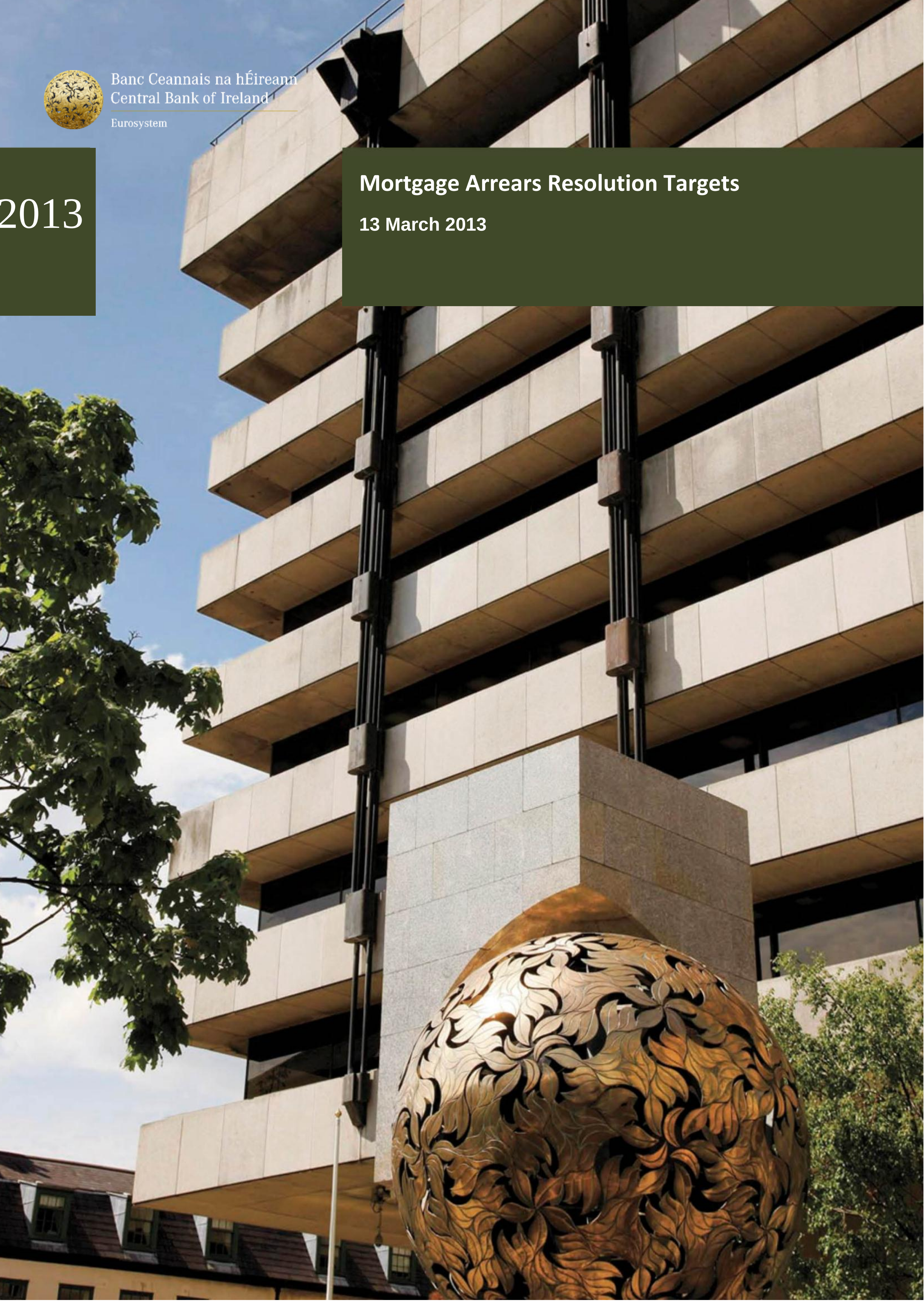
Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

2013

Mortgage Arrears Resolution Targets

13 March 2013



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Executive Summary

The Central Bank of Ireland (the "Central Bank") is publishing its framework for setting performance targets for mortgage arrears resolution for the following Irish mortgage credit institutions: ACC Bank plc, Allied Irish Bank plc (including AIB Mortgage Bank, EBS Limited and EBS Mortgage Finance), The Governor and Company of the Bank of Ireland (including Bank of Ireland Mortgage Bank and ICS Building Society), KBC Bank Ireland plc, Permanent Tsb plc and Ulster Bank Ireland Limited (the "Specified Credit Institutions") with respect to their Republic of Ireland principal dwelling home / primary residence ('PDH') and buy-to-let ('BTL') mortgagees.

This initiative follows extensive engagement with credit institutions on their handling of mortgage arrears, including: requirements to comply with the Code of Conduct on Mortgage Arrears ('CCMA'); development and implementation of Mortgage Arrears Resolution Strategies ('MARS'); regular review of credit institutions' operational capabilities; direct communication with senior management and CEOs; and obligations to provide management information and key performance indicators.

The Specified Credit Institutions are being set common public targets regarding their performance in resolving, on a sustainable basis, those arrears cases which are 90 days or more overdue. They are also being set other institution-specific targets at a more operational level which will be internal to each institution, as part of on-going supervisory engagement, principally concerning handling of early arrears cases.

The Public Targets will have the following elements:

- quarterly targets will be set in relation to the number of sustainable solutions[1] <u>proposed</u> to customers. These will become progressively more demanding over time. These will apply for the quarter ending 30th June 2013 onwards;
- progressively more demanding quarterly targets will be set for the <u>conclusion</u> of sustainable solutions. These will apply for the quarter ending 31st December 2013 onwards; and
- targets regarding subsequent performance of these solutions will be set.

