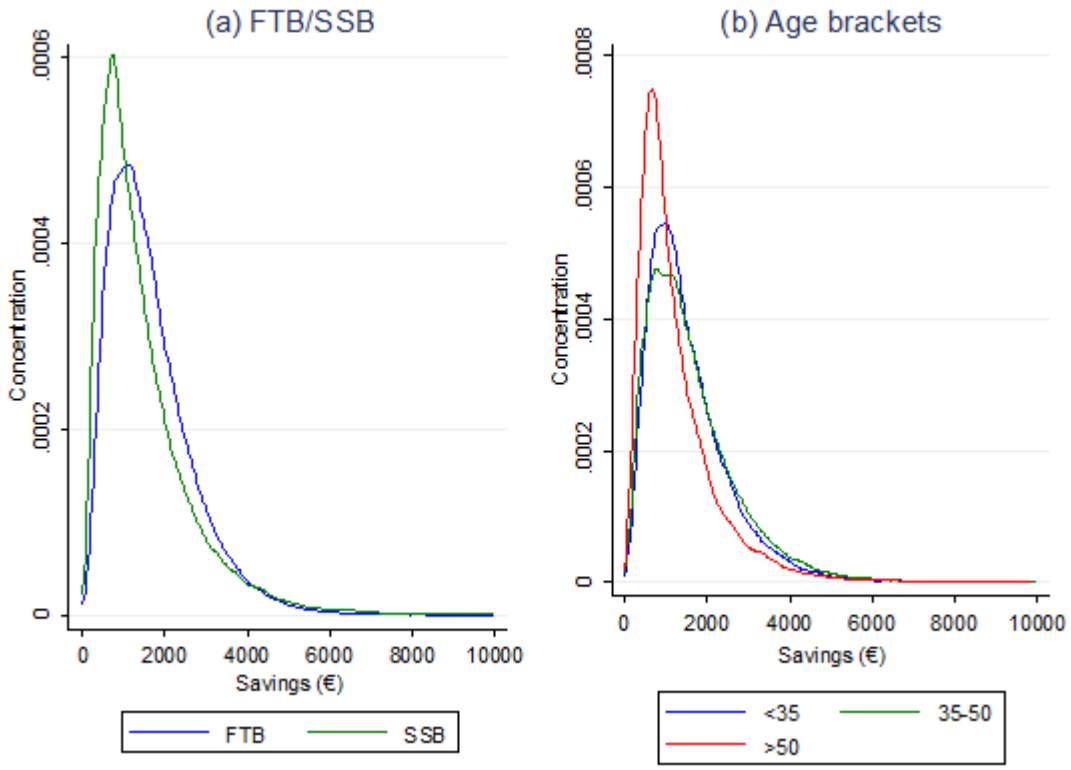
For illustrative purposes, we extrapolate beyond a one-year horizon and find that 61 per cent of eligible switchers could save over €10,000 over the remaining course of their mortgage (Table 1). If we first condition on a mortgage being able to save over €1,000 in the first year after a switch, the number of eligible switchers that stand to gain over €10,000 over the remaining term falls to 54 per cent. Among this latter group, the average lifetime saving is estimated to be €27,198. Even adjusting for the present-value of these estimates by way of the application of a 2 per cent per annum discount factor, we find that 51 per cent still stand to gain over €10,000 over the remaining term, and 13 per cent stand to gain over €30,000 in present-value terms.[12] Among this group, the average estimated lifetime savings are €21,782 in present-value terms. However, we caution that the calculation of lifetime savings is based on

[12] With a much more severe 10 per cent per annum discount factor, we find that these numbers decline to 27 per cent and 1 per cent respectively.

a strong assumption of no further movement in interest rates after a customer switches to the lowest rate currently available to them.

Figure 4 illustrates how the distribution of savings varies across borrower type and by age profile. The distribution of savings for First-Time Buyers (FTBs) over a 12-month period is more skewed to the right relative to that of Second-Time Buyers, suggesting higher average potential savings among the FTB group. A similar pattern is evident for younger borrowers, relative to the older age cohorts.

Figure 4 | Year 1 Savings



Note: Figure illustrates savings available over a 1-year horizon among eligible switchers, separating by borrower type (First Time Borrowers/Second and Subsequent Borrowers) and age bracket.
Source: Author calculations based on Central Bank of Ireland Loan-Level Dataset.

