

IMAF

*Proactively dealing with the
Personal, Social and Economic Crisis of
Mortgage Debt*

October 2011

Executive Summary

“The last big decision you’ve got is what are you gonna do about the mortgage deal. The quicker you flush that out, the quicker you’re going to generate small business and domestic demand and growth”

Bill Clinton – 2nd Global Irish Economic Forum- 7/10/11

The Independent Mortgage Advisors Federation (IMAF) strongly believe every resident in Ireland should have the right to remain in their family home.

Today in Ireland, many of our homeowner’s are suffering from significant financial distress. While, the recent financial crisis has focussed the attention of the Government, Regulators and lenders on the need to be understanding and sympathetic when dealing with borrowers facing mortgage repayment difficulties, a lot more needs to be done.

At the time of writing, some 86,000 mortgage accounts are either in arrears greater than 90 days or have been restructured and are still in arrears. This represents some 11% of mortgages in existence.

There are many divergent views on how to respond to this problem, however it should be recognised that many borrowers are encountering difficulties through no fault of their own, often as a result of reduced income and/or loss of employment.

However, it is not just financial stress. The impact of this crisis is very far reaching and will leave a permanent mark on society. Borrowers in distress are suffering both mentally and physically. Worryingly, suicide rates are at the highest levels ever recorded in this country.

The Director of the National Office of Suicide Prevention stated in his 2009 annual report:

“These figures are extremely worrying. The impact of the economic downturn in 2008 and particularly in 2009 has led to substantial increases in both self harm and suicide numbers. It seems likely that the increase is primarily a result of the impact of the economic downturn with substantially more people unemployed and suffering from personal debt”.

In dealing with this crisis, all stakeholders must recognise that these are very real people, trying to cope with very difficult circumstances, often not of their own making.

Recent figures from the Department of Social Protection, showed that 66% of all claims for Disability Benefit were related to stress and anxiety. The experts in the field claim that 66% of these claims relate to stress/anxiety associated to financial worries.

IMAF, as the representative body of independent financial advisers who specialise in the provision of mortgage advice, is committed to securing lasting improvements in lenders’ arrears handling capabilities and processes thereby ensuring mortgage arrears customers receive both good advice and a fair outcome.

We commissioned this report to ensure that lenders would at all times:

- Systematically provide forbearance and support in a humane manner.
- Act in the best interest of customers experiencing financial difficulty.

Our own members experience is that where support is provided:

- *With due care*, it has a beneficial impact for both the lender and the borrower in that it can reduce repossessions and lower realised losses.
- *Without due care or any knowledge or understanding of the impacts*, it has potentially adverse implications for borrowers who are already under considerable stress.

Our objective in commissioning this report is to ensure that:

- Customer's are not placed in a worse position than they would have been otherwise.
- Lenders work with mortgage customers and their advisors to bring the mortgage back into *sustainable terms* within a reasonable timeframe.
- Measures implemented are fair and transparent.

While there has been much debate and rhetoric, the time has come for meaningful action. All stakeholders must commit and undertake the necessary steps to protect the many vulnerable households in Ireland.

IMAF has consulted widely and has developed the following action plan for discussion with all stakeholders.

- 1. Ensure all lenders provide flexibility and forbearance measures.**
- 2. Ensure transparency of forbearance arrangements.**
- 3. Provide greater clarity on outcomes for borrowers under CCMA.**
- 4. Ensure mortgage arrears are dealt with by approved Persons.**
- 5. Ensure access to independent mortgage advice.**
- 6. Name and shame lenders for Non-Compliance with CCMA.**
- 7. Apply enforcement restrictions to all lenders.**
- 8. Implement Deferred Interest Scheme and test effectiveness.**
- 9. Warehouse unsustainable element of mortgage.**
- 10. Implement recommendations of Expert Group on Mortgage Interest Supplement (MIS).**
- 11. Provide clarity on position regarding Non-Sustainable Mortgages.**
- 12. Bottom-out Moral Hazard and Debt Forgiveness Debate.**
- 13. Provide a cohesive policy for Social Housing Support.**
- 14. Reform Personal Insolvency & Bankruptcy Laws.**
- 15. Facilitate one-off access to Pension Funds.**
- 16. Incentivise borrowers to switch their Tracker Mortgage to a Long Term Fixed Rate.**
- 17. Government to articulate and commit to a longer-term strategy to support vulnerable homeowners.**

The proposals listed above should form a menu from which solutions can be found to help all people experiencing mortgage debt.

In summary, IMAF believes the implementation of the above initiatives will benefit mortgage customers experiencing difficulties, the lenders and society as a whole.

However, these measures must be adopted and implemented with a real sense of urgency to arrest the continuing acceleration of mortgage arrears and the potential for significant repossessions.

Section 1: Introduction

The future path of Irish house prices is of significant interest from a number of perspectives.

While many countries experienced a significant house price boom over the past 10-15 years, the increases in Irish prices were the largest across OECD countries. Correspondingly, the decline in Irish house prices since 2007 is now one of the most protracted and sizeable internationally.

Critically, a relatively large portion of the total stock of Irish mortgages was issued when house prices were considerably overvalued and when the general public was well placed to service the resulting high mortgages.

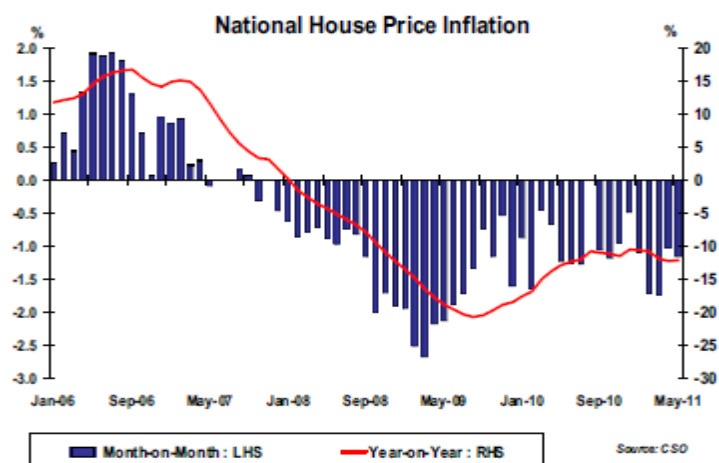
This rapid turnaround in house prices over a relatively short period of time, coupled with the significant volume of mortgages taken out by a young population during a period of heightened price levels, raises a number of worrying macroeconomic issues.

Sharp fall in Irish House Prices

Since they reached a peak in early 2007, Irish house prices have fallen by 50%. When combined with other data such as falls in household disposable income, the burden of mortgage repayments within Irish society is very onerous. This suggests that many more Irish households are or will soon be experiencing difficulties with their mortgage repayments and that the arrears data is lagging behind the reality.

