Guidance consultation

Forbearance and Impairment Provisions – ‘Mortgages’

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INTRODUCTION

This document sets out what we found during a prudential review of firms' mortgage forbearance and impairment provisions processes, and sets out actions we want firms to take. We have included good and poor practice guidance to help your firm comply with its responsibilities in this regard under the rules set out in our Handbook[1] (SYSC Chapter 4, SYSC Chapter 7 (Risk Control) and Principle 8 (Conflict of Interest)). The principles outlined in the Guidance are applicable to other loan facilities and should be considered within this wider context.

Arrears and forbearance support provided with due care by firms has a beneficial impact for both the firm and the customer, in that it can reduce repossessions and lower realised losses. However, where such support is provided without due care or any knowledge or understanding of the impacts, it has potentially adverse implications for the customer, for the firm's understanding of the risks inherent within its lending book, and in turn for the regulators and the market.

This review considers forbearance processes wherever they arise in the firm, whether in customer services, operations, debt management, credit risk or finance functions. It includes consideration of internal reporting of forbearance activities, impairments and provisions to management committees and boards, and external disclosures of credit risk exposure and impairment provisions.

Our interest in forbearance issues is not new. Specific conduct of business rules have long sought to ensure the fair treatment of borrowers in payment difficulties. Thematic review findings subsequently highlighted a number of aspects of concern (especially among specialist lenders), leading us to publish good and poor practice examples, take enforcement action and enhance our conduct rules. This document confirms our thinking on the prudential considerations that arise in the same circumstances.

Who is this relevant to?

This review is primarily aimed at firms who are residential mortgage lenders or mortgage administrators. However, many of the principles outlined are equally applicable to other loan facilities and should be considered within this wider context.

The review should be considered by management responsible for any aspect of forbearance activities and credit risk reporting, and also by finance, audit and compliance functions of firms. Since, under the IFRS financial reporting framework, quantitative data provided in annual reports about a firm's exposure to risk (including credit risk) should be based on information provided internally to a firm's key management personnel, it is also relevant to financial reporting disclosure, and to external auditors of those firms who are active in providing forbearance facilities for customers.

[1] http://fsahandbook.info/FSA/html/handbook/

Context and scope

This prudential review looked at forbearance practices in firms which impact on the loss risks and loss risk recognition of first charge residential mortgages. It followed earlier work considering the conduct implications of arrears-handling standards in mortgage firms. In particular, this review considers mortgage book *impairment* across the firms' mortgage servicing operations rather than being specific to specialist debt management following the crystallisation of mortgage arrears. The main aims of the review were:

- to understand the extent and variation of forbearance practices in place in firms and to identify good (and poor) practice;
- to assess whether there is clear and transparent reporting of forbearance, *impairment* and loss risks of a portfolio; and
- to understand whether lenders have sustainable business models where loss risks are fully recognised and embedded within the loss models of the firm, including impairment provisions; and, whether the executives of the business are aware of these loss risks.

We are supportive of forbearance facilities that benefit both lenders (firms) and customers. We recognise that the provision of support and forbearance has, generally, been good for consumers and can enable customers in temporary financial difficulties to stay in their property.

However, we observed and are concerned that where support or forbearance is provided without due care and consideration of the customer's circumstances it can also act against the customer's best interests and place them in a worse position than they would have been otherwise, in some cases leading to the mortgage moving into a long-term unsustainable position. Such an outcome is neither in the interest of the firm or the customer. From a prudential perspective, these accounts have a higher long-term loss risk which should be accounted for within reporting by firms.

The guidance provided in this document covers the following:

- the provision of forbearance support for customers undergoing financial stress;
- the recognition of *impairment* within the book through management committees and Board reporting; and
- the disclosure of *impairment* and its recognition through loss provisions in external reporting.

Annex 1 provides a glossary of terms used throughout this document.

This review is focused on the prudential risk responsibilities of firms and thus on practices that impact on the loss risks of accounts (forbearance provided to support financial stress), the effective management of these risks and the mechanisms for their recognition and reporting. We believe forbearance provided based on sound conduct principles provides for sound prudential management This review is very much aligned with the provision of forbearance and support which acts in the best interest of customers undergoing financial stress.

Conduct Risk

This guidance should be considered with the relevant existing Handbook material such as Principle 6,[2] Chapter 13 of the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).[3]

Our Mortgage Arrears Handling thematic, completed between 2007 and 2010, specifically focused on the fair treatment of customers in arrears. This programme reviewed a selection of mainstream lenders, specialist impaired credit lenders and third party administrators (TPAs) contracted to handle mortgage arrears and repossessions work on behalf of lenders. It looked at firms' arrears management policies and practices; assessment of customers' individual circumstances; the forbearance options considered before court action was taken; fees and charges and how they are applied; the fairness of securitised mortgage contracts; and, the conduct and oversight of third party outsourced services.

The conduct review observed several mortgage sector weaknesses, in particular, in the way specialist impaired credit lenders and TPAs were handling mortgage arrears and repossessions. It identified good and poor practice across the sector and guidance examples were published in 2008 with further updates in 2009.[4] This publication neither replaces nor revises that previously published good and poor practice or the guidance examples. It does, however, highlight the interconnectedness of prudential and conduct considerations where there are potential or realised payment problems on mortgage accounts.

As a result of the Mortgage Arrears Handling thematic work, a number of firms were referred to enforcement, leading to four firms so far being issued a Final Notice with financial fines and customer redress programmes imposed. Enforcement action continues, supporting our intensive supervision and credible deterrence strategies. The thematic work also informed the strengthening of our existing arrears rules and guidance, confirmed in the June 2010 publication of the Mortgage Market Review: Arrears and Approved Persons Policy Statement.[5]

We remain committed to securing lasting improvements in firms' arrears handling, enabling arrears customers to receive fair outcomes.

What we want firms to do

After reading this Guidance we want firms to review their policies and processes for the following:

Policies and controls – for the purposes of our Handbook[6] Systems and Controls (SYSC),[7] develop a firm-wide strategy and policy regarding the provision of forbearance facilities to customers. This policy and the associated controls should be subject to annual review.

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[2] A *firm* must pay due regard to the interests of its *customers* and treat them fairly.

[3] http://www.fsa.gov.uk/pubs/hb-releases/rel61/rel61mcob.pdf

[4] http://www.fsa.gov.uk/Pages/Library/Other_publications/Miscellaneous/2009/mortgage_arrears_1/index.shtml

[5] http://www.fsa.gov.uk/pages/Library/Policy/Policy/2010/10_09.shtml

[6] http://fsahandbook.info/FSA/html/handbook/SYSC/4/1

[7] SYSC4.1.1, SYSC 4.1.2/2A, SYSC 4.1.4/4A, SYSC 4.1.10/10A, SYSC 7.1.2/2A and SYSC 7.1.5 &.1.7/7A

Current practices – for the purposes of SYSC 4.1.10, review practices in the provision of forbearance provided to assist customers and be mindful of the provisions of Principle 8 (Conflicts of Interest). This Guidance is looking to firms to ensure that:

- customers are not placed in a worse position than they would have been otherwise; and
- the firm either avoids the mortgage moving into an unsustainable position or continues to work with the customer to bring the mortgage back onto *sustainable terms* within a reasonable timeframe.

Ensure internal control, committee and Board reporting – for the purposes of SYSC 4.1.1 ensure that effective processes are in place in the identification, reporting, monitoring and loss risk assessment of forbearance provided to assist customers and customer *impairment*.

Consistent reporting of impairment by firms – we believe that there is scope for considerable improvement in firms' interpretation of the IFRS 7 disclosure requirements (firms to be additionally mindful of the provisions of SYSC 4.1.9 in this regard).

We are also looking to accounting and auditing firms to become more aware of forbearance practices in the firms they audit and the requirement for consideration of its effect in the recognition and disclosure of accounting *impairment*.

EXECUTIVE SUMMARY

Extent and variation of forbearance practices in place regarding first charge residential mortgages

1. We observed a range of different forbearance facilities provided by firms to customers who experience a period of financial stress. The customer's financial stress may or may not have been identified by the firm, but where the forbearance facility has been requested or provided, this trigger is defined in this guidance document as a *potential impairment indicator*. The degree to which the customers who utilise these facilities are actually impaired varies but we have observed that *impairment* losses relating to these customers are much higher than the norm.

2. *Potential impairment indicators* were evident at every customer contact point (branches, call centres, mail). These could be identified from a customer request to change *contractual terms* (e.g. transfer to interest only, extension of term, payment holiday, drawdown, further advance), the customer notifying the firm of current or likely financial stress, or through pro-active contact by debt management functions following a trigger event (e.g. missed payment on the mortgage, behavioural-scoring referral, missed payment on another account).

3. Some firms were pro-active in looking for customer financial stress from a *potential impairment indicator* and then referring the customer to debt management where the personal circumstances of the customer and levels of affordability were assessed to identify the best forbearance solution for that customer.

4. Forbearance has benefits for the customer in supporting them through periods of difficulty and enabling them to remain in their property. However, forbearance provided without due care and consideration of the current full financial circumstances of the customer, the potential for future recovery and intent can lead to increased difficulty in achieving recovery, which in turn can lead to the mortgage becoming non-sustainable or to higher losses for both the customer and the firm if repossession takes place. *Sustainable terms* are defined as revised contract terms where the mortgage can be fully serviced over its full life.

