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PUBLIC INFORMATION ANNOUNCEMENT

SUMMARY OF RESULTS OF REVIEW OF RESIDENTIAL REAL ESTATE MORTGAGE MARKET GUIDELINE

I. Background

The Central Bank of Trinidad and Tobago (Central Bank), in consultation with the Bankers Association of Trinidad and Tobago (BATT), introduced the "Residential Real Estate Mortgage Market Guideline" in September 2011[1]. The main aim of the Guideline is to improve transparency in the local residential mortgage market by requesting that commercial banks disclose to their customers information about how banks set mortgage rates and the conditions under which rates are adjusted over the term of their mortgage.

The Guideline also established a Mortgage Market Reference Rate (MMRR) which banks have utilised as the basis for adjusting their variable mortgage rates. The current MMRR formula has two components — the banking system "cost of funds" and a representative interest rate, with the former having a weight of 40 per cent and the latter 60 per cent. Information on the cost of funds is derived from the weighted average costs of bank liabilities and other funding liabilities and policy and deposit insurance costs, while the 15-year Treasury bond yield is used as the representative interest rate[2]. The calculations are done on a quarterly basis and the results announced by the Central Bank.

The Guideline provides for triennial reviews. The first review was conducted in 2013, while the latest commenced in mid-2016 and involved participation of the Central Bank, BATT and the results of a survey of mortgage holders. The most recent review focused on three broad questions: 1. Was the implementation of the Guideline successful in improving transparency? 2. Was the technical basis of the MMRR appropriate? 3. Was communication on the MMRR effective?

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[1]The Guideline can be found on the CBTT website under the Legislation, Guidelines and Letters - "Guidelines for the Banking Sector" section: http://www.central-bank.org.tt/content/legislation-guidelines-and-letters-0

[2]The 15-year Treasury bond yield replaced the 10-year bond yield in the formula in December 2013.

II. Key Results

1. **The Guideline and transparency.** The review found that disclosure requirements have indeed facilitated greater transparency in the local mortgage market. While commercial banks have complied with the disclosure requirements set out in the Guideline, some improvements can be made to the content of the disclosure statements and other mortgage documentation to better inform consumers on the terms and conditions of their mortgage contracts.

2. **Technical basis for the MMRR calculations.** The use of the MMRR has provided a clear benchmark to enable consumers to understand how repricing occurs in their mortgage contracts with banks in Trinidad and Tobago. International experience shows that use of a representative interest rate is common in setting reference rates but this component could be somewhat volatile depending on the state of financial markets. The incidence of use of "cost of funds" metrics is much lower and care must be taken to cater for potential measurement and reporting issues. International experience also demonstrated that transparency in the calculation of reference rates was essential, in order to avoid market concerns regarding potential manipulation. The Central Bank was of the view that a modest adjustment in the weighting structure to 50:50 between the cost of funds of the banking system and the 15-year Treasury rate (currently 40:60) would help to lower volatility in the MMRR moving forward, while BATT considered that such an adjustment would have led to more changes in the MMRR over the past few years[3].

3. **Communication on the MMRR.** Members of the public and other market participants found that information on the MMRR was readily available. The Central Bank further considered that the MMRR has often been incorrectly viewed as a policy measure of the Bank as opposed to an independent reference benchmark that the Central Bank calculates and makes available to the public and the financial institutions. As a result, the Central Bank determined that, in the interest of clarity to the public, efforts needed to be strengthened to communicate how the MMRR is calculated in order to distinguish it from policy rates of the Central Bank, such as the "repo rate". BATT considered that the MMRR was a policy rate set by the Central Bank.

[3]The MMRR was maintained at a rate of 3.00 per cent since March 2016 when the latest review commenced. Based on available data to March 2017, the 50:50 formulation would result in the MMRR remaining at 3.00 per cent. The 40:60 formulation would result in an MMRR of 3.50 per cent.

III. Implications

During this comprehensive review process changes in the Guideline and the MMRR were kept on hold. Publication of the MMRR by the Central Bank will resume on June 1, 2017 and the Guideline updated, taking into account the following changes based on the results of the review:

1. Commercial banks have committed to adjust the wording of their mortgage contracts, advertisements and published statements to further clarify, where necessary, the basis on which mortgage rates are to be adjusted. All commercial banks will remain bound by the disclosure requirements in the Guideline.

2. The weighting structure of the MMRR will be adjusted to 50:50 between the cost of funds of the banking system and the 15-year Treasury rate. Given that the MMRR is not a policy rate of the Central Bank and alignment of mortgages to the MMRR is not mandatory, individual commercial banks would explicitly indicate whether they would continue to align their variable mortgage rates to the MMRR. The list of banks that utilise the MMRR in determining their variable interest rates will be published on the Central Bank's website. In the interest of public disclosure and transparency, other commercial banks not aligned to the MMRR will need to declare to their customers and to the Central Bank the reference rates to which their mortgages are aligned.

3. The quarterly calculations of the MMRR will be simultaneously published online by the Central Bank and the commercial banks whose mortgage rates are aligned to the MMRR. Public education on home ownership and mortgages by the Central Bank will also be expanded in the context of its financial literacy programme.

Please address questions to info@central-bank.org.tt

Central Bank of Trinidad and Tobago
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