

OPINION OF THE EUROPEAN CENTRAL BANK

of 17 November 2016

on the conferral of powers on the Central Bank of Ireland to assess competition in the market for mortgage loans and to issue lenders with directions on variable interest rates

(CON/2016/54)

Introduction and legal basis

On 6 October 2016, the European Central Bank (ECB) received a request from the Chairman of the Oireachtas (Irish National Parliament) Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach (Irish Prime Minister), for an opinion on the Central Bank (Variable Rate Mortgages) Bill 2016 (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 third and sixth indents of Article 2(1) of Council Decision 98/415/EC¹, as the draft law relates to (a) the basic task of the European System of Central Banks (ESCB) to implement the monetary policy of the Union pursuant to the first indent of Article 127(2) of the Treaty, (b) 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, (c) the Central Bank of Ireland (CBI) and (d) rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. 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 measures intended to identify and address market failures in the market for principal dwelling house mortgage loans. In order to achieve this purpose, the draft law confers a number of tasks on the CBI.
- 1.2 The draft law requires the CBI to carry out assessments on the state of competition in the market for principal dwelling house mortgage loans on at least a quarterly basis, and sets parameters for such assessment. The factors to be taken into account by the CBI in carrying out this assessment include: the variable interest rates being charged by lenders; the ease with which borrowers can switch their principal dwelling house mortgage loans; the relationship and proportionality between the variable interest rates being charged by each lender and the cost of funds of that lender; lenders' weighted average cost of capital and the trend in lenders' weighted average costs of capital over time; lenders' reasonable profit expectations in the prevailing market conditions; the

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).

proportion of the principal dwelling house mortgage loan market accounted for by each lender; and such other matters as the Governor of the CBI may certify as being of relevance.

- 1.3 Upon completion of its assessment, the draft law requires the CBI to form a conclusion whether the state of competition is such that a 'market failure' exists. The draft law defines a 'market failure' as a situation in which market conditions are such that a lender is charging a variable interest rate which is higher than the CBI considers can be reasonably and objectively justified. Where the CBI forms such a conclusion, the draft law confers powers on the CBI to issue directions to lenders not to charge a variable interest rate which exceeds certain thresholds. These thresholds can be: (a) rates specified by the CBI; (b) margins specified by the CBI above the lenders' cost of funds; (c) margins specified by the CBI, above a rate set by the ECB; and/or (d) a proportion if not more than one-third, specified by the CBI, above the average variable interest rate charged in the market for comparable principal dwelling house mortgage loans as determined by the CBI.
- 1.4 With regard to enforcement, the draft law confers powers on the CBI to enforce such directions on lenders that fail to comply, by applying to the High Court for an enforcement order. When granting the enforcement order, the High Court must also impose a fine on the lender, unless the High Court determines that it would be unjust to impose such a fine, in which case it may impose a lesser fine or dispense with the requirement to impose a fine.
- 1.5 Furthermore, the draft law imposes a requirement on lenders not to discriminate between existing and new borrowers when setting a variable interest rate for a group, and confers powers on the CBI to enforce that prohibition. In this respect, the CBI may apply to the High Court to seek a rectification order requiring the lender to cease the relevant discriminatory practice. The High Court may also make a compensation order to ensure that the lender compensates the borrowers for such discriminatory practice, and may also impose a fine on the lender.
- 1.6 Finally, the draft law further specifies that there is no right of appeal to the Financial Services Appeals Tribunal or to the High Court in respect of the assessment of the CBI, a direction of the CBI to a lender, or a decision by the CBI to seek an enforcement or rectification order.

2. Scope of the opinion

This opinion focuses on: (1) specific aspects of the power to issue directions to lenders not to charge a variable interest rate which exceeds certain thresholds and the relationship of this power with the CBI's existing functions with respect to monetary policy, banking supervision and financial stability (Section 3.1); (2) the potential effects of the draft law on the independence of the CBI (Section 3.2); and (3) the new tasks conferred on the CBI in relation to the prohibition of monetary financing under Article 123 of the Treaty (Section 3.3).

3. Observations

3.1 *Specific aspects of the power to issue directions to lenders not to charge a variable interest rate which exceeds certain thresholds*

As a starting point, the ECB wishes to emphasise that administrative control of market pricing by public authorities, such as issuing directions to lenders not to charge a rate exceeding certain

thresholds, should only be undertaken where it is clear which purpose the controls seek to achieve and that they are likely to achieve this purpose.

3.1.1 *Effects on the transmission of monetary policy*

The ECB has concerns that the administrative control of the interest rates charged by lenders could interfere with the market determination of lending decisions. In turn, this could have a detrimental effect on the transmission of monetary policy.

On the one hand, the smooth pass-through of changes in the ECB policy rates to bank borrowers is a component of the monetary policy transmission mechanism, which relies on well-functioning and competitive markets for bank credit. For that reason, any measures aimed at ensuring the pass-through of ECB rates or the proper functioning of the monetary policy transmission mechanism are, in principle, welcome.

