FINANCE

COVID-19 Payment Breaks: Looking back, and looking ahead

October 2020

Borrowers are beginning to roll-off the industry-wide COVID-19 payment breaks introduced in March 2020. While these payment breaks will no longer be offered on an industry-wide basis by the participating retail banks, non-bank lenders or credit servicing firms after 30 September 2020, appropriate and sustainable solutions will still be needed for borrowers in financial difficulties as a result of the pandemic. Importantly, the Central Bank of Ireland confirmed this week that there is no regulatory impediment to payment breaks continuing to be offered on a case-by-case basis.

Following this week's publication by the Central Bank of Ireland (the **Central Bank**) setting out lessons learned from the last financial crisis when dealing with distressed mortgages,[1] this briefing looks back at the crucial temporary arrangements made available to borrowers impacted by COVID-19 over the last six months, and looks ahead to what might happen next.

LOOKING BACK

Liquidity

The industry-wide payment breaks provided much-needed liquidity and breathing space to personal and business borrowers impacted by COVID-19 (for more information, read our earlier briefings: COVID-19: Supports announced for affected customers of banks and other lenders and COVID-19: Payment Breaks Extended to Six Months).

30 September 2020 end-date

As expected, borrowers will no longer be able to apply for those payment breaks after 30 September 2020. This was confirmed in statements released this week by the Banking & Payments Federation (Ireland) (**BPFI**) (here) and the Department of Business, Enterprise and Innovation (here), following a meeting between Government ministers, the BPFI and the CEOs of the five retail banks on 28 September 2020.

EBA Guidelines to be phased out

The European Banking Authority (**EBA**) has also confirmed that it will phase out its Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (the **EBA Guidelines**).

The beneficial regulatory treatment set out in the EBA Guidelines will continue to apply to all eligible payment breaks granted before 30 September 2020 to avoid any sudden need to re-classify the relevant loans as in forbearance.

For further information on the EBA Guidelines, read our earlier briefings: COVID-19: EBA Guidelines on Payment Moratoria, COVID-19: EBA Guidelines on Payment Moratoria: Application to Securitisations and COVID-19: EBA extends application of Guidelines on Payment Moratoria.

How many borrowers availed of payment breaks?

Based on recent statistics published by both the Central Bank and the BPFI:[2]

Payment breaks were granted for > 220,000 loans (> 152,000 of those loans were to Irish borrowers) and > 80% of payment breaks were availed of by performing borrowers.

Residential mortgage borrowers, and those with personal loans, are rolling-off payment breaks earlier than SME and corporate borrowers; in many cases, they may have applied for payment breaks more quickly, or not extended their original payment break beyond the initial three-month period.

SMEs were more likely to avail of payment breaks than larger corporates. More than 32,000 payment breaks were granted to SMEs, with approximately 4,000 payment breaks granted to large corporates. Almost 20% of SME loans had benefitted from a payment break by 4 September 2020, with the Central Bank noting that, pre-COVID-19, SMEs had "*remarkably low levels of cash holdings and...quite limited access to undrawn credit*".

1 McCann and O'Malley, Resolving mortgage distress after COVID-19: some lessons from the last crisis, Financial Stability Notes Vol 2020, No 7

2 BPFI, Wide range of solutions available for customers coming off COVID-19 six month payment breaks (28 September 2020); Central Bank Deputy Governor Ed Sibley, Opening remarks delivered at Distressed Debt Webinar run by the University of Limerick (28 September 2020); Duignan and McGeever, Which firms took COVID-19 payment breaks? Financial Stability Notes Vol 2020, No 6; Gaffney and Greaney, COVID-19 payment breaks on residential mortgages, Financial Stability Notes Vol 2020, No 5.

Borrower sector/primary economic activity was the best available indicator of the need for a business loan payment break – as might have been expected, the accommodation, food, arts, entertainment and recreation sectors accounted for the largest percentage of payment breaks on business loans. Borrowers with higher numbers of employees on the Pandemic Unemployment Payment, or availing of the Temporary Wage Subsidy Scheme, were more likely to apply for payment breaks. Business borrowers were also more likely to avail of payment breaks in respect of term products than revolving facilities.

LOOKING FORWARD

What happens next?

Through the BPFI, it was confirmed that the banks have committed additional staff and resources to help those customers who are rolling-off payment breaks.

