Inter-Departmental Mortgage Arrears Working Group

30 September 2011

Preamble

The Government's Economic Management Council tasked an Inter-Departmental Group to consider further actions to alleviate the increasing problem of mortgage arrears and to report to it by the end of September. The work of the Group formally commenced on 29 July last. The terms of reference of the Group covered 15 specific items for consideration and these are listed in Appendix 2 of the Report along with high level findings.

Given the severe pressure on the public finances, the Group was conscious of the need to minimise the cost to the Exchequer. In assessing the mortgage arrears issue, the Group found that blanket debt forgiveness schemes would, by design, be broad-based in nature and consequently it would be impossible to effectively target scarce State resources at those most in need. These are simply not affordable. The vast majority of mortgage holders can and must continue to meet their mortgage commitments and indeed any other debt obligations.

The issue of mortgage arrears is complex, with individual circumstances varying greatly, and the resolution of the issue requires a broad range of actions. Given the complexity of the issue, the Group is recommending the establishment of an independent mortgage advice service to guide mortgage holders through what can be a difficult and stressful process.

The Group confirms that the Central Bank's Code of Conduct on Mortgage Arrears (CCMA), which amongst other things, requires each mortgage lender to establish a Mortgage Arrears Resolution Process (MARP), will continue to play an important role in structuring the case by case engagement between the parties. The recommendations of the Group provide a framework to guide these engagements.

The Group found that forbearance measures will continue to be a suitable response in many circumstances. However, existing forbearance arrangements will not always be appropriate and the Group is looking to the industry to extend the range of alternative solutions. In this regard, the Group recommends that specific proposals be developed by the mortgage lenders, including trade-down mortgages, split mortgages and sale by agreement.

Importantly, it will not be the case that the distressed mortgage holder will be entitled to a particular solution and all solutions carry consequences. Given the challenging environment, the unfortunate reality is that some people will lose their home. The challenge is to minimise the incidence and consequences of this event.

The early reform of personal insolvency legislation will be a central element in the resolution of the mortgage arrears problem by providing a catalyst for change in the relationship between the mortgage lender and the distressed mortgage holder. Rapid progress will be necessary in this area to provide for certainty on both the judicial and non-judicial mechanisms and to allow settlements to be reached. Such mechanisms need to be carefully calibrated to ensure that there is no suggestion that borrowers can easily leave outstanding debts behind them. Changes that incentivise behaviour to cease paying debt would make the arrears problem worse and add to taxpayer costs.

In line with the findings of two previous reports, the Group found that the receipt of Mortgage Interest Supplement should be time limited. In order to alleviate the difficulties this may cause, the Group recommends the establishment of two mortgage to rent schemes for social housing eligible households.

The Group is acutely aware of the dramatic rise in the level of mortgage arrears in the last two years and expects further deterioration. The Group agreed that the Government should consider early implementation of the recommendations. In this regard, an implementation roadmap to guide next steps has been set out in the Report.

Important notice

- The group was established to consider 15 specific matters as approved by the Economic Management Council (EMC). However, as is the case which such reviews, our group has extended beyond the specific approved areas to a certain extent
- The 15 matters are set out in the group's terms of reference in Appendix 1
- We draw your attention to the significant limitations of our procedures:
  - The working Group met 8 times over a 9 week period
  - Notwithstanding the fact that we did extend somewhat beyond our specific terms of reference our work was primarily focused on those matters
  - While we met with several of the banks during the course of our work we did not carry out in-depth reviews of their loan books or operations
  - The data used in our analysis was restricted to available Central Bank data
  - No data is available on what proportion of those mortgage holders who are currently making their schedule repayments is close to going into arrears
  - Our work focused on home owner mortgages and did not consider Buy-to-Let mortgages
- Accordingly, it is not contemplated that the Working Group will provide an exhaustive set of recommendations and/or solutions

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The challenges

The broad challenges underpinning our analysis of the issues were:

- To keep people in their homes, where appropriate
- To avoid inappropriate mortgage holder behaviour thereby compounding the arrears problem
- To reduce the burden on home owners facing debt servicing difficulties
- To reduce the drag on the economy from a significant cohort of over-indebted people whose spending is constrained by mortgage debt obligations
- To strengthen and provide transparency on the loan portfolios of mortgage lenders
- To facilitate market funding of mortgage asset portfolios
- To minimise the cost to the State and to target scarce State resources for maximum efficiency

See Appendix 2 for an outline of the Group's responses to these challenges

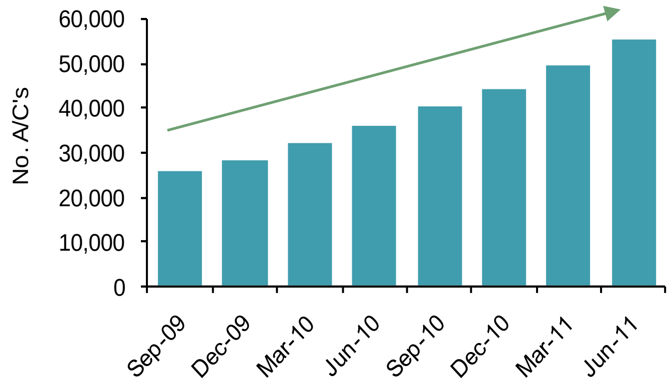
Scale of the problem

Arrears trends

- There has been a dramatic rise in the level of mortgage arrears in the last 2 years and this trend is continuing
- Approximately 45,000* households are in 90 days plus arrears, of which approximately 32,000 households are in 180 days plus arrears
- Numbers in the 180 days plus arrears category have doubled since end 2009
- On average in the 180 days plus arrears category, due arrears amount to over 10% of the principal
- There are also approximately 56,000 households with restructured loans (approximately 70,000 mortgage accounts)