However, the draft law seems instead to be motivated primarily by an assumption that, due to a lack of competition in the Irish market, lenders operating in Ireland are maintaining rates on variable rate mortgages in excess of the rates necessary to cover the lenders' cost of funds, the credit risk associated with lending, operational costs and the cost of capital. Despite this, the measures specified in the draft law do not seek to promote competition in the market, or to address other possible root causes influencing variable interest rates in Ireland, such as the large legacy portfolio of tracker mortgages, which have an adverse impact on bank profitability, the burden of non-performing loans on lenders' balance sheets, and the pricing of credit risk in Ireland.

Against this background, imposing administrative controls on the variable interest rates for principal dwelling house mortgage loans may have several unintended side effects. This is particularly relevant given the prevalence of this type of mortgage in a very important segment of the Irish market for bank credit. This may not only affect the transmission mechanism of monetary policy but also run counter to the very objective of the draft law.

For example, imposing administrative controls could potentially affect the rates offered by lenders for other types of bank credit, impairing the pass-through of the ECB's accommodative monetary policy stance to low interest rates on loans to other sectors of the economy. For example, lenders aiming to achieve a sustainable level of profitability may try to compensate for insufficient margins on their variable interest rate mortgage portfolio by charging higher rates on other types of bank loans.

In addition, lenders might adapt their credit standards, and offer variable interest rate mortgages only to new borrowers with a very low risk profile. This would effectively ration the supply of variable interest rate mortgages in the Irish market. Lenders could be motivated by a desire to sustain a risk-adjusted margin on variable interest rate mortgages which is comparable to the margin that would otherwise prevail. Riskier borrowers might instead be offered fixed-rate mortgages, which are outside the scope of the draft law.

Furthermore, the possibility of restrictions on the maximum rate that banks are allowed to charge for variable interest rate mortgages could potentially render the market less attractive and discourage new entrants. This would lead instead to lower competition in financial services in Ireland, effectively defeating the purpose of the draft law.

Overall, the power to issue directions to lenders not to set rates in excess of a certain threshold could interfere with the implementation of monetary policy by the CBI, one of its basic Eurosystem tasks, due to the potential for such directions to interfere with the monetary policy transmission mechanism.

3.1.2 *Effects on the banking sector*

In the context of its direct responsibility for the supervision of significant banking groups within the euro area, the ECB monitors closely the profitability of credit institutions. The CBI also closely monitors profitability, in the context of its responsibility for less significant credit institutions. One of the reasons for this is because low profitability has been identified as a business model risk, which warrants particular supervisory attention. It is important that banks are not prevented from generating sustainable profits which will result in well capitalised banks operating competitively. The high level of non-performing loans in Ireland and the low level of repossessions have brought large credit losses to Irish banks in the recent past and indicate that Irish banks could expect higher credit losses over the economic cycle than banks in a number of other euro area countries. In addition, it is worth noting that, while tracker rate mortgage contracts are currently not offered to new customers in Ireland, a substantial share of Irish mortgage borrowers, as tracker mortgage holders, are currently paying an average interest rate considerably below the average rate offered to new borrowers in the euro area.

In general, when pricing mortgages, credit institutions should take account of many factors, including the actual and future cost of funding, expenses and overhead, the cost of capital, and expected credit losses. The factors the CBI must consider in carrying out its assessment under the draft law reflect these issues only to a limited extent, as they focus on the lenders' cost of funds, the lenders' weighted average cost of capital and reasonable profit expectations in the prevailing market conditions. While the draft law permits other matters to be taken into account by the CBI for the purposes of the assessment (provided that the Governor of the CBI certifies these as relevant), it does not fully acknowledge the wider matrix of factors that credit institutions need to take into account in setting their interest rates.

The ECB would like to emphasise that extreme caution should be exercised when transferring the power to take commercial decisions from market actors to public authorities. The benefits need to be weighed against a number of risks including information asymmetry and moral hazard.

Thus from a supervisory perspective, the ECB also has concerns about the powers conferred on the CBI by the draft law. While the CBI is not obliged to exercise the rate-setting power, such intervention in the setting of rates by the market could affect overall profitability in the banking system, which is already challenged by the prevalence of tracker mortgages and the high level of non-performing loans. As a consequence, the exercise of the power conferred on the CBI could possibly conflict with the effective use of the supervisory powers conferred on the ECB as part of the single supervisory mechanism (SSM) in accordance with Council Regulation (EU) No 1024/2013².

² Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

3.1.3 *Effects on financial stability*

The ECB notes that the implementation of the draft law and exercise of the powers thereunder by the CBI could entail financial costs for the banking sector. Consequently, the possibility to set administrative limits on the profitability of a core business activity of the banking system might induce more risk-taking behaviour with banks engaging in alternative projects that do not reflect prudent risk-taking behaviour thus potentially leading to financial instability. Overall, given the scope of the draft law and the importance of mortgage portfolios in total bank assets, these factors may have a negative impact on the profitability; capitalisation and the future lending capacity of the credit institutions affected, and ultimately may have implications for financial stability.

3.1.4 *Compliance with the principle of an open market economy with free competition*

The Treaty provides that the ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources. Likewise, the Treaty provides that Member States' economic policies shall be conducted in accordance with this principle. The ECB is generally not in favour of the regulation of interest rates charged by credit institutions, including for the reasons outlined in this paragraph 3 and more generally because such regulation would, under normal circumstances, diverge from basic economic and market principles³. Conferring powers on a public authority to intervene in the market could undermine the principle of an open market economy with free competition and favouring an efficient allocation of resources. In particular, the ECB is concerned that such intervention by the CBI could create market distortions, and could be inconsistent with the gradual return of the banking system to full private ownership. As outlined above, the draft law presents challenges for the efficient transmission of monetary policy. It could also place possible additional earnings' pressure on Irish credit institutions and result in a loss of investor confidence. Moreover, the decision to direct lenders as to the interest rate they can charge could even lead to a decrease in competition, and discourage foreign lenders from entering the market.

3.1.5 *Observations on the procedure to be followed by the CBI to assess, form conclusions and issue directions to lenders*

In terms of procedure, the draft law requires the CBI first to assess and form a conclusion on the state of competition in the market as a whole. If the CBI concludes that a market failure exists, it may issue directions to a specific lender or lenders, or to lenders in general. The factors to which the CBI must have regard in conducting its assessment include both factors influencing the state of the market as a whole and factors influencing individual lenders. From a practical perspective, the ECB has concerns about a lack of coherence in the procedure to be followed. While conclusions must be drawn based on a market-wide assessment, this may result in targeted measures imposed on individual lenders, without an individual assessment being conducted in relation to those lenders.

With regard to the assessment of a 'market failure', it may need to be further examined whether the definition under the draft law is fully aligned with the understanding of that concept under

³ The ECB is also generally not in favour of the regulation of savings remuneration, as pointed out in its recent opinion CON/2016/51. All opinions are available on the ECB website at: www.ecb.europa.eu.

competition law, in particular, in order to encompass considerations relating to the market structure and entry barriers.

Moreover, with regard to the requirement under the draft law for the CBI to publish its assessment, the ECB wishes to stress that publication must be conducted in accordance with the Union law requirements on professional secrecy, including Article 53 of Directive 2013/36/EU of the European Parliament and of the Council⁴, which provides that confidential information 'may be disclosed only in summary or aggregate form, such that individual credit institutions cannot be identified'.

In addition to these practical concerns, the ECB notes that it is for the Irish authorities to assess whether the draft law complies with Irish constitutional and other legal principles.

3.1.6 *Interaction with the existing objectives and tasks of the CBI*

The CBI does not currently have an objective related to competition policy or any function to assess competition in the financial sector: the competition authority in Ireland is the Competition and Consumer Protection Commission.

As noted in paragraph 3.1.1 above, the power to issue directions to lenders not to set rates in excess of a certain threshold could interfere with the CBI's basic Eurosystem task to implement monetary policy, due to the potential for such directions to interfere with the monetary policy transmission mechanism. Section 6A(1) of the Central Bank Act 1942 states that the primary objective of the CBI, in discharging its functions and exercising its powers as part of the ESCB, is to maintain price stability. This is in line with the primary objective of the Eurosystem under Article 127(1) of the Treaty. It is difficult to see how the CBI could properly perform a task which could interfere with its overriding monetary policy task and objective.

The CBI also has other objectives as set out in section 6A(2) of the Central Bank Act 1942, i.e. the stability of the financial system overall; the proper and effective regulation of financial service providers and markets, while ensuring that the best interests of consumers of financial services are protected; the efficient and effective operation of payment and settlement systems; the resolution of financial difficulties in credit institutions; the provision of analysis and comment to support national economic policy development and the discharge of such other functions and powers as are conferred on the CBI by law.

As the national authority responsible for banking supervision and contributing to the stability of the financial system, the CBI will have to mitigate any potential conflicts of interests between the proposed new competition tasks under the draft law and, *inter alia*, its banking supervision and financial stability mandates by always taking the latter into account when exercising its powers. Sufficient mitigation measures would be necessary to ensure that, in the event of a conflict of interest, financial stability and prudential supervisory considerations prevail. However, in light of the objectives of the CBI set out in the Central Bank Act 1942, it appears particularly difficult to ensure that sufficient mitigation measures can be put in place. As all of the secondary objectives under Section 6A(2) of the Central Bank Act 1942 must be regarded as equal by the CBI, it would not be able to mitigate the conflict of interest between the competition objectives of its new role and its

⁴ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

existing financial stability and prudential supervision objectives, by giving precedence to the latter objectives when exercising its new powers.

3.2 *Central bank independence*

As noted in paragraphs 3.1.1 and 3.1.6, the power to issue directions to lenders not to set rates in excess of a certain threshold has the potential to interfere with the overriding monetary policy task and objective of the Eurosystem, including of the CBI. The ECB has concerns that the conflict of interest between this new task and the exercise of the CBI's monetary policy and financial stability tasks, which have different objectives, may potentially have an impact on the institutional independence of the CBI and the personal independence of the Governor of the CBI. This could, by extension, potentially damage the credibility of the CBI, the ECB and the Eurosystem as a whole.

In addition, as outlined in further detail in paragraph 3.3, the CBI itself will have to dedicate additional human and financial resources to carry out the assessments required under section 2 of the draft law and may also incur further costs in the context of monitoring compliance with directions, and applying to the High Court for relevant court orders. The CBI should be provided with sufficient resources to perform the new tasks.

For these reasons, the ECB has concerns that the draft law could undermine the independence required of the CBI as a central bank of the Eurosystem, and of the Governor of the CBI as a member of the ECB Governing Council.

Furthermore, the CBI is a national competent authority (NCA) of the Single Supervisory Mechanism (SSM) and in the exercise of the powers conferred upon the ECB by the SSM Regulation, and thus is, under Article 19 SSM Regulation, required to act independently. The ECB has concerns regarding the interaction of this new task with the exercise of the CBI's supervisory tasks. The exercise of the powers assigned by the draft law could potentially conflict with the effective use of the supervisory powers conferred on the ECB on the basis of the SSM Regulation, and therefore may potentially impact on the CBI's independence as an NCA member of the SSM.

3.3 *Conferral of new tasks on the CBI*

3.3.1 As noted in paragraph 1, the draft law confers a number of new tasks on the CBI regarding the assessment of whether the state of competition in the market for principal dwelling house mortgage loans is such that a 'market failure' exists, the issuance of directions in such circumstances to lenders not to charge a variable interest rate which exceeds certain thresholds, and related enforcement powers.

3.3.2 The ECB underlines that, in the context of a proposed conferral of tasks on a national central bank (NCB) in the ESCB, it is necessary to assess such conferral against the prohibition on monetary financing under Article 123 of the Treaty. For the purposes of that prohibition, Article 1(1)(b)(ii) of

Council Regulation (EC) No 3603/93⁵ defines ‘other type of credit facility’, inter alia, as ‘any financing of the public sector’s obligations vis-à-vis third parties’.

As the objective of the monetary financing prohibition of maintaining a sound budgetary policy of Member States may not be circumvented, the task of financing measures which are normally the responsibility of the Member States, and financed from their budgetary sources rather than by the NCBs, must not be entrusted to NCBs by law. In order to decide what constitutes a form of financing of the public sector’s obligations vis-à-vis third parties – which can be translated as the provision of central bank financing outside the scope of the central bank tasks – an assessment of whether the task to be undertaken by an NCB is a central bank task or a government task, i.e. a task within the responsibility of the Member States, needs to be carried out on a case-by-case basis. In other words, sufficient safeguards must be in place to ensure that circumventions of the objective of the monetary financing prohibition of maintaining a sound budgetary policy of Member States do not take place.

- 3.3.3 As part of its discretion in the exercise of its duty, on the basis of Article 271(d) of the Treaty and Article 35.6 of the Statute of the ESCB, to ensure that NCBs honour the obligations laid down by the Treaty, the Governing Council has endorsed safeguards of that kind in the form of criteria for determining what may be seen as falling within the scope of a public sector’s obligation within the meaning of Article 1(1)(b)(ii) of Regulation (EC) No 3603/93 or, in other words, constitute a government task as follows:

First, central bank tasks are in particular those tasks that are related to the tasks that have been conferred upon the ECB and the NCBs by the Treaty⁶ and the Statute of the ESCB. These tasks are mainly defined in Article 127(2), (5) and (6) and Article 128(1) of the Treaty, as well as Article 22 and Article 25.1 of the Statute of the ESCB.

Second, as Article 14.4 of the Statute of the ESCB allows NCBs to perform ‘other functions’, new tasks, i.e. tasks that are not related to tasks that have been conferred upon the ECB and the NCBs, are not precluded per se. However, new tasks that are undertaken by an NCB and which are atypical of NCB tasks or which are clearly discharged on behalf of and in the exclusive interest of the government or of other public sector entities should be considered government tasks.

Third, an important criterion for qualifying a new task as atypical of an NCB task or as being clearly discharged on behalf of and in the exclusive interest of the government or other public sector entities is the impact of the task on the institutional, financial and personal independence of that NCB.

In particular, the following aspects should be taken into account:

- (a) Whether the performance of the new task creates conflicts of interest with existing central bank tasks which are not adequately addressed and does not necessarily complement those existing central bank tasks. If a conflict of interest arises between existing and new tasks, sufficient safeguards to mitigate that conflict should be in place. The complementarity between a new task and the existing central bank tasks should not be interpreted broadly, so as to lead to the

⁵ Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty (OJ L 332, 31.12.1993, p. 1). Articles 104 and 104b of the Treaty are now Articles 123 and 124 of the Treaty.

⁶ This includes the Treaty on European Union and the Treaty on the Functioning of the European Union.

creation of an indefinite chain of ancillary tasks. Such complementarity should be examined also in relation to the financing of those tasks.

- (b) Whether without new financial resources the performance of the new task is disproportionate to the NCB's financial or organisational capacity and may negatively impact on the capacity to perform properly the existing central bank tasks.
- (c) Whether the performance of the new task fits into the institutional set-up of the NCB in light of central bank independence and accountability considerations.
- (d) Whether the performance of the new task harbours substantial financial risks.
- (e) Whether the performance of the new task exposes the members of the NCB decision-making bodies to political risks which are disproportionate and may also impact on their personal independence and, in particular, on the guarantee of term of office set out in Article 14.2 of the Statute of the ESCB.

3.3.4 On the basis of the criteria set out above, the following paragraphs assess whether the CBI's new tasks are in line with the monetary financing prohibition.

3.3.4.1 Tasks related to the tasks conferred upon the ECB and the NCBs by the Treaty and the Statute of the ESCB

The powers conferred on the CBI by the draft law are expressly characterised as powers for the purposes of protecting competition in the mortgage loan market. These powers could also be seen as being related to the protection of consumers of mortgage loan services. However, the goal of consumer protection appears to be subsidiary to the draft law's overriding goal of protecting competition in the mortgage loan market.

It has to be examined to what extent these powers are related to the performance of Eurosystem tasks, including the implementation of monetary policy, the specific tasks conferred upon the ECB concerning policies relating to the prudential supervision of credit institutions and contributing to the smooth conduct of policies pursued by the competent authorities relating to the stability of the financial system in accordance with the first indent of Article 127(2), Article 127(5) and (6) and Article 128(1) of the Treaty, as well as Article 22 and Article 25.1 of the Statute of the ESCB. Importantly, although in accordance with Article 127(1) of the Treaty the Eurosystem must act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, the Eurosystem has not itself been conferred with any tasks in the area of competition policy.

As noted in paragraph 3.1.1, the power to issue directions to lenders not to set rates in excess of a certain threshold could interfere with the CBI's basic Eurosystem task to implement monetary policy, due to the potential for such directions to interfere with the monetary policy transmission mechanism. As noted in paragraph 3.1.2, the exercise of this power by the CBI could also possibly conflict with the effective use of the supervisory powers conferred on the ECB on the basis of the SSM, and therefore has the potential to create tensions with the CBI's role as a NCA within the SSM.

The supervision of consumer credit providers⁷, as well as the oversight of the market for credit agreements relating to residential immovable property⁸, can be considered tasks related to those referred to in Article 127(5) and (6) of the Treaty, based on the understanding that they are complementary to the banking supervision tasks exercised by NCBs and are linked to the task of contributing to the stability of the financial system. In Ireland, the CBI's responsibilities include ensuring compliance with, inter alia, the Consumer Protection Act 2007, the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 and 2000 and with the European Union (Consumer Mortgage Credit Agreements) Regulations 2016. However, in light of the fact that the draft law is primarily aimed at addressing market failures and enhancing competition in the banking sector, rather than directly aimed at protecting the consumers of banking services, it is difficult to characterise the draft law as complementary to the banking supervision tasks of the CBI, also taking account of the implications of the draft law for the banking sector and on financial stability, as outlined in paragraphs 3.1.2 and 3.1.3.

For these reasons, the tasks conferred on the CBI by the draft law cannot be considered as related to the tasks of monetary policy implementation and contribution to financial stability referred to in the first indent of Article 127(2) and Article 127(5) of the Treaty, or to the tasks exercised by the CBI as part of the SSM, in accordance with Regulation (EU) No 1024/2013.

3.3.4.2 *Tasks which are atypical of NCB tasks*

As outlined above, the powers conferred on the CBI by the draft law are expressly characterised as powers for the purposes of protecting competition in the mortgage loan market. However, the ECB has not identified any other NCB in the ESCB which has been conferred with or exercises similar powers for the purposes of protecting competition.

With regard to ensuring the protection of consumers of mortgage loan services, the ECB has generally accepted the allocation of consumer protection tasks to NCBs, including supervisory tasks related to the provision of consumer credit⁹ and the fight against usury¹⁰, provided such tasks do not interfere with the performance of the NCB's ESCB-related tasks¹¹ and provided that those tasks 'complement existing supervisory powers and thus contribute to the soundness of the financial market and the preservation of confidence in the market place'¹². In light of the CBI's statutory responsibility for banking supervision and financial stability, further powers in the area of consumer protection could be argued to be not atypical of a central bank.

The ECB understands that the laws in a number of Member States have put in place limitations on the maximum interest rates that can be charged by lenders¹³ for consumer loans¹⁴, including

⁷ See paragraph 3.3 of Opinion CON/2015/54 and paragraph 3.3 of Opinion CON/2016/31.

