



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
Dublin 2

17 January 2018

Dear Deputy McGuinness

I am responding to the Committee's request for clarification and further information on a range of issues following our previous meeting with the Committee. I set out below our responses in respect of these matters, taken in the order listed in the enclosure to your letter of 6 November 2017.

I will also take the opportunity to address your letter of 21 December last concerning the substance of the correspondence exchanged between Mr Jim Daly, TD and Central Bank of Ireland officials in the period 2014 - 2017. Your letter invited the Central Bank's views on this correspondence in advance of next week's meeting and my response is set out at section 2 further below.

1. Replies in follow up to the JOC meeting on 19 October 2017

Item 1: Inform the Committee whether any of the lenders' auditors raised a concern about tracker-related issues (Page 40 of Transcript)

Issues relating to governance arrangements and controls regarding tracker mortgage loans in lender audited accounts were not raised by relevant auditors prior to the initiation of the Tracker Mortgage Examination (i.e. 2015).



After the commencement of the Tracker Mortgage Examination, there were discussions on risks and concerns regarding the level and nature of provisions made by banks in respect of potential losses arising from the Tracker Mortgage Examination at meetings between auditors to the banks and Central Bank staff.

Item 2: Inform the Committee whether any staff in the lenders included in the Tracker Examinations raised concerns or whistleblowing claims about the manner in which those lenders were handling tracker customers (Page 54 and 67 of Transcript)

Under the relevant legislation (the Central Bank (Supervision and Enforcement) Act 2013 and the Protected Disclosures Act 2014) people making protected disclosures benefit from a range of employment and other protections should they be penalised by their employer or suffer any other detriment for making the disclosure. A key protection is that the identity of the reporting person is kept confidential. Except for specific, prescribed circumstances, the Central Bank cannot disclose the identity of the reporting person or any information which may by implication identify them. This protection is often of critical importance to those making such reports. The Central Bank takes this confidentiality obligation with the utmost seriousness. Any compromise of this obligation might discourage people from making disclosures to the Central Bank, all the more so if they are employees raising concerns about their own employers. Therefore, owing to the prohibition under the relevant legislation on the disclosure of any information which might identify the person by whom the protected disclosure was made, the Central Bank is prohibited from disclosing the information sought regarding protected disclosures relating to the Tracker Examination in precise detail.

More generally, the Central Bank has experienced a substantial year-on-year increase in the number of protected disclosures received from the public (including employees of regulated firms) with 93 protected disclosures received in 2017 compared to 50 in 2016. 28 of the 93 protected disclosures received in 2017 related to the banking sector (credit institutions and retail credit firms).

The Central Bank welcomes approaches from anyone with information that can help the Central Bank carry out its mission of safeguarding stability and protecting consumers including from staff working in the lenders included in the Tracker Mortgage Examination. The Central Bank has a dedicated unit, the Protected Disclosures Desk, to receive protected disclosure/whistle-blowing reports regarding alleged breaches of financial services legislation from members of the public including employees working in regulated firms. The Protected Disclosures Desk is the primary point of contact for people



to make reports. It also provides information regarding the process for making reports and how the Central Bank assesses the reports. There is a dedicated section on the Central Bank's website with further information on protected disclosures: <https://www.centralbank.ie/regulation/protected-disclosures-whistleblowing>

The Central Bank considers protected disclosures as a valuable tool to assist in its supervision of regulated firms and individuals in those firms. A subject matter expert in the relevant supervisory division considers each protected disclosure and examines the allegations thoroughly. The Central Bank follows up with the reporting person as necessary. Various supervisory actions have been initiated following receipt of protected disclosures reports by the Central Bank including: enforcement action, on-site inspections, risk mitigation plans issued and firms placed on a watch list. Not all reports received will result in supervisory action being initiated as the information may not be sufficient to take action; or the information received was not substantiated when investigated; or insufficient information was provided anonymously and contact for further supporting information could not be made.

We publish details on the work of the Protected Disclosures Desk in the Central Bank's Annual Reports as well as an Annual Protected Disclosure Report setting out the number of reports received during the relevant reporting period and action taken. The Central Bank of Ireland received 44 protected disclosures from July 2015 to June 2016 and 79 from July 2016 to June 2017. All disclosures received were thoroughly assessed and, where required, appropriate action was taken.