Within the context of the targets set, it is recognised that in some cases alternative arrangements may not be agreed or are not appropriate and therefore voluntary surrender, voluntary sale or legal action for repossession may be required or that personal insolvency proceedings may be initiated.

[1] See Appendix 2 for full details of what constitutes a sustainable solution.

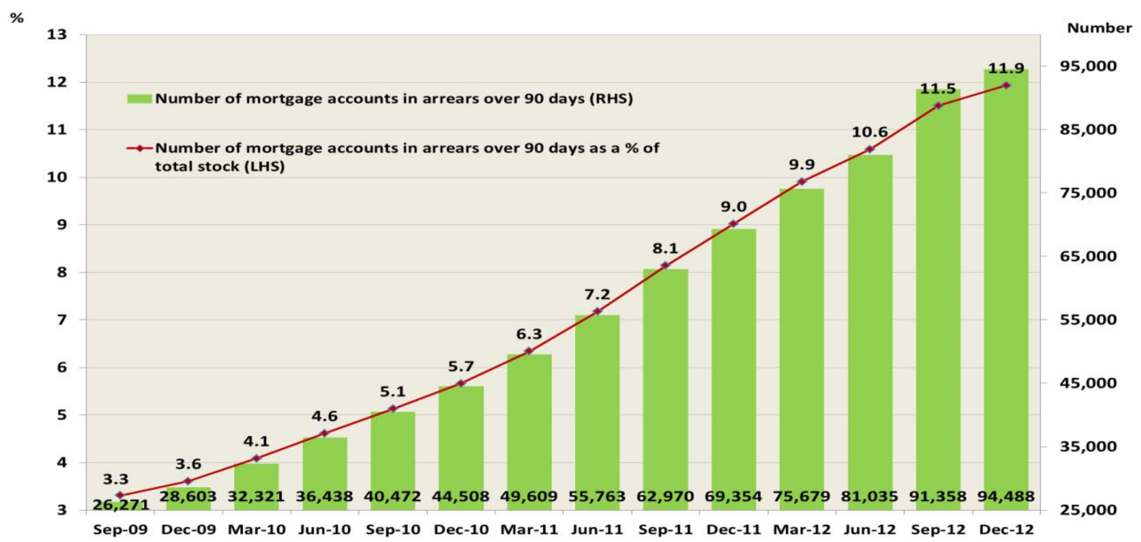
The Specified Credit Institutions will be required to make public disclosure of their performance against these targets. The Central Bank will periodically audit performance against the targets, including whether arrangements have been made on a sustainable basis. The Central Bank will consider regulatory action, including the imposition of additional capital requirements, for Specified Credit Institutions that fail to meet targets or which demonstrate poor resolution strategies or poor execution against their strategies. The Central Bank is also setting out its plans to require more rigorous provisioning for mortgage loans in arrears greater than 90 days which have not been subject to a sustainable solution.

1. Introduction

1.1 Context

Mortgage arrears have now reached unprecedented levels and are continuing to increase, albeit at a slower pace. The extent of the problem is evidenced by the 94,488 or 11.9% of private residential mortgage accounts secured on PDH in arrears of more than 90 days at the end of December 2012. The number of accounts in arrears has more than doubled over a two year period, as can be seen from Graph 1 below; however the latest increase in arrears over 90 days is the slowest quarter-on-quarter rate of increase since the Central Bank commenced collecting these statistics in 2009. A total of 28,421 residential mortgages secured by BTL properties were also more than 90 days in arrears at end December.

Graph 1: PDH Mortgage Arrears



Further action is urgently required to stem the growth in arrears, to return as many loans as possible to performing status, and where necessary to make such modifications to loans as are necessary to ensure a sustainable outcome. The introduction of the new personal insolvency regime, which provides for the creation of a new non-judicial debt resolution process to include secured debt, may have a significant impact on credit institutions and borrowers; it is important that where sustainable solutions are feasible, that these are put in place to avoid a more costly resolution process.

While 101,652 cases were restructured at end December 2012, almost all of these restructures have entailed only temporary periods of reduced payment (including interest only) sometimes accompanied by formalised term extension. While such temporary forbearance will be sufficient to assist many borrowers experiencing only temporary difficulties, there are other cases where temporary forbearance is not a sustainable solution and for which a more lasting arrangement will be necessary. In some cases, especially including but not limited to BTLs, and notably where the borrower is not cooperative, repossession of the property security will be inevitable.

Each case is different, depending in particular on the circumstances and prospects of the borrower. This means that finding a sustainable solution that fits each case is challenging and time-consuming; no simple mechanical formula can substitute for a case-by-case approach. Yet experience shows that delays in treating loan arrears worsen the outcome for both borrower and lender.

The Central Bank is therefore concerned to ensure that, by employing the resources and strategies developed by credit institutions over the past year and a half, the Specified Credit Institutions will now accelerate progress towards providing a sustainable solution to as many of the current long-term arrears cases as possible. At the same time, it is vital that early intervention by the Specified Credit Institutions to address and correct the inflow of new arrears cases is also emphasised.

To ensure that these tasks are being accomplished sufficiently quickly and that credit institutions are effectively managing their credit risks in this regard, the Central Bank has decided, as a prudential policy measure, to set progressively more demanding quantitative targets for Specified Credit Institutions to process arrears cases and achieve sustainable outcomes.

In order to ensure that all steps of the process are delivered, targets are being set not only for the proposal of sustainable solutions by the Specified Credit Institutions to borrowers, but also for the conclusion of such proposals.

Each of the Specified Credit Institutions will be required to report the results of the targets to the Central Bank on an on-going basis and these reports will be assessed by the Central Bank. Achievement against the targets, as set out in this document, will be required to be published by the Specified Credit Institutions as a disclosure.

