# Philip R Lane: 2019-2021 strategic plan focuses on consumer protection, resilience and Brexit

Introductory statement by Mr Philip R Lane, Governor of the Central Bank of Ireland, before the Joint Oireachtas (National Parliament) Committee on Finance, Public Expenditure and Reform, and Taoiseach (Head of Parliament), Dublin, 26 March 2019.

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Chair, Committee members,

I welcome the opportunity to meet with you today for our regular engagement. I am joined by Derville Rowland (Director General for Financial Conduct) and Ed Sibley (Deputy Governor for Prudential Regulation).

The Irish economy continues to perform well. While I will return to Brexit-related risks later in this statement, our most recent projections are that underlying domestic demand will expand by 4.3 percent in 2019 and 3.9 percent in 2020. Unemployment is projected to average 4.9 percent in 2019 and 4.7 percent in 2020. The improvement in the labour market means that we expect wages to increase by 3.4 percent this year and 3.6 percent next year. Given the recent downgrades in European and global economic forecasts and the list of downside risks, we will be closely monitoring the impact for Ireland of any further deterioration in the external environment.

The mission of the Central Bank is to serve the public interest by safeguarding monetary and financial stability and by working to ensure that the financial system operates in the best interests of consumers and the wider economy. In terms of policy priorities, our new strategic plan for 2019–2021 highlights: (a) strengthening consumer protection; (b) resilience; and (c) Brexit. I will address the issues listed in your invitation letter by reference to these strategic priorities.

### Strengthening Consumer Protection

The protection of consumers is a priority for the Central Bank. Our aim is to enhance confidence and trust in the financial system through high quality regulation, purposeful engagement, effective gatekeeping, assertive supervision and robust enforcement. Consumer protection is therefore embedded in every key area of the Central Bank's work.

For instance, the macroprudential mortgage measures are designed to both enhance the resilience of the financial system and protect borrowers from over-indebtedness. Our work on mortgage arrears has also involved considerable collaboration and coordination across all parts of the Bank and has been central to our analysis of non-performing loans (NPLs).

Furthermore, the work of prudential supervision in driving the resilience of individual firms is critical in ensuring that consumers can trust that deposits are safe, investments are protected and insurance policies will pay out when a claim is due. In addition, prudential and conduct supervisors have a shared interest in: business model sustainability; governance, risk management and control arrangements; and the culture of regulated firms.

Our new strategic plan builds on our extensive existing consumer protection framework and reinforces our strategic focus on the conduct of firms. This is essential, given the wide range of financial misconduct scandals internationally and domestically, including the Tracker Mortgage scandal. It is also reflected in the evolution of our supervisory approach in recent years to strengthen its focus on conduct and cultural issues.

The supervisory phase of the Tracker Mortgage Examination is now in the final stages. As of end-February 2019, lenders have identified nearly 40,000 customers who suffered unacceptable harm from tracker mortgages-related failures. This overall number is unchanged since our last update based on date at the end of December. Total redress and compensation paid has increased by €18 million since the end of December to €665 million now. By the end of this month, we expect the number of customer accounts awaiting redress to be down to about three hundred, which will be mostly paid in April.

In finalising our supervisory work, our focus at all times is to ensure that all affected groups of customers have been identified and remediated. This work has now been completed at the majority of lenders. In the case of the remaining lenders, we are working to ensure that these have addressed satisfactorily any remaining issues affecting groups of customers and all eligible groups of customers have been included for redress and compensation. We expect this work to conclude in the coming weeks, with a final report published thereafter. While the “project” phase of our supervisory work is nearing completion, any further individuals or groups that are identified will receive the same treatment under our standard supervisory approach.

Finally, our enforcement work is ongoing. These investigations are detailed and forensic, involving the scrutiny of thousands of documents and the conduct of interviews to establish the exact circumstances of matters under investigation, including the actions of regulated entities and individuals.

While we have a strong suite of existing powers, the findings of our Report into the Behaviour and Culture of the Irish Retail Banks last year set out additional reforms that include the proposed introduction of a new Individual Accountability Framework. This would ensure clearer lines of accountability within firms, as well as providing for an enhanced Fitness and Probity Regime and a unified enforcement process. I appreciate the Committee is holding separate hearings on these recommendations.

Looking at the PCP market, staff from the Central Bank published an overview in an Economic Letter last year. Data to the end of June 2018 show 69,668 outstanding PCP contracts (with a total value of €1,243 million) provided by banks. As part of the Central Bank’s Central Credit Register (CCR) remit, from 30 June 2019, the CCR will collect information on personal contract plans from all lenders that provide loans.