The CSO Residential Property Price Index August 2011 data indicates that house prices in Dublin are almost 48% lower than at their highest level in early 2007. According to the CSO, apartments in Dublin are 57% lower than they were in February 2007.

The CSO data indicates that the fall in the price of residential properties in the Rest of Ireland is somewhat lower at 40%. Overall, the national index is 43% lower than its highest level in 2007.



The Daft property index reports an acceleration of the decline in asking prices in the three months to June suggesting a further fall in house prices in the coming months.

Under the *Prudential Capital Assessment Review*, BlackRock Solutions have modelled that house prices will fall by some 55% in their base case and by some 59% in a stressed scenario.

Based on experience elsewhere, actual prices could remain somewhat below what market fundamentals suggest they should be for quite some time.

Increased Mortgage Delinquency and Insolvency

The Irish economy has been particularly affected by the recent financial crisis. The culmination of continued uncertainty surrounding the financial system and the deteriorating state of the public finances resulted in Ireland seeking an IMF-EU fiscal support programme in November 2010.

One of the requirements of the programme was the need to bridge the significant exchequer deficit. A significant austerity programme was intensified in November 2010. The scale of the associated public expenditure cutbacks and taxation increases has inevitably raised the concern that these measures may exacerbate the situation amongst distressed mortgage owners.

The Central Bank of Ireland estimates that disposable income fell by 3.4 percent to 2010 with a further downward adjustment of 2.1 percent for 2011. Furthermore, the post-2007 global economic downturn has had a distinctly harsh impact on the Irish economy with unemployment rates, in particular, experiencing a swift increase from 4.5 per cent in mid-2006 to 14.3% currently.

Of particular note is that over the period 2004-2006, when house prices were at their peak, almost 340,000 mortgages were approved. This was in a period when the Irish economy was experiencing significant improvements in living standards and hence the general ability within the economy to sustain such mortgages was quite high. Clearly the situation is very different today.

Considerable financial stability concerns now exist over the growing levels of financial distress being experienced by Irish mortgage holders.

In looking at the problem, it is necessary to consider the combination of delinquency (heightened levels of mortgage distress leading to default) and insolvency (negative equity).

Delinquency in a loan contract typically arises when a borrower is unable to make a payment by a certain date because of liquidity failure. From the perspective of a household, the ratio of the actual mortgage repayments to the disposable income of the household (MRTI) can cause payment failure. The Central Bank of Ireland define this ratio as annual mortgage repayments (capital plus interest payments) as a share of annual household net disposable income for households.

Insolvency occurs when the value of the house is worth less than the outstanding mortgage. The household is, as a result, in negative equity. Clearly, from a credit default perspective, negative equity is a necessary but not a sufficient condition.

By the end of 2010, the Economic Social Research Institute (ESRI) estimated that almost 30% of mortgaged households in Ireland were in negative equity. The number of households in negative equity will have deteriorated further given the continued fall in house prices.

At the macro level, negative equity can also have a depressing effect on economic activity. Housing investment tends to be adversely affected in a period of falling house prices while negative equity can act as a drag on consumption since households that are in negative equity can be credit constrained and may also seek to increase their precautionary savings. Negative equity has also been shown to dampen household mobility.

Ireland is facing a protracted period of negative equity and critically, the Central Bank of Ireland believes there are good reasons for believing that incidences of mortgage repayment distress may be correlated with that of negative equity.

Furthermore, the Central Bank of Ireland believes that further house price and income falls could result in heightened financial distress among mortgaged households in Ireland and an increase in the number of households in negative equity. Arguably, the potential distressed nature of their residential mortgage book is the one of the greatest issues confronting lending institutions in Ireland today.

The Central Bank of Ireland has sought to address international market concerns over future residential mortgage losses through the recent Prudential Capital Assessment Review process.

Factors Used in Modelling and Forecasting Mortgage Arrears and Repossessions

The international financial crisis has had costly implications for many home-owners through a surge in mortgage repossessions and arrears, raising political concern and social distress in many countries.

In the UK, the National Housing and Planning Advice Unit (NHPAU) has worked to improve the Governments understanding of the drivers of mortgage arrears and repossessions.

Similar to the Central Bank of Ireland, NHPAU use a '**double trigger**' framework to estimate future levels of mortgage arrears and possessions i.e. a combination of two factors are required for a household to default on their mortgage:

1. a poor debt equity position (negative or little equity)
2. a problem making mortgage payments – possibly due to a loss of income in unemployment, an increase in mortgage costs due to rising interest rates, or being over-stretched in their finances

The '**double trigger**' framework requires that both elements are satisfied for a home to be repossessed, as:

- if the household is in negative (or has little) equity but is managing to make the mortgage payments, then it will not be in their interest to have their home repossessed because they will still be responsible for the balance that is not covered by the sale of the property.
- if the household has a problem paying the mortgage but has significant equity, they will have the option to sell up and downsize or change tenure (providing there are other suitable properties available).

The NHPAU have also developed a model to predict how arrears and repossessions move over a range of economic scenarios. Their model suggests that there are six key drivers:

- 1) **The debt service ratio** – a measure of how easy it is for households to pay their mortgages, defined as mortgage interest payments divided by disposable income.
- 2) The proportion of properties in **negative equity**.
- 3) **Unemployment** rate.
- 4) **Loan quality**.
- 5) **Government policy** – specifically the support for people who are having difficulties paying their mortgage, for example, Support for Mortgage Interest.
- 6) **Lenders' forbearance policy** – the response of lenders to borrowers who get into difficulty in paying their mortgage.

NHPAU key conclusions are:

- **Repossessions and arrears are both highly sensitive to the debt service ratio and interest rates.** In the short term, the debt service ratio moves in line with changes in interest rates.
- **Lenders' forbearance policies and more generous income support to those in difficulties with their mortgage appear to have had a notable effect in lowering repossessions.**
- **Modelling of a wide range of economic scenarios suggests that it is likely that repossession rates will rise in the next three to four years.** The combination of higher interest rates and weak growth in house prices in the short term will lead to a sharp rise in repossessions.

IMAF concurs with the HHPAU assessment in terms of the drivers of repossessions and their key conclusions.

Mortgage Arrears and Repossessions in Ireland

The impact of the recent economic crisis on households has been very considerable. A variety of issues have conspired to increase mortgage arrears and consequently repossessions.

We must not lose sight of the reality that borrower's identities are closely bound up with where they live. Being in arrears and facing the threat of repossession are distressing experiences.

Mortgage arrears and repossession levels are on an upward trend and will accelerate over the next few years.

At the end of June 2011 there were 777,321 private residential mortgage accounts held in the Republic of Ireland to a value of almost €115 billion.