*Note: * This equates to the c55,000 mortgage accounts in the Central Bank data*

90 days plus arrears by No. A/C's



Source: Central Bank of Ireland

Key recommendations

Guiding principles	▪ Those who can discharge their mortgage obligations must do so ▪ There is no entitlement to a particular solution and solutions have consequences ▪ There are unsustainable situations and unfortunately it is inevitable that people will lose their homes; this needs to be minimised
Develop a range of practical solutions	▪ A blanket debt forgiveness scheme is not recommended ▪ A range of solutions are recommended. These and others need to be further developed, over time, by the banks. ▪ Case by case approach required ▪ Decision tree approach to facilitate assessment ▪ An active housing market will be required for certain solutions to work effectively
Curtail mortgage interest supplement	▪ MIS is not an appropriate long term support ▪ Replace with more sustainable solution
Two State sponsored mortgage to rent schemes – Approved Housing Bodies; and – Mortgage lender leasing	▪ To protect the most distressed mortgage holders with social housing needs ▪ Ownership of the house passed to an Approved Housing Body or the mortgage lender ▪ Existing owner will become a social housing tenant and the State, where necessary, will subsidise the rental ▪ Avoids an unnecessary extension of the social housing list
Reform Bankruptcy Legislation	▪ Central catalyst to the resolution of the mortgage arrears problem ▪ Early introduction of reformed bankruptcy law and new non-judicial debt settlement arrangements is vital ▪ Implementation of new complex insolvency provisions may take time and will require resources
Independent mortgage advice function	▪ To advise and support mortgage holders in assessing their options ▪ To build trust in the debt resolution process

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Arrears trends

Arrears have been growing steadily for the last 2 years

More information and analysis is required to fully understand the potential scale of the problem

- Latest arrears data shows significant and consistent growth in arrears over the past 18 months – over 45,000* households are now 90 days past due with their mortgage payments
- Approximately 56,000 households (70,000 mortgage accounts – see chart) with restructured loans
- Leading indicators such as ICB data would confirm expectations that the trend in arrears is still upward
- The problem has been mitigated significantly by a historically low interest rate environment
- Future budgetary measures, eventual ECB rates increases and further increases in SVR mortgage rates is only going to increase the problem:
  - It is not possible to estimate the impact that any such changes may have on arrears. The banks and the Central Bank do not have access to mortgage holders' current income levels so it is not possible to tell with any reasonable accuracy whether the 88% of mortgage holders who are paying their original mortgages can absorb further hits. The Central Bank and the banks are undertaking a study to improve forecasting knowledge in this area. While the Working Group does not include this as a key recommendation we draw attention to the importance of progressing this study to fully understand the potential scale of the arrears challenge

*Note: * This equates to the 55,000 mortgage accounts in the Central Bank data*

Restructure type	Number of Accounts
Term extension	9,410
Reduced payment (interest & part capital)	10,777
Interest-only	25,786
Reduced payment (less than interest-only)	9,405
Arrears capitalisation	8,994
Hybrid	3,269
Payment moratorium	2,163
Other	33
Total	**69,837**

Source: Central Bank of Ireland

Response to date

There is a need to change behaviour and ensure mortgage lenders and mortgage holders agree more sustainable solutions. To do so we need to focus on some of the influencers of the current "wait and see" approach

Approach to date

- To date the collective approach (by mortgage holders, mortgage lenders, the Regulator and the State) has been to buy time – adopt a wait and see approach
- Given the level of growth in arrears and the lack of resolutions, it is evident that a broader response is required
- Many people are entering forbearance agreements or are sheltering behind the moratorium on legal action or the slow legal process, when in reality their mortgages are unsustainable

Influencers of approach

- The length and complexity of the legal process required to obtain repossessions
- The moratorium on legal action under the Code of Conduct on Mortgage Arrears
- The low level of activity in the housing market means significant foreclosures and/or disposals are not realistic options for mortgage lenders
- While forbearance arrangements are mostly appropriate, they are not always (see next slide)
- The unlimited (time) availability of Mortgage Interest Supplement
- The penal nature of the Irish bankruptcy laws and the full recourse nature of mortgages
- The lack of alternative solutions
- An expectation that the State may provide a bail out mechanism in the future

Mortgage arrears – the key factors

Given the number of variable factors impacting every situation, blanket solutions will not be effective

A range of practical solutions are required which should be applied, based on the assessment of individual mortgage holders affordability, the level of negative equity and future prospects

Factors impacting mortgage arrears

- Mortgage arrears are influenced by three factors: affordability, negative equity and future prospects
  - *Affordability:* Changes in people's ability to meet their monthly mortgage obligation due to changes in things such as employment, salaries, tax, is the key driver of mortgage arrears
  - *Negative equity (LTV):* Negative equity has not of itself given rise to mortgage arrears. However it does influence the scale of loss that the mortgage holder and the bank face and, as a result, the potential solution
  - *Future prospects:* While the scale of the problem can be estimated for each mortgagee now, the bigger difficulty is in determining how their income, interest costs, house value will fare in the future. Age, and how many future years of earning capacity an individual has, is also a very important consideration

Forbearance has a role

Forbearance is a very useful solution but the long term position needs to be kept under review

Forbearance suitability

- Forbearance is a very useful and appropriate solution in many cases. However it is not the solution in all situations
- The suitability of forbearance arrangements for a mortgage holder should be assessed based on their future prospects[(i)]
- Where there is little prospect of ever being able to build up reasonable equity in the property, forbearance may not be appropriate

(i) Considers whether future income and or future asset value will be sufficient to repay the loan. Need to also consider the mortgagees accommodation needs if the house has to be sold to eventually clear the loan

Deferred Interest Scheme (DIS)

- DIS was recently introduced as an Advanced Forbearance solution
- The group understands that lenders representing approximately 70% of the mortgages market have indicated that they will offer a DIS
- As the scheme was only recently introduced it is too early to assess its effectiveness

Other key findings

- A blanket debt or negative equity forgiveness scheme would not be an effective use of State resources and would not solve the problem:
  - It is estimated that it would cost in the region of €14 billion to clear the negative equity in the Irish mortgage portfolios
  - Even a more targeted population (mortgage taken out between 2006 and 2008) would cost in the region of €10 billion
  - The primary driver of mortgage arrears is affordability not negative equity. While a write-down of the negative equity would help a mortgage holders in arrears, in many cases it is unlikely to create an affordable mortgage
  - The Central Bank estimates that only 10% to 13% of those in negative equity are in arrears
- The Group examined the proposal to increase mortgage interest relief to 30% for First Time Buyers in 2004-08 but it was considered that this change should not be recommended. The proposal would give increased relief in an indiscriminate manner as it would give benefits to all who took out mortgages in the relevant years, regardless of their economic circumstances. The proposal would cost the Exchequer approximately €120m in a full year and it would not be appropriately targeted at those who need the support
- MABS as currently resourced and structured is not suitable to provide the support needed by distressed mortgage holders
- Unsecured borrowing and BTL borrowing is quite pervasive and will complicate any solution.
- 50% of the arrears to date are outside the Covered Banks

