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BY EMAIL AND BY POST

Bríd Dunne

Select Committee on Finance, Public Expenditure and Reform, and Taoiseach

Leinster House

Dublin 2

18 September 2018

Re: Consumer Protection (Regulation of Credit Servicing Firms) (Amendment) Bill 2018 – Committee Stage consideration of the Bill

Dear Ms Dunne

I refer to your letter dated 27 July 2018 requesting the views of the Central Bank of Ireland ('the Central Bank') on what it considers to be the optimum approach to regulating loan owners from a consumer protection and prudential supervision perspective.

As you referenced in your letter, the Central Bank has previously written to the Oireachtas Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach ('the Oireachtas Joint Committee') on 30 May 2018 regarding the Consumer Protection (Regulation of Credit Servicing

Firms) (Amendment) Bill 2018 ('the Bill'). That letter outlined the Central Bank's concerns regarding the Bill. The European Central Bank (ECB) also provided an opinion on the Bill in July in which it highlighted a number of issues.

It is important to highlight that the Central Bank's work on mortgage arrears and non-performing loans ("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 in place.

A sale of a loan book containing NPLs is one of the options (among others such as workouts, restructures and foreclosures) a lender may take to seek to address the issues that arise from having a large book of NPLs. NPLs (including mortgage arrears) are a significant cause for concern for supervisory authorities, as in addition to causing distress for borrowers, they can cause dysfunction for the banking system and its ability to serve the needs of borrowers and the wider economy.

The Central Bank seeks to ensure through its regulatory approach a consistent framework of protections for consumers, which apply regardless of the category of regulated financial service provider they are dealing with. In this regard, the Central Bank seeks to ensure that there are clear obligations on all such firms to have appropriate resolution strategies and systems/processes in place to deal with borrowers facing financial difficulties.

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 ('the Credit Servicing Act'), which came into

effect in July 2015. This ensures that when a loan is transferred to an unregulated entity, relevant borrowers maintain the same regulatory protections they had prior to the sale. These protections include those provided by the Central Bank's Consumer Protection Code, the Code of Conduct on Mortgage Arrears and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015. The Central Bank notes that the Bill now proposes that loan owners would be subject to such requirements.

I note that the Bill has significantly changed since our initial comments were provided to the Oireachtas Joint Committee in May, and that the Bill in its current form addresses a number of the technical and drafting concerns which the Bank expressed in its letter of 30 May 2018. I note also that the amended Bill proposes to clarify that the owner of credit, whoever that might be, is to be the only regulated entity, and therefore responsible for all regulated activity (e.g. credit servicing), in respect of a loan it owns. This is important, as there should be no room for confusion as to what entity is responsible for a regulated activity. The Central Bank welcomes the amendments that have been made in this regard.

Recognising that the policy objective is to regulate loan owners, the Central Bank continues to be concerned in relation to the scope of the definition of "credit servicing" as set out below. I also have two other substantive suggestions on the provisions of the Bill, which are set out in the Appendix. The remainder of our suggestions are of a technical nature, which we will communicate separately to the Department of Finance.

Scope of "Credit Servicing"

The Central Bank notes that the Bill proposes to regulate the legal ownership of credit, which is provided for in paragraph (a) of the new definition of "credit servicing".

In addition to this regulation of legal ownership, the Bill provides for the proposed inclusion in the definition of "credit servicing" of the following activities:

a) the determination of the overall strategy for the management and administration of a portfolio of credit agreements; and
b) the maintenance of control over key decisions relating to such portfolio.

It is not clear why these activities are included, given that these are matters related to ownership, which is already captured by paragraph (a) of the definition of "credit servicing".

It is important to highlight to the Committee that the inclusion of these activities within the definition of "credit servicing" will not have the effect of enabling the Central Bank to intervene in relation to loan owners' overall strategies for the management of credit agreements or to require loan owners to make key decisions in a particular way, where such owners are acting in a manner which is compatible with relevant regulatory and contractual requirements.

This is because the Central Bank has no power to impose requirements on loan owners requiring them to have particular strategies or to make particular decisions, where they are complying with regulatory and contractual obligations. Equally, the Central Bank could not seek to determine the overall strategy of a loan owner or control its key decisions through regulation. For example, loan owners are entitled to decide the interest rates they charge, once this is consistent with the contracts they have agreed with their customers and their regulatory obligations.

The Central Bank does not have such powers in relation to any category of regulated entity, nor would it be appropriate for the Central Bank to have such powers. Regulated entities are entitled to rely on their contractual rights and make their own commercial decisions within the Central Bank's consumer protection framework. These are not matters on which the Central Bank can or should intervene.