We are working on additional measures to strengthen consumer protection in the Licensed Moneylending sector. In 2018, we published the ‘Review of the Consumer Protection Code for Licensed Moneylenders Consultation Paper CP 118’, which proposed adding certain consumer protection measures to this Code in order to raise the standard of consumer protection, while recognising the specific nature of the sector. We plan to introduce regulations to replace the current Moneylending Code in the second half of 2019. In developing these additional measures, we recognise the vulnerability of the households that typically engage with Licensed Moneylenders and the high cost of moneylending loans.

## Resilience – Capital Requirements, Interest Rates and NPLs

A core element of our strategic plan is to ensure that the financial system is resilient, so that it can withstand future shocks and protect the wider economy from financial instability. The first set of issues you invited me to address – capital requirements, interest rates and NPLs – can all be captured under this objective.

In terms of capital, the domestic banking system is far more resilient than in the past.

- Its capital position (relative to risk-weighted assets) has improved almost threefold relative to 2007.
- Reliance on short-term wholesale funding from international capital markets has declined. The domestic banking system is now primarily funded by domestic customer deposits.

- Funding costs have declined and remain contained, despite recent market volatility.

The Central Bank has also introduced a range of macroprudential measures that aim to build resilience in the system. As mentioned above, these include the mortgage measures designed to enhance both bank and borrower resilience and mitigate the risks of credit-house price spirals emerging. The countercyclical capital buffer (CCyB) – set at one percent with effect from July 2019 – is a time-varying capital requirement designed to make the banking system more resilient and less pro-cyclical by requiring firms to hold more capital at the appropriate time so they are prepared for a downturn. Finally, the Other Systemically Important Institutions (O-SII) buffer looks to build additional resilience for institutions whose failure would have a systemic impact on the economy and the financial system.

In considering prevailing mortgage rates, a number of factors need to be taken into account. These include:

- historical default rates and the levels of NPLs in Irish residential mortgage portfolios;
- mortgages in Ireland continue to be issued at relatively high loan-to-value ratios, when compared to levels within other jurisdictions;
- the small scale of the Irish market means that the cost base is higher, in view of the increasing importance of fixed costs in banking (including the cost of IT systems);
- lower levels of mortgage switching in Ireland than that observed in many other European markets; and
- the limited number of banks reduces competitive pressures on pricing margins.

Addressing NPLs in a sustainable way that provides strong protections for borrowers remains a priority. This is essential in ensuring the resilience of the banking system and borrowers alike, since elevated levels of NPLs compromise the capacity of both lenders and debtors to weather future downturns. The Central Bank, as the National Competent Authority and as part of the Single Supervisory Mechanism (SSM), continues to require banks to reduce NPLs in a sustainable way. The stock of NPLs held by the retail banks has declined by €67.2bn (c.79 percent) since the 2013 peak.

Multiple tools have been used to enable this reduction, including: re-engaging with borrowers; restructures; accounting write downs; engaging through the Insolvency Service; loan sales; loan securitisations; and seeking resolution through the courts.

The approach taken by the Central Bank and other parts of the State consumer protection framework has ensured that the reduction in the level of non-performing mortgages has been primarily achieved through the restructuring of loans. The Code of Conduct on Mortgage Arrears (CCMA) has played a critical role in ensuring that borrowers are protected. The CCMA, and within it, the Mortgage Arrears Resolution Process, require that repossession be used only as a last resort. The number of mortgage accounts for principal dwelling houses (PDHs) in arrears over 90 days continued to decline in Q4 2018, marking the twenty-first consecutive quarter of a fall in the number of accounts in this category. The number of PDH mortgage accounts that were classified as restructured at end-December was 111,504. Of these restructured accounts, 87 per cent were deemed to be meeting the terms of their current restructure arrangement, the same as last quarter.

Nonetheless, secured property lending does require that the underlying property can be re-possessed as a last resort. The extensive protections that are in place for distressed borrowers do not preclude loss of ownership – although the CCMA and related protections has meant that repossessions in Ireland are relatively low in an international context. In 2018, 877 primary dwelling properties have been repossessed: one third as a result of court actions and the remainder through the sale or surrender of the property.

We are acutely conscious of the vulnerabilities of those borrowers at risk of losing their homes and maintain the focus of our supervisory work on ensuring all lenders adhere to the CCMA. Furthermore, we continue to urge all borrowers and lenders to engage and seek solutions that minimise loss of ownership.