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Introduction

Our recommended strategy for dealing with the problem would be to influence, encourage and support rather than be prescriptive

Bank ownership and influence

- While the State owns a very significant part of the Irish retail banking sector, it does not own it all
- 50% of existing arrears are outside the "covered banks"
- Short of prescriptive legislation, the Government is not in a position to force solutions on the market
- However where the State is funding an existing or new scheme, there is scope to influence the behaviour of mortgage lenders through policy initiatives
- Likewise new bankruptcy legislation has the capacity to fundamentally change the commercial dynamic between the mortgage holders and mortgage lenders

Bank ownership and influence (continued)

- Therefore our proposed strategy is to:
  - Influence the situation by introducing reformed bankruptcy legislation and by amending or introducing new support schemes
  - Encourage mortgage lenders to develop a range of alternative solutions in the context of reformed bankruptcy legislation; and
  - Support mortgage holders through a complex and potentially stressful process by introducing an independent mortgage advice function

Introduce new bankruptcy legislation

Early introduction of new judicial and non-judicial bankruptcy options is vital; but this is highly complex and will need to be properly resourced

Without effective bankruptcy legislation the mortgage arrears problem will not be resolved

Changes that incentivise behaviour to cease paying debts must be avoided

- The current legislative framework for personal insolvency does not offer a meaningful resolution to any party – mortgage lender or mortgage holder
- Given the full recourse nature of mortgages there is no current insolvency option for many mortgage holders who are in difficult or unsustainable mortgages – they could face permanent bankruptcy
- Publication of new legislation is planned for Q1 2012 which could fundamentally change this position and the dynamic of any relationship/negotiation between the mortgage lender and the mortgage holder
- While this is urgently needed, and the group does not see a resolution to the mortgage problem without it, care is needed to ensure that it strikes the appropriate balance between the interests of debtors and creditors. This view was also held by the Mortgage Arrears and Personal Debt Group
- It is recommended that all of the new non judicial debt settlement arrangements are introduced at the same time as reformed bankruptcy legislation so as to discourage any potential overuse of bankruptcy which could give rise to a volume of cases that the courts process would be unable to deal with.
- The State currently has no infrastructure or resources in place to run a non-judicial debt settlement process. This is likely to be very complex and take time to implement

New bankruptcy legislation – three tiered approach

The current proposal is to introduce a three tiered debt settlement process:		
A revised judicial process	**A non-judicial debt settlement process**	**Debt Relief Order to settle lower value bankruptcy cases**
■ The group understands that the automatic bankruptcy discharge period under the judicial process could be set as low as 3 years ■ Uncertainty exists as to how the courts will deal with an income earning bankrupt – it could require them to make payments to the creditors beyond the discharge period ■ Irrespective of the courts' assessment, the group's view is that a move in this direction (i.e. away from the current 12 year automatic discharge period) is fundamental in order to provide mortgage holders with meaningful options	■ The non-judicial debt settlement process is common in many other jurisdictions and should act as a more cost effective and efficient alternative to a court process ■ A non-judicial debt settlement period would normally run for 5 years ■ There is no identified precedence where secured lending is captured within such a process ■ In Ireland the matter is somewhat more complicated than other jurisdictions. The level of negative equity in the mortgage portfolios means that secured loans essentially contain significant amounts of unsecured debt in bankruptcy or repossession scenarios ■ It would be difficult to obtain a debt settlement approval from the unsecured creditors if they saw that it improved the security position of the mortgage lender ■ According, mortgage lenders will need to make allowance within their mortgage solutions, on a case by case basis, to make some funds available to facilitate unsecured debt settlement	■ A Debt Relief Order (DRO) would allow persons with "no assets – no income" to fully write-off unsecured debt within a short period of time ■ In the UK a DRO is available for debts up-to €17,000 (equivalent). UK equivalent figures for disposable income and qualifying assets are €57pm and €340 respectively ■ No definitive monetary caps have yet been established for the proposed Irish scheme

Mortgage interest supplement

MIS should be curtailed once new alternatives options are available

- MIS is a very important support provided by the State to certain mortgage holders in difficulty
- It has grown substantially over the past number of years - the latest estimate is that over 18,700 households are availing of the support (2007: 4,100)
- It was designed as a short term support however it is now supporting people for significantly longer than originally envisaged
  - Approximately 12,000 households are on MIS for over 1 year
  - Over 6,000 for over 2 years
- As currently designed MIS can continue indefinitely. Indeed in certain situations it could be regarded as a "welfare trap"
- Long-term MIS effectively acts as a State subsidy to the bank
- A previous Value for Money and Policy Review of MIS recommended that it should be time limited. That view was re-affirmed by the Mortgage Arrears and Personal Debt Group and is supported by this working group
- The introduction of Mortgage to Rent schemes (as discussed later) could provide a better and more sustainable solution for many people in long term MIS

Range of solutions

Suggested solution	Key principles
■ In this section we set out a range of suggested solutions ■ These are not exhaustive and would need to be adapted to the individual circumstances ■ The group recommends that mortgage lenders and State bodies (where appropriate) develop these and or other solutions ■ However in developing or offering any solution the group recommends and endorses several key principles ■ The Central Bank should assess proposed solutions against its prudential policy and consumer protection objectives	■ Those who can meet their mortgage obligation must do so. ■ Mortgage holders and banks must comply with the MARP ■ Mortgage holders are not entitled to any particular mortgage solution ■ Availability would depend on individual circumstances ■ Any solution would have consequences including: – Loss of the house – Loss of ownership – Realisation of other assets – A bankruptcy/debt settlement period – Bad credit rating

Mortgage arrears resolution process

The Central Bank will continue monitoring compliance by mortgage lenders with the MARP and publically report its findings

Background

- The MARP was recommended by the Mortgage Arrears and Personal Debt Group as a standardised industry approach to deal with arrears and pre arrears customers
- It is a very important foundation to the individual case by case assessment approach
- It should ensure consistency of approach both within and between lenders
- The formal MARP was included in the revised CCMA which became effective on 1 January 2011
- The Standard Financial Statement, which is a key element of the MARP, became effective from 1 July 2011
- To date, the Central Bank has completed a themed inspection of the provision of the revised CCMA restricting surcharge interest and arrear changes. The findings from this themed inspection were published on 1 July 2011
- Further assessment of the implementation of MARP is planned for later in 2011