While sustainability of a debt arrangement can only be fully assessed on a case-by-case basis, the Central Bank will assess the success of the institution's progress by sampling cases and gauging the plausibility of their sustainability, including through the use of quantitative tools.

Specified Credit Institutions that do not meet the targets to the satisfaction of the Central Bank and within the timeframes set out may be subject to regulatory and supervisory actions, including those set out in this document for non-performance.

The Central Bank will continue to monitor other aspects of the credit institutions MARS including through the use of additional institution-specific targets.

1.2 MARS Strategy to Date and for 2013

In the second half of 2011 the Central Bank intensified its engagement with lenders in relation to MARS. The MARS programme commenced an engagement with lenders to ensure the development of strategic plans and operational capability to address the mounting problem of mortgage arrears. During 2012, the Central Bank commenced, and continues to perform, a programme of rolling reviews with the main lenders, assessing their operational capability to progress their MARS strategies, which includes: assessment of strategy roll-out; treatment options; resources; systems; and management information.

Credit institutions have also developed strategies for the treatment of borrowers on a case-by-case basis, ranging from temporary forbearance, to longer-term modifications, and solutions involving change of ownership. The Central Bank has reviewed these strategies and these longer term modifications have been piloted by credit institutions during the second half of 2012. Further detail regarding the Central Bank's approach to mortgage arrears is set out in Appendix 1.

The focus of the Central Bank in relation to the resolution of mortgage arrears in 2013 is driven by prudential and consumer protection objectives concerning the need to ensure the fair treatment of consumers and to minimise loan losses through improved management of arrears cases and distressed loans. For each institution, this will involve an appropriate workout strategy, a change in emphasis from extended short-term solutions to sustainable solutions and ensuring that there is proactive resolution of distressed loans on a-case-by-case basis underpinned by an operational infrastructure that is 'fit for purpose'. The resolution of mortgage arrears is also an important element of restoring financial stability.

As borrower circumstances differ so widely, few universally applicable generalisations about mortgage debt distress are possible. The Central Bank is concerned that credit institutions persist in relying on temporary forbearance measures even where a demonstrable ability of the borrower to resume the original contractual repayments at the conclusion of this forbearance term is unlikely. Such lender behaviour tends to trap those borrowers who cannot realistically service the original contract in a position of economic insecurity which can damage their future earnings potential (thereby lowering their long-term debt servicing ability). If temporary forbearance allows distressed borrowers to prioritise unsecured debt repayment at the expense of mortgage repayment, this can result in borrowers potentially putting their homes at risk. This outcome can also result in the case of borrowers whose debt servicing capacity would in fact be sufficient, but by maintaining an unaffordable lifestyle during an extended period of forbearance this is not the case. In all of these cases of mortgage arrears, the long-term interests of both borrower and mortgage lender are better served by determining, agreeing and adhering to a sustainable payment plan.

Accordingly, credit institutions need to have more challenging conversations with customers about the implications of not paying their mortgage in circumstances where it is due, for such reasons as the prioritisation of other debt or as a result of lifestyle choices that the borrower cannot afford. At the same time, where debt servicing capacity of the borrower has been impaired, credit institutions need to be realistic about what payments can be expected to be sustained over the long-run.

While the processes that credit institutions employ need to take account of the range of borrower situations that may arise, it is important that these processes are not over-engineered at the price of efficiency. To ensure that credit institutions continually improve their collection capability, the quality assurance framework that they employ will need to be improved, to oversee the various types of arrears cases and how effectively they are being treated within the credit institution.

1.3 Measuring Progress on Resolving Mortgage Arrears

The Central Bank collects and publishes data on residential mortgage arrears for PDH and BTL mortgage accounts on a quarterly basis, as well as information on restructured accounts and repossessed properties. The data show the number of accounts that are in arrears, broken down by the length of time in arrears. This allows users of the data to distinguish between incidences of early arrears (less than 90 days), which can be volatile and not necessarily an indication of financial distress, and longer-term arrears cases (over 90 days) that tend to be a signal of more serious problems. In recent months, the Central Bank has commenced publishing greater detail in relation to longer-term arrears, including information on accounts in arrears over 360 days and over 720 days. The outstanding balance and arrears amount on all accounts is also reported and published.

Detailed statistics on the stock of restructured mortgage accounts are also collected and published on a quarterly basis. These are disaggregated by restructure type, including a variety of temporary or short-term forbearance arrangements and the more long-term modification options. It is also possible to determine which restructured accounts are performing and which are in arrears of less than and greater than 90 days. The quarterly data also capture information on the lenders' efforts to tackle the issue of mortgage arrears through measures other than loan modification, such as various stages of court proceedings, repossession of properties and the appointment of receivers.

Over the coming months, the Central Bank will commence publication of additional statistics, designed to provide more information on the level of progress in relation to mortgage arrears resolution. One such measure is the number of newly agreed loan modifications during each reference quarter. This will be captured for both temporary and permanent restructure types. A second measure of progress is the performance of restructured loans. Current data collection only allows the user to identify whether a restructured account is in arrears or not. It does not capture information on those accounts that still have old arrears outstanding but are meeting the terms of the new restructured arrangement. Modified accounts that are not meeting the terms of their current arrangement have essentially "re-defaulted". Reporting performance against specific resolution targets, as well as the full suite of KPI's[2] published by the Central Bank on a quarterly basis, should provide a more complete measure of progress in addressing arrears cases.

2. Scope, Legal Basis and Prudential Rationale

2.1 Scope

The targets in this document are being applied in relation to Republic of Ireland PDH and BTL mortgages and are applicable to the Specified Credit Institutions set out below:

- ACC Bank plc;
- Allied Irish Bank plc including AIB Mortgage Bank, EBS Limited and EBS Mortgage Finance;
- KBC Bank Ireland plc;
- Permanent Tsb plc;
- The Governor and Company of the Bank of Ireland including Bank of Ireland Mortgage Bank and ICS Building Society; and
- Ulster Bank Ireland Limited.