4. Loan and borrower characteristics of switchers

The mapping of differences in cohorts across engagement levels in a household financial decision is an important first step in informing consumer-focused policymaking in that area (Iscenko et al, 2016). As discussed in Section 2, the literature has shown that loan and borrower characteristics can differ across the mortgage switching decision. In Table 2, we report the loan and borrower characteristics of switchers and non-switchers. We compare all borrowers classified as 'pure switchers' in H2 2019 (that is, PDH borrowers who switched their existing loan to another provider without drawing down any top up to the loan balance)[13] against a comparable cohort of all PDH loans that remained with their original provider over the same period though they were eligible to switch (in accordance with the definition of eligibility given in Section 3).[14] While this descriptive comparison does not imply that the switching decision is driven by any particular characteristic,[15] it helps to build a comparative profile of the minority who do actually complete the switching process successfully, amidst a background of widespread unclaimed beneficial switching opportunities. In line with findings from Bajo and Barbi (2018) based on Italian bank data, we see that switchers have, on average, larger loan balances on more expensive properties, have higher leverage ratios, and are younger than non-switchers. In contrast to Bajo and Barbi (2018), however, we find that switchers in Ireland have mortgages with shorter remaining terms relative to non-switchers. In Table 2, we also see a significant portion of switchers with fixed rate mortgages, with 81 per cent of borrowers opting to switch to a fixed mortgage, against a fixed rate share of just 13 per cent among the stock of continuing eligible switchers. The average interest rate payable among switchers in our dataset is almost a full percentage point lower than non-switchers, with switchers paying an interest rate of 2.8 per cent on their outstanding loan balances and non-switchers paying 3.5 per cent, on average.

[13] When we repeat this comparison including switchers who additionally topped up their loan balance, the results remain broadly unchanged.
[14] Switchers are observed in the Monitoring Template, and non-switchers are observed in the Loan-Level Dataset.
[15] It does not account for levels of savings across the two cohorts.

Table 2 | Mean Statistics by Group

	Switch	No Switch	Difference (No Switch – Switch)
Loan Characteristics			
Outstanding Balance (€)	235,401	136,559	-98,843 ***
Property Value (€)	419,047	340,454	-78,593 ***
Loan-to-Value (%)	59	46	-13 ***
Loan Term (Years)	22	27	5 ***
Fixed Rate (%)	81	13	69 ***
Interest Rate (%)	2.8	3.5	0.8***
Dublin (%)	43	31	-12 ***
Leinster excl. Dublin (%)	25	28	3 ***
Connaught (%)	8	10	2 ***
Munster (%)	20	25	5 ***
Ulster (%)	2	5	3 ***
Borrower characteristics			
Borrower Age (Years)	40	46	6 ***
Joint Borrower (%)	75	66	-9 ***
Observations	1,584	181,296	182,880

Note: *** Significant at 1 per cent level; ** Significant at 5 per cent level; * Significant at 10 per cent level. Table compares characteristics of borrowers and loans classified as 'switchers' relative to 'non-switchers' in H2 2019. Non-switchers are those mortgages remaining with their existing provider in the reference period though they are eligible to switch. Borrowers who additionally received a top up to their loan balance are not included in the Switcher category.
Source: Central Bank of Ireland Monitoring Templates and Loan-Level Dataset.

