OPINION OF THE EUROPEAN CENTRAL BANK
of 5 March 2018
on mortgage arrears resolution
(CON/2018/13)

Introduction and legal basis

On 29 January 2018 the European Central Bank (ECB) received a request from the Chairman of the Oireachtas (Irish National Parliament) Joint Committee on Justice and Equality for an opinion on a Mortgage Arrears Resolution (Family Home) Bill 2017 (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 to the specific tasks conferred upon the ECB concerning policies relating to 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 provides for the establishment of a Mortgage Resolution Office (MRO), within the existing Insolvency Service of Ireland. The Insolvency Service of Ireland was established under the Personal Insolvency Act 2012 (hereinafter the '2012 Act')[2]. The 2012 Act was further amended by the Personal Insolvency (Amendment) Act 2015.

1.2 The draft law provides for the establishment of a framework applicable to certain 'Financially Restricted Mortgagors'. The draft law provides that a Financially Restricted Mortgagor is a mortgagor who resides in, and is the registered owner of, a mortgaged property that is a family home, and whose disposable income, non-essential assets, and total personal debts are restricted below a level to be prescribed by ministerial order.

1.3 The draft law provides the MRO with powers to make mortgage resolution orders in respect of Financially Restricted Mortgagors that submit an application for such an order under certain conditions. These include that the Financially Restricted Mortgagor has already corresponded and/or communicated with the financial institution that provided the mortgage for the purpose of

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 See Opinion CON/2012/70. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

seeking to renegotiate or restructure their mortgage. Moreover, the draft law will only apply to Financially Restricted Mortgagors who were in arrears on or before 1 January 2017.

1.4 The draft law provides that various types of mortgage resolution orders may be made by the MRO. These include, inter alia, an order that (1) the Financially Restricted Mortgagor make interest only payments on the mortgage for a period of time that will not exceed four years; (2) the mortgage period be extended by a period of time that will not exceed 20 years; (3) the mortgage payments due to be made by the Financially Restricted Mortgagor be deferred for a period that will not exceed one year; (4) the terms and conditions of the mortgage be amended so that the interest rate can be changed to a fixed or variable interest rate, including a change to the rate itself, that the MRO considers appropriate, taking into account prevailing market conditions; (5) the principal sum due on the mortgage be reduced in a fair manner, provided that the mortgagee be granted a share in the Financially Restricted Mortgagor's equity in the family home as the MRO considers appropriate; and (6) the principal sum due on the mortgage be reduced in a fair manner, taking into account certain factors.

1.5 The draft law provides that the effect of such orders is to *inter alia* prevent the financial institution that provided the mortgage from commencing any legal proceedings for the recovery of a debt or repayment, save in limited circumstances, or to seek to eject the Financially Restricted Mortgagor from their tenancy in the family home. The financial institution may object to the order, and the order may be amended or terminated in certain circumstances.

1.6 The draft law also provides for an independent appeals system, whereby a mortgagor or financial institution aggrieved by a decision of the MRO may appeal against that decision. The draft law also stipulates offences and penalties concerning cases of fraudulent or dishonest conduct by the mortgagor, and in respect of circumstances where any person seeks to improperly influence an Appeals Officer, wilfully neglects to attend oral hearings or interferes with documents relevant to the appeal.

2. Observations

2.1 *Interaction with existing national measures*

2.1.1 The ECB recalls that the introduction of the 2012 Act was required by the EU-IMF Financial Support Programme for Ireland. The ECB was consulted on the draft of the 2012 Act, and supported the aim of lowering the cost and increasing the speed and efficiency of personal insolvency proceedings, while at the same time mitigating moral hazard and maintaining credit discipline. The ECB considered that the draft of the 2012 Act provided for debt relief in appropriate cases and contained provisions that aimed to protect the interests of creditors by applying strict eligibility criteria to the availability of the insolvency arrangements, providing for oversight by the Insolvency Service and the courts and requiring supermajority creditor approval of the insolvency arrangement in appropriate cases. The ECB considered that the provisions struck a reasonable balance between the interests of creditors and debtors in coming to an insolvency arrangement[3].

3 See paragraph 2.2 of Opinion CON/2012/70.

2.1.2 The ECB notes that the 2012 Act was further enhanced by the Personal Insolvency (Amendment) Act 2015, in particular by ensuring that a borrower whose proposal for a personal insolvency arrangement is refused by the mortgage lender or other creditors can seek an independent review of that refusal by the courts. The courts in turn have power, subject to certain conditions, to impose the rejected proposal on the mortgage lender or other creditors.

2.1.3 Several other measures have also been introduced in Ireland to seek to address mortgage arrears and debt resolution. First, the Central Bank of Ireland adopted a Code of Conduct on Mortgage Arrears in 2009, in accordance with Section 117 of the Central Bank Act 1989. This Code is binding on mortgage lenders, and the Central Bank of Ireland has the power to administer sanctions for a contravention of the Code under Part IIIC of the Central Bank Act 1942. Second, the Consumer Protection (Regulation of Credit Servicing Firms) Act 2015 seeks to protect borrowers who are parties to credit agreements in respect of which credit servicing firms undertake certain services. The ECB welcomed the measures thus introduced, as they aim to strengthen consumer protection and thereby contribute to preserving confidence in the marketplace[4]. Third, the Irish Government has put in place various measures to assist distressed borrowers, including the *Abhaile* scheme, which is a scheme that has been established to allow homeowners to access independent legal advice and support, and the Mortgage to Rent Scheme. Support is also provided to distressed borrowers by the Money Advice and Budgeting Service.

