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Opinion of the European Banking Authority on Good Practices for the Treatment of Borrowers in Mortgage Payment Difficulties

Table of Contents

Abbreviations 1

Definitions 1

Introduction and legal basis 2

Background 3

Scope of this Opinion 5

Good practices for the treatment of borrowers in mortgage payment difficulties 6

- General Principles 6
- Policies and Procedures 6
- Provision of Information and Assistance to the Borrower 8
- Resolution Process 9

Abbreviations

EBA	European Banking Authority

Definitions

Capitalisation of shortfall	The shortfall is added to the loan to be repaid during the normal term of the mortgage.
Payment holiday	An agreement a borrower can make with the creditor that allows him to temporarily stop or reduce the monthly mortgage repayments.

Introduction and legal basis

1. Mortgage credit is a key element to allowing consumers to buy and retain their own home. However, mortgage credit can also give rise to risks for consumers, which need to be mitigated by consumers making responsible borrowing choices; by credit institutions taking responsible lending decisions; and by competent authorities protecting consumers from poor lending practices.

2. To ensure that potential risks associated with borrowers in mortgage payment difficulties are managed adequately by credit institutions, and to contribute to the development of consistent practices in this area, it is desirable for the European Banking Authority (EBA) to adopt an Opinion on good practices for the treatment of borrowers in mortgage payment difficulties (Opinion). The Opinion complements the provisions on arrears and foreclosure expected to be set out in the pending Directive on Credit Agreements Relating to Residential Property (also known as the Mortgage Credit Directive) and provides suggestions on how to give effect to these provisions.

3. The Opinion is addressed to competent authorities, as defined in Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions; covers supervisory and market practices; and is non-binding.

4. The EBA's competence to deliver an opinion is based on Article 29(1)(a) of Regulation No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.[1]

5. In accordance with Article 14(5) of the Rules of procedure of the EBA, the Board of Supervisors has adopted the Opinion as set out in the pages overleaf. This Opinion will be published on the EBA's website.

[1] OJ L331, 15.12.2010, p. 12.

Background

1. Mortgage lending is the primary mechanism used in many countries to finance private ownership of residential property. Although the terminology and precise forms will differ among countries, the basic components tend to be similar and include: a property as the physical residence being financed; a creditor as the institution providing a loan; a mortgage as the security interest of the lender in the property; a borrower as the person creating an ownership interest in the property; the principal as the original size of the loan that will go down as it is being repaid; and foreclosure or repossession as the possibility for the creditor to seize the property under certain circumstances.

2. A mortgage is likely to be the single greatest financial commitment the majority of consumers will enter into in their lifetimes.

3. However, mortgage credit can also give rise to risks. One of these risks is that mortgage borrowers might encounter payment difficulties, that is they find themselves in a situation in which they are not able to keep up with the required mortgage repayments on their home. The words 'payment difficulties' are used for the purpose of this document to refer to what in some countries is referred to as 'arrears' or similar such terms, depending on whether they are used for prudential, financial accounting or consumer protection purposes. 'Payment difficulties' is therefore to be interpreted broadly, so as to account for these national differences. However, it is not intended to cover either forced sales or foreclosure practices as these are inseparable from issues of local law. Competent authorities should establish a definition of payment difficulties and this definition should be applied to the good practices set out in this Opinion.

4. For many consumers their mortgage will run for the agreed term with repayments being made as scheduled. However, the global financial crisis and the ongoing challenging economic environment have led to regulatory concerns in many Member States about the levels of borrowers in financial difficulties. Financial difficulties can cause great stress to the borrower, and early proactive engagement is crucial to identifying a viable solution to the situation and, consequently, reaching a positive outcome for that borrower. Such a solution is usually also preferable for the creditor, as the proceeds from a forced sale will usually result in a lower return.

