RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

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Dear Chief Executives

Extension of regulatory guidance on loan repayment deferrals

This letter provides updated guidance regarding the application of prudential capital requirements to loan repayment deferrals in the period to 31 March 2021. This guidance is effective from 27 September 2020.

We have appreciated the extensive engagement that we have had with the New Zealand Bankers' Association (NZBA) and with individual lenders in considering options for the future of the loan deferral arrangements.

Background

On 27 March 2020, the Reserve Bank issued regulatory guidance to facilitate banks offering loan repayment deferrals to their customers. This guidance enabled banks to temporarily treat deferred loans as performing (non-defaulted) for a period of up to six months.

Loan deferrals were initially made available to residential mortgages, including business lending secured against residential property. In April the scheme was extended to cover other lending, including lending to small and medium enterprises (SMEs) and agriculture. We also clarified that there were no barriers in the regulatory capital framework to non-bank deposit takers (NBDTs) also offering loan deferrals to their customers.

In the absence of further intervention, the Reserve Bank's regulatory guidance would expire on 27 September 2020 and the standard regulatory treatment of deferred bank loans would apply from that point forward. The majority of deferral applications were approved in April, and hence will begin to roll off from October onwards.

Overview of decision to extend regulatory guidance

The Reserve Bank has decided to extend its concessionary treatment of deferred loans until 31 March 2021. The revised regulatory guidance in this letter covers both new applications for loan deferrals and extensions of loan deferrals granted since the beginning of the programme. The new guidance will take effect from 27 September 2020, when the existing guidance expires.

As with the previous guidance, the extended guidance will allow banks to treat loans deferred under the programme as performing (non-defaulted), provided they were not otherwise recorded as in arrears, on a watch-list or impaired in any way at February 29, 2020. Deferred loans should not be treated as being in arrears, or as a distressed restructuring. The Annex to this letter provides more detail about the application of this approach under the relevant provisions of BS2A/B of the Banking Supervision Handbook.

We consider that extending our concessionary guidance is the best approach to managing risks to financial stability. There is still significant uncertainty around the economic outlook, and adjustments in the economy will take time. Extending the guidance allows more time for banks and borrowers to assess their positions and identify the most appropriate way forward (for example, returning to usual payments, restructuring the loan, extending the deferral period, or putting the loan into bank hardship arrangements). It will also provide flexibility to grant deferrals to new applicants who did not previously require assistance with their loan payments.

The Reserve Bank considers the standard regulatory settings, as reflected in the existing text of BS2A/B of the Banking Supervision Handbook, to be appropriate in the medium term. These settings will resume once the guidance expires on 31 March 2021. The time limited concessionary treatment described in this letter reflects the unprecedented economic circumstances arising from COVID-19.

Expectation to engage with borrowers

The Reserve Bank's clear expectation is that repayment deferrals should not be the default option offered to customers. In particular, the Reserve Bank expects lenders to only approve an extension or new loan deferral where there is a need for it and a benefit to the borrower, and when the lender assesses that there is a reasonable prospect of that customer resuming payments when the deferral period ends.

For many borrowers, resuming, or continuing payments in some form will be the most suitable approach, rather than extending a repayment deferral. This may include returning to payments on the original schedule, or on a revised schedule following a loan restructure. There may also be borrowers where the lender considers that there is little reasonable prospect that the borrower will be able to resume payments once a deferral ends.

In all cases the Reserve Bank expects that lenders engage with each borrower with a deferred loan, or seeking a new deferral, to identify the most appropriate solution for that borrower.

In cases where a deferral is agreed, it is not mandatory nor necessary to extend deferrals for the full eligible period. Banks and customers have flexibility over the term of any deferral, but the concessionary loan treatment will expire on 31 March.

The Reserve Bank recognises that there is still a high degree of uncertainty around the economic outlook. This means that making assessments of borrowers' circumstances will not always be straightforward.

The Reserve Bank does not intend to specify the precise criteria or steps that lenders should take as part of their engagement with borrowers as we consider that lenders are best placed to make these decisions. Banks should follow the internal processes they consider necessary to make decisions on offering new or extended loan deferrals. The Reserve Bank does not anticipate that banks will need to carry out new valuations of security as part of this process, although such an approach may be needed in some cases where loans are being restructured.

Other regulatory obligations

The Reserve Bank notes that there are other regulatory obligations that lenders must consider in granting new or extended deferrals to customers. For example, lenders have obligations under the Credit Contracts and Consumer Finance Act (CCCFA) and the Responsible Lending Code.

