EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 18 February 2019

on court orders for possession of principal private residences

(CON/2019/8)

Introduction and legal basis

On 14 January 2019 the European Central Bank (ECB) received a request from the Irish Department of Justice, Equality and Law Reform for an opinion on the Land and Conveyancing Law Reform (Amendment) Bill 2019 (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the sixth indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft law relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets and the tasks conferred upon the ECB concerning the prudential supervision of credit institutions pursuant to Article 127(6) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The draft law amends the Land and Conveyancing Law Reform Act 2013 (hereinafter the '2013 Act'), to set out the range of matters which a court is obliged to take into account when deciding to grant an order for possession of land (hereinafter 'possession order') to a mortgagee ('lender') in respect of a the principal private residence of a mortgagor ('borrower'). The stated objective of the draft law is to ensure that the repossession of a borrower's principal private residence should remain an action of last resort, when all other possible remedies have failed.

1.2 The 2013 Act already specifies the matters that a court would have to take into account before granting an adjournment of proceedings for a possession order in respect of a borrower's principal private residence, in order to enable the borrower to secure a Personal Insolvency Arrangement (PIA) under the Personal Insolvency Act 2012, as amended.

1.3 The draft law is designed to address cases where the borrower has not secured a PIA under the Personal Insolvency Act 2012, or where the PIA procedure has come to an end[2]. The draft law provides that the court must take into account certain matters when considering whether to make or refuse to make a possession order, and may take these matters into account when considering

1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 Proposed new Section 2A,, subsections 1, 5 and 6 of the 2013 Act, as set out in Section 3 of the draft law.

whether to make any other order it considers appropriate in the circumstances[3].

1.4 The first matter referred to in the draft law is whether the possession order would be proportionate in all the circumstances[4], having regard to matters such as the total amount that remains to be paid to the lender on foot of the mortgage or any associated loan agreement; the amount of arrears of payments due on foot of the mortgage; the advised market value[5] of the principal private residence on the date on which proceedings were commenced; and where the lender is not the original lender, the advised market value of the principal private residence on the date on which the new lender acquired the mortgage[6].

1.5 The other matters referred to in the draft law include the circumstances of the borrower and his or her dependants; whether the lender has made a statement to the borrower of the terms on which it would be prepared to settle the matter in such a way that would allow the borrower and his or her dependants to remain in their principal private residence; details of any proposal put forward by, or on behalf of, the borrower to enable them to remain in the principal private residence, including through participation in a scheme designed to assist persons in mortgage distress, or to secure alternative accommodation; the response, if any, of the lender to any proposal of the borrower; and the conduct of the parties to the mortgage in any attempt to find a resolution to the issue of dealing with arrears of mortgage payments[7]. The court may also take into account such additional matters as it considers appropriate[8].

2. Observations

2.1 *Interaction with the existing national framework*

The ECB takes note of the clarifications provided in the draft law on the matters that must be taken into account by the courts when deciding to grant a possession order to a lender in respect of a borrower's principal private residence. The ECB understands that the matters listed in the draft law partly reflect the case law of the Irish Supreme Court[9] on this topic, and the Code of Conduct on Mortgage Arrears, introduced by the Central Bank of Ireland (CBI) in 2013, while the draft law also expressly sets out the range of matters which a court is obliged to take into account when considering whether to make or refuse a possession order.

2.2 *Effects on the banking sector and on financial stability*

2.2.1 In the context of its direct responsibility for the supervision of significant banking groups within the euro area, the ECB closely monitors the stability of credit institutions. The high level of non-performing loans (NPLs) in Ireland has brought large credit losses to Irish banks in the recent past. Thus, it is important that NPLs are dealt with in an efficient and effective manner, balancing the need to ensure, on the one hand, observance of the general duty of debtors to meet their payment

3 Proposed new Section 2A, subsection 2, as set out in Section 3 of the draft law.
4 Proposed new Section 2A, subsection 3, as set out in Section 3 of the draft law.
5 As defined in the proposed new Section 2A, subsection 9, as set out in Section 3 of the draft law.
6 Proposed new Section 2A, subsection 4, as set out in Section 3 of the draft law.
7 Proposed new Section 2A, subsection 3, as set out in Section 3 of the draft law·
8 Proposed new Section 2A, subsection 2, as set out in Section 3 of the draft law.
9 *Launceston Property Finance Limited v Burke*, [2017] IESC 62.

obligations and, on the other hand, the need to provide assistance to individuals in dire financial situations[10].