- 55,763 or 7.2%, mortgage accounts in arrears for more than 90 days. This compares with 44,508 accounts (5.7% of total) at the end of December 2010.
- In value terms, €10.8 billion was owed in relation to all accounts more than 90 days in arrears.
- Of these there were 35,341 mortgage accounts, or 4.5% more than 180 days in arrears.
- In value terms, €8.0 billion was owed on accounts more than 180 days in arrears.
- In addition, 69,837 residential mortgage accounts were restructured of which 39,395 were performing as per the restructured arrangement.
- The balance of the restructured accounts (30,442), are in arrears for varying amounts (arrears both less than and greater than 90 days).
- As such, 86,205 accounts are either in arrears greater than 90 days or have been restructured and are in arrears as at the end of June 2011.

Particulars	Jun-11		
	Number	Balance '000	Arrears '000
Outstanding:			
Total residential mortgage loan accounts outstanding - at end of quarter	777,321	115,088,537	-
Arrears:			
Total mortgage arrears cases outstanding - at end of quarter <i>which are:</i>			
- In arrears 91 to 180 days	15,723	2,852,565	87,488
- In arrears over 180 days	40,040	7,985,161	859,877
Total arrears cases over 90 days outstanding	55,763	10,837,726	947,365
% of loan accounts in arrears for more than 90 days	7.2%	-	-
Repossessions:			
Residential properties in possession - at end of quarter	809	-	-
Restructured Mortgages:			
Total outstanding classified as restructured - at end of quarter	69,837	12,428,628	218,188
- which are not in arrears	39,395	6,655,099	

Source: Central Bank of Ireland

While repossession levels in Ireland remain substantially lower than those experienced in the UK, a recent report by the Irish Independent Newspapers highlighted that 361 new repossession actions were lodged in the first six months of 2011, compared to 229 for the same period last year, representing an increase of 60pc in a year.

As at the end of June 2011, there were 809 properties in possession. We believe this number will increase significantly in the next few years. Undoubtedly, the BlackRock assumptions model repossessions at levels never experienced in Ireland before.

Macroeconomic Scenarios and Implications for Mortgage Arrears in Ireland

As part of the Financial Measures Programme, the Central Bank of Ireland was required to set macroeconomic scenarios for the banks, within which the stress-testing exercise was to take place.

The Central Bank of Ireland prescribed a common baseline macroeconomic scenario and an adverse scenario broadly consistent with those being applied for the European Banking Authority (“EBA”) 2011 EU-wide stress test. The EBA prescribed macroeconomic and market variables were applied when performing forecasts.

The baseline was built off a December 2010 EU Commission forecast for Ireland with additional property price assumptions provided by the Central Bank of Ireland. These assumptions set out a continuation of subdued domestic demand and continued declines in both residential and commercial property prices over the time horizon.

- In the base case, economic growth takes place through an export-led recovery which, in turn, depends on a revival in economic growth in important trading partners within the EU and continued strong global demand generally.
- The adverse case assumes a decline in EU and global economic growth combined with a further weakening of domestic demand. This resulting overall effect is renewed economic contraction concentrated in 2011-2012 followed by a modest recovery.

The Central Bank of Ireland applied a scenario that projects a decline in both commercial and residential property prices in the base and the adverse case. The Central Bank of Ireland stresses that these are not forecasts of outcomes and that they represent two possible paths from a large range of future outcomes regarding property prices.

In this regard, there is a significant degree of uncertainty surrounding the range of possible future outcomes for the domestic property market. The Central Bank of Ireland attributes this to:

- Borrower and bank behaviour.
- Measurement problems in determining property price declines due the paucity of transactions.
- Continued unavailability of property price indices.
- Future demand for residential and commercial property.

The Central Bank of Ireland believes the actual macroeconomic outcome will be more favourable than the stress case, however, states that it is improbable that either the base or the stress scenario will prove to be accurate across the macroeconomic indicators given the uncertainties in the current climate.

IE – Ireland	Baseline				Adverse			
	2010 ^e	2011 ^t	2012 ^t	2013 ^t	2010 ^e	2011 ^t	2012 ^t	2013 ^t
GDP	-0.2	0.9	1.9	2.5	-0.2	-1.6	0.3	1.4
GNP	-3.0	-1.5	0.8	1.5	-3.0	-2.6	-0.2	1.2
Consumption	-1.4	-1.9	-1.0	0.5	-1.4	-3.9	-1.3	0.1
Investment	-21.1	-8.9	1.8	4.3	-21.1	-11.3	-1.7	-0.3
<i>Of which construction</i>	-28.9	-15.6	-1.3	2.0				
<i>Equipment</i>	-5.2	1.4	5.8	7.1				
Government Consumption	-2.2	-5.7	-1.8	-2.4	-2.2	-5.5	-4.3	-2.4
Exports	5.7	4.5	4.5	4.6	5.7	2	2.1	2.5
Imports	2.3	0.9	2.7	3.3	2.3	-1.1	0.5	1.7
Balance of Payments (%GDP)	-0.9	1.2	2.2	2.6	-0.9	1.6	3.1	4.3
Employment	-4.0	-0.8	0.5	1.1	-4.0	-2.5	-1.1	0.1
Unemployment Rate	13.6	13.4	12.7	11.5	13.6	14.9	15.8	15.6
Inflation								
HICP	-1.5	0.4	0.6	1.6	-1.5	0.1	0.6	1
CPI	-1.0	0.9	0.8	1.6	-1.0	0.7	0.9	1
House Prices	-15.5	-13.4	-14.4	0.5	-15.5	-17.4	-18.8	0.5
Commercial Property	-13	-2.5	1.5	1.5	-13	-22	1.5	1.5
Personal disposable Income	-3.4	-1.4	0.1	2.4	-3.2	-3.9	-1.2	0.2

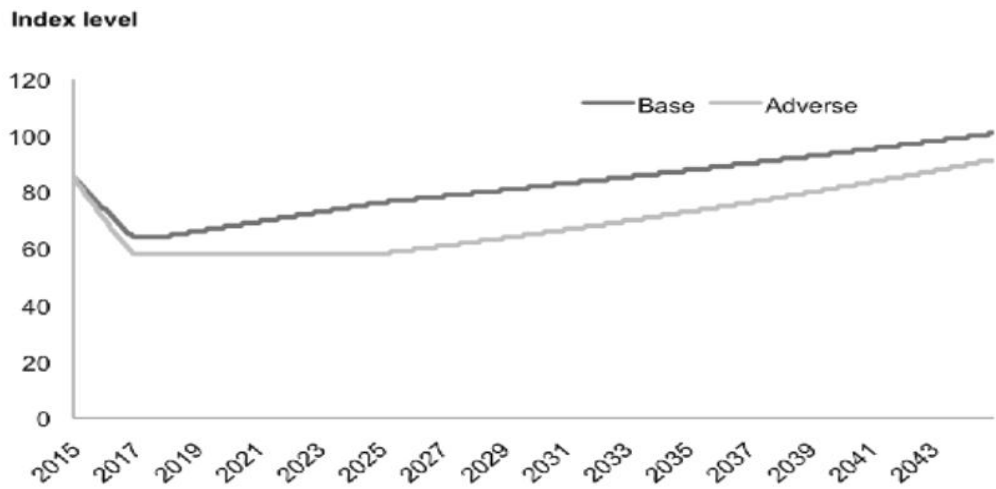
Source: Central Bank of Ireland of Ireland

Critically, the Central Bank of Ireland believes that the adverse scenario ensures that the capital basis of the covered banks is appropriately stringent.