5. Each firm we reviewed provided a slightly different mix of forbearance facilities, but the primary facilities observed supporting a period of financial stress were as follows (see Annex 2 for a more complete list):

Primary facilities observed supporting a period of financial stress
1. Temporary reduction in monthly repayment amount (this may include zero or nil payment concessions and deferral of payment pending sale of property)
2. *Capitalisation* • Standard capitalisation • Repayment capitalisation
3. Temporary or permanent transfer of all or part of mortgage on to interest only (IO) terms

4. Extension of the mortgage term
5. Utilisation of flexible facilities or other equity withdrawal: • payment holidays; • drawdown against previous *overpayments* or perceived overpayment; • use of linked pre-approved reserve/credit/overdraft limits on mortgage or a linked account; and • further advance or second loan.

6. It was observed that some firms have recently introduced effective controls and checks to identify a customer's circumstances and affordability details at the point of a *potential impairment indicator*. Where these checks have been implemented material levels of *impairment* have been found for some facilities. For example, one firm's experience is that more than 95% of customers requesting a conversion to permanent interest only terms were found to be in financial stress. As a result, firms who have implemented sound checks to identify financial stress, and in such circumstances provide forbearance support with lower long-term adverse impacts, may see their volume of permanent conversions drop significantly.

7. The volume of mortgages where *potential impairment indicators* were observed varied by firm and depended on each firm's policies and available facilities. In many firms these volumes were found to be material and to warrant a much higher level of executive scrutiny in respect of their role in account management and forbearance, and much greater consideration of their associated loss risks by the credit and finance teams than we saw operating within firms.

8. We want firms to:

- **Policies and controls – for the purposes of SYSC,[8] develop a firm-wide strategy and policy regarding the provision of forbearance facilities to customers. This policy and the associated controls should be subject to annual review.**
- **Current practices – for the purposes of SYSC 4.1.10, review practices in the provision of forbearance provided to assist customers and be mindful of the provisions of Principle 8 (Conflicts of Interest). This Guidance is looking to firms to ensure that:**
    - **customers are not placed in a worse position than they would have been otherwise; and**
    - **the firm either avoids the mortgage moving into an unsustainable position or continues to work with the customer to bring the mortgage back onto *sustainable terms* within a reasonable timeframe.**

[8] SYSC 4.1.1/4.1.2/2A, SYSC 4.1.4/4A, SYSC 4.1.10/10A, SYSC 7.1.2/2A and SYSC 7.1.5/&.1.7/7A

Reporting, monitoring and disclosure of impairment and loss risk

Internal reporting and monitoring

9. Given the significant incidence of potential impairment indicators and forbearance and its role in supporting customers during periods of financial stress, we would expect to see full and effective reporting, performance monitoring and loss risk assessment in place in firms. We require firms to report accurately and transparently the impairment of their mortgage book.

10. We did not generally observe this, and reporting by firms of facilities provided, impairment, forbearance and the loss risk associated with these was found to be lacking across firms. It is our observation that there is room for considerable improvement in firms' understanding, control and reporting of forbearance.

11. Where reporting was in place this was generally found to be incomplete and either aimed at those facilities where regulatory reporting was required such as standard *capitalisation* or purely local to the operational team. Usually, the credit risk team and executives did not see this reporting nor were they in a position to assess the implications, impacts or loss risks.

12. We require firms to ensure that loss risks are fully assessed, monitored and accurately and transparently reported within the business and that executives are informed of the true nature of such risks in making business decisions and accounting for the loss risks of the book through provisions.

13. One firm has, however, recently developed a forbearance database, monitoring a range of *potential impairment indicators* with the aim of developing its reporting, performance monitoring and loss risk understanding. This firm is now benefiting from some early results that are providing significant insight.

14. We want firms to:

- **ensure internal control, committee and Board reporting – for the purposes of SYSC 4.1.1 ensure that effective processes are in place in the identification, reporting, monitoring and loss risk assessment of forbearance provided to assist customers and customer impairment.**

External reporting

15. Given that we consider that there is scope for considerable improvement in firms' understanding, control and reporting of forbearance, it follows that we also found that firms' disclosure in this area shows scope for considerable improvement, since IFRS 7 *Financial Instruments: Disclosures* stipulates that quantitative risk disclosures made by firms should be based on information provided internally to key management personnel (IFRS 7.34(a)). We are concerned that firms' disclosures under IFRS 7 may not reflect the additional credit risk attached to accounts in forbearance and hence may not provide a complete picture of the credit risk profile of firms' portfolios. In addition, to the extent that loans subject to forbearance arrangements have not been separated from the general up-to-date pool for the purposes of

impairment assessment, the impact of this additional credit risk may not be fully reflected in a firm's *impairment* calculation.

16. IFRS 7 is clear that firms should provide information about the credit quality of financial assets even if these are neither past due nor impaired (IFRS 7.36(c)). In addition, the Standard prescribes that, if the quantitative data disclosed as at the end of the reporting period are unrepresentative of a firm's exposure to risk during that period, a firm should provide further information that is representative (IFRS 7.35). In the case of retail loan portfolios, we consider that the use of forbearance procedures that may have the effect of masking the true credit risk of the underlying portfolio warrants separate disclosure.

17. We want firms to:

- **review their current practices to move towards better disclosure which reflects appropriate recognition of *impairment* and a position where there is consistent reporting of impairment by banks. We believe that there is scope for considerable improvement in firms' interpretation of the IFRS 7 disclosure requirements noted in paragraphs 15 and 16 in this regard. Firms to be additionally mindful of the provisions of SYSC 4.1.9; and**
- **we want accounting and auditing firms to become more aware of forbearance practices in the firms they audit and the requirement for consideration of its effect in the recognition and disclosure of accounting impairment.**

FORBEARANCE PRACTICE GUIDANCE

The following sections contain a summary of what, in our view, represents good and poor practice in the overall provision of forbearance to customers and our conclusions on the adequacy of controls, oversight, reporting and disclosure which we suggest may be of assistance to firms in complying with their responsibilities in this regard in our Handbook.[9]

This prudential review focuses on practices which impact on the loss risks of accounts and the effective management of these risks. Given this, there is significant emphasis on early recognition of the financial circumstances of the customer and understanding and managing forbearance to achieve fair consumer outcomes and long-term sustainability of mortgages where impairment exists.

We believe forbearance provided based on fair conduct principles provides for sound prudential management. We have highlighted Mortgages and Finance: Conduct of Business sourcebook (MCOB) references, where relevant, to draw attention to existing conduct requirements, but this guidance note does not purport to represent additional guidance under these rules.

Good and poor practice in the overall provision of forbearance to customers

18. The primary aim of providing a forbearance facility to a customer should be to enable the complete recovery of the mortgage through the full repayment of arrears. In this case the long-term impact on both the firm and the customer is minimised. Where the circumstances of the customer mean this primary aim cannot be achieved, the secondary aim would be to recover the customer into a *sustainable terms* position on their mortgage.

19. This guidance should be considered in the light of relevant existing Handbook material such as Principle 6,[10] Chapter 13 of MCOB[11] and the good and poor practice in Mortgage arrears and repossessions handling published in 2009.[12]

    Firms should be mindful of these obligations and treat customers in arrears fairly. In relation to mortgage accounts in arrears:

    - The determination of a reasonable repayment period will depend upon the individual circumstances. In appropriate cases this will mean that repayments are arranged over the remaining term (reference to MCOB 13.3.4A R (1)).
    - Firms should not agree to capitalise a payment shortfall except where no other option is realistically available to assist the customer (reference to MCOB 13.3.4A R (1)(d)).

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[9] SYSC Chapter 4, SYSC Chapter 7 (Risk Control), Principle 8 (Conflict of Interest)

[10] A *firm* must pay due regard to the interests of its *customers* and treat them fairly.

[11] http://www.fsa.gov.uk/pubs/hb-releases/rel61/rel61mcob.pdf

[12] http://www.fsa.gov.uk/Pages/Library/Other_publications/Miscellaneous/2009/mortgage_arrears_1/index.shtml

Good practice

Potential impairment indicators are proactively identified at all customer contact points across the firm such as:

- a customer request to change *contractual terms* (e.g. transfer to interest only, extension of term, payment holiday, drawdown, other equity withdrawal within or outside flexible terms, further advance);
- the customer notifying the firm of current or likely financial stress;
- pro-active contact by debt management following a trigger event (e.g. missed payment on the mortgage, behavioural-scoring referral, missed payment on another account, change of payment source); and
- another trigger event (e.g. change of payment source (the direct debit (DD) account, to cash or from/to Department of Social Security (DSS)), a request to change the payment day of the mortgage or move on to weekly repayment, exceptional lump sum payments (insurance, redundancy or pension payout, backdated DSS claim), or a change in activity or arrears on other accounts held by the customer (identifiable from firm data or credit bureau data).

Any temporary or permanent forbearance solution provided by the firm (whether directly within debt management or indirectly within other functions of the firm or its agents) is made with full awareness of the customer's personal needs, circumstances and intent, and is affordable and sustainable by the customer.

Affordable repayments are sought that minimise the build up of a *contract shortfall* (repayments made which fall short of those required under their *contractual terms*) and thus the future capital repayment burden.

All concessionary arrangements are made for periods relevant to a customer's individual circumstances with set regular reviews (e.g. three or six monthly) with the aim of recovering the loan as soon as is reasonably possible.

The firm has provided the customer with clear, timely and adequate information to understand the implications of any proposed arrangement or change in terms; and, the firm is aware that any permanent changes in terms are *sustainable*.

