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YEARS OF PUBLIC SERVICE

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Mr John McGuinness TD
Chairman
Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach
Leinster House
Kildare Street
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D02 XR20

3 August 2018

Dear Deputy McGuinness

Further to the Central Bank's appearance before the Committee on 10 May 2018, and the subsequent letter from the Committee on 5 June 2018 seeking supplementary information, please find attached the Central Bank's responses to these issues.

The Central Bank is grateful to the Committee for its continued support in this matter of public importance and trusts that this response will assist the Committee members in their work.

Yours sincerely

Philip Lane

Central Bank of Ireland responses to the Oireachtas Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach on outstanding issues following the 10 May Committee hearing

1. **Commitment given to Deputy Doherty to furnish information on real estate investment trusts (REITs) activity in the Dublin region.**

The Central Statistics Office (CSO) records the volume and value of monthly residential property transactions. These data can be broken down between household buyers (consisting of first time buyers (FTB), owner occupiers, former owner occupiers i.e., second/subsequent buyers and non-owner occupiers, such as buy-to-lets) and non-household buyers (including but not limited to purchases on behalf of local authorities, state/semi-state bodies, approved housing bodies and private investment enterprises such as property companies, investment funds and REITs).

According to CSO data, total housing transactions reached approximately 59,500 units (€14.3 billion) in 2017, up from 55,100 units (€12 billion) in 2016 (Chart 1).[1] The non-household buyer share of the market has been increasing steadily from an average of 4 per cent in 2011 to over 14 per cent (8,650 units with a value of €2.04 billion) at the end of 2017. This is the number cited in my opening statement.

The CSO also provide information detailing the location of properties involved in these transactions. The proportion of Dublin-based property purchases in the entire sample of residential property purchases has remained relatively stable at 30-35 per cent since 2011 (Chart 2). Dublin-based properties account for a higher share of total non-household buyer transactions, an average of 44 per cent over the period 2011-17, and more than 55 per cent of all non-household purchases on occasion (2014 and 2015).

At present, the CSO does not provide a detailed breakdown of the categories of private and publically funded non-household purchasers, referred to in the opening paragraph above. We understand that the CSO are investigating this matter however, and are working towards the provision of more detailed information on non-household transactions broken down by NACE division. In the meantime, alternative data from the Department of Housing, Planning and Local Government and the Irish Council for Social Housing (ICSH) could be used as a proxy for this breakdown: local authority statistics for housing acquisitions show a total of 1,454 residential units were purchased during 2017, 326 of which were in Dublin.[2]

According to the ICSH, 760 residential units were acquired by non-profit housing agencies or approved housing bodies through various schemes in 2017.[3]

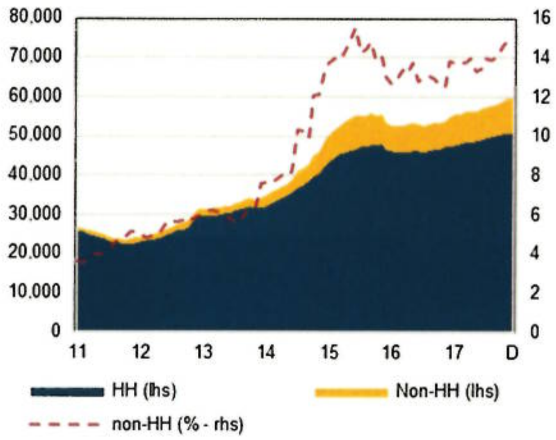
[1] Total housing transactions include market and non-market sales.
[2] See local authority acquisition statistics available here.
[3] See Irish Council for Social Housing data available here.

The addition of these numbers suggests that in the region of 2,214 housing units were obtained by the non-household public sector in 2017 – which equates to a little over 25 per cent of all non-household residential property transactions last year. The other state/semi-state actor that may be involved to some extent in this market is NAMA, although no publicly-available data exist on its role. In the absence of these data and the probability that other publicly-sourced units are also absent from these simple calculations, the figure of 25 per cent is likely the lower bound estimate of public involvement in non-household housing transactions. Furthermore, the proportionately higher level of non-household buyers activity in the Dublin market and the much lower ratio of Dublin-based local authority acquisitions (326 out of 1,454 = 22.4 per cent) indicate that the ratio of Dublin properties obtained by private non-household investors may be higher than the national figure. This would tally with evidence pertaining to the current residential property holdings of REIT investors, which appear to display a preference for Dublin properties.