BlackRock Solutions have estimated losses using a statistical modelling approach incorporating additional macroeconomic factors such as the (assumed) forward path of house prices and interest rates, as well as lender-specific borrower credit characteristics.

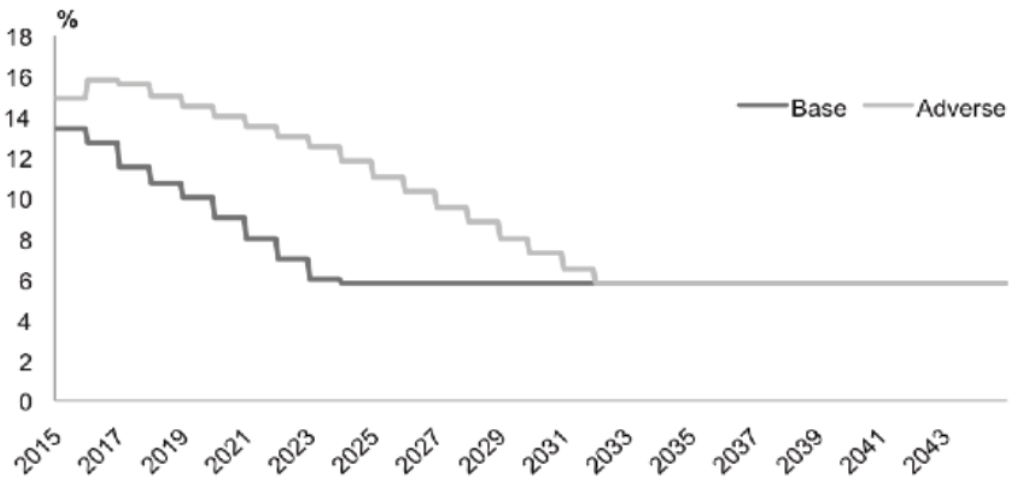
Of particular interest are the BlackRock assumptions on prices and unemployment levels.

Central Bank - House prices base and adverse scenarios (2011 – 2040)



- House prices remain depressed and as such negative equity persists.

Central Bank - Unemployment base and adverse scenarios (2011 – 2040)



- In the base case, unemployment remains above 10% until 2016.
- Under the adverse scenario, unemployment remains above 10% until 2023.

BlackRock Solutions Impairment Calculations

The total Irish residential owner occupier mortgage book analysed by Blackrock across the covered banks was €74.4bn. This does not take account of the residential owner occupier mortgage books of the foreign owned banks of some €41.6bn excluding balances outstanding to sub-prime mortgage lenders.

In terms of the covered banks, BlackRock lifetime losses for residential mortgage portfolios are €5.7bn in their base scenario and €10.2bn in the stress scenario.

This excludes the buy-to-let Irish portfolio of the covered banks of €23.3bn where additional losses are €4.0bn in the base scenario and €6.1bn in the stress scenario.

The Central Bank of Ireland three-year projected losses derived from BlackRock figures for Irish residential owner occupier mortgage book amount to €3.5bn in the base and €5.7bn stress cases.

Again this excludes a further €2.2bn and € 3.3bn respectively for the buy to let book.

Product		AIB		BOI		ILP		EBS		Total	
		Base	Stress	Base	Stress	Base	Stress	Base	Stress	Base	Stress
Ireland	BlackRock lifetime loan losses post-deleveraging	3,077 (11.2%)	4,846 (17.6%)	2,249 (8.0%)	3,836 (13.7%)	2,993 (11.4%)	5,103 (19.4%)	1,411 (8.9%)	2,495 (15.7%)	9,729 (10.0%)	16,280 (16.7%)
	CB three-year projected losses	1,983 (7.2%)	3,007 (10.9%)	1,255 (4.5%)	2,016 (7.2%)	1,598 (6.1%)	2,594 (9.9%)	848 (5.3%)	1,380 (8.7%)	5,684 (5.8%)	8,997 (9.2%)
OO	BlackRock lifetime loan losses post-deleveraging	1,768 (8.8%)	2,968 (14.7%)	1,104 (5.3%)	2,075 (9.9%)	1,669 (8.6%)	2,975 (15.3%)	1,187 (8.5%)	2,164 (15.5%)	5,729 (7.7%)	10,181 (13.7%)
	CB three-year projected losses	1,139 (5.6%)	1,791 (8.9%)	656 (3.1%)	1,115 (5.3%)	969 (5.0%)	1,598 (8.2%)	700 (5.0%)	1,164 (8.3%)	3,465 (4.7%)	5,668 (7.6%)
Buy-to-Let	BlackRock lifetime loan losses post-deleveraging	1,308 (17.8%)	1,879 (25.5%)	1,145 (16.2%)	1,761 (24.9%)	1,323 (19.2%)	2,128 (30.8%)	224 (11.6%)	331 (17.1%)	4,000 (17.2%)	6,099 (26.2%)
	CB three-year projected losses	844 (11.5%)	1,216 (16.5%)	599 (8.5%)	901 (12.7%)	629 (9.1%)	996 (14.4%)	148 (7.6%)	216 (11.2%)	2,219 (9.5%)	3,330 (14.3%)

Source: Central Bank of Ireland of Ireland

As there is a maturity tail of up to 30 years associated with residential mortgages, only a portion of these lifetime losses is included in the Central Bank of Ireland's three-year projected losses. An additional capital buffer has been applied for post-2013 losses.

Losses are defined as the principal loss amount crystallised at the time of property liquidation. The objective of the modelling was to project cash flows and principal losses based on expectations regarding loan amortisation and prepayment, borrower delinquency and default, and loss severity.

The modelling work identified ten factors including indexed loan-to-value (LTV), and loan age and affordability that are predictive in forecasting delinquency and prepayment. The model predicts that LTVs drive loan losses at default, as do the cost and time to recover properties.

Implicit in the model is the assumption that forbearance of high LTV loans moderately increases losses by increasing time and expense to recovery, while impairing property value through accumulated disrepair.

In contrast, the covered banks' assessment of loan losses places considerable weight on employment as a model input and focuses less on LTV.

The covered banks' own forecasted provisions reflect losses following forbearance measures; as employment data improves over time, loan performance improves regardless of LTV.