5. Best efforts should always be used to restore the mortgage to a sustainable position, and legal enforcement should only be considered when other alternatives have been explored. Even before the borrower is in payment difficulties there are usually warning signs for problem loans. An inability to pay the full loan instalment may induce the borrower to pay nothing at all and thereby risk entering into an unsustainable level of indebtedness. Identifying and engaging at an early stage with these borrowers can be a very cost effective approach for the creditor. It is also important that borrowers are encouraged to engage with the creditor about any financial difficulties which may prevent them from meeting the scheduled repayment.

6. There can be many causes of payment difficulties and better consumer outcomes are likely where creditors are flexible in their response to the situation.

7. Creditors who identify borrowers in (or close to) payment difficulties will naturally want to treat these borrowers fairly and try to reach a solution which is acceptable for all parties involved. To some extent this is of course dependent on the borrower being willing to co-operate with the lender to resolve these difficulties.

8. This consumer protection objective should not be seen in isolation. There are obvious prudential reasons for creditors to closely and efficiently manage loans that are not fully performing. These considerations may well influence the particular forbearance approach any specific creditor adopts, and these published good practices are neither exhaustive nor intended as a rigid framework to be applied in all cases.[2]

9. Given that EBA's founding regulation[3] has given the EBA the objectives to contribute to enhancing consumer protection (Articles 8(f) and 9) and to contribute to ensuring the stability, integrity and effectiveness of the financial system (Articles 4, 22, 23, and 24), and that inappropriate approaches to treating mortgage borrowers in payment difficulties might undermine the EBA's ability to deliver on these objectives, the EBA has undertaken work to identify good practices for the treatment of borrowers in mortgage payment difficulties across EU Member States.

10. Good practices relate to the retail conduct of creditors towards mortgage borrowers in payment difficulties that, if applied, will enhance consumer protection and will, as such, also contribute to ensuring the effectiveness of the financial system more generally. They are aimed at promoting common practices amongst competent authorities and are addressed to them as an Opinion under Article 29 of the EBA Regulation. Competent authorities are likely to want to consider how the good practices, alongside measures already in place or to be implemented (e.g. EU Directive on Credit Agreements Relating to Residential Property), might support their own national regulatory objectives.

11. The evidence for this Opinion is drawn from an EBA survey of national supervisory as well as more general market practices in respect of both responsible lending and the treatment of borrowers in mortgage payment difficulties. On responsible lending, this survey collected information from competent authorities on the consistency between national practices and the FSB Principles. Authorities were also asked to identify national approaches to responsible lending that supplemented the FSB Principles, this information being used to identify additional good practices. The result of this work is published in an Opinion separate to this. In respect of the treatment of borrowers in mortgage payment difficulties, the EBA survey collected information on the national supervisory and market approaches to key consumer protection outcomes identified by EBA members.

[2] For EBA's definitions and associated reporting templates on forbearance and non-performing exposures, see EBA's separate (and at time of publication ongoing) consultation at EBA/CP/2013/06.

[3] See OJ (2010), *Regulation (EU) No 1093/2010 of the European Parliament and of the Council*.

Scope of this Opinion

12. This Opinion is directed towards competent authorities. These authorities will typically have supervisory responsibility for credit institutions[4]. In some, but not all, Member States these authorities will also supervise mortgage lending done by non-credit institutions. Where this is the case, competent authorities are likely to also want to promote the adoption of these good practices since the nature of the creditor (i.e. whether it is a credit institution) will not alter the positive effect of the good practices. In view of this, any reference to “creditor” in this paper can be read as applying to both credit institutions and non-credit institutions and any reference to payment difficulties can be read as mortgage payment difficulties. Competent authorities will want to consider the widest application of these good practices, consistent with their scope of supervisory responsibility, to minimise the risk of regulatory arbitrage.

13. Where the competent authority is not the supervisor for non-credit institutions, or where there isn't national regulation that applies to non-credit institutions, the good practices identified in this Opinion may still be of interest to the appointed supervisor or to the creditors themselves.