2.1.4 It is unclear how the provisions of the draft law will interact with these existing measures or with ongoing processes for the resolution of mortgage arrears. This uncertainty could introduce further delays in ongoing processes. In particular, unlike the 2012 Act, the draft law addresses only the mortgage debt of the borrower, and does not address the resolution of other, non-mortgage debt. In order to ensure an efficient and effective regime for addressing personal insolvency, a borrower's entire debt should be taken into account.

2.1.5 Moreover, the draft law does not provide for the publication of relevant data on the functioning of the proposed regime or the independent review of the efficacy of mortgage resolution orders and their impact on Irish credit institutions and the Irish financial system[5].

2.1.6 It is suggested that it would be more appropriate to build on and enhance the existing regime, rather than establish a new regime. In that respect, the ECB notes that in March 2017 the Department of Justice and Equality launched a public consultation on the operation of the Personal Insolvency Acts 2012-2015, as part of the mandatory review of the legislation provided for under section 141 of the 2012 Act. This review may provide an appropriate opportunity to address the shortcomings of the existing legislation.

2.2 *Effects on the banking sector*

2.2.1 In the context of its direct responsibility for the supervision of significant banking groups within the euro area, the ECB monitors closely the stability of credit institutions. The high level of non-performing loans in Ireland has brought large credit losses to Irish banks in the recent past. Thus, it is important that non-performing loans are dealt with in an efficient and effective manner, balancing

4 See Opinion CON/2014/69.

5 See paragraph 3.3 of Opinion CON/2013/34.

the need to ensure, on the one hand, observance of the general duty of debtors to meet their payment obligations and, on the other hand, the need to provide assistance to individuals in dire financial situations[6].

2.2.2 The draft law is being introduced without the benefit of a thorough economic impact assessment. The mortgage arrears resolution arrangements and the supporting administrative infrastructure should above all be workable. While partial write-down of debt can sometimes offer a solution in special cases where the borrower's solvency can be restored, and where creditor losses can be minimised, it is important to ensure that these measures do not result in blanket mortgage debt forgiveness and are geared to minimising the risk of abuse. In particular, the draft law may have a potential negative impact on credit institutions as well as the functioning of the financial system. It is only by making such a prior assessment that it may be possible to mitigate such negative implications. In turn, any reforms should be formulated in a manner that safeguards financial stability, promotes market efficiency and liquidity and supports the adequate flow of credit to the economy. In the absence of an impact assessment, however, it is difficult to be confident that the objectives set by the draft law will be achieved[7].

2.2.3 Even though the draft law, if adopted, will only apply to Financially Restricted Mortgagors who were in arrears on or before 1 January 2017, the scope of possible mortgage resolution orders is extensive, including various forms of debt forgiveness. 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. However, the draft law introduces changes that may affect the ability of lenders to give effect to the agreed terms of secured credit in Ireland, which could undermine legal certainty and the adequate management of credit risk in financial institutions. In this respect, it is important to carefully consider the impact of the draft law on credit agreements in order to ensure legal certainty and avoid undue interference with the contractual and property rights of credit institutions, and to prevent moral hazard from arising in the relationship between creditor and debtor[8].

2.2.4 It is for the Irish authorities to assess whether the draft law complies with Irish constitutional law and other applicable legal principles.

2.3 *Effects on financial stability*

Given the scope of the draft law and the importance of mortgage portfolios in total bank assets, the draft law may have a potential negative impact on the credit institutions affected, and ultimately may have implications for financial stability.

2.4 *Effects on the Irish economy*

2.4.1 As noted above, the scope of possible mortgage resolution orders is extensive, including various forms of debt forgiveness. Notwithstanding some of the safeguards in the draft law, such provisions may adversely affect the future supply of credit and the pricing of mortgages. Banks could respond by unduly tightening lending conditions, in particular to compensate for credit losses resulting from

6 See paragraph 3.1 of Opinion CON/2013/34.

7 See paragraph 2.3 of Opinion CON/2012/40, paragraph 2.3 of Opinion CON/2012/70, and paragraph 2.2 of Opinion CON/2010/34.

8 See paragraph 2.2 of Opinion CON/2015/56.

the application of the draft law. The implications for the real economy are uncertain, given the absence of a quantitative impact assessment.

2.4.2 While the draft law, if adopted, will only apply to Financially Restricted Mortgagors that were in arrears on or before 1 January 2017, the potential for interference with the ability of lenders to give effect to the agreed terms of secured credit in Ireland might nevertheless render the market less attractive and discourage new entrants. This could stifle competition in financial services in Ireland, due to a perceived increase in legal uncertainty[9].

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

Done at Frankfurt am Main, 5 March 2018.

[signed]

The President of the ECB

Mario DRAGHI

9 See paragraph 3.1.1 of Opinion CON/2016/54, paragraph 3.2.2 of Opinion CON/2015/56, and paragraph 3.1.2 of Opinion CON/2015/32.