Given the lack of re-possession data in Ireland, BlackRock assumed that Irish repossession levels would converge with those in the UK. **This suggests that 4% of mortgages, 3,000 homeowners are facing repossession, a 250% increase from the 886 repossessions recorded by the Central Bank of Ireland for the period September 2009 to June 2011.**

This has very significant implications for the Irish economy and the social fabric of Ireland.

Section 2: Steps taken to assist Homeowners in Mortgage Difficulties

1) Government Support for Homeowners in Mortgage Difficulties

While IMAF welcome the measures which the Government has announced to support homeowners in mortgage difficulties, we are extremely disappointed at the lack of implementation to date, specifically the DIS which has not been made mandatory.

Mortgage repossession is a catastrophic threat for struggling families. It is critically important that support is provided early. Fighting repossession as families are being evicted is too late.

Government needs to ensure that action is taken as soon as the potential for arrears is evident. Repossessing homes is not in the Government's interest as the former owners have the distress and expense of moving out of their home and finding alternative accommodation. Many will fall back on the local authority to provide housing and/or rent relief benefits. The reality is that the local authorities have neither the capacity nor the budgets to deal with significant repossessions at this juncture and this situation will persist in the medium term.

Unchecked, repossessions will add up to a significant cost to both the lender and the State and it begs the question whether this money could be better spent paying to keep the defaulting owner in their own home. In this regard, the payment of Mortgage Interest Supplement (MIS) represents a significant and valuable State intervention that provides an essential support for borrowers who are having difficulty in repaying their mortgage. MIS assisted almost 18,679 borrowers, at an estimated cost of €77million so far in 2011.

More action is needed and while the report of the Mortgage and Personal Debt Review Group together with the proactive and ongoing engagement with the Central Bank of Ireland, have brought about a number of important changes which have benefited many struggling homeowners, we are disappointed with the speed of implementation of many of the proposed initiatives.

Furthermore while the Government has acknowledged that maintenance of low interest rates together with forbearance by lenders are the two of the most effective actions to keep homeowners in their homes, IMAF are concerned that mortgage customers, with the exception of those on trackers, have experienced significant interest rate increases. All covered banks have increased their rates in excess of the ECB increases. Tracker mortgage rates are 2%+ yet variable rates range from 3.25% (AIB) to 5.69% (PTSB).

For some this has undoubtedly created acute pressure, particularly where consumers have little or no marginal income over expenditure. While there has been much comment in political circles about keeping interest rates low, there is no evidence of any tangible attempts to protect vulnerable mortgage customers from increasing interest rates.

We are encouraged by the recent intervention of Matthew Elderfield, Central Bank deputy governor, requesting the banks to curb increases in variable rate mortgages. Any increases or decreases should be linked to movements in the ECB base rate, not as an opportunity for bank's to exploit vulnerable variable rate mortgage customers.

Notwithstanding this, we are encouraged by the Government's commitment to reform the bankruptcy laws. We strongly encourage the Government to facilitate a statutory non-judicial debt settlement mechanism to enable borrowers, who have fallen on bad times, to earn a fresh start by discharging their debt after a reasonable period.

We also encourage Government to explore new initiatives and amendments to existing schemes to ensure an adequate safety net for homeowners in mortgage arrears and/or at risk of repossession.

2) **Recommendations of the Mortgage Arrears and Personal Debt Review Group**

IMAF were encouraged by the report of the Expert Group and support the broad thrust of their recommendations.

We are disappointed however with the slow progress being made in the adoption and implementation of many of their recommendations.

Standard Forbearance

The Mortgage Arrears Resolution Process (MARP) provides a framework for lenders to make an individual assessment of a borrower in mortgage arrears (or pre-arrears) and consider whether or not forbearance arrangements should be proposed.

Typically forbearance techniques employed by lenders, comprise of the following:

- a switch to an interest only mortgage;
- a temporary deferral of payment;
- extending the term of the mortgage; and
- capitalising arrears amounts and related interest.

These “Standard Forbearance” techniques: while they vary in their approach, typically have the common characteristic of rescheduling principal or interest repayments, rather than reducing them.

Forbearance for supporting customers in temporary financial distress is being provided by lenders which include processes that permanently affect the repayment terms of their mortgage.

Forbearance practices and volumes vary significantly across lenders and are often operating opaquely at various customer contact points. Lender processes appear to have largely developed in the absence of a clear specific strategy and without an informed understanding of their impact on the customer and future performance of the mortgage.

The Central Bank of Ireland's recent review of accounting standards confirmed there is significant variation in how judgement is being applied by institutions, producing wide variations in provision outcomes for similar portfolios, collateral values, emergence periods, forbearance and restructured loans.

IMAF believe greater clarity should be provided to lenders in dealing with mortgage customers in difficulty to ensure greater consistency. This should include best practices for each type of forbearance measure.

IMAF are also concerned by the evidence of a lack of flexibility and forbearance in the sub-prime sector.

Furthermore, IMAF strongly believe that any attempt to attach other debt (business or personal) to the family home should be prohibited by the Central Bank of Ireland.

Advanced Forbearance

The overriding objective of the Deferred Interest Scheme (DIS) is to provide more time for borrowers in difficulty to secure the sustainability of their mortgage, while limiting the extent to which they can fall further into arrears. Furthermore the borrower should not have to pay interest on unpaid interest.

The intention of DIS is to provide a degree of comfort to borrowers that that any interest repayments which they cannot afford to pay will remain static. The DIS should enable borrowers who can pay at least 66% of their mortgage interest (but less than the full interest) to defer payment of the unpaid interest for up to 5 years.

The report stated that when the accumulated amount in the deferred interest account is equal to a total of 18 months interest, or when the borrower has participated in the DIS for up to 5 years, the mortgage may be deemed to be unsustainable.

All mortgage lenders were requested on a voluntary basis to commit to the DIS or an equivalent scheme.

The DIS scheme was to become effective mid 2011. At this juncture, there is no evidence that the covered banks have implemented the scheme.

Furthermore, a number of the foreign owned banks have indicated that they will not engage with the DIS scheme. This undermines the Expert Groups objectives of:

- ***Providing an industry-wide approach to address a defined segment of the mortgage arrears problem and a consistency of treatment for borrowers who fall into this segment.***
- ***Demonstrating a firm commitment to work through problems with borrowers eligible for DIS and show an approach which is responsible and recognises the extent of the problem.***

The DIS scheme should be mandatory and information on its availability should be provided to mortgage customers experiencing financial difficulties.

Trade Down Options for Borrowers in Negative Equity

The Expert Group noted that for some mortgage holders in negative equity, trading down would result in a reduction in mortgage debt and more affordable monthly payments.

The Expert Group recommended that consideration be given by lenders to facilitating trading down by borrowers in this situation. The caveat being that such options would have to meet relevant prudential standards, with appropriate controls in place, and be in the customers' best interest.

A number of negative equity mortgage products have been introduced in the UK.