We note that the Government has approved an extension to the addendum to the Responsible Lending Code introduced in response to COVID-19. The addendum has been extended until 31 March 2021, and aligns with the Reserve Bank's updated regulatory guidance. This should provide additional certainty to all lenders regarding the application of consumer regulation with respect to loan deferrals

The Reserve Bank also recognises that lenders will need to follow IFRS 9 accounting rules for loan provisioning. We understand that banks and their auditors are having ongoing, robust discussions in this area. We note that to-date, there have been varying levels of reasonable and supportable information regarding the correct treatment of loan provisions in the context of COVID-19, but the extent of this is becoming clearer over time. The Reserve Bank will continue to monitor developments in this area.

Loan deferrals may have an impact on borrowers' loan-to-value ratios (LVRs). The Reserve Bank has removed LVR restrictions for 12 months starting from 1 May 2020. Accordingly there are no LVR restrictions associated with eligibility for loan repayment deferrals in the period up to 31 March 2021. However, we do expect banks to consider borrowers' financial position when the deferral ends as part of their discussions with borrowers about the best option for each borrower's circumstances.

To support the extension of the loan deferral arrangements, the RBNZ has also decided that mortgages impacted by the temporary deferral can be included in Internal Residential Mortgage Backed Securities (RMBS) loan pools, subject to the requirements that can be found on our website.

Application to non-bank deposit takers (NBDTs)

As we noted in April, there is no barrier in our capital adequacy regulations to NBDTs providing loan deferrals under the Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010. Loan deferrals do not impact on the calculation of risk-weighted assets and regulatory capital ratios for NBDTs in the way that they do for banks. The Reserve Bank is therefore comfortable with NBDTs continuing to provide loan deferrals if they wish. However, we note that NBDTs are covered by regulatory obligations under the CCCFA and the Responsible Lending Code in the same way that banks are. NBDTs will need to take these obligations into consideration in granting new or extended deferrals to customers.

Expiry of guidance

This guidance will apply until 31 March 2021, after which point the standard regulatory treatment of deferred loans will resume. Banks will still be able to offer deferrals to borrowers after this date, but will not be able to apply the concessionary regulatory treatment covered by the guidance.

Regardless of the date on which a loan deferral is agreed between a borrower and a lender, the updated regulatory guidance can only be applied up to 31 March 2021. For example, for a deferral granted in February 2021, the concessionary treatment described in this guidance can only be applied until 31 March 2021. A deferral could be offered with an expiry date after 31 March 2021, but the concessionary treatment must expire on 31 March 2021.

Any loan exiting the deferrals programme to resume payments on or before 31 March 2021 – including loans restructured by agreement between the lender and the borrower (e.g. interest-only or extended loan terms) – will not be considered to be in default, or part of a distressed restructuring under the Reserve Bank’s capital adequacy rules. The standard regulatory treatment of such loans will resume for any loans restructured after 31 March 2021.

In cases where a return to regular payments is possible (either on the original payment schedule, or on a revised schedule following a loan restructure) borrowers and lenders should seek to resume payments as soon as practicable, in advance of 31 March 2021.

The Reserve Bank expects that lenders will facilitate an orderly exit of customers from the deferrals scheme, and proactively seek to return customers to regular or alternative payment schedules prior to this date.

Reporting

For transparency, the Reserve Bank is considering whether to require additional data reporting from lenders with respect to deferred loans, building off the existing Bank Customer Lending Survey (previously, Stress Indicators Survey). This will help to monitor the volume and performance of deferred loan exposures over time. We will be in contact with the industry during August to further discuss these processes and any arrangements regarding the public release of this information.

Yours sincerely

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Annex: Application of Guidance to Provisions in Banking Supervision Handbook

This guidance applies to loans secured by residential property, SME loans and agricultural loans, from 27 September 2020 until 31 March 2021.

For any such loans where the bank and the borrower have agreed to a loan deferral, up until no later than 31 March 2021, the Reserve Bank will allow banks to apply the following approaches in their capital adequacy calculations:

- For the purposes of BS2A 43(h) and BS2B 4.268-4.269, banks may treat these loans as non-defaulted loans, provided they were not otherwise recorded as impaired in any way at February 29, 2020.
- Banks need not treat the period of the repayment deferral, provided as part of a COVID-19 support package, as a period of arrears when determining whether a borrower is 90 days past due. The counting of days past due is paused when the repayment deferral is granted. At the end of the deferral period, the counting of days past due resumes from the number of days past due of that loan when it entered the payment deferral, unless that loan has been formally modified to a new repayment schedule (in which case the days past due is reset to zero).
- Banks need not treat loans granted a repayment deferral, as part of a COVID-19 support package, as a distressed restructuring.
- Where a borrower returns to the original or modified payment terms, loans exiting the deferral programme can remain on a non-defaulted grade (i.e. BS2B 4.272 does not apply).