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Banc Ceannais na hÉireann
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Eurosystem

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Deputy Michael McGrath, TD
Main Street
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8 March 2018

Dear Deputy McGrath

I refer to your email to my office and the enclosed letter to President Draghi of the European Central Bank (ECB) regarding the sale of Non-Performing Loans (NPLs). I welcome this opportunity to address NPLs and to set out the steps the Central Bank took to press for a regulatory framework that would protect consumers whose loans were sold to unregulated entities.

In line with our mission of safeguarding stability and protecting consumers, the Central Bank's work on mortgage arrears and NPLs spans its consumer protection, prudential supervision and financial stability roles. Within the remit of the Central Bank's responsibilities, the approach to mortgage arrears resolution is focused on ensuring the fair treatment of borrowers through a strong consumer protection framework while ensuring banks are sufficiently capitalised, hold sufficiently conservative provisions, and have appropriate arrears resolution strategies and operations.

NPLs are one of the primary sources of risk to the Irish economy and to the euro area as a whole. It is just under ten years since the crisis, and while banks in Ireland and elsewhere in the euro area have made progress in addressing this risk, significant asset quality challenges remain to be addressed. NPLs can affect the credit supply channel by raising the funding costs facing banks and casting doubt on

the underlying capital positions of banks. In short, in addition to causing distress for borrowers, NPLs can cause dysfunction for the banking system and hence its ability to serve the needs of borrowers and the wider economy.

Over the last decade, the Central Bank has pursued this supervisory priority by pushing the banks to resolve the issue of NPLs. The banks have a variety of options available to deal sustainably with NPLs including workout, write-offs, restructure, foreclosures or sales. Under the current ECB guidance, banks are required to define their own NPL reduction strategies and choose the most suitable solution for each relevant portfolio.[1] It is up to banks to define realistic but ambitious timeframes and appropriate options for each portfolio. The Central Bank and the Single Supervisory Mechanism do not have a preference for any particular work-out modality for NPLs. This is decided upon and implemented by the executive and boards of banks themselves.

As far back as 2011, the Central Bank highlighted the implications for consumers arising from the sale of loans to unregulated entities and advocated for the preservation of the protections afforded to borrowers under the regulatory framework. Following a public consultation by the Department of Finance, the Central Bank worked with the Department to develop the Consumer Protection (Regulation of Credit Servicing Firms) Act, which came into effect in July 2015 ('Credit Servicing Act'). Where loans are being sold, the Central Bank's position has been and remains that the protections should travel with the loans and that borrowers are protected in accordance with the regulatory framework.

The Credit Servicing Act ensures that relevant borrowers whose loans are sold to unregulated third parties are afforded the regulatory protections they had prior to the sale, including those protections provided by the Central Bank's Consumer Protection Code, the Code of Conduct on Mortgage Arrears and the SME Regulations. Under the Credit Servicing Act, if an unregulated firm buys loans from an original lender, then the loans must be serviced by a 'credit servicing firm' who is authorised and regulated by the Central Bank, thereby bringing such firms within the Central Bank's regulatory remit. Credit servicing includes all interactions with the consumer in respect of the loan including:

- Notification of changes in interest rates or payments due;
- Collecting repayments on the loan;
- Managing complaints; and
- Assessing the consumer's financial circumstances in cases of financial difficulties.

[1] See the ECB Guidance to banks on NPLs available:
https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf

In addition, the Credit Servicing Act ensures that a credit servicing firm cannot take an action, or fail to take an action, on behalf of or on the instructions of an unregulated loan owner, which would be a prescribed contravention if performed, or not performed, by a retail credit firm.

The Central Bank has developed detailed Authorisation Requirements and Standards as part of the regulatory regime for credit servicing firms and applicant firms are assessed against these requirements and standards. For example, credit servicing firms are required to have:

- Robust governance and adequate resources to ensure compliance;
- Agreements with loan owners that enable the credit servicing firm to fully comply with its obligations under Irish financial services legislation; and
- Adequate and effective control of loan servicing in the State to enable Central Bank oversight.

Considerable progress has been made in addressing mortgage arrears, primarily through the use of restructures, rather than loss of ownership. Private Dwelling House (PDH) mortgage arrears have declined by 49 per cent since the June 2013 peak of approximately 140,000. At present, just under 120,000 PDH residential mortgages are restructured. Overall, 87 per cent of these loans are currently meeting the terms of the arrangement. The significant restructuring activity illustrates a willingness to restructure distressed mortgage debt where there is meaningful engagement between lender and borrower, and a restructure can be agreed. This is in large part due to the Central Bank's persistence in ensuring, that banks have appropriate resources (capital and provisions) and strategies and operations in place to engage appropriately with distressed borrowers.

Where sustainable restructures cannot be found for borrowers, they can avail of arrangements such as Personal Insolvency Arrangements (PIAs). This can restore a borrower to solvency and give the lender certainty as to what can be recovered. Where banks deem it necessary, as a last resort or in the case of non-engagement, they have recourse to the underlying security through repossession proceedings in these circumstances.

The Central Bank's data also shows that:

- The total number of PDH mortgage accounts at end Q3 2017 was 731,119;
- Banks account for about 95% of the total number of these mortgages (693,219);
- Non-banks account for about 5% of these mortgages (37,900) of which:
  - 70% (26,586) are held by Retail Credit Firms regulated by the Central Bank; and
  - 30% (11,314) of mortgage accounts outstanding are held by unregulated loan owners.

While unregulated loan owners account for 2% of mortgages, they account for 12% of arrears cases greater than 90 days past due and 15% greater than 720 days past due. These accounts therefore have deeper arrears profiles than banks or retail credit firms. Non-bank entities (both regulated and unregulated) repossessed 124 properties in the year to end-Q3 2017: 61 of these were repossessed on foot of an order and 63 of these were surrendered voluntarily or abandoned. Banks, by comparison, repossessed 982 properties over the same period.

While clearly past behaviour is no guarantee of future actions and there are differences in the books, it is worth noting that, to date, unregulated loan owners and retail credit firms have not been more aggressive than the banks in pursuing legal action. 29% of loans in arrears over 90 days held by banks are in the legal process (as at end September 2017). The equivalent numbers for retail credit firms and unregulated loan owners are 25% and 24% respectively.

Finally, I am aware that you have introduced the Consumer Protection (Regulation of Credit Servicing Firms) (Amendment) Bill 2018. We are committed to ensuring effective consumer protections and will provide all assistance required to the Department of Finance in respect of the proposed Bill.

Yours sincerely

Philip Lane