Phases of MARP

Stage 1: Communication
Lender confirms to mortgage holder by written communication that he/she is a MARP case

↓

Stage 2: Financial information
Mortgage holder completes SFS and provides any necessary supporting documentation

↓

Stage 3: Assessment
Lender's ASU assess SFS and considers alternative repayment arrangements

↓

Stage 4: Resolution
Lender communicates assessment decision with mortgage holder

↓

Stage 5: Appeals
Mortgage holder has right of appeal on certain grounds. If he/she is not satisfied with the lender internal appeals decision they may appeal to the Financial Services Ombudsman

Mortgage to rent schemes

- The group recommends the introduction of two mortgage to rent (MtR) schemes aimed at those people who would qualify for social housing if they lost their home and where their house is appropriate to social housing
- As the State will be required to provide housing for people in these circumstances the group sees clear advantages of MtR schemes. The future social housing tenant will bring housing stock and bank funding with them and thereby avoiding unnecessary increases in the social housing list while at the same time keeping people in their homes
- There are certain inequities with these schemes as the mortgagee may by-pass those already on the housing list, but on balance the group considered that the advantages of MtR schemes out-weigh these inequities
- Two schemes are being developed (1) Utilising an Approved Housing Body to acquire the property and (2) A long term lease from the banks directly to the Local Authorities
- The schemes should be subject to an initial review after 12 months and a value for money review after 24 months

Mortgage to rent – approved housing body

Assessment

- Mortgage assessed (via MARP) to be unsustainable
- The mortgage holder and their property assessed as being social housing eligible

Transaction

- AHB buys the house from the mortgage holder at a discount to CMV*
- D/ECLG provides 25% equity to AHB
- The mortgage lender funds the remainder

Ongoing

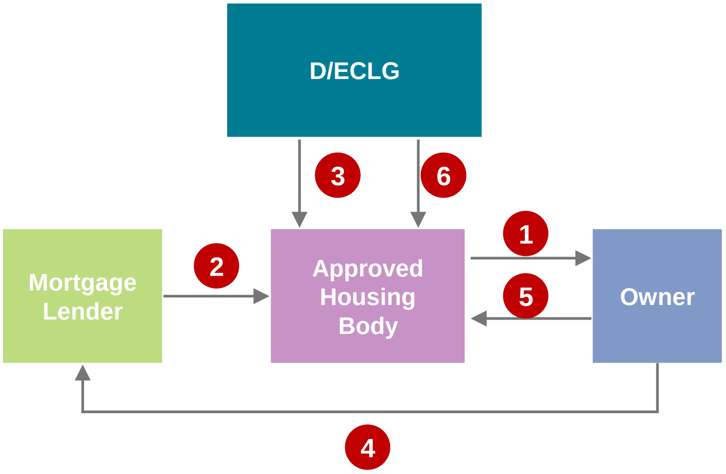
- Mortgage holder stays in the house as a social housing tenant
- They pay a "differential" rent to the AHB
- D/ECLG pays the balance, up to 80% of CMR **

Note: Tenants would be entitled to the same rights as other social housing tenants

** An equivalent scheme in the UK sets the acquisition price at 90% of CMV*

*** Where the AHB chooses to take responsibility for the repairs and maintenance of the property, the D/ECLG will pay up to 92% of CMR*

Structure



1. The house is sold by the mortgage holder to the AHB at a discount to CMV
2. The mortgage lender would provide a 75% long term loan to the AHB, secured on the property
3. The D/ECLG would provide the AHB with a 25% equity investment which has a second charge on the property
4. The owner would pay or part-pay the mortgage with the proceeds of the sale
5. The mortgage holder will rent the house from the AHB at an agreed means tested rate.
6. D/ECLG would pay up to 80% of market rental to AHB

Mortgage to rent – leasing

Assessment

- Mortgage assessed (via MARP) to be unsustainable
- The mortgage holder and their property assessed as being social housing eligible

Transaction

- The mortgage lender acquires the house from the mortgage holder on a voluntary basis
- The mortgage lender and a Local Authority (LA) enter into a 20 year lease
- The mortgage holder becomes a tenant of the LA

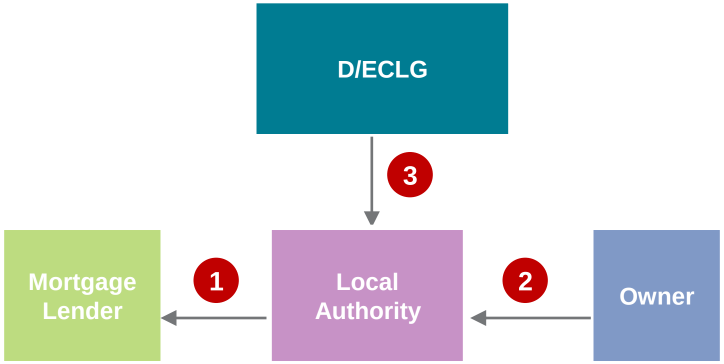
Ongoing

- The LA pays the mortgage lender a rent of up to 80% of CMR, where the property management functions are devolved to the LA *
- The mortgage holder stays in the house as a social housing tenant and pays a "differential" rent to the LA
- D/ECLG pays the LA the difference between the rent the LA pays the mortgage lender and the rent the LA receives from the tenant

Note: Tenants would be entitled to the same rights as other social housing tenants

* *Where the bank chooses to take responsibility for the repairs and maintenance of the property, the LA will pay up to 92% of CMR*

Structure



- The house is surrendered by the owner (mortgagee) to the mortgage lender

1. The mortgage lender would provide a long term lease to the LA
2. The original owner will rent the house from the LA at an agreed means tested rate
3. D/ECLG would pay rent up to 80% of market rental to LA