Notwithstanding the extensive use of forbearance and restructuring, other tools also have a role to play. In particular, the sale of loan portfolios to non-bank investment funds reduces the risk of financial instability in the event of a future downturn, since the risk is spread more widely across the financial system. In terms of national risk management, the transfer of credit risk and funding risk to investment funds that buy loan portfolios constitutes a national reduction in macro-financial risk, given that investors in these funds are primarily overseas.

Critically, the sale of such portfolios does not affect statutory consumer safeguards – the strong legislative framework ensures that borrowers benefit from the same consumer protections regardless of whether their loan is held by a bank or a non-bank.

Our twin focus on resilience and consumer protection explains why we have grave concerns about the “No Consent, No Sale” bill. Given that the consumer protection framework is identical whether a loan is held by a bank or a non-bank, the bill would not add any extra degree of regulatory protection for consumers. At the same time, it would severely damage resilience, since the transferability of loans is a central feature in a modern financial system. In addition to its impact on loan sales, the bill would limit the ability of banks to securitise loans or provide collateral to obtain liquidity from the inter-bank market or from the eurosystem.

While these restrictions would be costly even under normal conditions and thereby raise the interest rates charged to households, their impact would be especially de-stabilising in a crisis environment, since the ability to restructure balance sheets and tap liquidity is essential to resilience under crisis conditions. While the bill makes an exception for a “failing or likely to fail” (FOLTF) firm, such a designation is only made once a crisis is well advanced, whereas financial stability is best maintained by ensuring that resilience-enhancing measures can be taken in a timely manner, with the strengthening of balance sheets during good times allowing the economy and the financial system to better withstand adverse economic and financial conditions.

Building resilience is also critical for the credit union sector. The Central Bank recognises the important role played by credit unions in Ireland. Our vision of “Strong Credit Unions in Safe Hands” underpins our statutory mandate to ensure each credit union protects the funds of its members and the maintenance of the financial stability and well-being of credit unions generally.

Our recent report on financial conditions in the credit union sector that was published in December 2018 highlighted strong reserves, sustained lending growth and a continued reduction in arrears. However, financial challenges remain for the sector and individual credit unions in terms of low loan to asset ratio (average c.28 percent), high cost income ratio (average c.74 percent) and low return on assets (average 1.0 percent). As the Registrar recently highlighted, it is not the regulatory framework that inhibits future business model development. Credit union challenges are commercial in nature. Overcoming these challenges on a sustainable basis will involve credit unions enhancing their competence and capability, addressing operational effectiveness and expanding revenue through loan growth and non-interest income.

Credit unions benefit from a tailored and proportionate regulatory framework. With a loan to asset ratio across the sector ranging from 11 percent to 73 percent today under the same lending framework, some credit unions are faring better than others at meeting member lending needs. Additional lending capacity is currently being considered under an ongoing consultation on ‘Potential Changes to the Lending Framework (CP125). This additional capacity would facilitate further longer term lending on a prudent basis by credit unions while appropriately managing duration and concentration risks. It is clear therefore that credit unions have the required flexibility to evolve their future business models.

## Brexit preparations and the economic impact of Brexit on the Irish economy

Finally, let me turn to Brexit. As is well understood by all here, any form of Brexit will be damaging for Ireland, with a hard Brexit especially so. Recognising these risks, the Central Bank has been focused on Brexit risks since before the 2016 UK referendum. We continue to analyse and work to mitigate the risks posed to the economy, consumers, the financial system, and the regulatory environment.

We have taken a transparent approach to this work, recognising the importance of and interest in it. For the wider economy, the effects will be uneven, with indigenous sectors (such as agri-food) facing heightened risks of disruption to exports and supply chains.

In recent months, we have stepped up our work on mitigating the most material 'cliff-edge' risks of a hard Brexit. From a financial regulation perspective, our work has sought to ensure that:

- the financial system is sufficiently resilient for a hard Brexit not to cause significant financial stability risks;
- risks to consumers are mitigated to the greatest extent possible; and
- we are delivering a proportionate, robust, efficient and effective authorisation process in line with European regulatory norms, for those firms seeking authorisation in Ireland as a result of Brexit.

The Central Bank – in conjunction with the wider European regulatory community and, in relation to required legislative amendments, the Department of Finance – has worked to ensure that the financial system is prepared for all Brexit scenarios. While a no-deal Brexit would constitute a severe economic and financial blow, our work to improve resilience over the last decade, including in driving the material reduction in NPLs, means that the shock should not be amplified by fragility in the financial system. We also continue to be busy in authorising and supervising new firms and new lines of activity.

I welcome your questions.