FINANCE

NPL Update

March 2021

Non-performing loans (**NPLs**) and, in particular, the potential impact of the COVID-19 pandemic on levels of residential mortgage arrears remains a high priority for the Central Bank of Ireland (**CBI**). The CBI regularly highlights its expectation that regulated lenders and borrowers will engage effectively with one another to achieve sustainable solutions, and regulated lenders can continue to expect intrusive engagement to ensure that the CBI's expectations are met.

In this NPL Update, we analyse the Irish NPL landscape following the end of the industry-wide payment breaks, current arrears levels for primary dwelling-house (**PDH**) accounts and buy-to-let (**BTL**) accounts, the most common forms of alternative payment arrangement, the CBI's plans regarding its Code of Conduct on Mortgage Arrears (**CCMA**) and the key pillars of the European Commission's December 2020 NPL Action Plan.

THE END OF INDUSTRY-WIDE PAYMENT BREAKS

As discussed in more detail in our previous briefings (COVID-19 Payment Breaks - Looking back, and looking ahead and COVID-19 Payment Breaks - Active engagement and tailored sustainable solutions remain the Central Bank's priorities), it seems inevitable that we are heading into a period where consumer and business payment arrears will increase following the end of the industry-wide payment breaks in 2020. However, some comfort can be taken from:

- the well-capitalised nature of the Irish banking sector, as highlighted by the Minister for Finance in a recent speech where he noted that, due to those capital levels, the impact of the COVID-19 pandemic has not called into question the stability of the Irish banking system
- the fact that there should be well-embedded arrears handling frameworks in place within all relevant lenders based on the long-standing frameworks set out in the CBI's CCMA and Consumer Protection Code (**CPC**)
- the CBI's recent Economic Letter, which noted that COVID-19 supports from the Irish government significantly mitigated the impact of the pandemic on household incomes and debt sustainability during Q2 and Q3 2020

KEY STATISTICS

PDH and BTL Arrears Levels

The CBI's most recent Residential Mortgage Arrears and Repossessions Statistics, covering Q4 2020, show a continuing decline in the number of PDH accounts and BTL accounts in arrears.

At 31 December 2020, 5.3% of PDH accounts and 13.1% of BTL accounts were in > 90 days' arrears (a decrease of 0.1% and 0.5% respectively on the previous quarter). We expect that the CBI statistics for Q2 2021 (to be published in September 2021) will provide a more accurate picture of the impact of the COVID-19 pandemic on PDH and BTL arrears.

Payment Breaks for Businesses

Equivalent detailed statistics on arrears levels on business loan accounts are not available, but the CBI's July 2020 publication, Behind the Data - COVID-19 Payment Breaks – who has needed them? - July 2020, indicated that (at 19 June 2020):

- 26% by value of the Irish retail banks' SME portfolios were subject to a payment break at that time, with real estate; accommodation and food services; wholesale and retail trade; agriculture, forestry and fishing; and human health services being the sectors that required the most support.
- 10% by value of the Irish retail banks'

- corporate portfolios were subject to a payment break at that time, with real estate (17% by value of loans to that sector) and accommodation and food services (22% by value of loans to that sector) being the sectors with the highest percentage (by value) of payment breaks.

It is important to bear in mind the potential for correlation between arrears on business loans (in particular, SME loans) and arrears on PDH accounts. Small business owners will often have both business debt and personal debt, as will their employees, and an increase in arrears on SME loans may be indicative of a likely increase in arrears on PDH accounts.

Alternative Repayment Arrangements

The Banking & Payments Federation (Ireland)'s Payment Breaks Update - 31 December 2020 confirmed that only 4,200 accounts remained under an active payment break by the end of last year. However, more recent figures are not yet available to show how many impacted borrowers (consumer or business) are servicing their debt in full, and how many are operating under an alternative repayment arrangement (**ARA**) with their lender.

While, as mentioned above, it is unlikely that we will be able to assess the impact of the COVID-19 pandemic on PDH and BTL arrears until the CBI publishes its arrears statistics for Q2 2021 in September 2021, the CBI's recent statistics for Q4 2020 are useful insofar as they indicate that:

- Split mortgages and arrears capitalisation remain the most common ARA type for PDH accounts.
- Term extensions and arrears capitalisation remain the most common ARA type for BTL accounts.

CBI SFS CONSULTATION

PDH and BTL borrowers in arrears benefit from the arrears management frameworks set out in the CBI's CCMA and CPC respectively.

The Mortgage Arrears Resolution Process (**MARP**), which is a key component of the CCMA's arrears management framework, requires that specified financial information be gathered from relevant borrowers by way of a Standard Financial Statement (**SFS**). The CBI has launched a consultation on its form of SFS with the aim of making it easier for borrowers to understand what documents they need to provide, and to make the SFS more straightforward to complete. While the CBI does not plan to amend the MARP or the wider CCMA for the time being, it has encouraged stakeholders to provide feedback on either or both of the MARP and the CCMA as part of its SFS-related consultation which will inform any future review of the CCMA.

Separately, the CBI has been reviewing the CPC for some time to take account of emerging trends and risks, and plans to launch a public consultation on that review later in 2021. It is not yet clear whether the CPC's arrears management framework will be amended as part of this review.

THE EU PERSPECTIVE

While NPLs remain a priority for the CBI (as evidenced in a recent speech by Derville Rowland (CBI Director General, Financial Conduct)), tackling NPLs also remains a focus point for the European Commission (**Commission**) and the European Central Bank (**ECB**).

The Commission's December 2020 NPL Action Plan was developed in response to the need to ensure that NPL levels do not accumulate on banks' balance sheets, in particular as the COVID-19 pandemic and related lockdown measures across EU Member States has slowed, and in some cases halted, the previous steady decline in NPL levels.

The plan is centred on four key pillars, designed to free up banks' balance sheets, manage NPL stocks and remove regulatory obstacles to a liquid secondary market.

- Further developing secondary markets for distressed assets.
- Reforming the EU's corporate insolvency and debt recovery legislation.
- Supporting the establishment and cooperation of national asset management companies (**AMCs**). ECB President Christine Lagarde recently noted that this could be a useful way to deal with any systemic increase in NPL levels across the EU, which would itself require comprehensive national and EU-level approaches.
- Implementing precautionary public support measures, where needed, to ensure the continued funding of the real economy under the Bank Recovery and Resolution Directive and State aid frameworks.

Key to the first two aims are:

- The progression of the proposed Directive on credit servicers and credit purchasers, and the proposed Directive on accelerated extrajudicial collateral enforcement. For a status update on those proposals, see Credit Servicing - will the Irish regime need to change? and Credit Servicing and Loan Sales - Scope will be key in EU trilogue negotiations on proposed Directive.
- The Commission's proposal to remove regulatory obstacles to securitisations of non-performing exposures as part of its Capital Markets Recovery Package. For more information on that proposal, read our previous update: Securitisation Regulation: Disclosure, Synthetic Securitisations and Non-Performing Exposures – What you need to know. This proposed regulation is scheduled to be considered by the European Parliament this week.

NPLs are likely to be a feature of the Irish banking market for the foreseeable future. We will issue further updates as progress is made on above proposals in the coming weeks.

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