The Central Bank encourages any person/employee who may have information in relation to suspected breaches of financial services legislation specifically relating to the Tracker Mortgage Examination or otherwise to come forward. It is worth noting separately that senior persons in regulated firms are required (pursuant to Section 38(2) of the Central Bank (Supervision and Enforcement) Act 2013) to report suspected breaches of financial services legislation which they consider may be of material assistance to the Central Bank.

Item 3: Inform the Committee whether a person whose tracker case was previously rejected by the Financial Services Ombudsman (FSO) can make a new appeal to the FSO in relation to the same case (Page 59 of Transcript)

With respect to the specific question posed, namely whether a person whose tracker case was previously rejected by the Financial Services Ombudsman can make a new appeal to the FSO in relation to the



same case, having discussed this matter directly with the Financial Services Ombudsman (FSO), the Central Bank's understanding is as follows:

Findings by the FSO remain legally binding and consequently, the FSO is not in a position to re-examine elements of a complaint, which has already been the subject of a legally binding adjudication. However, the Central Bank also understands that where matters did not form the subject of the previous finding or if matters arise after the finding, for example through the Tracker Mortgage Examination process, these matters may form the basis of a new complaint to the office of the FSO.

In terms of wider FSO engagement, during the period from 2008 to 2015, the Central Bank intervened with a number of individual lenders where it was concerned that tracker mortgage customers were not being treated fairly. In total, tracker related issues for 7,100 impacted accounts were resolved during this period. This work influenced the Central Bank to enhance its statutory protections for customers in the Consumer Protection Code and the Code of Conduct on Mortgage Arrears. It also heightened the Central Bank's concerns that there was a risk of other tracker issues remaining within lenders that had not been proactively identified and resolved. As a result, the Central Bank launched the Examination in 2015.

The Examination Framework was developed with the role of the FSO in mind. Section 3.5.1 of the Framework, details a number of 'influencing factors' that lenders must consider, including

"issues raised via complaints received from customers with regard to Tracker Interest Rate mortgages, including complaints dealt with via the lenders' internal complaints process and those dealt with by the Financial Services Ombudsman, closed and pipeline cases. The focus should be on the underlying issue(s) complained of, regardless of the decision reached in each case."

Sections 6 and 7 of the Clarifications Document issued by the Bank to lenders on 5 May 2016 further explained:

6. Previous Tracker Mortgage Related Reviews

"Where customer accounts have been reviewed as part of previous tracker mortgage related reviews and/or investigations, the Central Bank expects lenders to review such accounts again in accordance with the Framework, as the scope of the Examination is broader than previous tracker mortgage issues that may have been reviewed in the past. As soon as possible following independent testing by the external independent third party, the lender should advise the Central Bank, based on the outcome of this review, whether further action is necessary."



7. Approach to be Adopted Where Customer's Complaints Have Previously Been Investigated by the FSO

"All mortgages captured in section 3.2.1 of the Framework should be included within the scope of the Examination including those mortgages that have previously been the subject of a complaint to the FSO. The Central Bank expects lenders to adopt this approach as the scope of the Examination is broader than issues that may have been raised by individual customers."

This approach is supported by the FSO. The FSO has informed the Central Bank that it issued a letter in early March 2016 to lenders against whom complaints regarding tracker mortgages were previously made, in which it set out its position in respect of this issue. For convenience, please see an extract from the FSO's letter below.

"As the scope of the CBI Examination is broader than the criteria considered by the FSO I am firmly of the view, a view which is shared by the CBI, that no mortgage holder who has made a complaint to this office should be treated any differently, with regard to the Examination, by virtue of the fact of having made such a complaint, irrespective of the outcome."

While the Central Bank's consumer protection mandate is focused on systemic issues, the FSO assesses the complaints of individual consumers against their financial services providers and can direct redress where the office finds against a firm. In the context of the Examination, the FSO has and continues to deal with individual consumer complaints, where customers are not satisfied with their redress and compensation from lenders under the framework or where they believe that they have been wrongly excluded from the examination. The FSO has the power to direct both compensation and rectification as appropriate. The FSO services are free to customers. Any decision taken by the FSO, which is appealed by the financial service provider, is defended by the office of the FSO and as a result, the costs associated with any such appeal are not borne by the customer.