2.2.2 On the one hand, the draft law adds to the existing protections and procedures for distressed borrowers under the CBI's Code of Conduct on Mortgage Arrears 2013, the CBI's Consumer Protection Code 2012, the Land and Conveyancing Law Reform Act 2009, the Land and Conveyancing Law Reform Act 2013 and the Personal Insolvency Act 2012. The draft law will ensure that where these existing avenues have been exhausted, and the lender applies to the court for a possession order, the borrower will have a further opportunity for matters, including his or her personal circumstances, and his or her proposals in respect of the mortgage, to be taken into account. The draft law does not specify what significance or relative weight a court should assign to the matters that must be taken into account in making or refusing to make a possession order.

2.2.3 On the other hand, long-term mortgage arrears are considered to be the most critical part of the NPL stock in the Irish banking sector. Repossession activity remains relatively limited, and the length of proceedings continues to be protracted[11]. The various matters which the draft law requires the court to take into account are likely to result in lengthy submissions and may provide additional grounds for appeal, particularly given the uncertainty regarding the significance and relative weight of some of the matters the court must take into account. Thus, it is important to consider the likelihood that the draft law will exacerbate the protracted nature of proceedings, and increase the associated legal costs, including for distressed borrowers. The negative impact of protracted proceedings on lenders, particularly in respect of the contemporaneous value of a borrower's collateral and in respect of secondary markets for credit institution assets, should also be considered.

2.2.4 The ECB underlines that the ability of financial institutions to effectively manage credit risk depends on a reliable, predictable and stable legal framework that adequately balances the interests of both the creditor and the debtor. In this respect, it is important to carefully consider the impact of the draft law in order to ensure legal certainty, and to prevent moral hazard from arising in the relationship between creditor and debtor[12]. If banks (or secondary market purchasers of assets) are deprived of efficient tools to work out NPLs in an effective and timely manner, this could result in unnecessarily high levels of NPLs and private sector debt, which in turn have an adverse impact on financial stability and could undermine future credit supply[13]. Moreover, when pricing mortgages, banks take account of many factors, including the actual and future cost of funding, expenses and overheads, the cost of capital, and expected credit losses. The impact of the draft law on these factors, and in particular on the ability of the lender to enforce security and the potential corresponding increase in default rates, should also be carefully considered. This is because additional costs are likely to be passed on to future borrowers, and could result in a significant impact on mortgage pricing and availability.

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10 See paragraph 2.2.1 of Opinion CON/2018/13 and paragraph 3.1 of Opinion CON/2013/34. All ECB opinions are published on the ECB's website at www.ecb.europa.eu

11 European Commission, Post-Programme Surveillance Report. Ireland, Spring 2018, 6 July 2018, page 17.

12 See paragraph 2.2.3 of Opinion CON/2018/13 and paragraph 2.2 of Opinion CON/2015/56.

13 See paragraphs 2.2 and 2.3 of Opinion CON/2015/14.

2.3 *Effects on secondary markets for credit institution assets*

2.3.1 The ECB has been a strong proponent of the development of secondary markets for credit institution assets, particularly NPLs, as reflected in the EU Council's action plan to tackle NPLs in Europe[14]. In the context of the large stocks of NPLs that remain on the balance sheet of some European credit institutions, and as part of a comprehensive solution to NPL resolution[15], the development of secondary markets may contribute to reducing NPLs. Looking ahead, well-functioning secondary markets may also prevent stocks of NPLs building up in the future.