As such, the purported inclusion of these activities as "regulated activities" is of no effect and I would suggest that these be deleted from the Bill. The legal ownership of a loan will already be regulated through paragraph (a) of the new definition of "credit servicing" in the Bill.

Such loan owners (requiring regulation under paragraph (a) of the definition of "credit servicing") will be required to comply with all relevant conduct of business rules including the protections stipulated in the Central Bank's various statutory Codes of Conduct (such as the Consumer Protection Code 2012 and the Code of Conduct on Mortgage Arrears 2013 (CCMA)), as is currently the case with existing credit servicing firms. These protections will be applicable to all loans to relevant customers owned by entities that are required to be authorised under the Bill. It should also be noted in the context of the sale of loans that, under contract law, once a contract has been entered into, the contract cannot be changed unilaterally by either party. Therefore, an unregulated loan owner cannot unilaterally change the terms of the loan agreement or an alternative repayment arrangement ('ARA') as agreed by the consumer and the original lender/loan owner. The Central Bank expects full compliance with the terms of the ARA and all applicable regulatory obligations, including the Central Bank's statutory codes, in respect of the ARA, including where there is any proposed amendment of an ARA.

Optimum Regime

Given the policy desire to regulate loan owners, your letter has specifically asked for our views on the optimum approach to be adopted. In the letter to the Oireachtas Joint Committee dated 30 May, I stated that the Central Bank believed that the retail credit firm regime was the most appropriate existing regulatory regime within which to address this issue. The main reasons for stating this were:

1. The retail credit firm regime relates to the provision of credit and there is an obvious direct link between the provision of credit and ownership of credit.

2. The policy proposal to regulate loan owners involves the narrowing of the existing exemption in the definition of "retail credit firm" which was only included to remove loan owners from the requirement to be authorised in the first instance. Therefore, in the

Central Bank's view, it is simpler to narrow this existing exemption rather than creating more complicated drafting by amending other regimes (i.e. credit servicing).

3. Regulating for credit servicing and ownership as the same regulatory activity is complex as this involves effectively regulating two distinct types of activity through the one regulatory regime. This results in a very complex regulatory regime for regulating "credit servicing".

It is important to note however that both retail credit firms and credit servicing firms are authorised under the Central Bank Act 1997 and the Central Bank has the same powers in relation to both of these regimes. There is no material difference in the standard of regulation between retail credit firms and credit servicing firms.

The Central Bank regulates both credit servicing firms and retail credit firms for conduct of business purposes, with a view to ensuring that these entities are in compliance with the Central Bank's statutory Codes of Conduct and relevant conduct of business rules. While credit servicing firms and retail credit firms are subject to the Central Bank's authorisation process and Fitness and Probity regime, they are not subject to the same intrusive prudential supervisory regime as credit institutions. It is not the case however that either category of firm is subject to a lower standard of regulatory scrutiny than the other.

As indicated above, the Central Bank will liaise with the Department of Finance in relation to other technical amendments that we would suggest to the Bill. As noted above, the ECB provided an opinion on the Bill in July. As the Bill has changed significantly since the ECB provided this opinion, consideration should be given to whether the ECB needs to be consulted again on the revised Bill.

Yours sincerely

Appendix – Additional Comments on the Provisions of the Bill

The Central Bank has set out below two additional substantive concerns we have on the provisions of the Bill, in respect of which we will liaise with the Department of Finance.

Transitional Arrangements

The Central Bank proposes an alternative transitional arrangement to that currently included in the Bill for loan owners requiring authorisation as credit servicing firms under the new regime. Under the proposed transitional arrangement in the Bill, a loan owner would have 90 days from the date the Bill comes into force to apply for authorisation as a credit servicing firm. During the transitional period while the loan owner awaits a decision on authorisation from the Central Bank, they would be 'deemed to be authorised'. The Central Bank is concerned that a number of loan owners would be based outside the State and would not be resourced to act as a credit servicing firm at the time the Bill comes into effect. During this period, it is likely that the current credit servicing firm would have withdrawn its authorisation, as it would not be required under the Bill to be authorised to continue to service loans on behalf of loan owners, as these firms would do so under an outsourcing arrangement. The Central Bank is therefore of the view that until the loan owner becomes fully authorised, it is important that the current credit servicing firm must remain in place.

Section 28(2) of the Central Bank Act 1997

We believe that the proposed new substitution for section 28(2) of the Central Bank Act 1997 is unnecessary and could lead to confusion given the proposed new definitions for credit servicing firm and owner of credit. We would suggest that this be deleted from the Bill.