IMAF understand some covered bank have developed proposals ; these need to be finalised and signed off with the Central Bank of Ireland as a matter of urgency.

IMAF fully support the introduction of such products, with the above caveats, which not only could reduce monthly payments to an affordable level but would also assist with the mobility of labour during a period of high unemployment.

The Group recognises that an early assisted sale may have advantages over a formal repossession in the case of an unsustainable mortgage. We recommend that lenders develop a protocol setting out their practices, procedures and charges in this area.

We have not seen any evidence of initiatives emerging from the lenders in respect of this initiative and suspect it is unlikely to be implemented.

This leaves a borrower with an unsustainable mortgage very much on their own in terms of trying to resolve their situation.

Coherence with Evolving Social Housing Policies

Qualification for Social Housing

The Expert Working Group recommended:

Where a borrower's situation is or becomes unsustainable, they should be facilitated, if necessary, in applying for social housing appropriate to their needs.

Furthermore, the Department of the Environment, Heritage and Local Government should swiftly implement new regulations to enable borrowers whose mortgage has been deemed unsustainable, to become eligible for social housing assessment before a repossession order has been made or repossession has taken place.

There needs to be an agreed definition of an unsustainable mortgage with a clear path to qualification for social housing support.

IMAF understand that guidelines have been issued to housing authorities to assist in the determination of the most appropriate housing supports for an applicant, while at a broader level, providing indicators to the housing authority as to how its housing supply programme should be planned.

These guidelines should be widely available in user friendly format and should be made available by lenders to mortgage customers in difficulty.

A mechanism should be put in place which would enable, where appropriate, the borrower and lender agree to a voluntary repossession, with *actual* repossession deferred for a specified maximum period, or until such time as the housing authority has sourced appropriate accommodation whichever comes sooner.

IMAF understand that this will not be implemented due to adverse capital implications for lenders and that, no alternative arrangement is forthcoming.

Given that other options, including:

- ***Leasing repossessed properties from the lenders.***
- ***Mortgage to Rent Scheme were already shelved, this further limits the options open to distressed homeowners.***

Mortgage Interest Supplement (MIS)

The Expert Working Group recommended:

The Department of Social Protection should introduce an alternative and more equitable approach to achieving the MIS objectives and its sustainability.

The Expert Group further recommended that changes should cover issues such as:

- No legal action should be taken by the lender while MIS is being paid and the borrower is cooperating with the lender.
- The ban on paying MIS to a couple where one person is in full-time employment should be removed and a revised means test developed.
- The current rule which excludes the payment of MIS when a house is for sale should be suspended.
- The State should not provide MIS where the lender is charging interest above the average variable rate in the market.
- MIS should only be payable where no capital is being repaid.
- MIS should be paid directly into the mortgage account of the borrower.
- An overall time limit for MIS should be considered to ensure that the scheme does not act as a disincentive to seeking or retaining work.
- The scheme should remain as a short term income support.

IMAF have not seen any evidence of changes to the MIS scheme and would encourage The Department of Social Protection to accelerate its plans to implement the recommendations of the Expert Working Group.

3) Central Bank of Ireland Interventions

Code of Conduct on Mortgage Arrears (CCMA)

In reality, when a borrower is struggling to keep up their repayments, the relationship with their lender changes dramatically.

In the vast majority of cases the problem has arisen as a result of loss of employment, reduction in wages or an increase in interest rates.

Prior to the new Code little allowance was made for the changed circumstances of mortgage customers .

Under the CCMA:

“Lenders must treat borrowers in or facing mortgage arrears, with due regard to the fact that each case of mortgage arrears is unique and needs to be considered on its own merits.

All such cases must be handled sympathetically and positively by the lender, with the objective at all times of assisting the borrower to meet his/her mortgage obligations”.

We welcome the provisions of the CCMA which state:

“Lenders must have in place a Mortgage Arrears Resolution Process (MARP) as a framework for handling arrears and pre-arrears cases”.

The CCMA sets out the steps and processes that lenders must include in the MARP. The major elements include:

- A centralised and dedicated Arrears Support Unit (ASU) to manage and access cases.
- A standard financial statement must be used by all lenders to obtain financial information from borrowers and to make an assessment in relation to alternative repayment measures.
- Lenders must establish an appeals process to consider any appeals submitted by borrowers.
- Specific information must be provided to borrowers in a clear and customer friendly manner.
- Borrowers in arrears must not be required to change from a tracker mortgage to another mortgage type.
- Where borrowers are co-operating with lenders, lenders must wait at least twelve months before applying to the courts to commence enforcement of any legal action on repossession of a primary residence.
- Lenders are not allowed apply certain charges to mortgage accounts that fall within CCMA.
- Lenders may only attempt to make unsolicited contact to arrears customers three times in a calendar month, regardless if the attempted contact is successful or not.
- The CCMA also applies to pre-arrears cases and requires lenders to pro-actively encourage its borrowers to engage with them about financial difficulties.

While IMAF welcome these changes, we are concerned that a principles based approach in the area of mortgage arrears has given far too much flexibility to lenders to interpret the rules.

The consequence has been a wide divergence in practice amongst firms with consumers treated in an inconsistent manner. Furthermore, there is little opportunity to establish whether they are been treated fairly.

It is imperative that there is an independent appeals process where the borrower and lender cannot agree on a restructuring request which is highlighted by the fact that of 70,000 mortgages restructured, 30,000 are now in arrears.

Compliance with the CCMA

The CCMA came into force on 1 January 2011. All lenders were to have fully implemented its provisions by 30 June 2011.

Notwithstanding this, it is clear to our members that consumers are still not being treated fairly when they fall into payment difficulties, resulting in poor outcomes for consumers.

The Central Bank of Ireland's own report of the 1st July of its themed inspection of mortgage lenders compliance with the CCMA bears out this point.

IMAF are disappointed that four mortgage lenders were not in full compliance with the CCMA with failings occurring for various reasons, including one-off system errors, inadequate monitoring processes and lack of adherence to the procedures in place.

We are particularly concerned that almost 3,100 mortgage arrears accounts were overcharged by nearly €70,000. While the refunded amounts may be small, they are significant to those mortgage customers who are in an arrears situation and for whom every cent counts.

While we note the Central Bank of Ireland's ongoing commitment to ensuring that mortgage lenders fully adhere to the CCMA, their own inspection demonstrates further effort are required by lenders to achieve full compliance.

Section 3: Recommended Plan of Action to Support Struggling Homeowners

1) Ensure All Lenders Provide Flexibility and Forbearance Measures

The primary aim of providing a forbearance facility to a mortgage customer should be to enable the complete recovery of their mortgage through the full repayment of arrears. In this case the long-term impact on both the lender and the customer is minimised.

Where the circumstances of the customer mean this primary aim cannot be achieved, the secondary aim should be to recover the customer into a sustainable terms position on their mortgage.