2.2 Legal Basis

Under Regulation 16(1) of the European Communities (Licensing and Supervision of Credit Institutions) Regulations 1992 (S.I. No. 395 of 1992, the "1992 Regulations"), every credit institution shall manage its business in accordance with sound administrative and accounting principles and shall put in place and maintain internal control and reporting arrangements and procedures to ensure the business is so managed.

Under Regulation 16(3) of the 1992 Regulations, credit institutions are required to have robust governance arrangements including, without limitation: (a) effective processes to identify, manage, monitor and report the risks they are or might be exposed to; (b) adequate internal control mechanisms; and (c) sound administrative and accounting procedures.

Under Regulation 16(4) of the 1992 Regulations, for the purposes of complying with Regulation 16(3), credit institutions are required to ensure that the arrangements, processes and mechanisms

[2] The KPI's are as follows: mortgage arrears of more than 90 days; early arrears of up to 90 days; stock of modified loans; new modifications during the reference quarter (publication will commence in 2013); and performance of existing restructures. Publication for the latter two KPI's will commence in 2013.

referred to in Regulation 16(3) are comprehensive and proportionate to the nature, scale and complexity of the activities of the institution and credit institutions are required to take into account the technical criteria in Annex V to Directive 2006/48/EC.

The technical criteria in Annex V include a requirement that credit institutions operate effective systems for the on-going administration and monitoring of the credit institutions' various credit-risk bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions. Annex V also makes clear that credit institutions should ensure that the process for approving, amending, renewing and refinancing credits should be clearly established.

The Central Bank notes also Regulation 65 of the European Communities (Capital Adequacy of Credit Institutions) Regulations 2006 (S.I. No. 661 of 2006, the "2006 Regulations") which provides that credit institutions shall have in place sound, effective and complete strategies and processes to assess and maintain on an on-going basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed, and that these strategies and processes shall be subject to regular internal review to ensure that they remain comprehensive to the nature, scale and complexity of the activities of the credit institution.

2.3 Key Prudential Concerns of the Central Bank

Based on our on-going assessment of credit institutions, including their mortgage arrears resolution units, the Central Bank has concerns in relation to whether the requirements in Regulation 16 of the 1992 Regulations as set out in paragraph 2.2 are being met, including bearing in mind the following:

- **Sustainable Solutions:** notwithstanding the increasing levels of mortgage arrears and financial household distress, sustainable solutions for borrowers are not being put in place in sufficiently large numbers, given the extent of the mortgage arrears problem, and this indicates a difficulty in managing problem credits;

- **Costs and Process:** if sustainable solutions are not implemented by credit institutions for borrowers and there continues to be a high level of temporary forbearance arrangements, credit institutions will continue have to support the cost of substantial mortgage arrears operational units and processes;

- **Capital:** by failing to pursue sustainable solutions for customers in arrears, credit institutions cannot ascertain fully the borrower's ability to repay and the likelihood of recovery of the sum due under the loan. This will potentially have further implications for the level of collective provisions required and the resultant impact on capital and indicates possible deficiencies in processes to manage credit risk;

- **Effective systems:** the Central Bank is of the view that a system for administering and monitoring arrears portfolios and exposures, including identifying and managing problem credits and making adequate value adjustments and provisions, cannot be considered to be effective in the context of a problem of the size of the mortgage arrears crisis facing the Specified Credit Institutions without there being in place:

  i. challenging targets for:

     a. proposals to borrowers of sustainable solutions;

     b. conclusion of sustainable solutions; and

  ii. on-going monitoring of the success of restructured arrangements.

2.4 Target Requirements

The Central Bank will assess whether the Specified Credit Institutions have met the targets set out in this paper. To the extent that the Specified Credit Institutions fail to meet these targets to the satisfaction of the Central Bank and within the timeframes set out, the Central Bank may take further regulatory action including, without prejudice to the generality of the foregoing, the imposition by the Central Bank of requirements under Regulation 70 of the 2006 Regulations, as well as any other measure which the Central Bank considers appropriate in the circumstances. The imposition of requirements under Regulation 70 of the 2006 Regulations may include, without limitation, obliging a credit institution to hold additional own funds or requiring a credit institution to apply a specific provisioning policy or treatment of assets, in terms of own funds requirements.

This is without prejudice to the power of the Central Bank to take regulatory action at an earlier date where appropriate.

2.5 Requirement for Disclosure of Targets

The Central Bank is of the view that in order for the Specified Credit Institutions to convey their risk profile comprehensively to market participants for the purposes of Regulation 72 of the 2006

Regulations, Specified Credit Institutions shall publicly disclose the level of compliance with these targets in the manner set out in Section 3.3.

Having regard to the size and duration of the mortgage arrears problem in each Specified Credit Institution, the absence of comparative data on their performance in resolving this problem and the fact that a failure to meet these targets could result in further regulatory action by the Central Bank, including without limitation additional capital requirements, the Central Bank is of the view that this information is material for the purposes of Part 1 of Annex XII of Directive 2006/48/EC as this is information which could change or influence the assessment or decision of a user relying on that information for the purposes of making economic decisions.

3. Targets

As a result of the performance of on-site assessments of credit institutions which includes file reviews, assessments of call centres and arrears support units, in addition to regular CEO meetings, the Central Bank has developed a more detailed understanding of credit institution functionality in relation to mortgage arrears. It is in the context of increasing arrears levels, and the need to deliver sustainable solutions for distressed mortgagees, that targets are now being set for the Specified Credit Institutions.