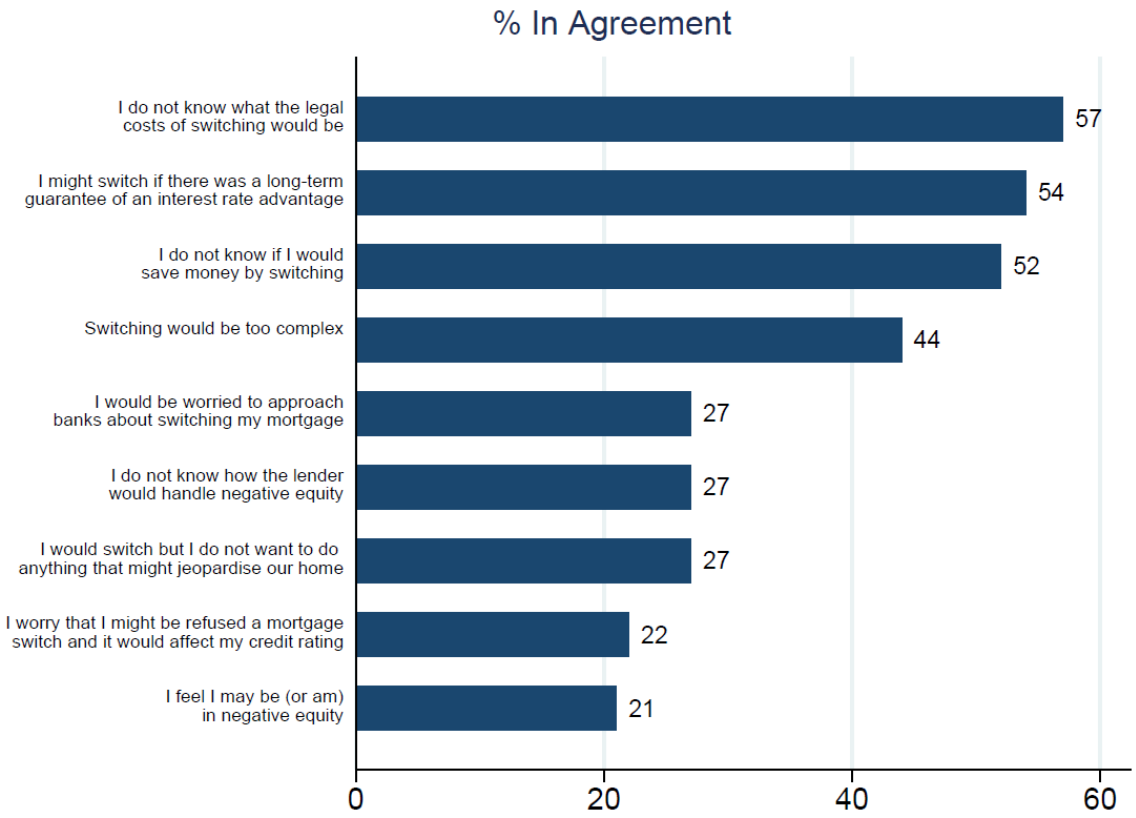
5. Barriers to switching in Ireland

The Central Bank (2017) published insights from a survey that was conducted among a representative sample of mortgage holders in Ireland on mortgage switching. Just over 2,000 mortgage holders were surveyed about their knowledge and experience with the mortgage switching process. The interviews took place in November and December 2016 in respondents' homes. The vast majority of mortgage holders (81 per cent) had no experience with mortgage switching nor did they ever consider switching their mortgage. Mortgage holders were asked about their attitudes to mortgage switching across a range of different

statements, and the responses can provide insights to the perceived barriers to switching mortgages. The results are depicted in Figure 5.

At the time of the survey, many customers were concerned that the mortgage switching process would be too difficult or complex to engage in, while over half of mortgage holders were uncertain if they could save money by switching their mortgage. Over half of mortgage holders (57 per cent) reported that they were not aware of the legal costs involved in mortgage switching, while a significant number of mortgage holders also reported uncertainty or worry about various aspects of the process. Collectively, the responses depicted in Figure 5 suggest that the perceived 'barriers' to switching cover issues such as a lack of knowledge on the costs or potential savings of mortgage switching and the level of complexity of the process, in addition to a fear or uncertainty about the outcome of the process.

Figure 5 | Attitudes to Mortgage Switching



Source: Central Bank of Ireland Survey Dataset.

We examine the prevalence of these perceived barriers among different customer types. To do this, we first create a summary variable for each individual that captures information on all of the statements in Figure 5 collectively. Specifically, if a respondent disagreed with the statement in Figure 5 they are allocated a score of 1, if they were indifferent to the statement they are allocated a score of 2, and if they agreed with the statement they are given a score of 3. We take the average value of each respondent's scores across the nine statements in Figure 5, and use this as a proxy for the respondent's degree of inhibition to the mortgage switching process. If the (rounded) average value equals 1, the respondent is deemed to have a low degree of inhibition, 2 indicates a medium degree of inhibition and 3 indicates a high degree of inhibition to the mortgage switching process. Overall, we find that 23 per cent of the sample had a high degree of inhibition to the switching process, while 30 per cent had a low degree of inhibition. We explore the characteristics of respondents according to their degree of inhibition in Table 3.

We turn first to the top panel of the table, which illustrates the loan characteristics of respondents' mortgages, according to the respondents' degree of inhibition to the mortgage switching process. We find that 4 out of 5 borrowers in the high category are first-time buyers, while a sizeable portion (57.9 per cent) took their mortgage out in the peak years of the housing boom. Turning to borrower characteristics, we observe a slightly higher proportion of female respondents in the high inhibition group, relative to the low category. Finally, there is a particularly stark difference between the high and the low categories in terms of the proportions of these groups with high financial literacy levels or with a college education; 55 per cent of respondents with low perceived barriers to mortgage switching have a college education while 71 per cent have high financial literacy levels. This compares to 40 and 48 per cent respectively among those with high-perceived barriers to mortgage switching. Overall, the results are suggestive of a positive association between perceived barriers to mortgage switching and gender, education and financial literacy, which is in keeping with much of the existing literature.