- ***IMAF welcome the fact that there is a standard financial statement that must be completed by clients in Financial distress. The form is too invasive and should be revised.***
- ***IMAF also believes the form should be generic and not lender specific.***
- ***The form should only be used for homeloans, yet many lenders are attempting to use the form for all applications on the pretence that it is a regulatory requirement..***
- ***IMAF recommends that the Central Bank of Ireland converts guidelines into rules to facilitate enforcement, thereby increasing compliance by all mortgage firms and ensuring that repossession is only a tool of last resort.***
- ***IMAF also recommends the development of best practice guidelines for the industry.***

2) Ensure Transparency of Forbearance Arrangements

In reaching an agreement with a customer over the method of repaying any payment shortfall or sale shortfall, customers should be given:

- A reasonable period of time to consider any proposals for payment put to them.
- Adequate information to understand the implications of any proposed arrangement.
- Adequate information about any applicable Government assistance schemes.

The current situation has many shortcomings and could easily be improved:

- ***The timeframe for the borrower to receive a reschedule proposal is extremely slow, 4-10 weeks not unusual.***
- ***To address this, IMAF recommends that on receipt of a request to reschedule, the lender should agree to the request immediately and formally review after one month by which time the request should have been properly assessed.***
- ***If a decision is not given within this timeframe or is under appeal, a further one month should be granted until agreement has been reached with the borrower.***
- ***Child Benefit, Carers Allowance and other similar allowances should not be included by the lender when assessing personal income.***
- ***In assessing a borrower, the lender should allow a borrower to maintain 6 months income as a "rainy day" fund to cover unforeseen circumstances such as loss of employment or illness.***
- ***The minimum restructuring period should be 12 months.***
- ***IMAF strongly believes that the appeals process should be made through an independent body. The current inhouse lender appeals process does not work.***
- ***IMAF also encourages the Central Bank of Ireland to agree a standard information sheet to ensure consumers can make informed decisions.***

3) Provide Greater Clarity on Outcomes for Borrowers under CCMA

We are concerned that a principles based approach in the area of mortgage arrears has given far too much flexibility to lenders to interpret the rules as to the options provided and how it determines suitability for various forbearance measures.

- ***The consequence of this has been a wide divergence in practice amongst firms with consumers treated in an inconsistent manner and little opportunity to establish whether consumers are being treated fairly. All Consumers should be given a copy of the MARP guidelines to be made aware of their consumer rights.***
- ***We encourage the Central Bank of Ireland to be more prescriptive in its guidelines.***

4) Ensure Mortgage Arrears are Dealt with by Approved Persons

In our experience, homeowners are not being treated fairly when they fall into payment difficulties.

Given their limited scope to move to another lender, the need for a borrower's current lender to demonstrate good arrears-handling practices and to ensure that they are treated fairly is of paramount importance.

Proper consideration is crucial to arriving at the most suitable forbearance options for a borrower. We are concerned that the majority of lenders have effectively "thrown bodies" at mortgage arrears with many staff being deployed without proper training and/or an appreciation for struggling homeowners.

There is a significant skills gap and variability both within the sector and within the individual lenders, resulting inconsistent decisions been reached by the same lender. This must be addressed by the Central Bank of Ireland as a priority.

- ***We encourage the Central Bank of Ireland to place responsibility on Boards, Chief Executives and senior management teams for deploying appropriate and adequate resources in the most effective way to achieve desired regulatory outcomes.***

5) Ensure Access to Independent Mortgage Advice

Each lender should ensure that its written policy and procedures, when dealing with any customer in payment difficulties, take into consideration the customer's preference for means of communication.

Where a customer requests, lenders should without question liaise with the customer's independent source of mortgage advice regarding their mortgage, their payments, payment shortfall and/or sale shortfall.

Our experience is that lenders often try to circumvent the customer's mortgage advisor and deprive the borrower of support at the time they most need it.

- *IMAF urges the Central Bank of Ireland to ensure that mortgage customers are given the choice of dealing with their lender through an authorised mortgage broker.*
- *All data held by lenders including underwriting notes should be available to the customer and their mortgage adviser.*
- *IMAF proposes that only authorised mortgage intermediaries who are both Qualified Financial Advisors (QFA) and have relevant experience in dealing with debt restructuring should be the appropriate people to advise mortgage customers in distress.*

6) Name and Shame Lenders for Non-Compliance with CCMA

Four mortgage lenders recently failed the Central Bank of Ireland's review of CCMA.

- *IMAF strongly encourage the Central Bank of Ireland to both name and penalise lenders not in compliance.*
- *Equally, we call upon the Central Bank of Ireland to spell out clearly how it will improve its own performance in terms of bringing miscreant lenders to account.*

7) Apply Enforcement Restrictions to all Lenders

Under the CCMA, mortgage lenders can only attempt to make unsolicited contact to arrears customers three times in a calendar month, regardless if the attempted contact is successful or not. This provision should be extended to all lenders as anecdotally, credit card and personal loans are being pursued vigorously, putting already stressed homeowners in an invidious position.

IMAF are also concerned that forbearance on the mortgage might be used to prioritise the repayment of unsecured debts placing the home at greater risk. Where borrowings are with the same lending institution, the lender should be compelled to inform the borrower of full facts.

Furthermore, IMAF are concerned that lenders are looking to attach other debt, both personal and business, to a borrower's family home through the re-negotiation of terms and conditions on these other borrowings. This limits the borrower's ability to re-negotiate and/or dispose of their property. Apart from the added stress, these actions in their own right can result in the family home mortgage becoming unsustainable. **The protection of the family home is sacrosanct and lenders should be prohibited from retro-fitting terms & conditions and putting the family home at risk.**

- *IMAF encourages the Central Bank of Ireland to implement these changes.*

8) Implement Deferred Interest Scheme (DIS) and Test its Effectiveness

The Covered Banks committed to implement the DIS by 30th June 2011.

It is unclear at this stage if any of the said lenders have implemented the scheme. This should be clarified without delay and be made **mandatory** for all lenders.

Furthermore, we are very concerned that the foreign owned banks have not engaged with DIS.

The availability of DIS should be widely publicised and it should be **mandatory** for lenders to advise customers in difficulty of its availability and to take DIS into consideration when reviewing arrears cases.

The effectiveness of the scheme will only be known through ongoing monitoring over time.

- ***IMAF encourage the Central Bank of Ireland to objectively monitor the implementation of DIS and its outcomes.***
- ***In implementing the scheme, lenders should not look to absorb more than 35% of a borrowers income, the level they feel is prudent and manageable for a new borrower, once a minimum of 66% of the interest on the mortgage is being paid.***
- ***Furthermore, while it presently looks unlikely that interest rates will increase, borrowers payments should be flat-lined for a minimum period of time, to enable borrowers to gain confidence and self-esteem as they adjust to their new economic realities.***
- ***IMAF also believes that it should be obligatory for lenders to ensure and provide if necessary, adequate mortgage protection so that borrowers are continually covered in the event of death, given the unnatural level of stress being experienced by struggling borrowers.***

9) Warehouse Unsustainable Element Of Mortgage

Where a borrower is unable to maintain his/her repayments on a capital and interest basis a percentage of the mortgage balance should be set aside for an agreed fixed period. The set aside amount of the mortgage becomes 'warehoused'.