While no official dataset as yet provides a further detailed breakdown of private non-household investor involvement in the residential property market, it is possible to obtain some information from annual reports and media coverage. For instance, IRIS – which is Ireland's main listed residential REIT - disclosed in its latest annual report that it owned 2,450 residential units in Dublin at the end of 2017. Hibernia REIT, which focuses mainly on the acquisition and management of commercial rather than residential property, disclosed holdings of 313 Dublin residential units last year.[4] Another major institutional investor to disclose details of its Irish residential property portfolio is Kennedy Wilson, which has approximately 2,100 units either built or subject to planning – with intentions to increase this to 5,000 over the coming years.

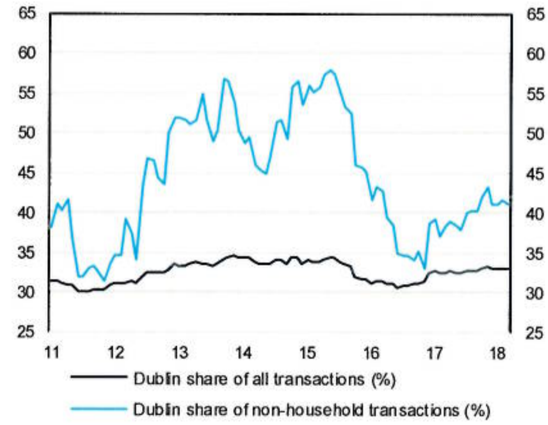
[4] Green, the other major listed Irish REIT, had 60 residential units but disposed of these during 2017.

Chart 1: Residential property transactions by buyer type



Source: CSO and Central Bank of Ireland calculations
Note: Data are 4 quarter rolling totals

Chart 2: Dublin-based residential property transactions



Source: CSO and Central Bank of Ireland calculations
Note: Of the c.59,500 total housing transactions which occurred in 2017, 19,600 (32.9 per cent) took place in Dublin. In contrast, of the 8,650 non-household transactions completed across the country, 3,550 involved Dublin properties.

Separately, the firm CBRE has been compiling figures on investment transactions of value greater than €1million in the Irish commercial property market by investor typefor the past number of years.[5] According to its data, REITs have accounted for €2.6 billion (15 per cent) of the approximately €18 billion of Commercial Real Estate transactions that have occurred since these began operating in the market during 2013. The data also show that REITs have been less active in the CRE investment market during the last couple of years, with their share of annual investment expenditure declining from 31 per cent (2014) and 20 per cent (2015), to 4 per cent (2016) and 2 per cent (2017) more recently.

2. Commitment given to Deputy McGrath to furnish information regarding the origin of how the Central Bank defines first-time buyers

For the purposes of the Central Bank Mortgage Rules, a first time buyer is defined as a borrower to whom no housing loan has ever before been advanced (in Ireland or abroad). Where the borrower under a housing loan is more than one person and one or more of those persons has previously been advanced a housing loan, none of those persons is a first-time buyer.

[5] Investor types include institutional funds, investment funds, other collective vehicles, REITS, property companies, private investors, occupiers and others including asset managers, hotels and the public sector.

The Central Bank introduced proportionate limits specifically to allow flexibility by lenders when assessing individual cases, such as may be the case in instances referred to in the Deputy's question. The proportionate limits mean that lenders are able to make decisions based on an individual borrower's circumstances up to a specific limit. Lenders will still be required to assess an individual borrower's affordability and lend prudently on a case by case basis, in line with the requirements of the Consumer Protection Code and other regulations.

3. Commitment given to Senator Burke to furnish information regarding Central Bank recommendations to the Government on housing in 2010/11

In its Quarterly Bulletins and the twice-yearly Macro-Financial Review (2012 onwards), the Bank provides commentary regarding the overall economy including housing market conditions. No recommendations in relation to housing were provided by the Bank to the Government during this period. This reflects the crisis conditions that prevailed, with the focus of Central Bank publications during that period on the management of the crisis (especially in the banking sector) and the restoration of the public finances. Looking through the archive of Macro-Financial Reviews, the mis-match between demand and supply in the housing sector was highlighted from June 2014 onwards.

4. Commitment given to Deputy McGrath to furnish data on the origination of restructured agreements

As at end-March 2018, 12,404 Private Dwelling Home (PDH) loans were held by unregulated loan owners, representing 2 per cent of all PDH loans outstanding. These entities hold a disproportionately large share of long-term arrears cases with 19 per cent of all cases (i.e. arrears of 720 days past due) held by unregulated loan owners.

Table 1 indicates the types and numbers of restructures put in place in the 12 months to end-March 2018 by type of loan owner. A split between Retail Credit Firms and unregulated loan owners is not possible for some restructure types due to confidentiality concerns arising from the very small numbers of restructures.

Caution should be exercised in analysing the trends across loan owners due to the different loan portfolio structures. The circumstances of each loan differ so it is likely that the use of restructures will differ if one portfolio has different characteristics to another.