Once the period of financial stress has ended and where affordability allows, the customer is encouraged to make greater than *contractual monthly payments* (the full repayment amount due under the mortgage contract) to repay the arrears, or consider contractual term changes to enable the full recovery of their account to minimise the long-term impact of the period of financial stress.

Care is taken to avoid forbearance on the mortgage being used to prioritise the repayment of unsecured debts placing the home at greater risk.

Information on free debt advice agencies (e.g. Citizens Advice Bureau (CAB)) is provided to customers where unaffordable unsecured debt exists or where a customer needs support to budget their finances.

Poor practice

Failure to identify *potential impairment indicators* and customer financial stress.

The firm has established a forbearance solution that does not seek either:

- to fully recover the mortgage (where this is feasible); or
- to minimise the build up of a contractual shortfall and thus minimise the future capital and interest repayment burden to the customer and potential future loss risks to the firm (i.e.: lower payments than the customer could afford are being accepted).

Medium or long-term arrears arrangements are being agreed which do not fully rectify the contractual shortfall position of the mortgage without an assessment of the circumstances of the customer (including the duration of their expected period of financial stress), or their affordability to the customer.

A forbearance solution is provided (e.g. a payment holiday or a drawdown) which tides the customer over for a limited period but is not sustainable for the whole period of financial stress and therefore places the customer in a worse position than they would have been otherwise.

A concession is set for a long period (e.g. nine or twelve months) with no interim review.

Consecutive extensions are applied to the arrangement period without a review of the customer's circumstances, or any consideration of whether an extension is in the best interests of the customer or whether alternative support or debt management strategies should be considered and without ensuring the customer is fully informed on the impacts of any extension or changes.

Good and poor practice where a capitalisation event takes place

20. *Capitalisation* has continued to be one of the core forbearance tools used by firms. There are two methods of capitalisation observed taking place in firms:

- standard capitalisation (defined as a singular capitalisation event); and
- repayment capitalisation (defined as the non-accrual of arrears when short payments are received).

These are defined in more detail in *Annex 1*.

21. This section provides additional good and poor practice where *capitalisation* is taking place.

Good practice

Capitalisation is provided selectively to those cases where the recovery of historical arrears or monies due under the contract is not possible and *capitalisation* is the only option realistically available to assist the customer.

Capitalisation is provided where the customer has demonstrated a sustained ability, intent and track record to repay, and regulatory requirements are observed.

The firm has formally sought confirmation that the customer understands and accepts the *capitalisation* event.

For larger value *capitalisation* events or re-defaulters, the firm applies more stringent intent and track record criteria, to recognise the increased risks and the increased long-term impact on the customer.

For standard *capitalisation* the revised monthly repayments are assessed as affordable now and sustainable over the term of the mortgage:

- the mortgage is paid on a capital and interest (C&I) basis and the revised repayments will fully repay the mortgage over the remaining term of the mortgage; or
- the mortgage is paid on a interest only (IO) basis and the repayment vehicle will fully repay the mortgage; or
- part of the mortgage is transferred on to C&I and each part satisfies the conditions above.

Where repayment *capitalisation* is taking place:

- the customer is provided with notification of any break clauses in place in the event that the customer fails to adhere to the requirements of the temporary arrangement;
- if the repayment *capitalisation* period is extended, revised information and consents are provided and sought;

- the revised monthly repayment required to repay the loan over the remaining term of the mortgage is recalculated and the customer is notified immediately following the *capitalisation* period and not unduly delayed in order to minimise the repayment shock and minimise the long-term impact of the *capitalisation* event; and
- in cases where a customer is placed in a *non-sustainable* position through *capitalisation* and where there is currently insufficient affordability, the firm has in place an effective regular review and contact process to actively manage and support customers from a non-*sustainable* position back on to *sustainable terms* over a reasonable timeframe.

The firm recognises that customers who have previously been given a *capitalisation* but then miss a repayment have higher loss risks than other accounts going into early arrears, so the firm prioritises them within the debt management process. The aim is to achieve early direct contact with the customer to reassess their circumstances and minimise the compounded impact of further financial stress or *capitalisation* events.

Poor practice

The firm fails to establish whether a *capitalisation* event is in the best long-term interests of the borrower and whether there are other options realistically available to the customer.

Standard *capitalisation* or repayment *capitalisation* events take place in cases where:

- the customer has not demonstrated sustained ability, intent or track record to meet future repayments;
- the customer has not met the qualifying criteria for *capitalisation*;
- the firm has not provided the customer with clear, timely and adequate information to understand the implications of the proposed changes in their terms;
- the firm has not given sufficient time to the customer to understand these changes, the *capitalisation* event, and the impact it will have currently and ultimately on their repayments and interest payable.
- the firm has not formally sought confirmation that the customer understands and accepts the *capitalisation* event;
- the customer has an effective repayment arrangement in place, and is paying more than the contractual monthly repayment which will fully repay the outstanding arrears within a reasonable timeframe; and
- the customer has been provided with misleading and biased information to encourage *capitalisation* which may not always be in the customer's best interests.

The firm operates a repayment *capitalisation* process whereby the difference between the *contractual monthly payment* and a reduced payment arrangement does not accrue as arrears; but the firm has failed to treat this as a *capitalisation* event and failed to apply all customer and firm good practice controls.

Good and poor practice where the customer is temporarily transferred or permanently converted on to interest only terms

22. We have observed that firms may offer their customers the ability to permanently convert on to interest only terms or a temporary transfer during periods of financial stress. Some firms have tightened their processes to identify where a customer request to transfer permanently is driven by financial stress and so they are able to provide the customer with a lower impact approach to supporting their circumstances.

23. This section provides additional good and poor practice guidance to firms which do provide permanent or temporary transfer to interest only (IO).

Good practice

Where the customer is requesting a permanent conversion on to IO terms (where this is allowable within the firm's policy):

- An acceptable capital repayment strategy is in place that the firm has assessed as plausible.
- An affordability assessment, using a stressed interest rate consistent with new business, is carried out on the basis of a C&I repayment mortgage. Where C&I repayments are unaffordable, a reasonable assumption is that the primary trigger for the customer conversion request is financial stress. The customer circumstances therefore need to be assessed to determine appropriate use of forbearance to maintain the mortgage on *sustainable terms*.
- In all cases an assessment of the customer's circumstances is carried out to identify any potential financial stress or expected difficulties. A sense check is conducted to confirm that the customer intent is to adhere to the repayment strategy.
- In general, those customers with current or recent mortgage arrears or where another *potential impairment indicator* has taken place are considered as unlikely to be able to demonstrate both ability and intent to fully sustain the mortgage and repayment strategy.
- Where a customer is converted following the affordability assessment, this should show that the customer can afford to repay the interest only repayments plus the cost of the repayment strategy.

Where a transfer on to temporary IO terms is being considered to support a period of financial stress then:

- If affordability allows for repayment above the IO element, a different forbearance solution is considered to maximise repayments and minimise the longer-term impact on the customer. This may include customers in receipt of Support for Mortgage Interest or Department of Work and Pensions (DWP) payments in some circumstances.
- The account automatically converts back to C&I repayments after the expiry of the agreed temporary IO period unless an extension has been considered and agreed with the customer.
- There is an active review process in place to work with the customer to transfer the mortgage back on to C&I *sustainable terms* within a reasonable timeframe.
- In those instances where a repayment *capitalisation* is operating, that *capitalisation* controls and regulatory requirements are applied for each agreed repayment *capitalisation* period and each agreed extension.

Poor practice

The debt management procedures of the firm defaults to transferring some segments of impaired borrowers on to IO repayment terms when affordability would allow for some capital repayment.

Borrowers are converted on to IO terms on a permanent basis without consideration of the customer's current and expected future circumstances, affordability assessment or without an effective review of the plausibility of the capital repayment strategy.

There is information available which indicates potential financial stress that may impede the customer's ability to sustain or adhere to an agreed repayment strategy.

A standard *capitalisation* takes place at the point of transfer to IO without satisfying the *capitalisation* performance requirements criteria and without applying normal *capitalisation* controls and notifications.

Good and poor practice where the mortgage term is being extended

24. It was observed that term extensions were being used to support a period of financial stress. Most worryingly, in a significant proportion of cases the term has been extended beyond the *retirement income age* (defined as the government state pension age (SPA) or customer declared retirement age, whichever is sooner), without a process in place to reduce the term once the period of financial stress has ended or alternatively an assessment as to the amount of available income to service the mortgage in retirement.

25. This section provides additional good and poor practice guidance to firms regarding term extensions.

Good practice

Where a mortgage term is being extended, an affordability assessment is carried out based on both the current payment rate and a stressed interest rate which allows for any future known or expected changes (for example, a fixed or discounted rate period ending) to ensure the repayments are sustainable over the life of the mortgage.

If the loan term goes beyond the *retirement income age*, retirement income is similarly assessed..

Where mortgage terms have been extended during a period of temporary financial stress, a review and follow-up process is in place to support the recovery of the mortgage back on to shorter terms once the period of financial stress has ended.

Where a mortgage term has been extended into retirement, and the retirement income to service the debt has not been validated, there is an active review process in place to work with the customer to reduce the term back to within working age limits and a full sustainable position within a reasonable timeframe.

Poor practice

Failure to understand the customer's reasons for a request for a term extension and, where this is due to financial stress, exploring whether alternative shorter-term forbearance might better serve the customer's circumstances to minimise the long-term impact of this change.

Where temporary financial stress exists and a term extension has been provided, the firm has failed to implement an effective review process to enable the recovery of the mortgage back on to shorter terms once the period of financial stress ends.

A customer mortgage has been extended permanently into retirement without an affordability assessment of the retirement income.

Good and poor practice where flexible terms facilities are being used

26. Customers are able to utilise the flexible terms of certain mortgage contracts to support various lifestyle choices and as a means of providing relief during periods of financial stress. Often these features are utilised without the lender considering whether there may be potential impairment and lenders do not sufficiently reflect the use of these flexible terms within their impairment calculations and loss risks, nor in pro-actively supporting the customer during that stress period, which could leave the customer in a non-sustainable position with their mortgage.

27. Flexible facilities, while providing the customer with additional features such as repayment flexibility or drawdown flexibility, should be used in a manner consistent with the customer repaying their loan in line with their original term. Firms need to be aware where flexible facilities are being used to support financial stress to prevent accounts moving into a non-sustainable terms position. Where this has happened, firms need to pro-actively work with the customer to bring the mortgage back into a *sustainable* position.

28. The terms of a flexible mortgage should be written to provide protection for both the customer and the firm at times of financial stress.

29. The following details additional good and poor practice regarding the provision and utilisation of flexible terms.

Good practice

Where material use is being made of flexible terms (considered cumulatively as equivalent to greater than three contractual monthly repayments by value, or having the impact of reducing the repayment value affecting cumulatively more than three monthly repayments), then this is treated as a *potential impairment indicator*. Further triggers are in place to identify potential financial stress in customers utilising flexible terms at an earlier point or where it is reasonable for the firm to capture information on customer circumstances (e.g. as part of an application for a payment holiday).

Where a *potential impairment indicator* has been identified, the firm assesses the customer circumstances to identify whether financial stress exists and, in those circumstances, identifies the best forbearance facilities that support these circumstances.

Where a drawdown, payment holiday or other process resulting in a drawdown of equity is being taken, processes are in place to identify where a mortgage may be at risk of moving into a non-sustainable position and the customer circumstances and facilities are reviewed with the aim of recovering the mortgage back on to *sustainable terms*. This should include an assessment as to whether the mortgage is at risk of not being fully repaid within the agreed mortgage term.

Where the mortgage is on a capital and interest repayment basis, credit limits are reviewed yearly to reduce the limit in line with their repayment plan, or create warning triggers where this limit is breached (e.g. where mortgage terms do not support a limit review).

Full reporting is in place to monitor flexible terms usage, *potential impairment indicators*, impairment, materiality and potential loss risks. Additional consideration is given to the assessment of *impairment* and loss risk attaching to mortgages where the flexible terms enable the customer to avoid arrears for a sustained period of time (e.g. utilising drawdown facilities to meet regular contractual monthly repayments). The loss risks may only be realised after a protracted period of time.

The utilisation of flexible terms will ultimately have an impact on the repayments due by the customer and interest payable in order for them to repay the loan in line with their original contract term. The firm provides the customer with clear, timely and adequate information and notifications so that the customer is fully informed about the impact of their flexible terms utilisation.

Appropriate limits are set for the account e.g. maximum utilisation limits and review controls, Loan to value (LTV), term of loan, repayment levels and valid/invalid uses of reserve/credit/secured overdraft limits, payment holidays and drawdowns.

Facilities are provided in line with the terms of the flexible mortgage, and where these limit the implementation of sound lending controls in an *impairment* situation then the affected mortgages are individually assessed for loss risk.

Applications for extensions of flexible terms or other equity withdrawal are fully underwritten and terms defined to protect both the customer and the firm.

The customer's envisaged use of the flexible facility is captured at application stage to aid the risk assessment process, identify early stage financial stress or envisaged stress, and aid in informing the lender in the event that the customer utilises the available facilities to a level that triggers a *potential impairment indicator*.

Poor practice

Flexible facilities are not reviewed on accounts with a *contract shortfall* or where a *potential impairment indicator* has taken place or other forbearance is being or has been provided.

The customer circumstances are not assessed when the material use (considered cumulatively as equivalent to greater than three contractual monthly repayments by value, or having the impact of reducing the repayment value affecting cumulatively more than three monthly repayments) of flexible terms are utilised or where potential financial stress is identified through other triggers.

A long payment holiday (cumulatively equivalent to greater than three months), a drawdown or subsequent holiday/drawdown is provided without giving due consideration to the customer circumstances and affordability to recommence payments at a higher level at the end of the payment holiday or after the drawdown. Holidays of significant length (e.g. 12 months) are provided with no additional interim update of the customer's circumstances.

Flexible mortgage buffers/limits/facilities are used to manage a financial stress situation by the firm without being clearly identified and separately reported.

A linked current account is allowed to go overdrawn, to make a mortgage repayment, but the mortgage is not identified as being potentially impaired.

Not monitoring accounts where the use of facilities is leading to the mortgage not complying with contractual repayment terms e.g. repayment of the mortgage on a capital and interest basis or moving into a non-*sustainable* position.

Good and poor practice: calculating overpayments where a drawdown facility is available

30. We observed a lack of effective controls in some firms regarding the allocation of payments into an 'over-payment' balance and the subsequent drawdown against these over-payments. There was insufficient scrutiny as to how the balance has accrued and the source of funds and whether drawing on this balance is appropriate.

31. The following additional good and poor practice seeks to ensure that effective controls are put in place and operated over the allocation of additional payment monies into an 'over-payment' balance and the subsequent drawdown of these funds.

Good practice

Where there is a *contract shortfall* as a result of *standard capitalisation* or *repayment capitalisation,* any additional repayment amount received above contractual monthly repayment or the agreed payment arrangement is not automatically allocated as an over-payment. Consideration is given to reducing the *contract shortfall* balance.

The firm has effective controls in place to identify capital repayments supporting the final repayment of the mortgage on an interest only account. The firm is fully aware of:

- where one or more repayment vehicles are paid out prior to the term end;

- where additional payments or increased repayments are being made to a mortgage whose stated repayment strategy would expect this e.g. 'additional repayments';
- where additional repayments are or have been made to support a capital repayment vehicle which is unlikely to fully repay the loan; and
- where a loan was previously on capital and interest terms and was transferred without effective validation of affordability and repayment strategy.

Where a mortgage is currently subject to a forbearance concession or has previously been subject to forbearance that included a *capitalisation event,* care has been taken to identify whether additional repayments are linked to the recovery of the mortgage back towards its original *contractual terms* or, where different, *sustainable terms* (e.g. DWP payments above the interest only amount).

Where the potential *overpayment* is to be drawn down, adequate checks are undertaken to ensure the mortgage is not placed in a non-*sustainable* position.

Poor practice

A firm has processed a *capitalisation* event but then marks an account as overpaid in the event that the borrower or DWP makes additional or backdated payments to the mortgage account.

The firm refunds to the customer monies paid by the DWP or from a payment protection plan, supporting the mortgage in the event of sickness or unemployment, when the account is placed in an over-payment situation as a result of being on temporary interest only forbearance.

The firm fails to consider if an additional payment made should be allocated as a capital repayment rather than an over-payment.

RECOGNITION OF IMPAIRMENT IN INTERNAL REPORTING

32. Firms reporting on *potential impairment indicators*, impairment and individual assessment of loss risk associated with these accounts was, in our view, found to show potential for considerable improvement within firms. Firms should review their reporting to ensure that they move to a position where impairment within the book and its associated loss risks are fully assessed and accurately and transparently reported through committee and Board reporting; and, that executives are informed when making business decisions. Additionally, firms would need to ensure that these loss risks are fully accounted for through provisions.

Good practice

All *potential impairment indicators* are identified, reported and monitored at all customer contact points across the firm.

All *potential impairment indicators*, forbearance provided, volumes of live accounts and their associated loss risks are monitored, fully reported through management and board committee structures, and incorporated into all decision-making processes of the firm where loss risk is evaluated or used (e.g. provisions, capital, credit decisions, product pricing, strategy and forecasting, and planning).This assessment considers the forbearance actions taken and the type and level of customer difficulty.

This reporting and loss risk assessment is segmented by type of *potential impairment indicator*, whether *impairment* exists and the severity of customer *impairment*, type of forbearance provided, time since last *potential impairment indicator* and key loss characteristics e.g. LTV. Additionally, further segmentation is considered where a difference to the performance or loss risks is evident. For example:

- re-defaulters;
- multiple forbearance applied;
- duration of potential financial stress period or severity;
- period since account recovery or last *potential impairment indicator*;
- *non-sustainable* account;
- utilisation of limits activity, accounts at risk of being *non-sustainable* due to activity;
- another account held by the customer shows potential impairment; and
- loans past maturity.

The performance and loss risks of a customer where a *potential impairment indicator* has taken place are considered within the whole up-to-date book only from the point when the loss risks and performance of this mortgage can be shown to be the same as the whole.

The firm's reporting, provisions and capital assessment is undertaken in full awareness of the *contract shortfall* of customers and thus the level of severity where financial stress exists or a *potential impairment indicator* has taken place.

Poor practice

The firm does not comprehensively report on the incidence of *potential impairment indicators* and customer *impairment*. These loss risks are not assessed or reported to executives who are not aware of the overall loss risks of the business.

Business decisions are made with incomplete *impairment* and loss risk information.

Incentive schemes for debt management staff which ignore the impact of forbearance facilities being provided, leading to a conflict in interests.

Management Information (MI) systems are not able to effectively monitor the performance of customers currently on, or previously on, a forbearance solution or post a *potential impairment indicator* to enable the firm to measure and understand the effectiveness and impact on the customer and longer-term outcomes.

Interest or fee income forbearance is not recognised in reporting, forecasts and loss risk assessment.

Customer decision systems do not incorporate *potential impairment indicator* and forbearance provision risks and these are not fully considered when making customer decisions (e.g. as part of a further lending scorecard development and monitoring process for customers).

RECOGNITION OF IMPAIRMENT IN EXTERNAL REPORTING

33. Transparency in accounting practice and disclosure is vital in achieving our goal of market confidence, particularly in judgemental and complex areas where the use of financial models may be required. To this end, we established new accounting functions following the recommendations of the Turner Review in

2009 in order to survey and scrutinise in more detail firms' accounting judgements, noting any significant divergences in practice and their implications for market confidence.

34. Whilst the observations and considerations provided around accounting in this document are driven by our wish to maintain market discipline and comparability between firms, and stem from prudential and conduct considerations, we recognise that there is some degree of overlap with considerations of accounting and auditing judgements.

35. This document is not intended as an interpretation of accounting standards, nor as mandatory accounting guidance; rather, it is a listing of accounting considerations which firms may find helpful in assessing their approach in the area of forbearance, and in which we will show an interest going forward.

36. We recognise that, in many cases, there may be limited actual experience of loss history data around which to provide accurate forecasts of cash flow profiles for loans subject to forbearance practices, since the forbearance actions in question may have taken place recently and the true credit risk inherent in these accounts may only become apparent in the future (such as in a scenario where interest rates increase). However, firms should consider monitoring these accounts separately in order both to meet the IAS 39 criteria around collective impairment and for management purposes to assess credit risk appropriately.

37. With regard to *impairment events* and forbearance, our observations on accounting practices fall into the following main categories:

- interpretation of impairment event;
- collective impairment and appropriate segmentation;
- use of historic data;
- realism in estimates; and
- disclosure.

38. In all of the above areas, we have concerns that certain accounting practices can have the effect of concealing the full effect of *impairment* and forbearance and thus may not present the true nature of credit risk within retail portfolios.

39. In assessing market practice in this area, we note that there is some divergence in terminologies used between firms. For example, the definition of 'default', and therefore of 'probability of default' may be interpreted differently among firms. Other interpretations such as 'non-performing' or 'provision coverage' may similarly differ. Whilst not the subject of this review, we nevertheless encourage firms to provide as accurate a description as possible of each term used in the area of *impairment* reporting within the firm's glossary of terms.

Interpretation of impairment event per IAS[13] 39.59

40. IAS 39 ascribes the recognition of *impairment* losses to two factors: that one or more objective events have occurred after initial recognition of an asset (an *impairment event*) and that event has an impact on the estimated future cash flow of an asset or group of assets, which can be reliably estimated. The Standard is clear that an event for which there is objective evidence can give rise to an impairment charge if it can be demonstrated that the event has an impact on future cash flows. The existence of present cash losses is therefore not a pre-requisite for recognising *impairment* losses (see *impairment event*).

41. Where there has been no cash loss to date, firms usually take account of the above factors by recognising a collective impairment on the 'good book' of assets where an individual *impairment event* has been observed. The collective impairment is intended to measure losses on those accounts where an *impairment event* may exist even though the firm is unaware of its precise nature.

42. Our concern is that, in some cases where individual monitoring of accounts takes place, certain loans that have been subject to forbearance procedures may give rise to future cash losses (when assessed against the original terms and discounted using the original effective interest rate as required by the Standard), whether due to lower overall cash receipts or to later payment. Thus, an objective assessment of future cash flows may give rise to a loss when compared with the original terms of the loan.

43. Factors such as (a), (c) and (f) detailed within the *impairment event* definition appear to have particular relevance in the context of forbearance practices, for example:

    - an impairment event (such as unemployment of the borrower) could indicate significant financial difficulty, even when payments are up-to-date, resulting in reduced anticipated cash flows and hence an impairment charge;
    - a forbearance action undertaken due to the financial difficulty of a borrower more generally may similarly result in reduced cash flow estimates; and
    - the adverse status of borrowers in a collective assessment of impairment may give rise to an *impairment event* for a certain pool.

44. IAS 39.64 is clear that assets that are individually assessed for *impairment*, and for which an impairment loss is recognised, are not included in a collective assessment of *impairment*. As such, if loans are individually found to be impaired (even if up-to-date in accordance with modified terms following a forbearance action), these loans should not be included in the 'good book' for collective impairment assessment.

45. In practice, for retail portfolios, the main indicator usually used by firms to separate out pools of loans from the overall pool of retail loans is delinquency (item (b) within the *impairment event* definition). Market practice varies considerably in terms of how many missed payments are required to trigger an *impairment event* and hence the transfer of a loan into individual assessment, or a separate pool, for the purposes of impairment calculation. Firms may wish to ensure that, where loans might be individually assessed, full account is taken of all factors that may trigger an *impairment* loss. Some examples of good

[13] International Accounting Standards

and poor practice in this area are as follows:

Good practice

Loans that are behind their payment schedule by 'one penny one day' are considered to have different risk characteristics to loans that are not behind their payment schedule and are not included in the general pool for collective *impairment* purposes.

The firm uses a 'cure rate' to estimate those accounts which can objectively be expected to return to payment patterns as per the original contractual schedule. This cure rate can be verified by means of a demonstrable roll rate based on actual experience, specifically for these loan types. Thus no cure is assumed unless objectively verifiable.

Independently of the 'one penny, one day' criteria, accounts which have been subject to an *impairment event* or forbearance procedure that has an impact on future cash flows are separately monitored as impaired loans.

For mortgage customers who also have unsecured personal loans (UPLs) with the firm that are in arrears, this is regarded as an *event* as a result of the significant financial difficulty displayed by the borrower, even if the mortgage product is up-to-date.

Customers who have material unsecured debt (relative to the customer circumstances), to the point where mortgage repayment appears dependent on further borrowing, are regarded as showing significant financial difficulty and assessed separately for *impairment*.

If arrears on an account have previously been capitalised, and the borrower has since relapsed into delinquency, the borrower is treated as individually impaired even if the firm otherwise has a longer period of delinquency as an indicator of *impairment*.

Poor practice

Loans without arrears or in early arrears are not deemed to be impaired even if they have been subject to forbearance practices and remain in the 'good book' for the purposes of *impairment* calculation or, when granting customers more favourable terms under a forbearance arrangement, the firm also changes the contractual monthly repayment for the customer. This has the effect of not showing the customer to be in arrears, and these arrears are effectively capitalised.

Thus, the firm presents an ageing analysis of these loans either as 'neither past due nor impaired' or 'past due but not impaired' for the purposes of IFRS 7 disclosure, potentially masking the separate risk characteristics of these loans.

Collective impairment and appropriate segmentation

46. In cases where accounts subject to an *impairment event* or forbearance are either individually assessed and found not to be impaired, or not individually assessed, a 'collective impairment assessment.' is possible. However, pooling of loans for collective *impairment* assessment is nevertheless dependent on certain criteria. Highlights of IAS 39 on collective *impairment* assessment are provided in *Annex 1*, which explains some of the restrictions. Given these restrictions around the use of collective impairment pools, it is unlikely that an entire retail portfolio of a large firm could be included in the same pool for the calculation in many cases. For example, it would be difficult to argue that loans that are subject to forbearance arrangements due to financial hardship have the same risk characteristics as those that are not. As such, even if it is determined that there is no individual *impairment* in such loans on the basis that they are not individually significant, they should not be included in a 'performing' pool together with other loans that have different risk characteristics.

Good practice

Impairment events and forbearance are considered in the loan portfolio when assessing *impairment*. Thus, for example, where significant levels of loan assets have been changed to an interest only basis from capital repayment, these assets are not viewed as having similar risk characteristics to the remaining portfolio.

Collective *impairment* for each pool is calculated using metrics (e.g. probability of default (PD), loss given default (LGD), emergence periods, etc) that are representative of that pool. This takes into account, for example, significantly different LTVs, debt on other accounts, or external bureau scores.

For buy-to-let properties, where possible those properties with tenants are separated from those without tenants.

The calculation for recovery discriminates by region.

For accounts that are in arrears after a certain period of time (e.g. six months), the PD is adjusted to 1.

Firms identify fraud rings and log up-to-date cases that were handled by third parties involved in fraud (e.g. packager, valuer etc.). A more realistic approach is taken towards *impairment* in these cases.

Accounts which are up-to-date, but have previously been in arrears or impaired, are separated out into a separate pool for loss assessment until such time as the loss risk is shown to match the rest of the up-to-date book (e.g. two years after the last *impairment* event).

Portfolios are segmented by loan-to-value ratios. Where a 'cure rate' is used, this is also subject to LTV bands so that cures seen in customers with low LTVs do not affect expectations for those with higher LTVs.

Poor practice

In their collective impairment methodology, firms have only one pool for the entire book, with the exception of those loans significantly in arrears.

Loans subject to an *impairment event* or forbearance are included in the same pool for *impairment* calculation purposes as all other unimpaired retail loans, on the basis that there have been no cash arrears.

Use of overlays in impairment calculations

47. We note that, in many instances, firms employ certain overlays in *impairment* calculations in order to take account of some of the portfolio characteristics mentioned above. However, in viewing the calculations prepared to date, it appears that many of the good practice points noted above are not included in such overlays. In addition, overlays have the major disadvantage that it is seldom straightforward and often impossible to assess the amount of overlay against the potential problem. Whilst we recognise and support the recognition of uncertainty by firms in applying overlays, we believe that an approach which segments aspects of portfolios as per the examples above is more transparent in assessing a firm's risk assessment.

Use of historic data in calculating impairments

48. In calculating collective *impairment* for retail portfolios, certain metrics in assessing probabilities are based on historic roll rates. For example, rates of customers going into significant arrears, or roll rates to possession may be based on a firm's experience to date over a set period of months.

49. The use of historic experience usually represents a reasonable starting-point for assessing potential 'latent' impairment within a collective provisioning calculation. However, historic experience alone may not take certain current conditions into account. Particularly in times of economic stress, retail portfolios may be subject to significant pressures which are not picked up by historic behaviour. In addition, historic information may mask the effect of forbearance and other activities designed to assist borrowers.

50. In some cases, the observable data required to estimate the amount of an *impairment* loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, this may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, an entity uses its experienced judgement to estimate the amount of any impairment loss. Similarly, an entity uses its experienced judgement to adjust observable data for a group of financial assets to reflect current circumstances. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

51. When using historical loss rates to estimate future cash flows, it is important that information about historical loss rates is applied to groups that are defined in a manner consistent with the groups for which the historical loss rates were observed. Therefore, the method used should enable each group to be associated with information about past loss experience in groups of assets with similar credit risk characteristics and relevant observable data that reflect current conditions (IAS 39.AG91).

52. As such, use of historic loss rates that take into account losses suffered on assets with different risk characteristics, or those which are based on losses in a different market environment, should be amended with relevant observable data that take into account the specific risk characteristics of the portfolio. An argument for the use of a single roll rate for an entire retail portfolio therefore appears unlikely to be appropriate.

53. A number of factors, whether individually or in combination, may have the effect of requiring significant adjustments to historic expectations. For example, where firms use historic roll rates to possession, these rates may be lower in current conditions due to the unattractiveness of possession given the current property market. Thus the current non-possession is not necessarily representative of a cure for an impaired customer. Similarly, the use of forbearance activities may result in accounts being up-to-date according to the new terms. Thus roll rates to default may appear lower than the actual risk profile of a portfolio would suggest.

54. In addition, for customers who are already impaired on a portfolio basis, certain macroeconomic factors may be relevant in assessing future recoverable cash flows from the customer for the impairment calculation in accordance with IAS 39.63. Consider, for example, the low level of current UK bank base rates, which have a direct effect on most mortgage repayments. For accounts which are already impaired (due, for example, to a forbearance action), the level of arrears in some cases may be low or zero. However, these low levels of delinquency may be due in part or in full to the fact that current rates are low and the borrower may have no means of servicing a mortgage when bank rates rise. Thus the levels

of arrears may not be representative of the true credit risk inherent in the portfolio. Firms may therefore need therefore to adjust probabilities of default to take this into account in order to arrive at probabilities which consider the true credit risk in the portfolio.

Good practice

Appropriate outcome periods are used as a model input to calculate accounting impairments. Although IAS 39 is a model based on incurred loss, once an asset is identified (individually or collectively) as impaired, expected cash flows (resulting from past events) are assessed on a forward-looking basis for those assets. Outcome periods may be significantly different for accounts which have been subject to certain forbearance arrangements. However, it is likely that there is limited data available to date on these accounts since the forbearance arrangements were made relatively recently. Thus, outcome periods for assessing defaults for loans subject to forbearance actions are set in a way which takes into account the period of forbearance, for example, at 24 months.

In addition, the effect of the arrangement itself on the outcome period is considered. For example, if a customer is moved to interest only for a period of six months, it is possible that losses only become visible after this point. Thus an outcome period of 12 months is unlikely to be appropriate taking into account the cash loss incurred for these accounts. Hence performance assessment may be best measured after completion of the forbearance process where this is feasible (e.g. a return from interest only back to full capital and interest repayment).

A realistic approach is taken in assessing probabilities of default by taking the current benign interest rate environment into account. Hence, for loans where there are signs of financial stress but which may not yet display cash arrears due to the current low interest rate environment, proper consideration is given to the true credit risk when assessing probability of default.

Accounts for which forbearance actions have been pursued are not shown as up-to-date when computing rolls of that pool to default. For example, the value of 'cumulative *capitalisation*' plus new arrears may be used for roll rate determination.

The up-to-date (UTD) book might include a number of accounts where the borrower is unemployed, and may be subject to forbearance. The firm separates out those accounts in arrears that are due to 'unemployment' and the average provision for those accounts. This is then used to extrapolate provision for the UTD accounts, that is, they assume all those who are unemployed in the UTD book will fall into arrears and roll in line with the unemployed accounts currently in arrears.

Poor practice

Cure rates are not used and firms incorporate an estimated roll to possession when accounts are in arrears. Thus, in the current market environment where possession is often unattractive due to property market considerations, some accounts are not captured.

Realism in accounting estimates

55. In calculating an impaired amount, firms are required by IAS 39 to estimate future cash flows arising from the impaired asset or group of assets. In estimating the future stream of cash flows, firms inevitably encounter a high level of uncertainty and this creates challenges in measuring the impaired amount appropriately.

56. For example, when a loan has moved to an interest only basis as a result of a forbearance arrangement, or arrears are capitalised, an entity may need to assess whether all of the original cash flows will be recovered and any delay compensated for using a degree of realism. In many cases, such as where there is

no repayment vehicle in place in such arrangements, there may be a strong argument for assessing that all cash flows may not be recovered.

57. We have noted an element of divergence for firms in their choice of accounting policy with regard to the values ascribed to collateral. Some firms calculate a period to possession, and then use retail price indices to estimate the value of collateral at the point of potential possession. This may result in a positive fair value movement of the collateral, hence a lower provision, if the index anticipates appreciation in house prices. In contrast, some firms take a pessimistic view of future house prices and build in a discount to the value as at the balance sheet date. Still others use the value at the balance sheet date without modification, on the basis that future movements are not within the spirit of the IAS 39 impairment model; hence, to recognise future gains in this way would not be appropriate.

58. We believe that there may be some lack of clarity in the accounting rules (IAS 39) regarding this question, which has led to divergent practice among firms. Whilst the *impairment* model is based on incurred loss, and should depend on past trigger events, disregarding future events, the cash flow stream estimated as a result of those past events necessarily extend into the future. Some argue that future rises in collateral values are future events and should not be included in an *impairment* calculation based on past events; others argue that they are only a factor that affects cash flow estimates (which necessarily extend into the future), and hence can be used.

59. If a firm uses future house price indices to predict collateral values at possession, we believe that an appropriate degree of realism needs to be factored into any such estimate to ensure that any impairment charge properly reflects the credit quality of the relevant assets and inherent uncertainty involved in predicting future house prices. Thus, if firms incorporate a significant appreciation of future house prices into cash flow models, careful consideration is required as to how realistic such estimates are likely to be, given the inherent uncertainty when predicting future prices.

60. We are conscious that to judge whether an appropriate level of realism has been applied poses significant challenges to firms and their auditors. Unless management is able to support its estimates (including any overlays), it will be difficult for the auditor to obtain sufficient appropriate audit evidence.

61. The auditor, or an auditor's expert, may use an independent model to compare its results with those of the model used by management in order to evaluate whether the values determined by the management's model are reasonable. In addition, the auditor may consider whether external sources provide audit evidence to which the auditor could benchmark an entity's practices. For example, sources that track provisioning by institutions may provide the auditor with evidence as to whether the entity's provisions are reasonable if it has loans of similar credit risk quality. We expect auditors to look to as much evidence as possible from the sources available to them when assessing the realism of firms' estimates.

Good practice

It is assumed that a significant proportion of accounts where arrears have been capitalised will fall back into arrears and this fallback rate is quantified on each pool segment.

In assessing recovery amounts, the collateral values used (before forced sale discounts) reflect an appropriate degree of realism which reflects the inherent uncertainty with regard to any potential future movements in the index.

Probabilities of default within the up-to-date book are revised to be made more pessimistic if behavioural scorecards suggest this is appropriate.

Credit quality of loans factors in the current low interest rate environment.

Poor practice

Conversions to interest only assume full repayment of the principal at the end of the loan term, even though there is no repayment vehicle in place.

Term extensions are granted and these extend the life of a loan to the point where the borrower is likely to enter retirement without an assessment of the retirement income. All cash flows are assumed to be received and the loan is not considered impaired.

Lack of appropriate caution in estimates of forced sale discounts when computing possession values. In most cases, a forced sale discount of 10% is unlikely to be sufficiently realistic in the current environment.

Shortfall values are revised in line with quarterly revisions to the indexed property valuations e.g. update to the quarterly house price index.

No arrears are recognised as the customer's contractual monthly repayment is changed resulting in repayment *capitalisation* following a forbearance action and the severity of their true arrears based on their 'cumulative *capitalisation'* is not assessed.

Accounts which are subject to a mortgage rescue scheme are not considered problematic and are not shown as impaired.

Disclosure

62. IFRS 7 stipulates that quantitative risk disclosures made by firms should be based on information provided internally to key management personnel (IFRS 7.34(a)). We are concerned that firms' disclosures under IFRS 7 may not reflect the additional credit risk attached to accounts in forbearance and hence may not provide a complete picture of the credit risk profile of firms' portfolios.

63. IFRS 7 is clear that entities should provide information about the credit quality of financial assets even if these are neither past due nor impaired (IFRS 7.36(c)). In addition, the Standard prescribes that, if the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during that period, an entity should provide further information that is representative (IFRS 7.35). In the case of retail loan portfolios, we consider the use of forbearance procedures that may have the effect of masking the true credit risk of the underlying portfolio warrant separate disclosure.

64. A firm's choice of accounting policies in addressing some of the measurement criteria used in impairment. Disclosure of significant accounting policies is a requirement of IFRS 7.21. We encourage firms to consider carefully which policies need to be disclosed in order to provide a fuller picture of how impairment is measured.

65. The Accounting Standards Board (ASB) of the UK Financial Reporting Council issued its report *Cutting Clutter: Combating clutter in annual reports* in April 2011. The ASB makes the observation that unnecessary clutter in financial statements can make it harder for users to find the salient points about a firm's performance and position. In the area of financial instruments, the tentative view is given that firms should address "only the risks that are material to the entity – many companies only have significant exposure to some financial risks, but still provide detailed disclosure about others". We support disclosure which is targeted to reflect the true credit risk inherent in loan portfolios, in a way which is unmasked by more generic disclosure.

66. In order to provide targeted disclosure in the area of forbearance and credit risk, we encourage consideration of the following, where relevant:

- Types of forbearance strategy used. These may include, but are not limited to, term extensions, conversions to interest only due to financial difficulties, capitalisation of arrears, payment holidays, reduced payment plans and other strategies used where customers exhibit financial difficulty.
- Quantification of loans subject to forbearance.
- Disclosure of impairment on loans which have been subject to the different types of forbearance.
- Descriptions of probability of default (PD) and loss given default (LGD) calculations, and emergence and outcome periods.
- Disclosure of accounting policy in treatment of collateral prices, including detail on whether indexed house prices used the results in an appreciation of expected collateral values.
- Where possible, further granular disclosure to show the number of non-sustainable accounts where forbearance procedures have been pursued, e.g. term goes past a reasonable *retirement income age* where no retirement income validation has taken place; transfer to interest only with no repayment vehicle in place.
- Number of pools used in collective impairment calculations, and a description of each pool.
- More precise information around use of triggers (e.g. number of days past due, other factors).
- Description and quantification of effects of manual overlays of models.
- Any other items which are relevant to assessing risk characteristics of these accounts.

Good practice

Firms disaggregate portfolios appropriately for *impairment* assessment to take account of the different types of forbearance action detailed in this document. This is mirrored in the disclosures provided on retail *impairment*.

Firms take account of the factors listed in paragraph *66* in providing disclosures in the credit quality of loan assets.

Poor practice

Firms disclose loans that are subject to forbearance arrangements due to customer *impairment* within the 'Neither past due nor impaired' bucket without further disclosure, thus giving the user of the financial statements the impression that these loans are of good credit quality and masking the true credit profile of these portfolios.

Within the analysis of credit quality of neither past due nor impaired loans as required by IFRS 7.36(c), no mention is made of forbearance arrangements.

Loans where arrears have been subject to standard or repayment *capitalisation* are treated as not past due for the purposes of IFRS 7.36-37 and no mention is made of the special status of these loans.

FURTHER RELATED WORK

67. As we apply our intrusive and intensive supervisory approach, we will be looking to see how firms have acted on this guidance. We will consider, for example, whether firms have robust procedures for the consideration of customer forbearance and that there is clear and transparent reporting of forbearance, impairment and loss risks of the portfolio including provision assessment, and that these loss risks are known by the executives of the business.

68. Capital implications were not assessed as part of this review. We will consider the implications for firms in respect of capital requirements where impairment and loss risks have not been comprehensively considered by the firm.

69. Regulatory reporting requirements were not considered as part of this review. We will be considering whether additional reporting to the FSA in relation to forbearance activities would assist in the regulatory process.

APPENDICES

Annex 1: Glossary of terms used

Accounting standards

Under International Financial Reporting Standards (IFRS), specific accounting rules around impairments (also referred to as 'provisions') are governed by the accounting standard IAS 39 Financial Instruments: Recognition and Measurement, in particular by IAS 39.58-70 and IAS 39.AG84-AG93, supported by the relevant Bases for Conclusions and Implementation Guidance. In addition to these specific rules, more general guidance in accounting estimates is provided by the Framework and the Standard IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

All references to accounting standards within this section are to IFRS. We note that certain institutions may not prepare accounts under IFRS. However, with regard to impairment methodology, the UK standard FRS 26 Financial Instruments: Recognition and Measurement is identical to IAS 39. FRS 26 is applied by almost all significant UK financial institutions who report under UK GAAP rather than IFRS. We consider the conclusions and recommendations around good and poor practice contained in this section to apply to UK institutions as a whole where forbearance strategies have been adopted. As well as IAS 39, this document refers to the IASB Framework as well as other international Standards.

Capitalisation or capitalisation event

Where a customer has made repayments that are less than is due under the *contractual terms* of the mortgage, but where this difference has not been retained as an arrears value, the mortgage is considered to have been subject to a capitalisation event. In these instances the interest repayable over the life of the mortgage and/or the future repayment amount and/or the term of the mortgage will have been affected.

It is recognised that a firm may capitalise small amounts of arrears where there is no resulting impact on interest payable, repayment amount or term of the mortgage, which have arisen from timing issues and interest rate rounding during rate change months etc. Where the long-term interest payable impact is less than £50 or less than £1 on the contractual monthly repayment amount and less than one month on the term, the capitalisation is deemed as immaterial and ignored for reporting and treatment purposes. Under this clause, where cumulative immaterial capitalisations become material, a *capitalisation* event is deemed to have occurred.

a) Standard capitalisation: a single capitalisation event to capitalise a pre-existing *contract shortfall*.

b) Repayment capitalisation: defined as any process which allows for a lower than contractual repayment to be made without this contract shortfall accruing as arrears (e.g. the account is temporarily transferred to IO, provided with a payment holiday or other payment arrangement where arrears are not accruing).

Collective impairment assessment.

a) IAS 39 states the following with regard to assessment of impairment on a collective basis (highlights added).

b) For the purpose of a collective evaluation of *impairment*, financial assets are grouped on the basis of similar credit risk characteristics that indicate the debtors' ability to pay all amounts due according to the *contractual terms* (for example, on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The characteristics chosen are relevant to the estimation of future cash flows for groups of such assets by indicating the debtors' ability to pay all amounts due according to the *contractual terms* of the assets being evaluated. However, loss probabilities and other loss statistics differ at a group level between (a) assets that have been individually evaluated for *impairment* and found not to be impaired, and (b) assets that have not been individually evaluated for *impairment*, with the result that a different amount of *impairment* may be required. If an entity does not have a group of assets with similar risk characteristics, it does not make the additional assessment.

c) *Impairment* losses recognised on a group basis represent an interim step pending the identification of *impairment* losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.

Contractual monthly payment

The contractual monthly repayment is defined as the monthly payment due based on the *contractual terms* of the mortgage. To avoid doubt, a payment holiday taken or a drawdown against a flexible credit line during the life of the mortgage is deemed to be a change to the *contractual terms* where the interest repayable over the life of the mortgage, and/or the future monthly repayments due and/or the term of the mortgage will be varied as a direct result of the payment holiday or drawdown.

Contract shortfall

This is the difference between the value of cumulative repayments made by the customers and the value of cumulative contractual monthly repayments due.

Contractual terms

This is defined as the original terms and conditions of the mortgage as agreed at the time of mortgage completion. *Contractual terms* are deemed to have changed to new terms where the new terms are a *sustainable* alternative to the original terms and the customer has been provided with clear, timely and adequate information to understand the implications of those changes in terms and have provided their consent to the changes based on that understanding.

Firms, when changing *contractual terms*, must remain compliant with the wider constraints of contractual legislation, for example FSA-published Undertakings and Unfair Contract Terms regulation.

Impairment

A financial asset is impaired if there is objective evidence that an impairment event has occurred, and that the *impairment event* has an estimated impact on the estimated future cash flows of the asset or group of assets which can be reliably estimated. An impairment may be caused by a single event, or a combination of events. If an asset is impaired, its new carrying amount is the present value of estimated future cash flows, discounted at the asset's original effective interest rate. The difference between this amount and the asset's previous carrying amount is taken to the income statement as an impairment loss.

Impairment event – Interpretation of impairment event per IAS 39.59

a) IAS 39 ascribes the recognition of impairment losses to two factors: that one or more objective events have occurred after initial recognition of an asset (an *impairment event*); and, that the event has an impact on the estimated future cash flow of an asset or group of assets, which can be reliably estimated. As such the Standard is clear that an event for which there is objective evidence can give rise to an impairment charge if it can be demonstrated that the event has an impact on future cash flows. The existence of present cash losses is therefore not a pre-requisite for recognising impairment losses.

b) The type of objectively observable *impairment* events are listed in the Standard as follows (IAS 39.59):

    a) significant financial difficulty of the issuer or obligor;

    b) a breach of contract, such as a default or delinquency in interest or principal payments;

    c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

    d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

    e) the disappearance of an active market for that financial asset because of financial difficulties; or

    f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

    i. adverse changes in the payment status of borrowers in the group (e.g. an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or

    ii. national or local economic conditions that correlate with defaults on the assets in the group (e.g. an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan

assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

Overpayments

This is where the firm has a facility to accumulate repayments made above *contractual terms* as an overpayment.

Potential impairment indicator

This is defined as an event which may be indicative of *impairment*. For example, the customer is provided with or requests a temporary or permanent reduction to their mortgage repayments or an increase in capital outstanding. This may take the form of a request to extend the term of the mortgage, the transfer of all or part of the mortgage on to interest only terms, to take a payment holiday, or take an equity drawdown (against the mortgage or a linked credit line). For the avoidance of doubt, if a firm does not have a robust mechanism for identifying impairment from a potential impairment indicator, they should not assume that *impairment* does not exist. This may also include all or part of a mortgage which has passed its maturity without full repayment.

A *potential impairment indicator* is also considered to have occurred when the lender has provided the customer with a concession that it would not normally have provided had the impairment position of the customer not existed. Examples may include paying costs to support a voluntary sale of the property, waiving of Early Redemption Charges (ERCs), provided with a reduced concessionary interest rate or support provided by smoothing of interest payments pre/post a rate change.

Retirement income age

The Office of National Statistics (ONS) states: "The transition from work to retirement involves a move towards part-time employment. The majority of those who are employed after State Pension Age (SPA) work part-time." Historically, a higher proportion of women than men have continued to work beyond SPA (in April to June 2010, 13.4% of women aged 60 and over were in employment, compared with 11.0% of men aged 65 and over). This is largely because women's SPA has been – and remains for the time being – lower than men's. It may also reflect the different types of work done by men and women and the fact that many couples make joint retirement decisions.

Economic activity by age: men[1], April to June 2010[2]

Great Britain	Percentages			Inactive	Inactive	Inactive
Age	Employed: full-time	Employed: part-time	Unemployed	Retired	Sick or disabled	Others
25 - 49	80.1	5.5	6.3	0.0	4.7	3.2
50 - 54	77.3	5.2	5.3	0.7	8.3	3.2
55 - 59	66.6	9.3	4.9	4.1	11.3	3.8
60 - 64	41.9	12.2	3.7	19.6	16.5	5.9
65 - 69	11.0	13.0	0.7	63.3	8.2	3.7
70+	1.4	3.5	0.1	94.9	0.0	0.0

1 The 'Inactive: others' category includes those seeking and not seeking work. This includes students and people looking after family home.

2 Data not seasonally adjusted.

Source: Labour Force Survey, Office for National Statistics

Economic activity by age: women[1], April to June 2010[2]

Great Britain	Percentages			Inactive	Inactive	Inactive
Age	Employed: full-time	Employed: part-time	Unemployed	Retired	Sick or disabled	Others
25 - 49	44.7	29.5	4.5	0.0	4.5	16.7
50 - 54	43.9	31.3	2.9	1.0	11.2	9.7
55 - 59	35.6	29.5	2.6	6.0	13.7	12.5
60 - 64	12.9	20.6	0.6	47.7	8.0	10.2
65 - 69	3.7	12.4	0.2	72.4	5.8	5.6
70+	0.3	2.3	0.0	97.4	0.0	0.0

1 The 'Inactive: others' category includes those seeking and not seeking work. This includes students and people looking after family home.

2 Data not seasonally adjusted.

Source: Labour Force Survey, Office for National Statistics

Given the low rate of full-time employment after SPA, it is reasonable to assume that retirement income will be required to support the repayment of a mortgage after the SPA, or the customer's expected retirement age, whichever is sooner. It may be reasonable to extend this age where a customer, close to the government SPA, is intending to continue to work full-time or part-time past the government SPA and the firm has assessed whether this is plausible for the customer's circumstances, employment type and validated that their employment income plus retirement income shows full affordability. ONS statistics identifies that the expected continued working life of a person working beyond the government SPA is less than three additional years for women and less than two for men.

Changes to SPA: currently the SPA for men is 65. SPA for women was 60 until 5 April 2010, but under the Pensions Act 1995 the SPA for women began to increase on 6 April 2010. The increases are being implemented in stages, with the exact age at which women become entitled to a state pension depending on their date of birth. Under the Pensions Act 1995, women's SPA would reach 65 (in line with men's) by 2020. Under the Pensions Act 2007, the SPA for both men and women would increase from 65 to 68 by 2046 (with increases to 66 from 2026, to 67 from 2036 and 68 from 2046). However, in January 2011, the government presented to Parliament a Pensions Bill which proposes faster increases to SPA. The proposed changes would bring women's SPA into line with men's at age 65 by 2018 and bring forward the increase in SPA for both men and women to 66 by 2020.

Sustainable terms

Contractual terms, which are considered to be a sustainable alternative, have met the following criteria:

a) In the event of a permanent transfer from capital and interest (C&I) repayment to interest only (IO), on all or part of the mortgage, that a valid repayment strategy is in place, which the firm has assessed is plausible. An affordability assessment has been conducted which confirms that the customer is able to

fully service the mortgage loan commitments and the repayment strategy, and it would be reasonable to assume that this can be sustained over the full mortgage term.

b) In the event that a mortgage term is extended, then the term remains within the reasonable employment period of each income earner (see *retirement income age*). Where the term does extend beyond this, then retirement income is validated and affordability assessed to ensure that the mortgage can be sustained over the full mortgage term.

c) In the event that a material drawdown, further advance, payment holiday or *capitalisation* is provided on an account (cumulatively equivalent to more than three months' payments) or there is an indication of potential customer impairment, an affordability assessment is conducted on the customer(s) to verify that the customer is able to fully service the revised mortgage loan over its full life on a capital and interest repayment basis. If the mortgage is on interest only terms, that a repayment strategy is in place which the firm has assessed as plausible and the affordability is assessed to ensure both the mortgage and the repayment strategy is affordable over the full mortgage term.

Where the *sustainable terms* above have not been met the mortgage is considered to be on non-sustainable terms. Mortgages on non-sustainable terms should be separately considered and judged on the basis of their previously agreed *contractual terms* for the purpose of monitoring, reporting, provisions and capital assessment until such time as the mortgage has been brought into a sustainable terms position (e.g. the customer's affordability has increased due to a return to work or other changes in circumstances, enabling the mortgage to be brought back on to shorter terms, a return to capital and interest or a return on to full contractual monthly repayment).

Annex 2: Forbearance facilities observed

Ref	Options available to assist customers in financial difficulty	Description of the option
1	Temporary 'rehabilitation' tools for customers both in arrears and pre-delinquency	
1.1.	Change in payment date	A temporary (or on occasions permanent) change of the payment due date, typically to align payments to a customer's changed income/salary date.
1.2.	Change in payment method/or schedule of payments	A temporary change from monthly direct debit payments to a method more aligned to a customer's needs. Examples include: monthly or weekly bank giro credit; debit card; standing orders and cheque payments.
1.3.	Arrangement or promise to pay	A short-term monthly or lump sum payment plan agreed with the customer, which is affordable and practical in terms of the customer's circumstances. This tool may be used to stabilise the arrears position or used to collect a sum above the contractual monthly repayment to reduce the *contract shortfall*.
2.	Temporary 'reduced repayment' tools for customers both in arrears and pre-delinquency	
2.1.	Reduced payment concession	A temporary reduced repayment concession is agreed where the repayment is lower than the actual contractual monthly repayment.
2.2.	Payment holidays for flexible mortgages	The customer has taken a payment holiday. This may be against previous *overpayments* on the mortgage, against a pre-approved credit limit or agreed with a maximum payment length boundary.
2.3.	Zero or nil payment concession	The lender has given the customer a zero or nil payment concession for a short period.
2.4.	Deferral of payment pending sale of property	The customer has deferred payments for a short period with the aim of selling the property. Appropriate evidence is supplied to the lender.
2.5.	Use of linked pre-approved reserve/credit/overdraft limits	The customers' pre-approved reserve/credit/overdraft limit account is debited with the contractual monthly repayment or the customer uses monies from the linked current account to pay the contractual monthly repayment or the customer makes a drawdown to support the repayment of other debts or living expenses.
2.6.	Temporary transfer to interest only (IO)	The main loan account is transferred to IO payments for a temporary period.

2.7.	Transfer to a lower interest rate	The main loan account is transferred to a lower preferential interest rate for a temporary period.
3.	Permanent forbearance tools resulting in contractual changes	
3.1.	Extension of the mortgage term	The customer extends the contractual mortgage term. This entails a formal contract variation.
3.2.	Permanent transfer to interest only (IO)	The main loan account is transferred to IO payments on a permanent basis.
3.3.	Transfer to an alternate (usually lower interest rate) product	This is a contractual change on to another product. Standard product fees/charges (e.g. product fees, ERCs, penalties etc) may be waived as a concession.
3.4.	Capitalisation of arrears	The arrears (full or part) are capitalised into the principal debt. For standard capitalisation, this is typically after the customer has met six contractual monthly repayment payments. Repayment capitalisation may take place as part of a payment arrangement, such as a temporary transfer to interest only terms.
4.	Hardship/possession tools (for customers typically in late arrears but also observed in pre and early arrears)	
4.1.	Transfer to a special hardship product or reduced interest rate	This is a contractual change on to a special hardship product. Standard product fees/charges (e.g. product fees, ERCs, penalties etc) may be waived as a concession.
4.2.	Deferral of interest	Customer has applied and been accepted into the Government Homeowner Mortgage Support Scheme (HMSS) or similar in-house scheme.
4.3.	Partial debt write off (discounted pay off)	Lender writes off a substantial part of the debt, typically used where the mortgage book has been bought at a discount.
4.4.	Assisted property sales or assisted voluntary repossession	Lender financially assists customer with the sale of the property. For example, free property sales advice, the waiver of interest or fees during the sale period – typically six months, waived ERCs and penalties or support with upfront agent or solicitor fees etc.
4.5.	Short sales/full & final settlements	Lender has agreed a waiver or partial waiver of the shortfall debt.
4.6.	Government Mortgage Rescue Scheme	Customer has applied and been accepted in any Government Mortgage Rescue Scheme or similar in-house schemes.