⁸ See paragraph 4.3 of Opinion CON/2016/34.

⁹ See paragraph 3.4 of Opinion CON/2015/54 and paragraph 4.4 of Opinion CON/2016/34.

¹⁰ See paragraph 4 of Opinion CON/2004/16.

¹¹ See, for example, paragraphs 2.1 to 2.3 of Opinion CON/2006/38, paragraphs 2.1 and 2.2 of Opinion CON/2006/47, paragraphs 2.1 to 2.5 of Opinion CON/2007/29 and paragraph 2 of Opinion CON/2009/71.

¹² See paragraph 3.1 of Opinion CON/2015/21.

¹³ The national laws may apply to credit institutions, to entities other than credit institutions, or to both, depending on the jurisdiction.

those relating to immovable property¹⁵. The national legislation in those Member States either: (a) sets out the methodology for determining the relevant reference index or reference interest rate, and the maximum margin above the reference interest rate which the interest rate charged by the lender cannot exceed¹⁶; or (b) determines the maximum interest rate in the law itself or in a decree adopted thereunder¹⁷. The role of the NCB in relation to the reference rates can include: (i) the provision of advice to the legislature or government on the setting of the rate, taking into account evolutions in the market¹⁸; or (ii) the periodic calculation and publication of a reference interest rate¹⁹. In many cases, the NCB must calculate the reference interest rate based on the average interest rate charged by market participants²⁰. The national authority responsible for monitoring and enforcement of compliance with such national laws varies, depending on the Member State, and may be conducted by the Ministry for Economics²¹, the national consumer protection authority²², national competition authority²³ the national competent authority for prudential supervision²⁴, the NCB²⁵ or by the courts, as a matter of civil²⁶ or criminal²⁷ law. It is noted that in one Member State²⁸, a specific consumer protection power is given to the NCB, in its capacity as supervisory authority, to monitor compliance of certain institutions with rules on business-to-consumer commercial practices. Further, it may impose sanctions on financial institutions in the event of a serious infringement of the provisions of the banking laws²⁹. Some Member States also seek to control the interest rate for savings deposits³⁰, including by means of tax incentives³¹.

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- 14 See, for example, Belgium: Royal decree of 4 August 1992; Bulgaria: Article 19(4) of the Law on consumer credits; Cyprus: Section 314A of the Cyprus Criminal Code, Cap. 154; this does not apply to credit granted by credit institutions and in some other specified cases; Estonia: Section 406 of the Law on obligations; France: Article L. 314-6 (1) of the Consumer Code; Croatia: Article 11c of the Law on consumer credit (Official Gazette 75/2009, 112/2012, 143/2013, 9/2015, 78/2015, 102/2015 and 52/2016); Hungary: Law CLXII of 2009 on consumer credit, as amended by Law LCCVIII of 2014; Italy: Law on usury (Law 108/1996); ; Malta: Article 1852 of the Civil Code: this does not apply to credit granted by credit institutions; Poland: Article 359 of the Civil Code and Article 304 of the Penal Code; Portugal: Decree-law 133/2009 of 2 June; Slovenia: Article 24 of the Law on consumer credit; and Slovakia: Article 53(6) of Law No 40/1964 Coll. Civil Code as amended, and Article 1a of Government Regulation No 87/1995 Coll., as amended.
- 15 See, for example, Belgium: Royal decree of 11 January 1993; Bulgaria: Article 29(9) of the Law on consumer credits related to immoveable property; France: Article L. 314-6 (1) of the Consumer Code; Croatia: Article 11b of the Law on consumer credit; Hungary: Law CLXII of 2009 on consumer credit, as amended by Law LCCVIII of 2014; Italy: Law on usury (Law 108/1996); and Poland: Article 359 of the Civil Code and Article 304 of the Penal Code.
- 16 This applies in Belgium, Cyprus, Estonia, France, Croatia, Hungary, Italy, Portugal and Slovenia.
- 17 The rate is set by law in, Malta, Poland and Slovakia. In Bulgaria, the Council of Ministers sets the limitation.
- 18 This is the case in Belgium.
- 19 This is the case in Cyprus, Estonia, France, Croatia, Hungary, Italy, Portugal and Slovenia.
- 20 This applies in Cyprus, Estonia, France, Croatia, Italy, Portugal and Slovenia.
- 21 This is the case in Belgium and Slovenia.
- 22 This is the case in Bulgaria and Latvia. It is also the case in Hungary in specific instances, depending on the type of breach.
- 23 The Hungarian Competition Authority carries tasks relating to competitive discipline (see Law XLVII of 2008 on the prohibition of unfair business-to-consumer commercial practices).
- 24 This is the case in France (Autorité de contrôle prudentiel et de résolution).
- 25 This is the case in Croatia, Italy, Portugal, Slovakia. This is the case in Hungary in specific instances.
- 26 This is the case in Estonia, France, Poland and Malta.
- 27 This is the case in Cyprus, France and Poland.
- 28 Hungary: Law CCXXXVII of 2013 on credit institutions and financial enterprises and Law XLVII of 2008 on the prohibition of unfair business-to-consumer commercial practices.
- 29 In those circumstances, the NCB may determine the highest rate of interest that may be charged by that credit institution.
- 30 France: Regulation n° 86-13 regarding the remuneration of funds received by credit institutions.