This enables the borrower to repay both capital and interest on the remaining mortgage balance. The warehoused mortgage should be at a zero interest rate and should be held as a general provision by the bank.

As the borrowers circumstances improve, some of the warehoused mortgage can be transitioned so that it becomes fully serviced by the borrower. Guidelines should be agreed between the Central Bank of Ireland and the industry to ensure a transparent and fair process is adopted.

- ***IMAF encourages the Department of Finance to engage with the Central Bank of Ireland and the industry to create a warehouse facility for the unsustainable part of a borrowers mortgages which will be of particular help to those in negative equity.***

10) Implement Expert Group Recommendations on Mortgage Interest Supplement (MIS)

These recommendations were made in November 2010 and to date there is no evidence that they have been implemented.

- ***IMAF call on the Department of Social Protection to implement and publicise recommended changes without further delay.***

11) Provide Clarity on Position Regarding Unsustainable Mortgages

There needs to be an industry agreed definition of an unsustainable mortgage. This will in turn facilitate better discussion between the industry and the various Government agencies. Where a mortgage is unsustainable, this should be recognised early in the process.

- *IMAF encourage the Central Bank of Ireland to engage with lenders and other stakeholders to have an industry agreed definition of an unsustainable mortgage.*

12) Bottom-out Moral Hazard and Debt Forgiveness

In reality, some mortgages will be unsustainable. IMAF fully agree with the Central Bank of Ireland that where a lender chooses not to take action against borrowers who are in arrears or in breach of covenants, that it is important that adequate provisions are set aside for prospective losses.

We also recognise that any approach to debt forgiveness needs to take account of the risk that it creates incentives for borrowers to cease meeting their obligations and for the potential to undermine the steps taken to ensure the stability of the Irish banking system.

While it is our considered view that those borrowers who can should pay, we welcome the recent comments from the Central Bank of Ireland that given the banks are conservatively capitalised that as such, they have more capacity to restructure the debts of their mortgage customers.

We are encouraged that the Department of Finance has undertaken a review.

- *We encourage the Department of Finance to facilitate an open and inclusive consultative process to determine the optimal solution for all stakeholders.*

13) Provide a Cohesive Policy for Social Housing Support

The Department of Environment should take the lead in

- *Agreeing the path from an unsustainable mortgage to social housing support.*
- *Adopt innovative measures to increase the availability of social housing.*

We note with interest the recent initiative between a Housing Association, the National Asset Management Agency (NAMA) and the Housing Finance Agency (HFA). Other potential solutions were looked at by the Expert Group and these should be re-visited.

- *IMAF believe all homeowners should be allowed to remain in their property.*
- *While a number of options have been looked at, IMAF believe borrowers should be given an option to rent their own home for a set period to enable them restore the sustainability of their mortgage. Clearly the rent would have to meet the interest element of their mortgage i.e. self-financing. This would facilitate the renting of a more modest property and where necessary further support could be provided through rental support and/or social housing.*
- *IMAF encourage the Department of Environment as a matter of urgency to explore this and other options to include public private partnerships, mortgage relief fund etc.*

14) Reform Bankruptcy Laws

We are encouraged by the Government's commitment to reform Personal Insolvency and Bankruptcy laws. Facilitating a statutory non-judicial debt settlement mechanism would be a welcome reform.

- ***IMAF encourage the Government to finalise proposed changes as a matter of urgency.***

15) Facilitate one-off access to Pension Funds

Many self-employed borrowers had invested in their pension when the economy and their business were performing well. Today, businesses in every sector are struggling with cash flow difficulties and the ability to withdraw an income severely curtailed. In this scenario, it makes financial sense for a borrower to access a lump sum from their pension to reduce the principal on their mortgage and as such, ensure the monthly repayments on their mortgage are sustainable.

During the heaviest lending boom, the banks introduced interest only products to try and target larger mortgage balances.

In such cases, the borrower had to identify a repayment vehicle other than the sale of the property in the longer term. In the majority of cases that vehicle was the borrower's Pension Fund. These properties tend to be in massive negative equity and were recently identified by leading economist Morgan Kelly, as representing the next black hole for the banks.

Recent changes in pension legislation will make the successful repayment of these mortgages much more difficult. Borrowers with sufficient funds should be allowed access to their Pension Fund to reduce their mortgage balance.

Flexibility in this area may reduce banking losses considerably. Many of these mortgages will not show in distress until the interest only period finishes.

Accurate figures on the extent of this problem have not been disclosed by the lending institutions to date.

- ***IMAF encourage the Government to revisit their decision not to allow the one-off access to pension funds for the reduction of the principal outstanding on a borrower's home.***
- ***We are disappointed with the narrow interpretation given by the Government recently. We want to tailor solutions to fit differing circumstances. This solution will help some people.***

16) Incentivise Borrowers to Switch their Tracker Mortgage to a Long-term Fixed Rate

Over 50% of mortgages are on loss making trackers. The economic cost of this is easily calculated and could be applied, on a net present value basis, to a reduction in the principal outstanding on a borrower's mortgage.

However to safeguard the borrower, IMAF believes that borrowers should be offered a long-term fixed rate. For this to work, the fixed rate product would have to minimise the break costs on redemption and/or foreclosure and the margin on the product kept to a minimum purely to cover servicing costs of the lender.

- ***IMAF encourages the Government to make a fund available for long-term fixed rate mortgages that encourages borrowers to switch out of unprofitable trackers through a reduction in their principal balance.***

17) Government to articulate and commit to a longer-term strategy to support vulnerable homeowners

There is an urgent need for a clear articulation and commitment to a long-term strategy to support homeowners in mortgage difficulties thereby ensuring that adequate mechanisms of support are put in place.

- ***IMAF encourage the Government to articulate and commit to a longer-term strategy to support homeowners in mortgage difficulties.***

ABOUT US:

Independent Mortgage Advisors Federation (IMAF) was founded in 1990.

We are a nationwide organisation of Mortgage/Financial Advisors who produce the core mortgage business generated through this channel.

We all have extensive banking experience having worked in this environment.

Our aim is to get the best product, rate and term for our customers based on their individual circumstances.

We meet with the Banks and Insurance Companies on a regular basis to represent the views of our customers and members.

We meet with the Central Bank of Ireland and other government agencies and have made numerous submissions in association with Professional Insurance Brokers Association (PIBA) and Irish Brokers Association (IBA) to both agencies.

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