Mortgage to rent

	Advantages	Disadvantages
Mortgage holder	■ Mortgage holder stays in their existing home ■ Avoids unnecessary market transactions	■ The mortgage holder will lose the ownership of their home and will have no added entitlements beyond what is available to other social housing tenants ■ There may be a mortgage shortfall that will still need to be dealt with
Mortgage Lender	■ Mortgage lenders avoid repossession and associated costs (likely therefore that sale price to AHB will include an agreed discount to CMV) ■ Avoids unnecessary market transactions which would impact on market prices	■ If mortgage lenders are required to hold property assets on their balance sheet they will attract a higher capital weighting ■ Mortgage lenders are not property management companies and therefore the leasing option will require investment in new operations and expertise ■ The proposed leasing scheme currently provides no exit mechanism for lenders
State	■ No unnecessary elongation of the housing list ■ Avoids social consequences of large numbers of people moving ■ MIS would cease for this mortgage holder, if applicable	■ Increased cost to the State – but this is an unavoidable cost in due course and given that many people in these circumstances probably qualify for MIS it is likely that their accommodation is already being funded by the State – Our estimates show that MtR is likely to be cheaper than MIS where the mortgage holder is on a SVR mortgage – Whereas if the mortgage holder is on a tracker at current ECB rates, MIS is likely to be cheaper

Trade down mortgages

If a trade down on existing terms is viable it is beneficial for both the mortgage lender and the mortgage holder and should be encouraged

- Certain mortgage holders in mortgage difficulties with higher value or larger properties maybe able to trade down to a lower value house and carry the negative equity with them
- The level of the mortgage holders sustainable income and negative equity and the scale of the trade down will determine whether this option is viable
- While there is general support for this solution in the appropriate circumstances there are two impediments:
  - An increased Loan to Value ratio
  - The interest rate on the reduced mortgage
- While the increased LTV is relevant, so long at the mortgage holder can afford the new mortgage and the ratio is not so high as to be a disincentive to the mortgage holder, it is a secondary factor
- Mortgage lenders may want to use this as an opportunity to move people off tracker and reduced rate mortgages – this would not be appropriate as in most cases it will defeat the objective of someone trading down to a more affordable mortgage

Illustrative examples

	Customer A		Customer B	
	Current Home	New Home	Current Home	New Home
Mortgage[a]	400,000	270,000[b]	400,000	307,000[c]
Current Value of Property	320,000	180,000	220,000	120,000
LTV	*125%*	*150%*	*182%*	*256%*
Approx Monthly Payment	€2,100	€1,400	€2,100	€1,600
Affordability Gain[d]		*33%*		*23%*

Notes: *(a) Assume 4% interest rate over 25 year term applies in the case of the existing and the new mortgages*

(b) €180,000 purchase price + €80,000 NE carry over + €10,000 selling costs

(c) €120,000 purchase price + €180,000 NE carry over + €7,000 selling costs (selling costs assumed at 3% of sales price)

(d) The affordability gain is the percentage savings in mortgage debt servicing costs

Customer A

- Very significant (33%) reduction in monthly mortgage repayments. The lender would also have a much more stable loan

Customer B

- Again significant reduction in the monthly mortgage repayments. However in this situation the scale of the remaining mortgage compared to the value of the house would be a concern. In order to ensure that a proposal is consistent with the Central Bank’s consumer protection and prudential policy objectives, a maximum LTV and other parameters would need to be agreed between mortgage lenders and the Central Bank

Split mortgages

- The group has received several suggestions regarding the concept of splitting a distressed mortgage into an affordable mortgage and warehousing the balance
- The group considers that split mortgages could be a viable solution in certain circumstances
- The size of the affordable mortgage, which would be paid down over the income earning life of the mortgage holder, could be calculated using an agreed model (illustrative approach discussed on next slide). This would be re-calculated on a periodic basis. Should a mortgage holders disposable income increase, an amount would transfer from the warehouse to the affordable mortgage, based on a pre-agreed formula.
- The mortgage lender and mortgage holder would need to decide how the balance remaining in the warehoused loan is to be settled at term end. There are several ways of dealing with this, including:
  - Selling the property and repaying the warehoused loan from the proceeds of sale
  - Trading down to a smaller property
  - Realising other assets or pension lump sums
  - Agreeing a life interest in the property
- Each case would need to be assessed on its merits. However, the mortgage holder would need to properly assess the level of equity that they are likely to create in the property over time. If that is not sufficient to meet their long term needs this may not be the an appropriate solution for them

Split mortgages – affordability

- The following is a suggested mechanism for calculating the amount a mortgage holder can afford to pay:
  - Recognising the concept that a mortgage holder should utilise a maximum percentage of their NDI[1] on their mortgage payments
  - This is a concept that mortgage lenders often use in assessing a new mortgage loan in order to ensure that the mortgage holder has capacity to repay and also maintain a certain standard of living
  - For split mortgages the NDI ratio applied to determine the level of affordable mortgage may be higher than that used to underwrite a new mortgage. However, this ratio should remain fixed
  - If NDI increases over time some of the warehoused mortgage will revert to the amortising affordable mortgage
  - By setting an agreed NDI ratio, the mortgage holder will know how much of any increased income must be used to service the mortgage

(1) NDI refers to a households income after the deduction of all relevant taxes and social insurance contributions.

Illustration of NDI approach

€	2012	2017
Annual NDI	20,000	25,000
Standard Mortgage amount (NDI @ 33%)	6,600	8,250
Assume:		
Split mortgage payment (p.a.) – assume 40% of NDI	8,000	10,000[2]
Income life remaining (years)	30	25
Rate of interest	*5%*	*5%*
Post split Affordable Mortgage	123,000	113,000[3]
Transfer from Warehouse		28,000 [4]
New Affordable Mortgage		**141,000**

Notes: (1) All ratios are illustrative only and figures are rounded. It is assumed that a mortgage holder offered a split mortgage will be required to pay a higher percentage of their NDI towards the mortgage than would be the case for a new mortgage holder

(2) Of the €5,000 increase in the mortgage holders NDI, assume 40% is required to service the mortgage. Therefore there is an incentive to increase income levels

(3) €10,000 in principal reduction over the 5 year period

(4) A transfer of €28,000 from the warehouse to the paying mortgage is derived by firstly calculating what size of mortgage a person with a €10,000 NDI can afford, based on a 25 year mortgage at 5% interest. The remaining balance in the affordable mortgage is subtracted from this figure to determine the transfer amount.

Split mortgages – outline example

- The table opposite builds on the "NDI approach" illustration on the previous slide and sets out how a split mortgage might work over a 30 year period
- The mortgage holder will need to determine whether the forecast equity will be sufficient to meet their needs in retirement. This would need to be continually reassessed over the life of the mortgage
- In scenario I (see table) the mortgage holder will need to assess whether the €115,000 is sufficient to meet their retirement needs
- However in scenario II the mortgage holder and the mortgage lender will in all likelihood need to consider alternative solutions including sale by agreement, bankruptcy/debt settlement, interest rate reductions on the warehouse, equity sharing, or perhaps a life interest arrangement
- The group recommends that mortgage lenders develop these or other solutions and present them to the Central Bank

Illustrative split mortgage scenarios [1]

€	Affordable	Scenario I Warehouse	Scenario II Warehouse
House value today	120,000	120,000	120,000
Estimated house value at term end (30 years)[2]	217,000	217,000	217,000
Existing mortgage		170,000	200,000
Split mortgage today	123,000	47,000	77,000
Year 1-5 Principal repaid	(10,000)		
Year 1-5 Interest roll-up		13,000	21,000
Balance at end year 5[3]	113,000	60,000	98,000
Income increase: transfer from warehouse	28,000	(28,000)	(28,000)
	141,000	**32,000**	**70,000**
Year 5-30 principal repaid	(141,000)		
Year 5-30 Interest roll-up[4]		70,000	156,000
Balance at term end	Nil	102,000	226,000
Net equity at term end[5]		**115,000**	**(9,000)**

Notes: *(1) This illustration is a continuation from the example in the previous slide. Affordable mortgage repayments of €8,000 per annum in years 1 to 5, and €10,000 per annum from year 6 to term end. For the purpose of this example, the applicable interest rate is assumed at 5% for both the affordable account and the warehoused account. Figures are rounded*

(2) Illustrative assumption of 2% HPI, this is not a forecast

(3) €10,000 in principal reduction over the 5 year period

(4) Assumes no further increases in NDI from year 6 to term end

(5) Estimated house value less balance on warehoused loan

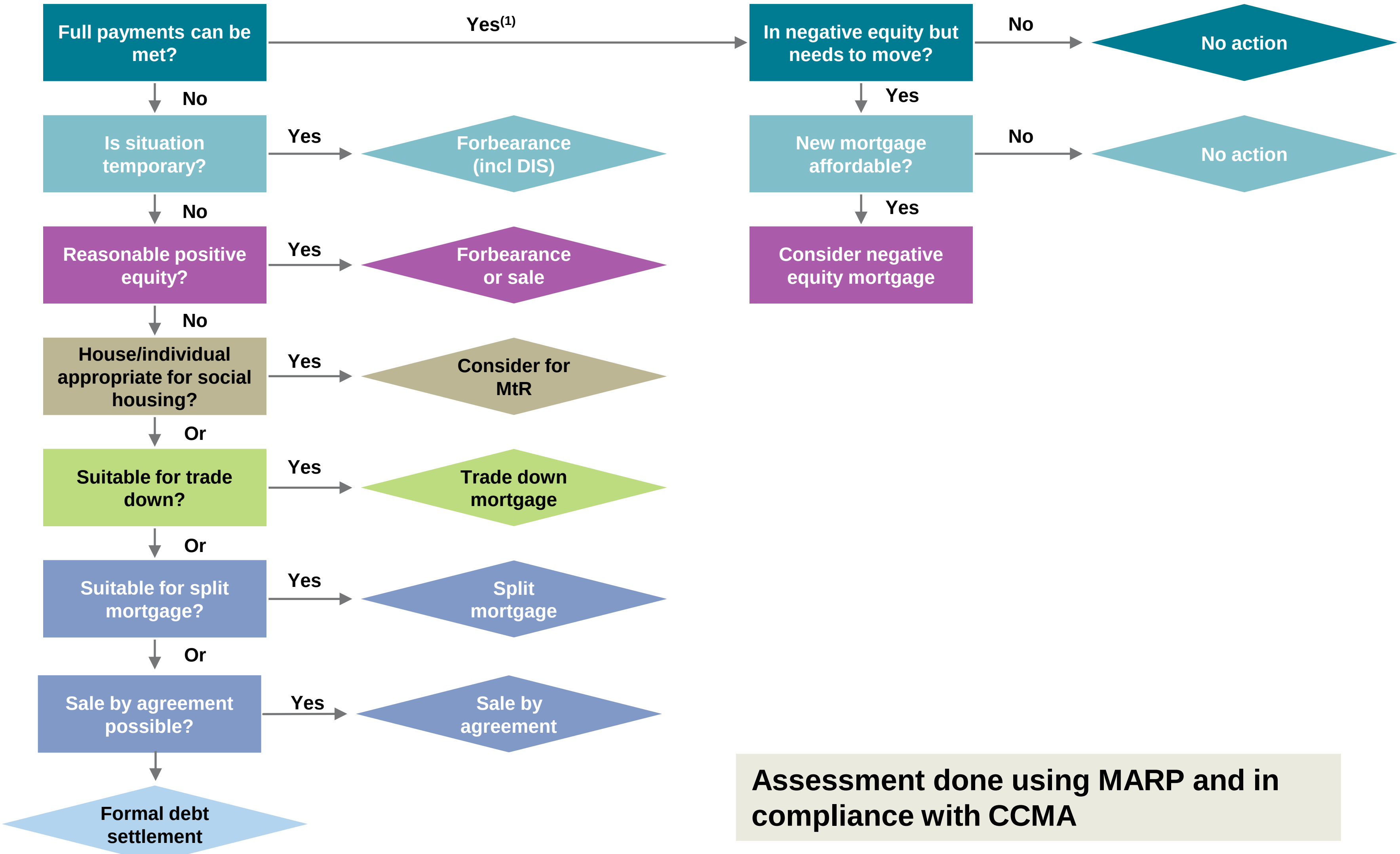
Split mortgages – mortgage holder

	Advantages	Disadvantages
Mortgage holder	■ Mortgage holder stays in their home ■ More certainty over their monthly repayments	■ If their income does not rise sufficiently they never own their home ■ They may not create sufficient equity in the property to meet their retirement needs
Mortgage Lender	■ Avoids unnecessary market transactions ■ Avoids repossession and associated costs	■ If the house value does not increase to the value of the warehoused loan the mortgage lender would be exposed to a shortfall loss at maturity. However this loss would in all likelihood be less than the loss that would arise today in repossession ■ As a new "product" it would have operational issues for mortgage lenders

Sale by agreement

- Unfortunately there will be cases where the mortgage is unsustainable and where mortgage to rent, trade down mortgage, split mortgages or other solutions are not suitable
- In these cases it will be in the interest of both mortgage holders and mortgage lender to agree to sell the property and to reach a reasonable and appropriate agreement regarding the shortfall taking account of the borrower's circumstances
- Such agreement should be more economically advantageous than formal bankruptcy for all parties

Decision tree approach to assessment



Assessment done using MARP and in compliance with CCMA

Note: (1) Not a focus of the Group's work as customers are not in arrears but the issue is worthy of consideration

Independent mortgage advice function

The group recommends the establishment of a mortgage support and advice function

The function should be a source of advice to the mortgage holder and should not encroach into the Central Bank's banking supervisory or consumer protection roles

The need for support and advice

- Any change to the "wait and see" approach will mean that mortgage holders will need to understand and assess their options and make important decisions
- New bankruptcy laws, non judicial debt settlement options and potential mortgage restructuring solutions will complicate these decisions
- MABS is not structured or resourced to provide this support and advice
- The aims of the service would be:
  - To advise customers (in arrears or pre-arrears) in their dealings with mortgage lenders
  - To review cases and advise customers who have entered or been through the MARP
  - To act as a consumer advocate in this area
  - To contribute to the debate and development of national policies and practices that exist
  - To build trust in the debt resolution processes

Independent mortgage advice function (continued)

Operations

- The advisors should operate in 3 to 4 regional clusters in order to ensure that expertise and knowledge is captured and shared
- We would recommend linking these clusters to MABS offices. The clusters could be legally part of MABS but would not have to be. However it would be important that there is a link to the MABS network to ensure that mortgage holders know how to access the advice
- Strict operating protocols would need to be enforced between MABS and these mortgage support clusters
- It would be envisaged that the need for this function would be time limited – perhaps 3 years

Scale

- It is very difficult to determine the number of people that will need this support
- Given that mortgage lenders estimate that they collectively require over 600 people in their Arrears Support Units it would be safe to assume that over 100 independent advisors would be needed in the first instance. However it would be quite likely that this number will increase in time

Skills

- The skills required would include financial, accounting and legal

Funding

- The Group would recommend that the funding for this function should be provided by mortgage lenders

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Implementation roadmap

Suggested strategy	Next steps
General comment	■ It has to be recognised that there are significant issue to be resolved before many of these options are available ■ While we would encourage all those involved to expedite the matters, it also important to recognise that they need to be progressed in a controlled manner ■ An implementation team will be necessary to deliver the various initiatives effectively and quickly ■ Ongoing oversight will be required to track progress ■ In this context there should be no expectation that the solutions discussed in the report will be immediately available
Bankruptcy legislation	■ An early Government decision on key elements of the reformed bankruptcy law and on the nature, scope and operation of the new non judicial debt settlement systems ■ Further consideration to be given to how secured mortgage creditors should interact with non-judicial debt settlement
Mortgage to rent	■ More detailed planning required between D/ECLG, the banking industry, the Local Authorities and the Approved Housing Bodies to implement these suggested schemes
Mortgage Interest Supplement	■ D/SP to devise transitional arrangements to provide for the curtailment of MIS ■ Establishment of a joint D/ECLG and D/SP Working Group to manage the movement from MIS to MTR
Trade down mortgage	■ Mortgage lenders and the Central Bank need to agree acceptable parameters ■ Mortgage lenders then need to implement them
Split mortgages and other solutions	■ Mortgage lenders to develop their proposed solutions in this area and present them to the Central Bank
Independent mortgage advice function	■ Develop and implement the necessary framework ■ Hire the senior management team to set up the operation as soon as possible ■ Recruit and training advisors

Contents

Appendix 1 – Terms of reference

Terms of reference		
No	**Action required**	**Key finding**
1	■ Assess the extent to which specific Mortgage Arrears and Personal Debt Group recommendations on the CCMA and the MARP have been implemented and consider follow on recommendations in light of experience to date	■ The CCMA was amended with effect from 1 January 2011. Lenders were provided with a period of up to 6 months in order to demonstrate full compliance with the amended provisions of the CCMA. The key recommendations implemented within the CCMA were the requirement for all mortgage lenders to establish a MARP, with supporting infrastructure such as an Arrears Support Unit (ASU), and the introduction of a Standard Financial Statement (SFS) ■ The Central Bank recently completed its first themed inspection on the CCMA (related to arrears charges and surcharge interest). Further work in the area of mortgage arrears will commence before end 2011 ■ While feedback suggests that the CCMA and MARP are operating effectively there may be certain implementation issues that require further assessment
2	■ Review the resources and skills available to MABS to assist vulnerable mortgage customers	■ MABS as presently structured and resourced lacks the capacity to deal with the volume of distressed mortgage holders and the range of complex issues which are likely to arise within the MARP and Debt Settlement process
3	■ Determine the extent to which the Deferred Interest Scheme is being implemented	■ It is understood that lenders representing about 70% of the market have indicated that they will offer a Deferred Interest Scheme
4	■ Assess the Deferred Interest Scheme criteria	■ The entry and exit tests proposed by the Mortgage Arrears and Personal Debt Group will bring some level of clarity around the determination of suitability for medium term forbearance. It is, however, too early to conclude that the criteria should be reviewed

Appendix 1 – Terms of reference (continued)

Terms of reference		
No	**Action required**	**Key finding**
5	■ Further develop the concept of "trade down mortgages" with the Central Bank and the banks and address specific implementation issues	■ Analysis by the Group confirms that the concept has the potential to deliver very significant savings in monthly repayments to certain mortgage holders and, as a consequence, to deliver a more stable loan for lenders ■ Changes to stamp duty legislation in the last budget has significantly reduced the transaction costs involved in such a move ■ The Group cautions that a trade down which results in a very high LTV may not be in the interest of either the mortgage holder or the lender ■ Trade downs which involve switching a customer from a tracker rate to a SVR may not achieve the desired objective of significantly reducing the monthly mortgage repayments
6	■ Review what progress has been made regarding the introduction of insolvency legislation and the policy approach being taken to the reform of the personal insolvency regime	■ New legislation is planned for publication by end-Q1 2012. Planning for the creation of the necessary infrastructure to operate a non judicial debt settlement process needs to commence in parallel to the passage of the legislation through the Oireachtas
7	■ Consider whether the proposed insolvency legislative changes are likely to achieve a balance of support to those in need without causing an unnecessary behavioural change in those who are not	■ This matter is under active consideration by the relevant Government departments, led by the Department of Justice and Equality, in the drafting of the necessary legislation
8	■ Carry out research into how the "inter-generational" mortgage market operates internationally	■ Research showed that country specific factors are very important and that the product would likely encounter serious legal difficulties in Ireland. However, the concept of having a residual balance on the mortgage at term end is considered under the "split mortgage" proposal
9	■ Consider increasing mortgage interest relief and whether an appropriate target cohort of individuals can be effectively identified for such a relief	■ It is considered that this proposal would be poorly targeted and represent an inefficient use of scarce public resources

Appendix 1 – Terms of reference (continued)

Terms of reference		
No	**Action required**	**Key finding**
10	■ Cost the mortgage interest relief proposal and consider what the incremental benefit would be to those in mortgage difficulties	■ It is estimated that it would cost approximately €120 million to increase the mortgage interest relief as envisioned. It was not considered that it would make a discernible difference to those in mortgage difficulties
11	■ Develop an initial outline for a principal modification scheme	■ The Group found merit in a "split mortgage" concept in certain circumstances.
12	■ Investigate, cost and assess the benefit of relief options to reduce or remove the negative equity burden from specified cohorts of mortgage holders	■ The cost of such a proposal could vary from €10 billion to €14 billion. ■ The benefits of such a proposal are questionable as it is likely that such a proposal would be very poorly targeted ■ The Central Bank has estimated that only 10% to 13% of households in negative equity are in arrears
13	■ Consider the merits of introducing a mortgage to rent scheme	■ Mortgage holders who hold unsustainable mortgages may find that there have no option but to turn to the State to service their housing needs in the event of losing their home ■ The Group sees clear advantage in mortgage to rent schemes, as they avoid unnecessary increases on the housing list
14	■ In conjunction with the Department of Social Protection consider the status of any proposed changes to the Mortgage Interest Scheme	■ Changes to the scheme are still under consideration ■ The Group considers that previously recommended curtailment of the scheme should be introduced in light of other alternative social housing solutions proposed by the Group
15	■ In conjunction with the Department of Social Protection consider the suggestion that MIS could be broadened to avoid the situation where people lose their homes and subsequently go onto a rental supplement, particularly in the context of the proposed changes to the MIS rules	■ MIS is not considered to be a sustainable solution for those in long term difficulty

Appendix 2 – Meeting the challenges

Challenge	Response
To keep people in their homes, where appropriate	■ Forbearance ■ Mortgage to rent ■ Split mortgages
To avoid inappropriate mortgage holder behaviour thereby compounding the arrears problem	Key principles: 1. If you can pay, you must. 2. There is no entitlement to a solution 3. A borrower who fails to co-operate within the MARP may lose certain protections 4. All solutions have consequences
To reduce the burden on home owners facing debt servicing difficulties	■ Reformed bankruptcy legislation ■ Mortgage to rent ■ Trade down mortgages ■ Split mortgages ■ Independent mortgage advice function
To reduce the drag on the economy from a significant cohort of over-indebted people whose spending is constrained by mortgage debt obligations	■ Mortgage to rent ■ Trade down mortgages ■ Split mortgages ■ Sale by agreement
To strengthen and provide transparency on the portfolios of mortgage lenders	■ Series of responses designed to change behaviour and generate more sustainable solutions ■ Mortgage to rent ■ Trade down mortgages ■ Split mortgages ■ Sale by agreement
To facilitate market funding of mortgage asset portfolios	■ Series of responses designed to change behaviour and generate more sustainable solutions ■ Mortgage to rent ■ Trade down mortgages ■ Split mortgages ■ Sale by agreement
To minimise the cost to the State and to target scarce State resources for maximum efficiency	■ Key principles ■ Range of solutions designed to ensure mortgage holders and mortgage lenders agree arrangements that are more economically advantageous than repossession for both parties

Appendix 3 – Working group members

Working group members	
Name	**Organisation**
Mr Declan Keane (Chairperson)	Department of Finance
Mr John Hogan	Department of Finance
Mr Niall O'Sullivan	Department of Finance
Mr John Fitzpatrick	Department of Finance
Mr Pat Ring	Department of Finance
Mr Brendan MacNamara	Department of Justice and Equality
Ms Mary O'Regan	Department of Justice and Equality
Ms Marie McLaughlin	Department of Public Expenditure and Reform
Ms Ciara Morgan	Department of Public Expenditure and Reform
Mr David Owens	Department of Public Expenditure and Reform
Mr John Conlon	Department of Public Expenditure and Reform
Mr Philip Nugent	Department of the Environment, Community and Local Government
Ms Aoife Joyce	Department of the Environment, Community and Local Government
Mr Francis Walsh	Department of the Environment, Community and Local Government
Ms Helen Faughnan	Department of Social Protection
Mr Darragh O'Conner	Department of Social Protection
Mr Kieran O'Dwyer	Department of Social Protection
Mr Reamonn Lydon	Central Bank of Ireland
Ms Anne McGuinness	Central Bank of Ireland
Ms Miriam Lee	Central Bank of Ireland
Mr Michael Quirke	AIB
Mr Owen Purcell	EBS

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Glossary

AHB	Approved Housing Body
BTL	Buy to Let
CB	Central Bank
CCMA	Code of Conduct on Mortgage Arrears
Covered Banks	AIB; Bank of Ireland; Educational Building Society; Irish Life & Permanent; Irish Bank Resolution Corporation
CMR	Current Market Rent
CMV	Current Market Value
D/ECLG	Department of Environment, Community and Local Government
D/SP	Department of Social Protection
DIS	Deferred Interest Scheme
ECB	European Central Bank
EMC	Economic Management Council
ICB	Irish Credit Bureau
LA	Local Authority
LTV	Loan to Value
MABS	Money Advice and Budgeting Service
MARP	Mortgage Arrears Resolution Process
MIS	Mortgage Interest Supplement
MtR	Mortgage to Rent
NDI	Net Disposable Income
SFS	Standard Financial Statements
SVR	Standard Variable Rate