Please note that:

- Data in the table below refer to new restructures by the loan owner type from April 2017 to end-March 2018 inclusive.
- Data include PDH mortgages only.

Table 1: Private Dwelling Home Loan Restructures by Loan Owner Type between April 2017 and March 2018 inclusive

	Banks	Retail Credit Firms	Unregulated Loan Owners	Total
Number of loans held at end-Mar 18	679,912	36,259	12,404	**728,575**
Share of:-				
- total PDH loans	93%	5%	2%	**100%**
- total long term arrears (720 days +)	73%	8%	19%	**100%**
- all new restructure arrangements (Apr-17 to Mar-18 inclusive)	86%	8%	6%	**100%**
Total new restructures (Apr-17 to Mar-18 inclusive)	22,766	2,040	1,605	**26,411**
of which:-				
- Arrears capitalisation	4,965	657	232	**5,854**
- Reduced payment (greater than the interest only)	4,157	360	838	**5,355**
- Payment moratorium	2,991	39		**3,030**
- Interest only (<=1 year)	2,840	144		**2,984**
- Term extension	1,963	35	59	**2,057**
- Split mortgage	1,273	88		**1,361**
- Reduced payment (less than interest only)	791	136	62	**989**
- Other restructures	3,786	642	353	**4,781**

5. Commitment given to Deputy McGrath to furnish detail regarding involvement of external independent persons in the complaints process established in regard to GRG

The "Principles governing Royal Bank of Scotland's ("RBS's") new complaints process for SME customers in GRG" (the "GRG complaints process"), sets out the scope and background of the complaints process for Small and Medium Enterprises ("SMEs") that were under the control of GRG in the United Kingdom or Republic of Ireland between 1 January 2008 and 31 December 2013. In line with the principles, an Independent Third Party ("ITP"), Sir William Blackburn, has been appointed to perform an assurance and appeal role whereby the ITP will:

"provide assurance that the methods used in the complaints process are appropriate and provide a framework that enables a thorough and robust assessment of complaints both:

i. at the outset; and
ii. on an ongoing basis; and

iii. operate a process to consider appeals against decisions made in the complaints process".

Further information in relation to the GRG complaints process, including details on the scope, background, considerations and limitations of the process, are publically available via the RBS and Ulster Bank Ireland DAC ("Ulster Bank") websites at the following links:

https://www.rbs.com/rbs/GRGComplaintsProcess.html

https://www.rbs.com/content/dam/rbs_com/rbs/Images/news/2016/11/New_complaints_process_principles.pdf

In addition, the Central Bank has been in close engagement with Ulster Bank since November 2016, when it announced that it would be taking steps to "put things right" for customers in GRG. This engagement includes a review of complaints received as part of the GRG complaints process for any consumer protection issues arising, particularly in the context of SME Code compliance. The Central Bank will continue to engage with Ulster Bank to ensure it delivers on its commitments.

The Central Bank encourages consumers/SMEs who are dissatisfied with their experience of financial products or services to ensure that they communicate their complaint directly to their financial services provider. The Consumer Protection Code 2012 (the "Code")[6] and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium Enterprises) Regulations 2015 (the "SME Regulations")[7] have defined processes for firms' for handling complaints by consumers/ SMEs.

6. Commitment given to Deputy McGrath to confirm whether representative bodies will be represented on the credit union CEO forum

Interaction with Credit Union Representatives

There is significant scheduled and ongoing engagement with the credit union representative bodies and associations of the Irish League of Credit Unions (ILCU), Credit Union Development Association (CUDA), Credit Union Managers Association (CUMA) and National Supervisors Forum (NSF). In this regard, it is important in the cases of ILCU and CUDA to distinguish between their advocacy and commercial service provision roles.

[6] Provisions 10.7-10.12 of the Code
[7] Regulations 25 and 43 of the SME Regulations.

The Registrar of Credit Unions (the Registrar) and his management team meet with the representative bodies in their advocacy capacity on a quarterly basis in relation to strategic sectoral developments and other regulatory and supervisory issues. The Registrar also addresses the Annual Conferences of these bodies, including providing updates on current developments and regulatory priorities. The Deputy Governor for Prudential Regulation also meets the representative bodies on an annual basis in relation to their strategic priorities.

In addition, there is ongoing engagement on areas such as Registry of Credit Unions publications and changes to the regulatory framework - recent examples include changes to the investment regulations, the Fitness and Probity regime for credit unions and current review work on Long Term Lending. The Registry also presents at various conferences, workshops and seminars on topical issues. Annually, the Central Bank engages with credit unions through our annual information seminars (in a roadshow format), where representative bodies attend.