The survey data also captures insights on the behavioural characteristics of respondents. The literature suggests a link between customer inaction on beneficial mortgage switching opportunities and time preferences, or the level of attention that a customer pays to financial developments. We find a positive link between an inhibition to mortgage switching and customers who report themselves as being impulsive or preferring to use credit rather than wait and save up to make a desired purchase (crude proxies for time preferences), which is in keeping with this. We further find a positive association between high inhibition to mortgage

switching and inattentiveness on financial matters. These results, therefore, provide tentative evidence that behavioural characteristics could also pose a barrier to customer engagement on mortgage switching in an Irish context.[16]

Table 3 | Degree of Inhibition to Mortgage Switching, Mean Characteristics

	(1) Low	(2) Medium	(3) High	(3)-(1) Difference
Loan Characteristics				
FTB (%)	69.8	82.3	80.2	10.4 ***
Interest Rate Type				
Fixed Rate (%)	25.3	24.2	25.3	0.0
Variable Rate (%)	44.9	51.3	50.5	5.7
Tracker Rate (%)	26.6	22.3	22.2	-4.4 *
Other Rate (%)	3.2	2.2	2.0	-1.2
Origination Year				
Pre-2000 (%)	17.8	12.9	10.0	-7.8 ***
2000-07 (%)	48.4	45.6	57.9	9.5 ***
2008-11 (%)	13.0	17.3	17.1	4.1 *
2012-16 (%)	20.9	24.2	15.1	-5.8 **
Borrower Characteristics				
Borrower Age (Years)	43.7	42.1	43.0	-0.7
Couples (%)	83.3	84.9	83.7	0.4
Male (%)	54.1	49.5	47.7	-6.4 **
Employed (%)	84.8	86.1	81.5	-3.3
College Education (%)	55.4	52.9	39.6	-15.8 ***
Financial Literacy (%)	70.8	51.4	48.4	-22.5 ***
Switching Experience				
Mortgage (%)	15.9	9.8	11.9	-4.0 *
Other Products (%)	89.0	82.7	87.7	-1.3
Behavioural Characteristics				

[16] The behavioural variables are constructed from survey responses to a variety of questions. We describe the construction of the behavioural variables in the Appendix.

Impulsive (%)	13.8	23.7	32.6	18.8 ***
Use credit rather than save (%)	13.2	17.0	26.2	13.0 ***
Inattention (%)	47.2	56.2	57.5	10.3 ***
Observations	593	955	455	

Note: *** Significant at 1 per cent level; ** Significant at 5 per cent level; * Significant at 10 per cent level.

Source: Central Bank of Ireland Survey Dataset.

6. Conclusion

Mortgage switching rates are relatively subdued in view of the potential for financial savings from switching. Our estimates show that three in every five mortgages classified as eligible for switching stand to save over €1,000 within the first year following a switch (112,723 mortgages), and that roughly the same proportion stand to save over €10,000 over the remaining term (110,494 mortgages).

Switchers tend to have higher average mortgage balances, higher average valued properties, and shorter remaining mortgage terms. A significant proportion of mortgage holders report a lack of knowledge or worry about the prospect of switching, and the degree of reported inhibition towards switching is positively associated with gender, education, financial literacy and behavioural characteristics.

Taken together, these insights point to the importance of taking account in policy design of the diverse obstacles that could drive patterns of engagement and inertia in the Irish mortgage market, including the behavioural barriers that may play an important role. This is especially important in cases where household inaction correlates with existing sources of vulnerability among consumers.

Appendix

The results reported in Section 5 on the perceived barriers to mortgage switching are from a survey conducted by the Central Bank of Ireland in 2016. The survey collected a variety of information from a representative sample of current mortgage holders, including demographic and socio-economic information, in addition to data on the experience of mortgage holders with switching their mortgage or other financial or non-financial products. Crucially, for the purposes of this study, the survey also collected information on the behavioural characteristics of respondents. We employ three such variables in our analysis - two that crudely approximate for the time preference of respondents ('impulsive' and 'credit preference') and one that captures the degree of attention that the respondent tends to pay to financial matters. We describe the construction of these variables below.

