Central Bank of Ireland's Strategic Plan 2019-2021

Social Justice Ireland

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Introduction

Social Justice Ireland is an independent think tank and justice advocacy organisation that advances the lives of people and communities through providing independent social analysis and effective policy development to create a sustainable future for every member of society and for societies as a whole. We welcome the opportunity to respond to the Central Bank of Ireland's call for submissions in respect of the development of its Strategic Plan for 2019-2021.

This submission follows the format of the submission questions contained in the consultation document. *Social Justice Ireland* is available to the Central Bank to expand or elaborate on any area within.

Submission Questions

1. What should be considered by the Central Bank in responding to the current and emerging risks in the economy and the wider financial system?

Ireland is emerging from a financial crisis, brought about by systemic failures in the regulatory and financial sectors. This crisis resulted in unprecedented levels of poverty and deprivation, unemployment and personal debt arrears. Record Government debt levels, and the implementation of the European System of Accounts at European level and the Stability and Growth Pact in Ireland constricted Ireland's capacity to develop infrastructure projects and provide essential services such as housing, healthcare, education and broadband. Many households and consumers generally who did not benefit from the boom, were disproportionately adversely affected by the measures taken during the bust. It is important, at a time when the Central Bank is reporting higher levels of household wealth now than before the crash, that a measured approach is taken to regulation in the financial sector which balances the necessity of prudence with the practicalities of a functioning system which caters for all income deciles. Those who cannot access mainstream credit because of excessively-stringent regulation will be driven to high-cost alternatives.

At a macro level, globalisation, while creating investment opportunities on an international scale, risks destabilising the domestic economy at a time when we need to secure investment in essential infrastructure. In a speech delivered by Ms Sirkka Hämäläinen, Member of the Executive Board of the European Central Bank, at the Symposium on Risk Management in the Global Economy: Measurement, Management and Macroeconomic Implications, Chicago, in 2000, she argued against domestic monetary policies being co-ordinated at international level and instead called for ensuring domestic stability.

The most recent Brexit Task Force report published by the Central Bank indicates that Brexit effects for the banking sector have been benign with 'no material impact reported on funding/liquidity or credit quality'[1]. However, while this may be the case, there will be an obvious impact for those whose livelihoods are largely dependent on trade with our nearest neighbour, and the challenge for the Central Bank and those institutions under its remit to balance prudential regulation with the flexibility required to sustain enterprises within this economy.

[1] https://centralbank.ie/docs/default-source/publications/brexit-working-group-reports/brexit-task-force-report-march-2018.pdf?sfvrsn=4

2. What should the Central Bank focus on in terms of the regulation of firms and markets?

Regulation in Ireland has been lacking for decades, primarily because of this lack of independence, where 'regulators' were used as an instrument of the State to effect Government policies at the time, rather than to regulate their respective sectors and ensure accountability from participant entities. The area most associated with 'light touch' regulatory policy in Ireland is the financial sector, with thousands of families continuing to feel the effects of the economic crash, but this issue is not confined to that sector alone.

Reactionary regulation, introduced after a crisis, can also serve to further exclude those who it should serve to protect, by placing barriers to goods and services in the way of those without the resources to engage with increasing bureaucracy. *Social Justice Ireland* believes that regulation has a place in protecting the rights of vulnerable people by addressing the balance of power when engaging with corporations, but not be so involved as to create a barrier rather than a safety net. Financial regulation, particularly in the mortgage arena, plays a key part in our economy – the availability of credit impacts on housing price inflation, which in turn impacts our ability to attract investment and build industry. As stated by Deputy Governor Ed Sibley in his remarks to the Institute of Banking[2], "A functioning market should deliver a sufficient supply of appropriately priced mortgages to support house prices that are in line with the fundamentals of the economy, without driving credit fuelled house price bubbles".

Social Justice Ireland believes that regulation should have consumer protection at its centre rather than the aim of increasing market participation. Before engaging in any new regulatory processes, the Central Bank should consider not only competitiveness from an economic standpoint, but also the impact of regulatory policies on the consumer and small and medium enterprises.