Separate to the above, we have close regulatory engagement with both ILCU and CUDA in relation to their respective roles as service providers to groups or individual credit unions in the sector. A recent example would be our engagement on both bodies' respective mortgage frameworks for member credit unions.

The Central Bank is committed to constructive engagement with credit unions and other stakeholders. It is important to note that in terms of proactive support and engagement with credit unions and their representative bodies, the Central Bank goes well beyond that provided to any other regulated sector. This includes the level of supervisory engagement undertaken with individual credit unions, the bilateral engagements with representative bodies, our participation and contributions to sector events and our publications supporting credit union boards and management teams in discharging their important functions.

CEO Forum on Business Model Development (The Forum)

Internationally, credit union CEOs have led business model development that evolved over a period of time during which they committed resources, put the foundations in place and developed improved business model implementation capabilities. With professional advocacy support, they then successfully secured regulatory and legislative approval to provide an expanded service offering to their members. This process of transformational change was led by the CEOs of larger, stronger credit unions that commercially collaborated to develop the structures and capabilities required to achieve regulatory approval. In Ireland, with the exception of Member Personal Current Account Service (MPCAS), there has been limited tangible outcomes from CEO commercial collaboration to date. The Forum is designed to help CEOs of all credit union sizes address the need for business model change by facilitating increased collaboration on new initiatives in service of sector sustainability. This collaboration is necessary to address key credit union challenges relating to lack of scale-driven cost efficiencies including sourcing necessary technical expertise that may be unduly expensive on a standalone basis.

Under section 64 (a)(4) of the Credit Union Act, credit union managers are charged with "preparing and proposing to the board of directors for debate, scrutiny and approval, strategies for the strategic plan that the board of directors are required to prepare and approve". A number of credit unions have highlighted to the Central Bank that a CEO forum for the direct exchange of regulatory and industry perspectives on material business model issues would result in improved risk assessment by the sector of business model opportunities. It is expected that this will help drive forward higher quality proposals, grounded in a realistic assessment of competence and capability.

The Forum, which was initiated by the Central Bank, is independently chaired by Professor Donal McKillop. Consistent with credit union ownership of its business model, it has been designed to be a CEO-led Forum, focussed on those areas of business model development identified by credit unions as being of greatest importance to them. The process, managed by a CEO steering group, will lead issues-based work streams with the objective of delivering practical outcomes in terms of new product and service initiatives. The work streams and their outputs are led and driven by the CEO participants.

The Forum was designed to facilitate CEOs of all credit union sizes working together to achieve broad collaborative understanding of issues such as:

- future business models and their risk profiles;
- business model development strategies and enablers;
- steps necessary for prudent and safe transition in terms of the implementation of business model change; and
- risk-based business case for change.

The role of the Central Bank in the Forum is, as regulator, to engage constructively on potential risk aspects of proposed products, services and enabling frameworks with the CEOs within each workstream. Regulatory support and challenge is important at an early stage in product and service development. The Central Bank's engagement in the Forum is intended to be on a targeted basis, designed to add value where credit union CEO thinking has developed around workstream outputs.

The Forum had its initial meeting on 2 July 2018, which was strongly attended. Central Bank and Industry presenters addressed current business model challenges and international experience of change led through CEO collaboration. The CEO Steering Group was appointed and Professor McKillop announced as independent Chair. Initial areas for focus by Forum workstream were explored at the meeting. This will be further informed by a sectoral survey of all credit unions on their business model priorities. The CEO Steering Group had its first meeting on 10 July 2018 and will progress the survey and initial workstreams.

Participation Levels

In light of its CEO collaboration focus, the direct participation of the two credit union representative bodies (ILCU and CUDA) in this Forum was not proposed by the Central Bank. CUMA representatives participate in their individual capacity as credit union CEOs.

The reason for this approach is that the presence of other parties, such as representative bodies, as part of this Forum, could inhibit the open collaborative engagement and sharing of ideas that is so central to this process, due to the potential for undue deference to affiliation or commercial relationship considerations. Limiting participation to CEOs only ensures that the generation of new product and service collaboration can be pursued by CEOs working together independent from other influence. In order to avoid duplication of effort, CEOs who are involved or aware of other initiatives relevant to their workstreams can invite those third parties (including the representative bodies' commercial arms in their capacity as service providers e.g. ILCU – CUSOP or CUDA – Solutions Centre) to present to the Forum workstream on work underway, and any technical issues arising.

Indeed, the basis for the inclusion of representative bodies in the Forum is unclear, given the operational nature of much of the CEO Forum work streams in contrast with the broader advocacy role of representative bodies in addressing strategic sectoral issues and advocating for desired regulatory or legislative change necessary to enable prudent and sustainable model development.