Measurement of Specified Credit Institutions against targets will give a better measure of progress on a more consistent basis. It will also mean that there will be an increased focus on the high levels of temporary forbearance measures.

The targets recognise that in certain cases the only available option to the mortgage lender (consistent with the lender’s prudential responsibility to minimise losses), having considered the borrower’s degree of co-operation and/or the borrower’s actual and prospective ability to service the debt, may involve voluntary surrender or legal action for repossession. In this regard, initiation of legal proceedings for repossession will count towards meeting the ‘proposed’ target measure.

To ensure that borrowers will now be put on more sustainable solutions, the Bank will set two different types of target for each of the Specified Credit Institutions. The first will be public targets and institutions will be required to publish their performance against those targets for the year end 31 December 2013 in addition to making quarterly reports to the Central Bank.

3.1 Public Targets

The full text of these targets is set out in Appendix 2 of this document. We have set out below the key requirements of the public target. Targets are being set for Specified Credit Institutions for proposing and concluding sustainable solutions in respect of mortgage loans that are over 90 days in arrears. As a further measure of sustainability, a target will also be set that in 75% of such concluded arrangements the payments are being made in line with the new terms.

The level of the targets have been calibrated taking account of the current operational capability of the banks' arrears management, the fact that existing arrears cases and arrangements will need to be re-examined against sustainability criteria and that further measurement of the conversion rate of proposed to concluded solutions is required, taking account of the impact of the Personal Insolvency Act 2012, the proposed legislation to correct the legislative lacuna identified by Ms Justice Dunne in her judgment in Start Mortgages Ltd & Ors v Gunn & Ors, and experience of burden sharing between secured and unsecured creditors.

The targets set are as follows:

Sustainable Solutions %	**2013**			**2014**			
	Q2	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Proposed [Target 1][3]	*20%*	*30%*	*50%*	*TBD*	*TBD*	*TBD*	*TBD*
Concluded[Target 2]	*N/A*	*N/A*	*TBD*	*TBD*	*TBD*	*TBD*	*TBD*
Terms being met [Target 3]	*N/A*	*N/A*	*N/A*	*75%*	*75%*	*75%*	*75%*

3.2 Institution-Specific Targets

Individual institution-specific targets will be used to manage operational milestones at a more granular level within the Specified Credit Institutions. The targets will be set with each individual credit institution reflecting their capacity, processes and systems. They will be dynamic and adjusted quarterly to ensure that the targets are ambitious. These targets will primarily monitor early arrears cases and operational effectiveness.

[3] Measurement of proposed sustainable solutions: For example, for quarter 2 2013: 20% of stock at end quarter 1 2013 must have had a proposed sustainable solution communicated and for quarter 3: the measure is 30% of stock at end quarter 2 2013.

3.3 Form of Disclosure of Targets

For the purposes of compliance with the obligation to make disclosure under Regulation 72 of the 2006 Regulations outlined above, Specified Credit Institutions should include in the Specified Credit Institutions' 2013 Pillar III disclosure a statement in the following form:

Target 1: As at [reporting date] the [Specified Credit Institution name] has **proposed*** **sustainable solutions** in respect of [x] % of the loans in arrears greater than 90 days.

Target 2: As at [reporting date] the [Specified Credit Institution name] has **concluded*** **sustainable solutions** in respect of [y] % of the loans in arrears greater than 90 days

Target 3: As at [reporting date], [z]% of the concluded restructured arrangements of [Specified Credit Institution] are meeting the terms of the arrangement.

Please see Appendix 2 for full details of what constitutes a proposed sustainable solution, a concluded sustainable solution and when the terms of an arrangement are being deemed to be met for the purposes of the targets.

Institutions will also be required to report their performance against public targets on a quarterly basis to the Central Bank.

4. Audit Approach

4.1 Reporting Requirements

The details of the reporting requirements imposed on Specified Credit Institutions will be imposed pursuant to section 18 of the Central Bank Act 1971 and Regulation 16(2) of the 1992 Regulations and the Central Bank will be writing to the Specified Credit Institutions separately in relation to such requirements. The Central Bank considers it necessary to have this information and these returns for the proper performance of the functions imposed, and the proper exercise of the powers conferred, on it by law, namely to assess Specified Credit Institutions' compliance with the targets set out in this document (for the purposes of monitoring and assessing their compliance with the provisions of Irish law transposing Directive 2006/48/EC (including without limitation Regulation 16 of the 1992 Regulations)).

4.2 Audit of Targets

In considering the information and returns, the Central Bank will consider the completeness, accuracy and validity of the reported outcomes against targets. The Central Bank will also judge whether the Specified Credit Institutions' management information systems and data reporting processes are producing complete and accurate outputs from the full population of mortgages which are 90 days or more in arrears.

The Central Bank will also examine performance against targets so as to assess whether the modifications provided are in fact sustainable solutions. Supervisory audits will therefore be carried out periodically (not after each reporting quarter) to inform the Central Bank's judgment regarding whether the target results as reported by credit institutions have been substantively met in practice.

In determining whether a proposal constitutes a sustainable solution, the lender needs to evaluate both actual and prospective borrower affordability and the capital implications for the credit institutions in terms of their prudential responsibility to minimise losses.

While the Central Bank is not mandating any particular model of restructuring[4] and while sustainable solutions will be arrived at on a case-by-case basis, there are some fundamental principles that must be respected are as follows:

- The affordability assessment of the borrower needs to be based on both their current and prospective future servicing capacity for all borrowings; assumed prospective future increases in the debt servicing ability of the borrower must be credible and conservative;
- Lenders need to apply a realistic valuation of the borrower's assets, in particular their property. This also applies to any assumption of potential asset price appreciation, as well as the estimated costs related to a potential foreclosure of property; and
- Lenders need to use an appropriate interest rate when discounting future income flows, which should take account of the lender's cost of funds.