However, the key difference between the national laws mentioned and the Irish draft law relates to the powers conferred on the CBI. None of the above examples confer broad discretionary decision-making powers on an NCB to determine the appropriate level of interest rates which lenders may charge, as this kind of power is exercised by the legislature or by the government. Where NCBs play a role under such laws, this role is limited to the calculation and publication of a reference rate, based on predefined criteria, or to the enforcement of such laws against the relevant lenders, as an aspect of the NCB's mandate for consumer protection.

Thus, the decision-making powers conferred on the CBI by the draft law, to issue directions to lenders not to charge a variable interest rate which exceeds certain thresholds, may be considered atypical of a central bank, even if they could be characterised as consumer protection and not competition powers.

For the sake of completeness, the powers under the draft law also cannot be characterised as macroprudential powers, as it is difficult to conclude that they pursue a legitimate macroprudential objective. The legitimate objectives of macroprudential policy can be understood by reference to Recommendation ESRB/2013/1 of the European Systemic Risk Board on intermediate objectives and instruments of macroprudential policy³², which considers the objectives of macroprudential policy to include the mitigation and prevention of excessive credit growth and leverage, the mitigation and prevention of excess maturity mismatches and market illiquidity, the limitation of concentration of exposures, the limitation of the systemic impact of misaligned incentives, and the strengthening of the resilience of financial infrastructures.

To conclude, the conferral of these new powers on the CBI should be regarded as atypical of a central bank.

3.3.4.3 *Impact of the tasks on the independence of the CBI*

The draft law designates the CBI as the sole authority with the power to assess the state of competition in the market for principal dwelling house mortgage loans and to issue directions to lenders not to charge a variable interest rate which exceeds certain thresholds. Given the factual assessment that this task is atypical of a central bank, it should be considered, in addition, whether the task is being discharged on behalf of and in the exclusive interest of the government³³. An important criterion for this qualification is the impact of the task on the independence of the CBI. Such impact is analysed in paragraph 3.2 of this Opinion.

3.3.4.3.1 *Extent to which performance of the new task creates conflicts of interest with existing central bank tasks*

As noted above, the power to issue directions to lenders not set to rates in excess of a certain threshold could interfere with the CBI's basic Eurosystem task to implement monetary policy,

³¹ Belgium: Article 21, 5° Code of Income Tax and Royal decree of 27 August 1993.

³² Recommendation ESRB/2013/1 of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (OJ C 170, 15.6.2013, p. 1).

³³ In the context of the regulation of savings remuneration by an NCB, the ECB has pointed out that it considered such a role to be carried out on behalf of the government, and exercising this government task has the potential to place the NCB and its Governor in a position in which there is a conflict of interest between the exercise of this task and the exercise of the NCB's central banking tasks. See ECB Opinion CON/2016/51.

due to the potential for such directions to interfere with the monetary policy transmission mechanism. The exercise of this power by the CBI could also possibly conflict with the effective use of the supervisory powers conferred on the ECB on the basis of the SSM, and therefore has the potential to create tensions with the CBI's role as an NCA within the SSM. The ECB discourages the concentration of decision-making powers in the areas of competition and banking supervision in one body³⁴. In fact, the ECB has previously welcomed draft national laws transferring the responsibilities for the enforcement of competition policy in the banking sector away from the NCB to a national competition authority³⁵ and discouraged the concentration of decision-making powers in the areas of antitrust and banking supervision in one body³⁶. In doing so, the ECB highlighted the need to balance the potentially conflicting objectives of market competition and financial stability³⁷. While coordination is highly necessary to avoid an overly complex framework for supervised entities, it would seem appropriate to maintain a clear distinction between procedures that are pursuing distinct public interests³⁸ in particular for procedures leading to antitrust and banking supervision decisions³⁹. For that reason the ECB considers that in these circumstances draft national laws should reflect the principle of allocating powers to authorities in accordance with their respective objectives⁴⁰.

3.3.4.3.2 Extent to which performance of the new task is disproportionate to the CBI's financial or organisational capacity

The principle of financial independence requires NCBs to have sufficient means to carry out not only their ESCB-related tasks but also their national tasks, both from an operational and financial perspective⁴¹. Under the draft law, the CBI is obliged to carry out detailed assessments on the state of competition in the market for principal dwelling house mortgage loans on a at least a quarterly basis, taking into account a wide range of factors. This may require the CBI to impose additional reporting requirements on mortgage lenders, which will impose costs on those mortgage lenders. Moreover, the CBI itself will have to dedicate additional human and financial resources to compile the relevant indicators and methodology, to collect, process and analyse the relevant data in order to carry out that assessment, and to present and report the data. Moreover, the CBI may incur further costs in the context of monitoring compliance with directions, and applying to the High Court for court orders. The draft law contains no provision for the reimbursement of the CBI for this additional burden.