Item 4: Clarify how much of the amount paid in redress and compensation to date under the Examination comprises of redress and compensation (Page 59 of Transcript)

Compensation represents 15% of the total redress paid to date. The schemes provide for adjusted compensation amounts to reflect differing levels of detriment suffered by customers.

This is a provisional percentage which may change. Given the structure of the Examination, lenders are at different points in relation to paying redress and compensation. For that reason, the percentage



breakdown above cannot be interpreted as a representation of the expected final amounts across the categories.

Item 5: Provide a response stating what additional legal powers the Central Bank would like to facilitate the Tracker Examination (Page 65 of Transcript)

The Central Bank has, in recent years, been provided with a broad suite of new powers. One such power is the customer redress power as set out in the Central Bank (Supervision and Enforcement) Act 2013. This power however is not retrospective in nature and is a redress rather than a redress and compensation power.

While the Central Bank is satisfied that we are effectively using the full range of our powers to deliver for affected customers in relation to the Tracker Examination, we keep under constant review the question of whether additional powers would enable us to deliver more effectively our mission of safeguarding stability and protecting consumers.

In that context, our report into behaviour and culture at lenders, which will be undertaken in H1 of this year, will help identify any regulatory enhancements that are required and whether any additional legislative changes are needed.

Another example of how we keep our powers under constant review is our response this month to the Law Reform Commission issues paper on regulatory enforcement and corporate offences. The response contains a number of recommendations including:

- That reforms strengthening the accountability of senior personnel in regulated entities be adopted in this jurisdiction. Such reforms would permit the Central Bank to require senior managers to submit a statement of responsibilities that clearly states the matters for which they are responsible and accountable. These requirements would assist in assigning responsibility to individuals in a regulatory context and decrease the ability of individuals to claim that the culpability for wrongdoing lay outside their sphere of responsibility;
- The extension of the period for which individuals can be suspended from senior positions in regulated firms as part of the fitness and probity regime;
- That the legislative framework be strengthened to include a criminal offence of egregious recklessness by those in charge of financial firms that fail; and



- The embedding of certain core common standards within a legislative framework. These standards would be used to guide regulated entities, and the individuals who exercise influence and authority over them, as to what is expected of them. Core standards can sit alongside prescriptive rules, and can be enforced where entities or individuals fall below them. Such core standards could include the requirement on entities and individuals that they conduct themselves with honesty and integrity, possess the competence and capability to conduct their business properly and co-operate with relevant regulatory authorities.

The response has been issued to the Committee and is available to view on our website: <https://www.centralbank.ie/news/article/response-to-the-law-reform-commission-issues-paper-regulatory-enforcement-and-corporate-offences>

Item 6: Clarify whether the Central Bank believes that there should be a responsibility on, or a system provided by, either the financial institutions or the Courts Service to report to the Central Bank whereby a financial institution has broken the law (Page 80 of Transcript)

There is an existing responsibility under Section 28 of the Central Bank Act 1971 for a registrar or clerk of a relevant court to notify the Bank in relevant circumstances. The registrar/clerk is to notify the Bank ‘as soon as may be’ of a judgment, order or decree (and of its terms and of any appeal), whenever a person obtains in court a judgment, order or decree against the holder of a bank license for the payment of a sum of money due to the person by the licensed bank in its capacity as a banker. This provision is relatively limited and does not require the Courts to notify the Central Bank of all breaches of financial services legislation.

Item 7: Revert re the exposure of Irish banks in the UK market, specifically the loan default rates in the UK market (Page 84 of Transcript)

The analysis referred to at the JOC was conducted in the Q2 2017 Brexit Task Force Quarterly Report.

- Three stress scenarios similar to the UK’s National Institute of Economic and Social Research (NIESR) were used to model defaults for Irish banks’ UK mortgage market exposures.
- The scenarios for the UK economy were based on several possible future configurations for the UK’s trading relationship with the EU. One proposal was for a European Economic Area (EEA) relationship, one for a World Trade Organisation (WTO) relationship, and the final scenario involved the WTO scenario plus an additional stress. The default rates predicted under



the proposed scenarios were not deemed sufficiently high to place material stress on Irish banks' overall capital levels.