While many borrowers will be able to return to servicing their debts once their payment breaks expire, a large number of borrowers will not be able to do so (either for a temporary period, or permanently). An Tánaiste, Leo Varadkar TD stated this week that "*...the banks must continue to offer payment breaks to individuals and businesses that still need them*", and the Minister for Finance, Paschal Donohue TD emphasised that it "*is essential that borrowers and lenders discuss all options to ensure sustainable outcomes, on a case by case basis*".

The Central Bank has reminded lenders and distressed borrowers that engagement between them remains key to successful debt restructuring, and ensures the application of the protections set out in the Central Bank's Code of Conduct on Mortgage Arrears, the Consumer Protection Code and the SME Regulations.

The EBA has indicated that, while the beneficial regulatory treatment set out in the EBA Guidelines will continue to apply to all eligible payment breaks granted before 30 September 2020, any further extensions or new breaks should be classified "*on a case-by-case basis according to the usual prudential framework*".

What does the Central Bank expect?

In June 2020, the Central Bank wrote to the CEOs of the regulated lenders that offered payment breaks to clarify its supervisory expectations. Active engagement with borrowers, transparent communication, and the timely identification of appropriate and sustainable solutions for borrowers who remain in financial difficulties were its key focus areas. For more information on that letter, read our briefing: COVID-19: Payment Breaks – Central Bank Confirms Supervisory Expectations.

No regulatory impediment to further bespoke payment breaks

Central Bank Deputy Governor Ed Sibley clarified in a speech on 28 September 2020 that there is no regulatory impediment to lenders offering further payment breaks on a case-by-case basis after 30 September 2020, provided that it is appropriate to do so.

Proactive engagement by lenders

The Central Bank expects the boards and senior management of all regulated lenders to ensure that those lenders are proactively engaging with retail and SME borrowers to assess repayment capacity and establish whether additional forbearance is needed, and whether the relevant loan can be restructured or otherwise resolved.

Central Bank Deputy Governor, Ed Sibley, also reiterated the "*hard lessons*" learned from the previous financial crisis, including the following:

- temporary forbearance is appropriate where there are temporary liquidity issues, but not where the borrower's financial difficulties are permanent
- excessive reliance by lenders on temporary forbearance measures may not be in the best interests of borrowers – over-reliance on short-term forbearance and non-recognition of financial distress may make it more difficult for a borrower to reach a sustainable repayment arrangement

Pre-existing residential mortgage arrears remain a focus area

The Central Bank will also continue to focus on those who were already in mortgage arrears before the COVID-19 pandemic (mainly primary dwelling-house (**PDH**) mortgage borrowers).

The Central Bank's Residential Mortgage Arrears & Repossessions Statistics: Q2 2020 (published on 28 September 2020) included more granular detail than usual on long-term arrears and borrower cooperation levels. Split mortgages and arrears capitalisation remain the most common restructuring options for PDH mortgage loans, but it is more likely that the impact of COVID-19 on these statistics will not be seen to any substantive degree for another two quarters.

Additional data on long-term mortgage arrears published

The Central Bank's related publication, Behind the Data: Understanding Long-term Mortgage Arrears in Ireland indicated that almost one-third of PDH mortgage accounts in arrears are more than five years in arrears, with 8% being more than ten years in arrears. Following a large number of loan portfolio sales in recent years, non-bank lenders hold almost two-thirds of PDH mortgage accounts in more than ten years' arrears. Findings in relation the length of the court process were also notable – the first court hearing for most active cases was between two and five years ago. In more than 2,500 cases, that first hearing was more than five years ago. What is also notable is the recent finding that strategic defaults by those who 'can pay' is not a significant issue in Ireland, and that Irish borrowers are more willing to engage with their bank than to default without engaging.[3]

CONCLUSION

The Government, the Central Bank, the retail banks, the other non-bank lenders and credit servicing firms acted quickly to address the immediate liquidity issues that arose with the onset of the COVID-19 pandemic in March 2020. It may be some time before a clear picture emerges of the number of personal and business borrowers who will not return to full repayments once they roll-off their payment breaks. The Central Bank has signalled that regulated lenders can expect intrusive engagement to ensure that they are meeting the Central Bank's expectations regarding the treatment of borrowers in financial difficulties.

While it seems inevitable that we will be heading into a period where mortgage arrears and commercial loan arrears increase significantly, some comfort can be taken from the fact that the banking sector is well-capitalised and that there should be well-embedded arrears handling processes in place at all of the relevant lenders based on Central Bank requirements that have been in place for some time.

3 McCann and O'Malley, Resolving mortgage distress after COVID-19: some lessons from the last crisis, Financial Stability Notes Vol 2020, No 7.

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