3. What should be considered by the Central Bank in respect of its financial conduct and consumer protection role?

Mortgage Arrears - Non-Performing Loans

Late stage mortgage arrears remain a problem in Ireland. In Q4 2017 the number of private dwelling house (PDH) loans in arrears was 70,488, a reduction of just over 50 per cent from the peak of 142,892 in Q2 2013. However, while the number of mortgages in arrears has almost halved, the monetary value of those arrears **increased by 36.5 per cent**, from just over €2 billion to €2.76 billion between Q2 2013 and Q3 2017, before reducing slightly to €2.5 billion. Research published in April by the Central Bank indicated that 44 per cent of mortgages in late stage mortgage arrears, some 13,000 households, are now more than five years in arrears. This equates to approximately 35,000 people[3]. It is likely that possession proceedings will have issued in respect of most of these cases; however there is no defined point at which both borrower and lender are assured of a resolution.

Non-Performing Loans (NPLs) have a significant impact on Ireland's economic stability, creating uncertainty in the housing market and difficulties for those households living under threat of repossession or eviction, or the possibility of having their mortgage sold to an unregulated fund. In her speech at the Peterson Institute for International Economics, Deputy Governor Sharon Donnery

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[2] https://www.centralbank.ie/news/article/irish-mortgage-market-2018-and-beyond-ed-sibley

[3] Based on Census 2016 household formation data

spoke of how NPLs can constrain both credit growth and economic activity[4]. According to a letter from the Central Bank to Deputy Michael McGrath[5] in March 2018, NPLs can affect the credit supply chain by raising the funding costs of banks and calling into question their underlying capital positions.

In its Country Specific Recommendations for Ireland, published in May 2018, the European Commission included a recommendation to 'promote faster and durable reductions in long-term arrears, building on initiatives for vulnerable households and encouraging write-offs of non-recoverable processes'[6]. The issue of non-performing loans (NPLs) has received a considerable amount of media and political attention in recent months with the announcement by two pillar banks of their intention to sell more than 20,000 mortgages to unregulated 'vulture' funds in order to reduce the number of NPLs in line with EU targets. These sales were opposed by numerous groups on the basis that families in late stage mortgage arrears, or who are tenants of landlords in late stage mortgage arrears, will be evicted by funds looking for a short-term gain on their original investment. While some protections are afforded to these households pursuant to the contractual obligations of the original lenders and the provisions of the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015, these policy instruments do not go far enough in terms of consumer protection and a more comprehensive consumer protection strategy is required under the auspices of the Central Bank, in partnership with Government to address the two significant issues, namely:

i) funds that do not engage credit servicing firms regulated in Ireland to manage their loan portfolios will not be compelled to engage with any consumer protection processes; and
ii) the current Code of Conduct on Mortgage Arrears is not fit for purpose, being as it is a set of guidelines to be complied with at the discretion of individual lenders. This is particularly evident in provision 39, the 'Resolution' provision, which provides that lenders must 'explore all of the options for alternative repayment arrangements **offered by that lender**' (emphasis added). Accordingly, if the fund, via the credit servicing firm, offers no more than lump sum settlements, out of reach of most borrowers in late stage mortgage arrears who cannot access alternative sources of affordable finance, they have complied with that provision of the Code.

Pressure from European regulators to reduce the rate of NPLs by 2021 by over half its current rate has been cited by one lender who proposed selling over 18,000 loans, 14,000 of which were home loans. While the European Central Bank has stated that this was not the only way NPLs could be reduced, it is the quickest way to reduce a lender's NPL ratio rather than working with individual borrowers, in voluntary or statutory processes, to come to an affordable, sustainable arrangement.

Social Justice Ireland believes that the Central Bank should incentivise lenders who reduce their NPLs in a sustainable way that is not only good for the balance sheet, but benefits society as a whole, making use of write-down provisions to 'right-size' loans in circumstances where a sustainable payment by the borrower resulting in a higher return for the lender, albeit within a longer period.

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[4] https://centralbank.ie/news/article/address-by-deputy-governor-sharon-donnery-at-the-peterson-institute-for-international-economics

[5] https://www.centralbank.ie/docs/default-source/publications/correspondence/oireachtas-correspondence/correspondence-with-deputy-michael-mcgrath-re-non-performing-loans-published-12-march-2018.pdf?sfvrsn=4

[6] https://ec.europa.eu/info/sites/info/files/file_import/2018-european-semester-country-specific-recommendation-commission-recommendation-ireland-en.pdf

Mortgage Arrears - Enhance the Code of Conduct on Mortgage Arrears

The latest iteration of the Code of Conduct on Mortgage Arrears (CCMA) was published in 2013. This version stripped out many of the consumer protections contained in its predecessor, including a reduction in the protection of tracker mortgages, a narrowing of the definition of "not co-operating" and a reduction in the moratorium on legal action to 8 months from the date the arrears first arose or 2 months from the date the borrower was deemed by the lender to be "not co-operating". Provision 36 mentioned earlier in this submission, which allows for lenders to choose which forbearance measures to offer, limits the ability of mortgage holders in distress to address their mortgage arrears issues in line with their resources.

A review of the CCMA is urgently required, which extends the range of consumer protections, compels lenders to offer a suite of long-term, sustainable solutions, and applies not only to main lenders, but explicitly includes their agents, credit servicing firms and funds, which while owning only 2 per cent of mortgages, account for 12 per cent of mortgages in arrears over 90 days and 15 per cent of those in arrears more than 520 days. Placing the CCMA on a statutory footing would also greatly enhance the protections for borrowers facing repossession proceedings as it would act as a 'pre-legal protocol, ensuring all mortgage lenders comply with each stage of the Mortgage Arrears Resolution Process, that the definition of 'not co-operating' was universally applied in a standardised way, and ensuring that repossession proceedings are only brought as a last resort, which would also reduce the length of court proceedings and give assurance to lenders that they could effectively enforce their security in genuine 'won't pay' cases[7]. In addition, *Social Justice Ireland* urges the Central Bank to introduce a licensing system for currently unregulated funds purchasing mortgage loan books to develop a domestic regulatory regime and safeguard consumer protection.

Financial Services and Unsecured Debt – Enhancing the Consumer Protection Code

Improvements made to the Consumer Protection Code (CPC), and in particular the expansion of the definition of 'vulnerable consumer', however in recognition of the psycho-social causes and effects of financial difficulties, *Social Justice Ireland* proposes to the Central Bank to review the CPC to include financial vulnerability within this definition.

While the CPC regulates the provision of information to consumers by financial institutions, it is clear from research conducted by the Central Bank that there is a lack of understanding in areas such as the payment of commission[8] and certain types of insurance[9].

In line with our proposals above that the CCMA be placed on a statutory footing, we further propose that the provisions of the CPC be included in a statutory instrument, with sanctions imposed for non-compliance and an adequate right of recourse to the courts for borrowers who can prove damage as a result of negligent lending practices. This is particularly important in the context of arrears on non-mortgage consumer debt, which places additional strain on households struggling to provide for essentials such as food and utilities and accommodation costs. In this regard, *Social Justice Ireland* proposes the adoption of the principles contained in the BPFI / MABS Operational Protocol[10] into any

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[7] In 2017, the Central Bank published research which suggested that 9,680 mortgages associated with over 8,000 unique properties were in the deepest state of arrears and had no engagement with their lender. https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/10rt17---resolving-a-non-performing-loan-crisis-the-ongoing-case-of-the-irish-mortgage-market.pdf

[8] https://centralbank.ie/docs/default-source/publications/consumer-protection-research/consumer-understanding-of-commission-payments---november-2017.pdf?sfvrsn=4

[9] https://centralbank.ie/docs/default-source/publications/consumer-protection-research/consumer-experience-of-purchasing-gadget-insurance---december-2017.pdf?sfvrsn=6

[10] https://www.mabs.ie/downloads/news_press/BPFI_MABS_protocol_2014.pdf

revision of the CPC to ensure the protection of an adequate standard of living for those experiencing repayment difficulties in respect of unsecured debts.

Financial Exclusion

Gloukoviezoff defines the process of financial exclusion as "the process whereby people face such financial difficulties of access or use that they cannot lead a normal life in the society to which they belong"[11]. In their 2011 study, the ESRI[12] found that Ireland had the highest instance of banking exclusion among the EU15 States and that those who are economically and socially disadvantaged, and those on low incomes, are at most risk of financial exclusion.

Access to financial services, particularly in today's increasingly cashless society, is key to inclusion in society generally. Kempson and Collard[13] found that those on low incomes are often restricted from accessing mainstream credit, turning instead to subprime and high-cost credit alternatives. The report found that there was a significantly higher instance of over-indebtedness among households with gross annual incomes of under £10,000 (23 per cent) than among households of more than £35,000 (5 per cent). The result of this financial exclusion[14] is that over-indebted and low-income consumers are excluded from banking services on the basis of charges and conditions attaching; affordable credit on the basis of conditions attaching and difficulty of the application process; and insurance costs, as low-income consumers are more likely to live in disadvantaged areas, incurring a higher premium.

In 2015, 6.3 per cent of households (107,244) did not have a current account, 8.2 per cent of households (139,588) did not have an ATM card and 45.5 per cent of households (774,541) did not have a credit card[15]. With financial services becoming increasingly digitised and a move towards online and automated telephone banking, cash has become an outdated method of payment. Many essential services now require consumers to set up direct debits, or offer discounted rates to those who do, amounting to a 'poverty tax' for the financially excluded, paying premium rates and surcharges for use of other payment mechanisms for essential utilities[16].

In 2016, the EU Payment Accounts Directive was transcribed into Irish law, requiring banks to offer a basic payment account to financially excluded consumers who met basic criteria. While, in principle, this has happened and banks are ostensibly offering products in line with the requirements of the directive, in practice, internal lender policies on what constitutes identification documentation has meant that those without 'standard' identification (for example, a passport or driving licence, utility bills, Revenue statement) are unable to access this account contrary to the Guidelines on the Criminal Justice (Money Laundering and Terrorist Financing) Act, 2010 under which those policies are purportedly enacted. These Guidelines state:

> People who cannot reasonably be expected to produce conventional evidence should not be unreasonably denied access to Services – where people are not in a position to provide 'standard documentation' banks should refer to the list of documents and information

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[11] Gloukoviezoff, G, (2011) Understanding and Combating Financial Exclusion in Ireland: A European Perspective. What could Ireland learn from Belgium, France and the United Kingdom? Dublin: The Policy Institute, TCD.

[12] Russell, H., MaÎtre, B. and Donnelly, N. (2011) Financial Exclusion and Over-indebtedness in Irish Households. Dublin: ESRI.

[13] Kempson, E. and Collard, S. (2012) Developing a vision for financial inclusion. Bristol: University of Bristol

[14] Corr, C. (2006) Financial Exclusion in Ireland: An exploratory study and policy review. Dublin: Combat Poverty Agency

[15] Central Statistics Office,

[16] Stamp,S., McMahon, A. and McLoughlin C: Left Behind in the Cold? Fuel Poverty, Money Management & Financial Difficulty Among Dublin 10 & 20 MABS Clients 2013 and 2017

requirements in AML Appendix 2, and not cite the requirements of the Act as an excuse for not providing services without giving proper consideration to the evidence available.

Financial exclusion is not just about access to bank accounts, but access to reasonable, affordable credit that takes account of the financial position of the consumer while cognisant of the need for people on low incomes to meet contingency expenditures without resorting to high cost credit or 'pay day loans'. The 'It Makes Sense' loan scheme introduced in 2016 and operated through participating credit unions is therefore a welcome addition to the financial products market. This allows a member of a participating credit union to access a moderate loan, of between €100 and €2,000, with payments deducted at source from their social welfare payments via the Household Budget Scheme. Not all credit unions provide this loan, with some citing regulatory and macroprudential lending issues and others providing a similar product to existing customers. The It Makes Sense loan is an inter-Departmental initiative and, as such, should be subject to monitoring and review, focused on consumer protection and financial inclusion. We suggest that the Central Bank, in its role as regulator of credit unions and within its consumer protection remit, would be best place to conduct this monitoring and review function.