Respondents were presented with the following statements and asked if they agreed or disagreed with them:

- I am impulsive and tend to buy things even when I can't really afford them
- I prefer to buy things on credit rather than wait and save up

Based on the responses we create two dummy variables for use in our analysis ('impulsive' and 'credit preference'); borrowers who agreed with the statements were allocated a value of 1 in the respective dummy variables and those who disagreed were allocated a value of 0.

The third variable of interest to our study is a measure of attention to financial matters. To construct this variable, we amalgamate responses to 5 questions, as follows:

First, respondents were asked if they were aware of the Competition and Consumer Protection Commission (CCPC) Consumer Help website (yes / no); if they had ever visited the CCPC website (yes / no); if they were aware of the complaints process for mortgages (yes / no); if they followed the debate in the media about mortgage interest rates (yes / no). Positive responses were allocated a value of 1 and negative responses a value of 0. Respondents were subsequently asked if they paid any attention to their annual mortgage statement when it was received. Respondents who reported that they tended to, at a minimum, check that the balance and the transactions on the account looked correct were allocated a value of 1, while paying little or no attention to the statement attracted a value of 0. We sum up the values for each of these five variables for each respondent, and deem the respondent to be attentive if their aggregate score is at least 3.

References

Adams, Paul, Stefan Hunt, Christopher Palmer, and Redis Zaliauskas. "Attention, search and switching: Evidence on mandated disclosure from the savings market." *FCA Occasional Paper* 19 (2016).

Adams, Paul, Stefan Hunt, Laura Smart, and Redis Zaliauskas. "Stimulating interest: Reminding savers to act when rates decrease." *FCA Occasional Paper* 7 (2015).

Andersen, Steffen, John Y. Campbell, Kasper Meisner Nielsen, and Tarun Ramadorai. Sources of inaction in household finance: Evidence from the Danish mortgage market. No. w21386. National Bureau of Economic Research (2015).

Australian Competition and Consumer Commission. "Residential Mortgage Price Inquiry." *Final report* (2018).

Bailey, Andrew, "Speech: The future of financial conduct regulation," *London: Bloomberg* (2010).

Bajo, Emanuele, and Massimiliano Barbi. "Financial illiteracy and mortgage refinancing decisions." *Journal of Banking & Finance* 94 (2018): 279-296.

Central Bank of Ireland, "Mortgage switching research," *Technical Report* (2017).

Central Bank of Ireland, Macro-Financial Review 2018:1 (2018).

Devine, Kenneth, Sarah Frost, and Rory McElligott. Switch and Save in the Irish Mortgage Market. No. 08/EL/15. Central Bank of Ireland (2015).

Financial Conduct Authority, "Mortgages market study: *Final report*" (2019).

Iscenko, Zanna, Peter Andrews, Kristine Dambe, and Peter Edmonds. "Economics for Effective Regulation." *FCA Occasional Paper* 13 (2016).**Johnson, Eric, Stephan Meier, and Olivier Toubia**. "Money left on the kitchen table: Exploring sluggish mortgage refinancing using administrative data, surveys, and field experiments." *Unpublished working paper* (2015).

Kell, Peter, "Speech: ASIC and behavioural economics: Regulating for real people," Brisbane:*Australian Securities and Investments Commission* (2016).

Keys, Benjamin J., Devin G. Pope, and Jaren C. Pope. "Failure to refinance." *Journal of Financial Economics* 122, no. 3 (2016): 482-499.

Lusardi, Annamaria, and Olivia S. Mitchell. "Financial literacy and retirement planning: New evidence from the Rand American Life Panel." *Michigan Retirement Research Center Research Paper No. WP* 157 (2007).

McCarthy, Yvonne. "Behavioural characteristics and financial distress." ECB Working Paper Series 1303, European Central Bank (2011).

Timmons, Shane, Martina Barjaková, Terence J. McElvaney, and Peter D. Lunn. "Official advice improves mortgage-holders' perceptions of switching: experimental evidence." *Behavioural Public Policy*: 1-29 (2020).

Van Rooij, Maarten CJ, Annamaria Lusardi, and Rob JM Alessie. "Financial literacy, retirement planning and household wealth." *The Economic Journal* 122, No. 560 (2012): 449-478.

Wheatley, Martin, "Speech: Making competition king – the rise of behavioural economics at the FCA," Brisbane: *Australian Securities and Investments Commission* (2014).

T: +353 (0)1 224 6000
E: xxx@centralbank.ie
www.centralbank.ie

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem