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Expectations for lenders in supporting borrowers affected by the COVID-19 Pandemic

Dear [CEO],

The Central Bank of Ireland (Central Bank) continues to focus on the response and approach of lenders[1] to the economic effects of the COVID-19 pandemic. Our focus includes ensuring that the interests of borrowers affected by COVID-19 are appropriately protected.

The purpose of this letter is to set out the Central Bank's further expectations of lenders' approaches to supporting borrowers who are experiencing financial difficulties as a result of COVID-19. This letter builds on, but does not supersede, our letter of the 8 June[2] (in which we outlined our expectations regarding the operation of payment breaks and the preparation for the transition to individually assessed borrower supports) and the ECB letter of 28 July[3].

We acknowledge that considerable efforts were made at a time of uncertainty and operational stress to implement payment breaks at pace and in a consistent manner in the early stages of the pandemic. Moreover, we recognise that lenders developed strategic and operational plans for supporting borrowers after payment breaks expire. The common themes identified in our review of those strategic and operational plans are incorporated into the expectations set out in the Appendix to this letter.

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[1] For the purpose of this letter, 'lenders' includes banks, retail credit firms and credit servicing firms that extended COVID-19 payment breaks under the Irish non-legislative moratoria programme.
[2] Dear CEO Letter 8 June.
[3] ECB Letter of 28 July on distressed debt operational capabilities.

The pandemic and the associated public health restrictions have affected the incomes of many individuals, households and businesses. There is considerable uncertainty as to the timing and extent of recovery of some borrowers' incomes. It is apparent that lenders are applying resources to engage with borrowers who are experiencing financial difficulty and are putting in place temporary supports and forbearance. However, there are some warning signs that need to be addressed quickly to deliver appropriate outcomes for both borrowers and lenders, specifically:

1. *Board and executive oversight:* The availability and reporting of management information (MI) on solutions and supports being provided to borrowers is, in most cases, not sufficiently granular to facilitate effective board and executive oversight and challenge, or timely to allow the board track outcomes. This MI is fundamental to effectively ensure that the treatment of borrowers is in line with lenders' own strategies, its regulatory obligations and the Central Bank's expectations.

2. *High reliance on temporary and very short-term forbearance:* In light of the uncertainties referred to above, it is understandable that lenders are supporting affected borrowers with temporary forbearance measures in the main, including interim arrangements for mortgage borrowers, as provided for under Provision 38 of the Code of Conduct on Mortgage Arrears (CCMA) (see Appendix for more details). However, there are early indications that some lenders are overly relying on very short-term arrangements, whereby borrowers do not repay any capital. These arrangements may not be in the borrowers' best interest as they increase the overall cost of credit for the borrower and do not address the affordability of their loans over the longer term.

3. *Expertise and judgement:* Most lenders appear to have mobilised sufficient resources to allow them to engage with borrowers who need support. However, there is some anecdotal evidence, particularly in the case of SME lending, that borrowers have concerns regarding the rationale and judgement applied in arriving at credit decisions. This includes reported instances of lenders inappropriately justifying these decisions as being driven by regulatory requirements.

4. *Lack of innovation:* All lenders are reporting that their existing, pre-pandemic, suite of forbearance solutions are sufficient to manage the current crisis and effectively support

borrowers affected by the pandemic. We have not seen any evidence of this assumption being challenged by boards and executive management.

Lessons from the past show that excessive use of short-term forbearance and non-recognition of distress allows problems to build up such that it becomes more difficult for appropriate and sustainable solutions to be implemented. No single measure will be successful in resolving all distressed debt, and research shows that borrowers and lenders benefit from taking a candid up-front view of borrowers' repayment capacity, and having a range of solutions appropriate to all circumstances. Together with the combination of the warning signs outlined above, this context raises concerns that elements of past mistakes may recur.

All lenders need to take action now to ensure that this is not the case.

It is imperative that you and your board are ensuring that [FIRM] has the required and sufficiently expert resources to assess individual borrower circumstances, and to offer appropriate and sustainable solutions to affected borrowers. This should be done in a timely manner and in line with your overarching strategy, regulatory requirements and Central Bank expectations.

In the context of the financial resilience of all lenders and the future availability of credit across the wider financial system in Ireland, a significant deterioration in the risk profile, or increase in the number of long-term arrears cases, will have a negative impact on capital. Effective and efficient management of distressed debt, is therefore important to protect the capital reserves of lenders, which are not unlimited. While the current focus is on the impact of the pandemic and the expiring systemic payment breaks, the Central Banks expectations set out in this letter also apply to pre-existing, longer term distressed debt.

Next steps

You are asked to consider the contents of this letter and to provide the Central Bank with confirmation that:

1. [FIRM] has undertaken a review to establish whether or not its relevant systems, policies, procedures, practices and borrower communications are in line with the expectations outlined in this letter; and

2. where the firm identifies that any systems, policies, procedures, practices or borrower communications are not in line with the expectations outlined in this letter, [FIRM] has taken or will take appropriate corrective action as a matter of priority.

Please submit the above no later than 18 December.

Yours sincerely

Ed Sibley	Derville Rowland
Deputy Governor, Prudential Regulation	Director General, Financial Conduct

Appendix: Supporting all borrowers affected by the COVID-19 Pandemic: Central Bank Expectations

1. **Boards and executive management need to effectively oversee and challenge the appropriateness and effectiveness of their firm's approach to supporting borrowers.**

The Central Bank expects the board and executive management to have sufficient information on, and oversight of, the support being provided to borrowers to ensure:

- that there is an appropriate suite of tools and solutions available to support borrowers' circumstances, and that the full suite of tools is being used appropriately;
- short-term solutions are not over utilised and are only used where it is in the borrowers' longer term interest;
- the timeliness and accuracy of reporting supports effective board oversight and challenge of the progress being made, and the approaches being taken;
- reporting on asset quality developments, including early warning indicators, are tracking the effectiveness of arrangements implemented, risk classification and IFRS9 staging; and operational metrics, borrower feedback and complaints are monitored and acted on.

2. **Proactive early engagement between lenders and borrowers is key to achieving appropriate outcomes for both lenders and borrowers.**

- After more than seven months of operating within the COVID-19 pandemic, lenders are expected to be in a position to act at pace to continue to support businesses and personal borrowers experiencing financial difficulties. Lenders must conduct efficient assessments of individual borrower circumstances to assess their affordability in a timely manner.
- Lenders should engage proactively, effectively and sympathetically with distressed borrowers – in line with their regulatory obligations CCMA[4], the Consumer Protection Code[5] and the SME Lending Regulations[6] – to deliver appropriate and sustainable solutions and facilitate as many borrowers as possible returning to repaying their debt.

[4] https://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/other-codes-of-conduct/24-gns-4-2-7-2013-ccma.pdf
[5] https://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/other-codes-of-conduct/4-gns-4-2-7-cp-code-2012.pdf
[6] https://www.centralbank.ie/docs/default-source/Regulation/consumer-protection/other-codes-of-conduct/39-gns-4-2-7-central-bank.pdf

- To the greatest extent possible, lenders should encourage borrowers to make payments or partial payments where they can, and to avoid accruing arrears where possible.

3. **A range of solutions will be required, tailored to individual borrower circumstances, to achieve appropriate outcomes for borrowers and lenders.**

- The likelihood of continuing changes in public health restrictions will require lenders to work with borrowers to assess income and affordability over time, rather than put in place a succession of reactive, very short-term reliefs.
- Lenders can avail of CCMA Provision 38, which provides for a temporary arrangement to be put in place prior to completing a full assessment of the Standard Financial Statement (SFS). Lenders that utilise Provision 38, must do so where appropriate, and specifically for accounts where a delay in putting a solution in place will further exacerbate an arrears/pre-arrears situation. Provision 38 should only be used for a limited period of time, sufficient to enable the lender to receive and complete a full SFS review. It must not be used as a substitute for the appropriate levels of resourcing required in order to complete assessments of borrowers' individual circumstances in a timely manner. Where Provision 38 is used, lenders should communicate clearly with borrowers, to provide them with sufficient information regarding the terms of the temporary arrangement.
- Payment breaks should continue to be made available where individual borrowers' circumstances indicate that they provide appropriate support (for example, if the borrower has not previously availed of a payment break).
- The duration of forbearance arrangements should reflect the likely period of a borrower's financial difficulties, enabling them to pay what they can afford, including capital where possible. Lenders must be able to articulate their policies on short-term arrangements, i.e. in what circumstances and for what duration the short-term solution will be applied. Lenders must advise borrowers that it is in the borrowers' interests to notify the lender if their circumstances change during the short-term arrangement. It should be explained to borrowers that this is to enable assessment for a sustainable solution to assist the borrower with meeting their debt obligations.
- Lenders should offer longer-term sustainable solutions, where possible, where there has been a more permanent change in a borrower's financial situation, based on their individual circumstances.