14. Many mortgage creditors outsource their operations to another business. For the purpose of this Opinion the operations of this second business are not considered separately. Rather, as the agent of the creditor, it would be for that creditor to consider the identified good practice and how it might be reflected in the approach adopted by the business carrying out the outsourced activities.

15. Given the consumer protection focus of this Opinion it inevitably concentrates on the treatment of the borrower. However, the borrower's payment difficulties can have important implications for others, not least any third parties acting as guarantors. Competent authorities may wish to ensure that when considering these good practices they also have regard to the interests of these guarantors, e.g. by extending to them the good practices concerned with the provision of information by creditors.

16. The good practices in this Opinion should be understood as referring to data use to the extent permissible under national data protection laws.

[4] As defined in EC (2006), *Directive of the European Parliament and the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (No 2006/48/EC)*

Good practices for the treatment of borrowers in mortgage payment difficulties

17. This Opinion considers good practices on the treatment of borrowers in mortgage payment difficulties under the following headings:

- General Principles
- Policies and Procedures
- Provision of Information and Assistance to the Borrower
- Resolution Process

General Principles

18. The interaction between creditor and mortgage borrower should be governed by general principles related to honesty, fairness, information, and privacy.

> ***Good practice 1:*** *It is good practice to ensure that creditors, when dealing with a borrower in payment difficulties:*
>
> - *act honestly, fairly and professionally;*
> - *pro-actively encourage the borrower to engage with them about the financial difficulties;*
> - *provide adequate information and assistance to borrowers in payment difficulties;*
> - *communicate clearly and in plain and simple language;*
> - *ensure that all meetings with the borrower in relation to their payment difficulties are conducted in private;*
> - *only impose permitted charges and those charges should not be greater than is necessary to compensate the creditor for costs incurred as a result of the payment difficulties.*

Policies and Procedures

19. It is vital for the correct handling of the borrower in payment difficulty that relevant staff are appropriately trained on the policies and procedures of the creditor and are sensitive to the situation of the borrower. This ensures that staff are both knowledgeable and capable of dealing appropriately with the borrower during this difficult and potentially stressful time for the borrower. It is also inevitable that the borrower will have queries on the process to attempt to resolve the difficulties and it is therefore imperative that staff are in a position to answer these queries.

__Good practice 2:__ It is good practice to ensure that creditors establish policies for the effective handling of borrowers in payment difficulties.

__Good practice 3:__ It is good practice to ensure that creditors establish procedures to detect early indications of borrowers going into payment difficulties.

__Good practice 4:__ It is good practice to ensure that creditors provide appropriate training for staff dealing with borrowers in payment difficulties.

20. Even before the borrower is in payment difficulties there are usually warning signs for problem loans. Identifying and monitoring indicators, such as a borrower's request to reduce/delay a payment, could be a cost effective approach to prevent the borrower going into over-indebtedness.

__Good practice 5:__ It is good practice to ensure that creditors monitor indicators to identify potential borrowers in payment difficulties.

21. Taking immediate action to engage with the borrower at the outset of the payment difficulties may prevent a worsening of the situation. It is important that the borrower engages with their creditor in a meaningful way so that they can influence how their arrears situation is resolved.

__Good practice 6__: It is good practice to ensure that creditors take immediate action when a borrower goes into payment difficulties or informs the creditor he/she is concerned about payment difficulties.

22. Creditors should be in a position to provide the relevant and necessary information to borrowers in writing, if so requested.

__Good practice 7__: It is good practice to ensure that creditors make available dedicated information resources such as providing information on their website or in a booklet to borrowers in, or concerned about, financial difficulties.

23. While it is important that the creditor engages with the borrower at an early stage, it should also be conscious of the level of engagement with the borrower who may already be feeling stressed and under pressure due to their financial circumstances.

__Good practice 8__: It is good practice to ensure that creditors maintain a level of contact and communication with a borrower in payment difficulties that is proportionate and not excessive.