3.3.4.3.3 Extent to which performance of the new task fits into the CBI's institutional set-up, in light of central bank independence and accountability considerations

As discussed in paragraph 3.1.6 above, it is difficult to see how the CBI could properly perform a task which could interfere with its overriding monetary policy task and objective. Moreover, the

³⁴ See paragraph 4 of Opinion CON/2008/44.

³⁵ See paragraph 14 of Opinion CON/2004/16.

³⁶ See paragraph 4 of Opinion CON/2008/44.

³⁷ See paragraph 3.3 of Opinion CON/2006/51.

³⁸ See paragraph 14 of Opinion CON/2004/16.

³⁹ See paragraph 8 of Opinion CON/2005/58.

⁴⁰ See paragraph 4 of Opinion CON/2007/17.

⁴¹ See the ECB's 2016 Convergence Report, p. 25.

exercise of this power by the CBI could also possibly conflict with the effective use of the supervisory powers conferred on the ECB on the basis of the SSM, and therefore has the potential to create tensions with the CBI's role as an NCA within the SSM. As the national authority responsible for banking supervision and contributing to the stability of the financial system, the CBI will have to mitigate any potential conflicts of interests between its competition tasks and its banking supervision and financial stability mandates, by always taking the latter into account when exercising its powers. Sufficient mitigation measures would be necessary to ensure that, in the event of a conflict of interest, financial stability and prudential supervisory considerations prevail. However, in light of the objectives of the CBI set out in the Central Bank Act 1942, it appears particularly difficult to ensure that sufficient mitigation measures can be put in place. As all of the secondary objectives under Section 6A(2) of the Central Bank Act 1942 must be regarded as equal by the CBI, it would not be able to mitigate the conflict of interest between the competition objectives of its new role and its existing financial stability and prudential supervision objectives, by giving precedence to the latter objectives when exercising its new powers.

Finally, there is the reputational risk that the CBI could be held accountable by the general public for problems related to the divergent treatment of holders of variable rate mortgages and tracker mortgages by commercial banks, even where the CBI's assessment concludes that the variable rates can be reasonably and objectively justified, by reference to the various factors outlined in paragraph 3.1.2.

Thus, given the absence of complementarity with the CBI's existing tasks, the new tasks do not appear to fit into the CBI's current institutional set-up.

3.3.4.3.4 Extent to which the performance of tasks harbours substantial financial risks

The draft law specifies that there is no right of appeal to the Financial Services Appeals Tribunal or to the High Court in respect of the assessment of the CBI, a direction of the CBI to a lender, or a decision by the CBI to seek an enforcement or rectification order. In that respect, the CBI may not be exposed to substantial financial risks. However, it is for the Irish authorities to assess whether the draft law complies with Irish legal and constitutional principles in this particular respect.

3.3.4.3.5 Extent to which performance of the new task exposes members of the CBI's decision-making bodies to disproportionate political risks and impacts on their personal independence

As noted in paragraph 3.1.2 and paragraph 3.2, while the CBI is not obliged to exercise its new interest rate setting power, the ECB would be concerned that new task could create a conflict of interest with the CBI's existing monetary policy and supervisory tasks, which would undermine the independence required of the CBI as a central bank of the Eurosystem and of the Governor of the CBI as a member of the Governing Council.

3.3.4.4 Conclusion regarding the compatibility of the draft law with the prohibition on monetary financing

The ECB considers that the CBI's new tasks relating to the variable rate mortgages qualify as government tasks, in the sense that they are, first, not linked to and do not complement the CBI's existing monetary policy, supervisory or financial stability tasks and, second, atypical of

central banks. In addition, given that the draft law is primarily aimed at addressing market failures and enhancing competition in the mortgage loan market, the conferral of this task on the CBI creates a conflict of interest with the CBI's monetary policy, banking supervision and financial stability tasks and objectives and raises concerns with regard to the independence of the CBI. Thus, the task is clearly discharged on behalf of and in the exclusive interest of the government. This conclusion is particularly evident with regard to the CBI's discretionary, decision-making powers under the draft law to issue directions to lenders, but is also true with regard to the requirement to assess competition and form a conclusion on whether the state of competition is such that a 'market failure' exists. The carrying out of this government task by the CBI would only be compatible with the monetary financing prohibition if this task were fully and adequately remunerated⁴². As this is not currently provided for in the draft law, the conferral of these new tasks on the CBI would not, therefore, appear to be compatible with the monetary financing prohibition.

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

Done at Frankfurt am Main, 17 November 2016.

[signed]

The President of the ECB

Mario DRAGHI

⁴² See the subsection headed 'Financing of the public sector or of public sector obligations to third parties' in Section 2.2.5.1 ('Prohibition on monetary financing') of the ECB's 2016 Convergence Report.