2.3.2 Moreover, a well-functioning secondary market for bank assets may have a positive effect on financial stability to the extent that it could facilitate the transfer of the risks of NPLs off credit institutions' balance sheets. The presence of significant volumes of NPLs on credit institutions' balance sheets reduces their ability to fulfil their function as providers of credit to the real economy and hampers the operational flexibility and overall profitability that are essential to a well-functioning banking sector. It is essential that the national legal framework applicable to secondary markets enables the efficient transfer of NPLs off the balance sheet of credit institutions.

2.3.3 The ECB notes that in the context of the court's consideration of whether the possession order would be proportionate in all the circumstances[16], the inclusion of one particular matter in the draft law would merit further reflection by the legislators. That is, where the lender is not the original lender, the court may have regard to the advised market value of the principal private residence at the date on which the new lender acquired the mortgage. In that respect, the ECB notes that borrowers will benefit from the CBI's Code of Conduct on Mortgage Arrears 2013, the Consumer Protection Code 2012, and Part V of the Central Bank Act 1997, as amended by the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 and the Consumer Protection (Regulation of Credit Servicing Firms) Act 2018, which provides for the regulation of credit servicing[17]. These protections apply regardless of whether the mortgage is owned or serviced by the original lender, or by a credit servicing firm[18]. The ECB would welcome further clarity in respect of how consideration of this matter would assist the court in its proportionality assessment, in light of the objective of the draft law to ensure that the repossession of a borrower's principal private residence remains an action of last resort. The draft law should also consider how issues of adverse selection may be avoided. While lenders remain responsible for prudently assessing collateral values, it is important to maintain sufficient incentives for repayment and effective safeguards to prevent strategic defaults.

2.3.4 In this context, the draft law must carefully balance the benefits of creating well-functioning secondary markets against the impetus to protect borrowers. The provision of the draft law

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14 See the Council of the European Union's press release of 11 July 2017 on the 'Council conclusions on Action plan to tackle non-performing loans in Europe', available at: http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/. See also Opinion CON/2018/31.

15 See, for example, Special features, Section B of the ECB's November 2016 Financial Stability Review, available at: https://www.ecb.europa.eu/pub/pdf/other/sfbfinancialstabilityreview201611.en.pdf.

16 Pursuant to the proposed new Section 2A, subsection 3, point (a) of the 2013 Act, as set out in Section 3 of the draft law.

17 Following the amendments made to Part V of the Central Bank Act 1997 by the Consumer Protection (Regulation of Credit Servicing Firms) Act 2018, the term 'credit servicing' in relation to a credit agreement is defined to include holding the legal title to credit granted under the credit agreement.

18 See *Launceston Property Finance Limited v Burke*, [2017] IESC 62 at paragraph 57. See also paragraph 2.4.1 of Opinion CON/2018/31 and paragraph 2 of Opinion CON/2014/69.

whereby the court may take into account the advised market value of the principal private residence at the date on which an investor acquired the mortgage may be perceived as placing investors at a disadvantage, as it is unclear what significance a court should assign to this information in its decision. This could impede investors' participation in secondary markets, thereby reducing overall participation and reducing price competition in the market place. Even if the provisions of the draft law do not result in reduced participation by investors, investors may pass the costs associated with such a perceived disadvantage onto the credit institutions selling the assets. As such, risks to financial stability may emerge either as a result of a failure to develop secondary markets or because prices in those markets are subdued by regulatory costs.

2.3.5 While risk transfer through asset sales, securitisation and other measures may be effective in reducing NPLs, risk reduction measures remain, nevertheless, an important channel, particularly in a context where NPL stocks are high. In that regard, and in the context of a comprehensive solution to NPL resolution, the originating credit institutions' internal procedures for handling the work-out of NPLs themselves will remain important.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 18 February 2019.

[signed]

The President of the ECB

Mario DRAGHI