24. It is important that the borrower is not harassed or put under excessive pressure by the creditor or by an agent of the creditor when attempting to resolve their payment difficulties. The creditor

should also be cognisant of only contacting the borrower at appropriate times in relation to their payment difficulties and only to the contacts provided by the borrower for that purpose.

> ***Good practice 9****: It is good practice to ensure that creditors avoid putting excessive pressure on borrowers in relation to their payment difficulties and contact should only be made at times which are reasonable to the individual borrower, including contact made by an agent of the creditor.*

25. Where a creditor intends to involve a third party to collect debts on its behalf, it is important that this information is conveyed and explained to the borrower so they have a clear understanding of the role and activities of the third party.

> ***Good practice 10****: It is good practice to ensure that creditors inform the borrowers in payment difficulties where they intend to involve a third party debt collection agency in dealing with the borrowers.*

26. The creditor should ensure that it keeps adequate records of all its dealings with the borrower in order to ensure its own compliance and demonstrate it to the competent authority, if necessary.

> ***Good practice 11****: It is good practice to ensure that creditors make and retain adequate records of its dealings with the borrowers in payment difficulties.*

> ***Good practice 12:*** *It is good practice to ensure that creditors review these policies and procedures periodically or keep them under review.*

Provision of Information and Assistance to the Borrower

27. The provision of information and assistance to the borrower is essential to a mutually beneficial resolution of the issue.

> ***Good practice 13:*** *It is good practice to ensure that creditors, as soon as they become aware that the borrower is in payment difficulty, communicate promptly and clearly with the borrower to establish why the difficulties have arisen.*

> ***Good practice 14:*** *It is good practice to ensure that creditors provide the following information in a timely manner to the borrower:*
>
> a) *the number of payments either missed or only paid in part;*
>
> b) *the total sum of the payment shortfall;*
>
> c) *the charges incurred as a result of the payment shortfall;*
>
> d) *the importance of the borrower co-operating with the creditor to resolve the situation;*

e) *information regarding the consequences of missing payments (e.g. legal procedures, costs, default interest rate, possible loss of property, etc.);*

f) *information regarding the expected timelines for the process, e.g., major milestones, average timing, etc.; and*

g) *information about available government/public schemes or support.*

Good practice 15*: It is good practice to ensure that where the payment difficulties persist, creditors provide an updated version of this information every quarter.*

Good practice 16: *It is good practice to ensure that creditors consider the role for information or advice to borrowers in preventing or mitigating payment difficulties where::*

a) *there is evidence to suggest the borrower is potentially in difficulties; or*

b) *the borrower has recently recovered from payment difficulties.*

Resolution Process

28. Resolution processes provide cash flow relief to the borrower and should result in the borrower bringing their payments back onto a schedule that will avoid moving further into payment difficulties, apart from the voluntary sale option, which will result in a different outcome for the borrower.

Good practice 17: *It is good practice to ensure that creditors consider whether, given the individual circumstances of the borrower and taking into account his/her ability to repay and the best interests of the borrower, it may be appropriate to do one or more of the following:*

a) *extend the term of the mortgage;*

c) *change the type of the mortgage;*

d) *defer payment of all or part of the instalment repayment for a period;*

e) *consolidate credits;*

f) *change the interest rate;*

g) *capitalise the shortfall* [5]

[5] The appropriateness of any of the listed practices (a) to (i) depends on a close consideration of the individual circumstances of the consumer. This is particular true for (e) – capitalisation of the shortfall – which might not be

h) *offer a payment holiday;*

i) *assist with a voluntary property sale.*

Good practice 18: *It is good practice to ensure that creditors document the reasons why the option(s) offered to the borrower are appropriate for his/her individual circumstances and keep that documentation for a reasonable period of time.*

the right approach for many. Creditors will need to take into account both consumer protection and prudential perspectives, with the underlying aim that resolution not only focuses on the short term, but is sustainable.

Done at London, 3 June 2013.

[signed]
Andrea Enria
Chairperson
For the Board of Supervisors