4. Central Credit Register obligations.

- Lenders are reminded of their obligations to submit accurate information to the Central Credit Register (CCR).[7]
- Where a COVID-19 payment break has been agreed with a borrower, lenders have been reminded that they should not report this to the CCR as "Number of payments past due'' or that the loan is ''restructured", during the period of the payment break.[8]
- As the COVID-19 payment breaks expire, reporting to the CCR will be a function/consequence of what lenders agree with their borrowers. Lenders will need to apply judgement around whether a restructure has been agreed in response to an identification of financial distress. In other words, the identification of financial distress precedes the reporting of a restructure to the CCR.
- In all circumstances, lenders should communicate with their borrower as to how any arrangement agreed will be reported on their credit report in the CCR.

5. Lenders should continue to focus on resolving longer-term arrears.

- Almost nine per cent[9] of all principal dwelling house (PDH) mortgage accounts in Ireland had some level of arrears prior to the start of the pandemic. The majority of those borrowers in long-term arrears (greater than two years) are deemed to be cooperating and are typically making some payments. Individually and collectively, lenders must continue to address this longer-term distress, prioritising those borrowers who are engaged and making payments.
- Lenders must also continue to encourage those borrowers that are currently classified as non-engaging to engage with their lender to work towards the resolution of the borrower's arrears.
- For new pandemic related distress and existing distressed debt, we expect lenders to keep the suite of products they offer to support borrowers experiencing financial difficulties under review, challenging traditional solutions for resolving distressed debt where they are not working. In this context, we expect lenders to consider innovative long-term solutions that will seek to ensure repayment of the original, or agreed revised principal sum. There are multiple tools and products available to resolve arrears in a sustainable way up to and including mortgage debt write-down, engaging with the insolvency process to tackle problem debt, and engaging with mortgage to rent schemes.

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[7] See www.centralcreditregister.ie.
[8] See CIP Circulars a) 05 issued 26.03.20; b) 06 issued 02.04.20; and c) 08 issued 12.06.20.
[9] Understanding Long-term Mortgage Arrears in Ireland.

6. **Lenders are expected to provide appropriate supports to SME borrowers to help them to assess the longer-term effects on their businesses.**

- Lenders should segment SME portfolios to identify and prioritise support for those sectors that have been hardest hit by the pandemic.
- A segmented approach to early engagement is critical to facilitate early credit risk assessment and to prioritise the most vulnerable sectors and sub-sectors of SME borrowers who are worst affected.
- Lenders must apply clearly communicated credit assessment procedures across all relevant restructuring units to support this approach.
- Considerable flexibility and judgement will be required in dealing with borrowers affected by the pandemic. Given the necessary heterogeneity of treatments, this makes it more challenging for boards and executive management to demonstrate how they are satisfying themselves that the treatment of SME borrowers is consistent with their stated strategies, regulatory obligations and Central Bank expectations.

7. **Lenders need to continue to ensure the timely and accurate recognition of any deterioration in the risk profile of borrowers.**

- Lenders must regularly assess whether the credit risk of any loan has increased significantly since its initial recognition.
- The level of distress in loan books should be prudently reflected in provisioning levels.
- Individual loans must be correctly classified in line with regulatory requirements, while additional attention in this respect shall be given to the loans exiting payment breaks.
- Lenders must proactively perform ‘Unlikely to Pay’ assessments in a prudent and effective manner in line with existing policies and procedures.
- As outlined in the 28 July 2020 SSM letter, the effectiveness of the risk management practices in this regard, will continue to be assessed by ECB Banking Supervision via its ongoing engagement with significant institutions.