The Central Bank will assess compliance with these principles in its supervisory audit of compliance with the targets, including through analysis of a sample of modifications.

[4] A number of possible solutions may be considered such as the use of 'split mortgages' and the other options in the Keane Report.

5 Provisioning

5.1 Introduction

An entity which prepares their financial statements in accordance with International Financial Reporting Standards (IFRS) is required to comply unreservedly with all of the requirements of those Standards. The Central Bank is conscious that its guidelines in respect of provisioning against impaired loans must be consistent with those standards and is satisfied that the approach to provisioning set out below meets that consistency requirement.

5.2 The Proposed Guidelines and Approach

5.2(i) Objective evidence of impairment required.

Under International Accounting Standard (IAS) 39 "Financial Instruments: Recognition and Measurement" an entity assesses at the end of each reporting period whether there is objective evidence that a loan or group of loans is impaired[5]. The standard states that a loan is impaired and impairment losses are incurred if there is "objective evidence" of impairment as a result of one or more events that occurred after the exposure was created, that the loss event has an impact on the estimated future cash flows of the loans and these cash flows can be reliably estimated[6].

5.2(ii) Steps to take when objective evidence is identified

IAS 39 stipulates that once it has been established that there is objective evidence that impairment on a loan measured at amortised cost has been incurred, the amount of the loss is measured as the difference:

- between the loan's carrying amount, being the current value of the loan's principal plus any accrued interest the credit institution is entitled to, calculated using the amortised cost approach; and
- the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the original effective interest rate[7]. Future cash flows include the value of applicable collateral less any foreclosure costs for obtaining and disposing of the collateral.

[5] As required under IAS 39.58.
[6] Refer to IAS 39.59.
[7] Refer to IAS 39.63.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience are required to use peer group experience for comparable groups of financial assets[8].

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions and to remove the effects of conditions in the historical period that no longer exist[9].

5.2 (iii) Treatment of loans in arrears greater than 90 days which have not been subjected to a sustainable solution

The Central Bank's Impairment and Provision Disclosure Guidelines ('Impairment Guidelines') as issued in December 2011 state that:

"For all loan asset portfolios, the Central Bank believes that, where applicable, when a loan asset is 90 days in arrears an impairment trigger has occurred and the exposure should be assessed for impairment."

Building on this current guideline, the Central Bank is minded to require credit institutions to set the present value of future cash flows at zero other than those arising from disposing collateral for the purpose of calculating the amount of the impairment provision required, without exception, for all loans in arrears greater than 90 days[10] which have not been subjected to restructured arrangements on a sustainable basis at the time of assessment.

This position reflects the view of the Central Bank that the majority of loans in arrears for greater than 90 days that are not restructured, using a sustainable solution, are in the long-term unlikely to recover. By setting out a clear threshold the Central Bank will remove the uncertainty from the market that exists due to the divergence in approaches currently adopted by institutions and will promote improved comparability across credit institutions.

Under IAS 39 the value of the collateral less costs to sell is required to be taken into account regardless of whether or not foreclosure is probable[11]. As this will be done on a collective basis it

[8] Refer to IAS 39.AG89.
[9] Refer to IAS 39.AG89
[10] This threshold may be subject to change depending on the appetite of the Central Bank.
[11] Refer to IAS39.AG84.

might be required to subject the portfolio of assets to a market average effectively applying a haircut based on the observable trend within the house pricing index for the period.

As part of these guidelines the Central Bank is considering setting the level of the haircut required to be applied. According to the Macro-Financial Review published by the Central Bank in November 2012 "National average house prices have declined 50 per cent from a peak in September 2007, and, notwithstanding increases in recent months, continue to fall on a year-on-year basis."[12].

The Central Bank may also set a standard cost to obtain and sell collateral in the event of foreclosure as well as the average time to foreclose for the purposes of preparing the impairment calculation.

5.2 (iv) Treatment of all other loans, including loans subjected to a restructured arrangement on a sustainable basis which were previously in arrears greater than 90 days.

All non-impaired loans and loans which have been subjected to a sustainable solution, not in arrears for more than 90 days, should continue to be treated in the same way as they are currently. That is to say that management will continue to apply their own assumptions and judgements when estimating the expected future cash flows and valuing the collateral provided such judgements and assumptions are consistent with the requirement of IFRS and observable market data.

If loans subjected to a restructured arrangement fall into arrears of greater than 90 days subsequent to the modification having been put in place such loans will be subject to the same assumptions as set out above for loans which have not been subjected to a restructured arrangement and are in arrears greater than 90 days.

IFRS requires that the methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Effectively, if there is no longer objective evidence of a loss having occurred or the difference between the carrying value of the loan and the present value of future estimated cash flows narrows then the amount of the provision must be reduced accordingly[13].

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[12] Note the CSO report stated that at 31 December 2012 "House prices in Dublin are 54% lower than at their highest level in early 2007. Apartments in Dublin are 62% lower than they were in February 2007. Residential property prices in Dublin are 56% lower than at their highest level in February 2007. The fall in the price of residential properties in the Rest of Ireland is somewhat lower at 47%. Overall, the national index is 50% lower than its highest level in 2007."

[13] Refer to IAS39.AG89.

However, the provisioning mechanism the Central Bank is minded to introduce as outlined above would require that credit institutions put sustainable solutions in place rather than merely seeking to defer providing for impairments or foreclosure. Restructuring arrangements which, based on the evidence of the audit performed by the Central Bank, as set out in Section 4 of this paper, are not considered to be sustainable solutions would also be subjected to the same assumptions as loans which are in arrears greater than 90 days.