There is a dearth of up to date data on the extent of financial exclusion in Ireland. For those experiencing it, it means more than lack of an ATM card, it can mean exclusion from essential services such as utilities and a 'poverty tax' for use of alternative methods of payment. Cashless transactions are becoming the norm and those who cannot engage are and will continue to be left behind. In light of the severity of its impact, *Social Justice Ireland* calls on the Central Bank to track levels of financial exclusion and to build and monitor policies and practices aimed at eliminating it in its entirety by 2020.

Financial Inclusion - Expanding the Central Credit Register

In 2017 the Central Bank began collecting personal and financial data for inclusion in its Central Credit Register (CCR). The implementation of this register, intended to replace the Irish Credit Bureau register, was phased between 2017-2019 to collect data on personal loans from mainstream lenders, business loans and moneylender loans. The parameters for data gathering are such that those who access small amounts (less than €500) will not be recorded. It is therefore possible that credit providers can make a series of smaller loans which would not be registered.

Another anomaly within the CCR is the lack of any reporting in respect of insolvency arrangements. While the Insolvency Service of Ireland (ISI) holds registers of all protective certificates and insolvency arrangements in place, this would provide ease for creditors in making determinations on credit applications.

Finally, *Social Justice Ireland* proposes the expansion of the CCR to include all household debt, in line with practice in the UK, which records both a positive and negative payment history, including utility payments, rents to local authorities and non-bank debts, would allow consumers to build a credit history, enabling them to move from high-cost credit to mainstream and low-cost alternatives, while at the same time providing all the detail needed by prospective lenders to make informed underwriting decisions.

Conclusion and Recommendations

Social Justice Ireland urges the Central Bank to balance fiscal probity with consumer protection in the context of its next strategic plan. To this end we make a series of recommendations:

1. Balance prudential regulation with the flexibility required to sustain enterprises within this economy in the context of Brexit.

2. Keep consumer protection at the core of new regulation. Before engaging in any new regulatory processes, the Central Bank should consider not only competitiveness from an economic standpoint, but also the impact of regulatory policies on the consumer and small and medium enterprises.
3. Provide incentives to lenders who reduce their NPLs in a sustainable way that is not only good for the balance sheet, but benefits society as a whole, making use of write-down provisions to ‘right-size’ loans in circumstances where a sustainable payment by the borrower resulting in a higher return for the lender, albeit within a longer period.
4. Review the CCMA to increase the consumer protections to at least 2011 levels and place it on a statutory footing.
5. Introduce a licensing system for currently unregulated funds purchasing mortgage loan books to develop a domestic regulatory regime and safeguard consumer protection.
6. Review the CPC to include financial vulnerability within the definition of ‘vulnerable consumer’.
7. Place the CPC on a statutory footing, with sanctions imposed for non-compliance and an adequate right of recourse to the courts for borrowers who can prove damage as a result of negligent lending practices.
8. Adopt the principles contained in the BPFI / MABS Operational Protocol into any revision of the CPC to ensure the protection of an adequate standard of living for those experiencing repayment difficulties in respect of unsecured debts.
9. Track levels of financial exclusion and build and monitor policies and practices aimed at eliminating it in its entirety by 2020.
10. Expand the Central Credit Register to include all household debt, in line with practice in the UK, which records both a positive and negative payment history; including utility payments, rents to local authorities and non-bank debts, would allow consumers to build a credit history, enabling them to move from high-cost credit to mainstream and low-cost alternatives, while at the same time providing all the detail needed by prospective lenders to make informed underwriting decisions.

Social Justice Ireland is an independent think-tank and justice advocacy organisation of individuals and groups throughout Ireland who are committed to working to build a just society where human rights are respected, human dignity is protected, human development is facilitated and the environment is respected and protected.

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