While the potential future configuration of the UK's trading relationship with the EU remains somewhat unclear at this juncture, the Central Bank continues to monitor credit quality trends, and undertakes regular risk assessments related to the risks posed by Brexit.

As at 30/06/2016

Total exposures		(€m) / %
Total exposures	265,109	
Of which defaulted	26,018	
Defaulted/ Total Exposure	9.1%	
UK Exposures		(€m) / %
Total UK exposures	74,809	
Of which defaulted	3,469	
Defaulted/ Total UK Exposure	4.6%	
UK as % of Total		(€m) / %
UK Exposures as % of total	26.2%	
UK Defaulted as % of total defaulted	13.3%	

As at 30/06/2017

Total exposures		(€m) / %
Total exposures	261,792	
Of which defaulted	21,765	
Defaulted/ Total Exposure	8.3%	
UK Exposures		(€m) / %
Total UK exposures	65,465	
Of which defaulted	2,499	
Defaulted/ Total UK Exposure	3.8%	
UK as % of Total		(€m) / %
UK Exposures as % of total exposures	25.0%	
UK Defaulted as % of total defaulted	11.5%	

Notes:

Banks in sample for both years : AIB, PTSB and BOI.

Some of the difference between exposure and default values between 2016 and 2017 is due to movements in the €/£ exchange rate as well as asset sales.

€/£ at 30/06/16 = 0.8265

€/£ at 30/06/17 = 0.87933

Definitions as per the EBA EU wide transparency Exercise.

*Please note a more granular bank by bank dissemination of data is provided for both the 2016 and 2017 data on the EBA website as part of the EU wide

2016

<https://www.eba.europa.eu/risk-analysis-and-data/eu-wide-transparency-exercise/2016/results>
<https://www.eba.europa.eu/documents/10180/1681549/Credit+Risk+Individual+Banks+2016.xlsx>

2017

<https://www.eba.europa.eu/risk-analysis-and-data/eu-wide-transparency-exercise/2017/results>
<http://storage.eba.europa.eu/documents/10180/2027259/Credit+Risk+Individual+Banks+2017.xlsx>

Item 8: Provide the current position to update on former Governor Honohan's letter to the Minister for Finance of August 2015 stating the Central Bank did not have statutory power to act on false information provided by insurers (Page 87 of Transcript)

The Solvency II Directive was transposed into Irish law through the European Union (Insurance and Reinsurance) Regulations 2015 ("the Regulations"). The Regulations came into force from 1 January 2016. The Regulations were made after Governor Honohan's letter to the Minister for Finance dated 18 August 2015.

Regulation 302 of the Regulations makes it an offence for a person to provide information to the Bank which the person knows or ought reasonably to know to be false or misleading (whether on the person's



own behalf or on behalf of another person). The offence applies where the information is provided in purported compliance with a requirement imposed by the Regulations.

In addition, using its powers under the Regulations, the Central Bank has imposed a condition of authorisation on all insurance undertakings to not, in any circumstances, provide the Central Bank with false or misleading statements or information which it knows or ought reasonably to know to be false or misleading. The failure by the insurance undertaking, or any person concerned in its management, to comply with this condition is a serious matter and may expose the undertaking, or persons concerned in its management, to consequences including, without limitation, administrative sanction.

2. Correspondence between Mr Jim Daly, TD and the Central Bank

Your recent letter dated 21 December 2017 advised that the Committee would explore at next week's meeting, the substance of a series of items of correspondence between Mr Jim Daly, TD and Central Bank officials in the period 2014 - 2017. Your letter invited the Central Bank's views on this correspondence in advance of the meeting and these are set out below.

The Central Bank places great importance on engagement with, and accountability to, the Oireachtas, be that in the shape of attending committee hearings, providing information for replies to parliamentary questions, or responding to correspondence from Oireachtas members.

While the Central Bank does not have the statutory mandate to deal with individual consumer complaints concerning financial services providers, it can and does use information provided by members of the Oireachtas to inform its supervisory approach, and accordingly welcomes all such information.