Credit institutions are and would still be required to carry an impairment provision in respect of the vast majority of loans which have been subjected to a restructured arrangement as the act of providing forbearance in itself is considered to be an objective indicator of impairment[14], thereby triggering the requirement for the credit institutions to assess the loan for impairment but the magnitude of the related provision may be less.

5.3 Transition Period

The Central Bank is minded to apply the provisioning approach set out above to accounting periods beginning on or after 1 January 2014. Where the Central Bank's supervisory audit of performance against targets identifies concerns regarding whether solutions have been made on a sustainable basis, the Central Bank may, as set out in section 2.2, in accordance with its powers under Regulation 70 of the 2006 Regulations, require particular credit institutions to apply a specific provisioning policy or treatment of assets, in terms of own funds requirements.

During the intervening period the Central Bank will continue to assess observable data in order to determine:

i. the average time to foreclose;

ii. the haircut to be applied to collateral; and

iii. the standard cost to sell.

5.4 Unsecured Debt

The Central Bank will examine the merits of a similar policy for credit institutions, including credit unions, in relation to unsecured lending whereby unsecured loans in arrears for greater than 90 days will be required to be provided for in full.

[14] As set out in IAS39.59(c).

Furthermore, consideration will be given to additional provisioning requirements for all unsecured loans (whether performing or not) where the customer also has a secured mortgage in arrears for greater than 90 days unless a sustainable solution is in place which takes account of all the unsecured debt. This is to reflect the conservative assumption that unsecured debt will not be repaid unless a sustainable solution for the secured debt is put in place.

6 Continued Review of Capital Requirements

6.1 Continued Review of Capital Requirements

The Central Bank will continue to examine the appropriateness of capital requirements in the context of mortgage arrears in the case of credit institutions. Performance against the targets will be a key component to any such assessment (as set out in Section 2.4 above). The Central Bank will also consider requiring credit institutions to hold additional own funds where any or all of the following apply:

- Credit institutions have poor mortgage arrears resolution strategies; and/or
- Mortgage arrears resolution strategies are not well executed.

The Central Bank will also examine the interaction between provisions and regulatory capital to ensure that:

- Risk is appropriately measured and captured in the overall regulatory capital position; and
- Cyclicality and adverse incentives are removed from the calculation of regulatory capital.

Specifically, the Central Bank will review, within the context of (i) residential mortgages calculated under the IRB approach, and (ii) the guidelines for provisioning described in the above section, the application of:

- Expected Loss (EL) for performing exposures;
- Unexpected Loss (UL) for performing exposures;
- Best Estimate of Expected Loss (BEEL) for non-performing exposures; and,
- The application and interaction between provisions and EL in the calculation of core capital.

6.2 Supervisory Measures

The effectiveness of operations may be evidenced by a failure to meet the new targets. As noted earlier, the targets will need to be assessed and this will form part of the basis of our review of the adequacy and effectiveness of operations.

The Central Bank will engage with the Specified Credit Institutions on an on-going basis to supervise this process.

As noted in Section 2.4 above, in cases where it is determined that a credit institution fails to meet the requirements of the Capital Requirements Directive ("CRD"), including the requirement in Regulation 16 of the 1992 Regulations as outlined above, the Central Bank has recourse to supervisory measures, including imposing additional Pillar II requirements under Regulation 70 of the 2006 Regulations**.**

Appendix 1

Mortgage Arrears Resolution Measures

In late 2011 the Central Bank of Ireland commenced a Mortgage Arrears Resolution Strategy (MARS) project the purpose of which was to ensure that each lender has:

1. An effective strategy and implementation plan, for both PDH and BTL mortgages, for dealing with consumers in difficulty or likely to be in difficulty and which should cover:
    a. pre-arrears;
    b. arrears and forbearance; and
    c. Loan modifications/resolution.

2. A robust framework that encompasses the fair treatment of customers, to deliver appropriate solutions to people in arrears and pre-arrears.

3. A framework that is sustainable from both the lender's and borrower's perspective and resolution mechanisms that are properly tested through a proof of concept process having assessed capital costs and behavioral implications.

All lenders were requested to submit Mortgage Arrears Resolution Strategies and implementation plans which were all received by December 2011. In Q1 2012 the Central Bank responded with a set of key milestones to be met by all lenders for the remainder of 2012.

The Central Bank instructed all lenders to consider a comprehensive range of loan modification and resolution options in order to resolve PDH and BTL mortgage arrears cases. Lenders were advised to consider each of the Inter-Departmental Mortgage Arrears Working Group (Keane Report) recommendations along with any other internally developed options. A range of options were received from each lender in May 2012 and included options such as, split mortgages, mortgage to rent, trade down mortgages and interest rate reduction.

Prior to commencing full roll-out of the selected range of options, lenders were told to assess the operational capability of their systems, controls, staff and procedures to include a review of a limited number of test cases (pilots). This work was completed throughout Q3 in the main with most lenders having commenced full roll-out of these loan modification and resolution options by year end as set out by the Central Bank.

Key areas of work completed by the Central Bank throughout the course of the MARS project are, as follows:

1. ***Sustainability Guidelines***: These Guidelines should be considered by lenders when assessing consumer sustainability.
2. ***Outreach Programmes***: All lenders were requested to have a comprehensive outreach programme in place by June 2012 and the Central Bank then issued feedback to lenders on the programmes submitted.
3. ***Income Survey:*** Central Bank released results of its independent research into the experience of borrowers facing or in mortgage arrears who are engaging in the CCMA's Mortgage Arrears Resolution Process ("MARP"). Borrowers surveyed were mainly positive about their overall experience when interacting with their lenders during the MARP process. Further work is to be completed from this survey regarding household incomes which should follow later in the year.
4. ***Standard Financial Statement Data Analysis***: A number of credit institutions have been submitting SFS data and agreed arrangements to the Central Bank since Q2 2012. Analysis is on-going in this area to better understand the pre-arrears and arrears population.
5. ***Distressed Credit Operations Review (DCOR):*** During H1 2012 the Central Bank engaged with BlackRock to complete a DCOR analysis. The purpose of this review was, as follows:
   - Audit of arrears management operational capability;
   - Review of policies, resourcing, skills, systems and reporting; and
   - Operational audits were completed for these credit institutions and workshops were held for other lenders to highlight areas of concern that needed review and remedial action where necessary.
6. ***On-site Assessments***: A collections expert was hired to conduct assessments with CBI staff on-site and case reviews of the main lenders. Various assessments have been completed with feedback provided and more detailed regular assessment of operational effectiveness and quality of Arrears Support Units is on-going.
7. ***Provisioning:*** Tests were completed by the Central Bank to analyse for the risk of under-provisioning to ensure that treatments are conservative and proven by performance.
8. ***Code of Conduct on Mortgage Arrears:*** The Central Bank issued clarification on the protections and limits on contact with customers in April and again in December 2012. The Central Bank today, 13 March, is launching the public consultation stage of the review of the CCMA.

9. ***Key Performance Indicators:*** As part of the on-going assessment of progress being made by lenders in the mortgage arrears space, a core list of KPIs was agreed and is being incorporated into the quarterly Mortgage Arrears and Repossession Statistics.

Core KPIs	Reason Recorded	Publication Date
Mortgage Arrears	Stock and quarterly change - demonstrates underlying trend	Quarterly change recorded from Q3 2012 and published from Q1 2013
Early Arrears	0-90 days – is the problem getting worse	Always recorded but published from Q2 2012
Stock of Arrangements	Temporary and permanent options demonstrates if lenders are moving from forbearance to modification	Captured from Q2 2012 and published from Q3 2012
New Arrangements in Period	Throughput of cases and ability to identify arrears where no action taken	Recorded from Q3 2012 and published from Q1 2013
Restructures Meeting Terms of Arrangement	Demonstrates whether arrangements applied are appropriate	Recorded from Q3 2012, however, changes to be made for Q1 2013 and published from Q2 2013

Appendix 2

Target Definitions

Public Target Definition

The targets set as at 13th March 2013 are as follows:

Sustainable Solutions %	**2013**			**2014**			
	Q2	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Proposed [Target 1][15]	*20%*	*30%*	*50%*	*TBD*	*TBD*	*TBD*	*TBD*
Concluded[Target 2]	*N/A*	*N/A*	*TBD*	*TBD*	*TBD*	*TBD*	*TBD*
Terms being met [Target 3]	*N/A*	*N/A*	*N/A*	*75%*	*75%*	*75%*	*75%*

The first target for *concluded* sustainable solutions will be end Q4 2013. This will be set by end Q3 2013 at the latest.

A sustainable solution is defined as one of the following:

(a) An arrangement concluded under a bank's Mortgage Arrears Resolution Process (MARP[16]), in accordance with the CCMA[17], where the borrower is cooperating under the MARP and the bank has satisfied itself that the arrangement provides a sustainable solution which is likely to enable the customer to meet the original or, as appropriate, the amended terms of the mortgage over the full remaining life of the mortgage, including repayment of the original or an agreed revised principal sum where offered. This may include an interest only or other temporary solution for a period if it is likely that full repayment of the original or revised principal will be achieved over time, or where there is a payment plan to return the account to sustainability through the clearance of arrears;

(b) A personal insolvency arrangement effected under the Personal Insolvency Act 2012[18]; or

(c) If an arrangement could not be reached or is not appropriate, that the PDH or BTL property securing the loan has been voluntarily sold or, failing that, any situation where a Specified

[15] Measurement of proposed sustainable solutions: For example, for quarter 2 2013: 20% of stock at end quarter 1 2013 must have had a proposed sustainable solution communicated and for quarter 3: the measure is 30% of stock at end quarter 2 2013.

[16] *These targets apply with respect to both owner-occupier and buy-to-let mortgages, but the references to the MARP and CCMA only apply with respect to mortgages protected by the CCMA.

[17] See footnote 15

[18] We understand that the relevant provisions of the Personal Insolvency Act 2012 are expected to be commenced shortly.

Credit Institution takes possession of the property including by way of voluntary agreement with the borrower or by Court Order or otherwise.

A sustainable solution is a “proposed sustainable solution” in the following circumstances:

i. In relation to (a) above, where the Specified Credit Institution has offered a sustainable solution to the borrower in accordance with the CCMA;
ii. In relation to (b) above, where the borrower has appointed a Personal Insolvency Practitioner in order to consider a personal insolvency arrangement under the Personal Insolvency Act 2012;
iii. In relation to (c) above, where an arrangement could not be reached or is not appropriate after completing the MARP and the Specified Credit Institution has advised the borrower that it should consider voluntarily surrendering to the Specified Credit Institution the BTL or PDH property or voluntarily selling it or where proceedings have been initiated for the repossession of the property or the Specified Credit Institution has taken other steps to take possession of the property.

The terms of an arrangement under (a) above are being met if there is no payment over-due longer than 60 days and no payments are missed without the agreement of the Specified Credit Institution. The terms of an arrangement under (b) above are being met if the borrower is complying with their obligations under the personal insolvency arrangement. The terms of a solution under (c) above have been met once the option has been concluded (e.g. the property voluntarily surrendered or repossessed pursuant to a Court Order or otherwise).

Institution Specific Targets

Institution specific targets will be set for operational milestones at a more granular level. The targets will be set with each individual bank reflecting their capacity, processes and systems. They will be dynamic and adjusted quarterly to ensure that the targets are ambitious.

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