In relation to now Minister of State Daly's correspondence between 2014 and 2017, the Central Bank understood the central subject of Deputy Daly's correspondence to concern tracker borrowers in arrears, an issue on which the Central Bank had proactively intervened in order to protect consumers.

During the period 2010 to 2013, the Central Bank strengthened the protections for mortgage-holders generally, through enhancements and additions to the statutory framework for all lenders, specifically the Consumer Protection Code (the "**Code**") and the Code of Conduct on Mortgage Arrears (the "**CCMA**"). This included significantly enhanced protections for tracker mortgage customers, including those in arrears and pre-arrears.



The CCMA was also updated and provides that lenders must only require a borrower, who is in arrears or pre-arrears, to change from an existing tracker mortgage to another rate as a last resort, and where all other options, which would retain the tracker rate, have been considered to be unsustainable.

In the 2008-2015 period, the Central Bank also intervened with a number of individual lenders where it was concerned that tracker mortgage customers were not being treated fairly, including circumstances where the Central Bank was concerned that lenders were not meeting their contractual obligations to, or obligations in respect of transparent communication with, tracker mortgage customers.

Prior to 2015, we pursued tracker mortgage issues with a number of individual lenders and ensured 7,100 cases were resolved in favour of affected customers.

We also took enforcement action against Springboard Mortgages Limited, resulting in a reprimand and monetary penalty of €4.5 million, the highest penalty ever collected by the Central Bank further to an enforcement investigation.

A full history of these interventions can be found in Part II (“Outline of the Central Bank’s policy and supervisory interventions and enforcement activity in relation to tracker mortgage-related issues in the pre-Examination period”) of our March 2017 update on the Tracker Mortgage Examination, available here: www.centralbank.ie/consumer-hub/tracker-mortgage-examination

In our early correspondence with Deputy Daly concerning this subset of tracker mortgage borrowers, we stated that we did not have any evidence at that time from our ongoing and intensive supervisory work that lenders were contravening these important requirements of the CCMA. We also confirmed that we would be undertaking a themed inspection across mortgage lenders of their compliance with the CCMA, the results of which we also furnished to Deputy Daly in June 2015.

While this themed inspection found no evidence of policies by lenders to move customers in arrears from tracker rates to more unfavourable rates, it did identify weaknesses in lenders’ monitoring of compliance with their internal policies on compliance with the specific and important CCMA protection.

The results of the inspection, together with separate work undertaken by the Central Bank on wider tracked-related issues as outlined, informed the scoping of the Tracker Mortgage Examination which



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

was launched in 2015. The Examination, as you know, covers all tracker mortgage accounts and not solely those which were or continue to be in arrears.

Deputy Daly also sought data relating to the number of mortgage borrowers who had converted from a tracker rate to a standard variable rate. However, the Central Bank did not and does not collect or publish data series on trends in movements on different mortgage types. Nor indeed would this appear to be a common practice among our peer supervisory authorities.

It is important to note, in the context of the Tracker Mortgage Examination, that such raw data in itself would not have exposed the unacceptable tracker mortgage failings by lenders which the Central Bank Examination is requiring those lenders to correct. For example, failings where a customer was never offered a tracker they were entitled to or transparency issues around entitlements at the end of a fixed term would not be identified. In addition, there would have been voluntary movement from trackers to other products in periods when, for example, certain fixed rate products were lower than typical tracker rates.

For example, while tracker products were attractive to consumers upon their introduction to the Irish market place, the cost of such products rose for a period between 2005 and 2008 as the ECB's interest rate increased incrementally. This prompted some consumers to switch voluntarily to other products such as fixed rate mortgages.

From late 2008 onwards, as the financial crisis took hold and the ECB interest rate fell, tracker products became loss-making for lenders, leading to the withdrawal of these products from the Irish market. More generally in this period, a significant number of mortgage holders fell into arrears.

The Central Bank was alert to the risks involved on both fronts from a consumer protection perspective, and made a series of policy and supervisory interventions in the years that followed in addition to those outlined above.

For example, in late 2008, the Central Bank issued a public warning to lenders in respect of their duty to act in the best interests of their customers when recommending a switch from tracker to fixed or variable rate mortgages. A series of further actions followed.

I trust that the above information is of assistance to the Committee and look forward to engaging with you at the meeting.

Yours sincerely