

Summary of the Directive on Arrears Management of 2013 (P.A.A 315/2014) and the Amending Directive of Arrears Management of 2014 (P.A.A 57/2014)

Application of the Directive

- Applicable to all credit institutions which possess a license by the Central Bank of Cyprus in accordance with section 4(1) of the Business Institutions Law of 1997 to (No.3) 2013.
- Applicable all to all branches of credit institutions of other member states operating in the Republic, in accordance with section 10A of the said Laws, unless corresponding provisions have been enacted in the regulatory framework by the competent authority of other member states.

Purpose of the Directive

- The application by all Authorized Credit Institutions (ACIs) of efficient and effective strategies, policies, structures, procedures and mechanisms for the management of arrears and attainment of fair and feasible restructurings of credit facilities of borrowers with financial difficulties.

A. Arrears Management Framework

Purpose: to provide the key principles for a fair and expeditious resolution to the restructuring efforts for borrowers in financial difficulties across the banking sector in the Republic of Cyprus.

- The principles and requirements by the framework should only be used as a benchmark for the minimum standards required and each ACI should evaluate the relevance and applicability of each provision in the framework in relation to its own specificities and based on the principle of proportionality.
- The Central Bank of Cyprus (CBC) requires ACIs to implement efficient and effective structures, processes and tools to support arrears management and execute fair, adequate and sustainable debt restructuring.

Methodology for ACIs on Arrears Management

- ACIs should adopt the 5 key pillars when dealing with the arrears and borrowers in financial difficulties:
 1. Adherence to the Code of Conduct (aka Code) on the Handling of Borrowers in Financial Difficulties;
 2. The development of a robust arrears management strategy;
 3. The utilization of relevant, effective and sustainable debt restructuring techniques and options;
 4. The establishment of a powerful organization and operating model to handle increasing arrears and volumes;
 5. The monitoring of arrears management performance against key objectives and taking corrective measures as and when required.
- ACIs should undertake a critical internal assessment of their current Arrears Management Strategy (AMS), policies and procedures and benchmark them to the provisions aforementioned, thus identifying gaps and areas of improvement and developing an implementation plan to make the necessary changes.

Code of Conduct on the Handling of Borrowers in Financial Difficulties:

- Outlines the responsibilities of all ACIs in the arrears management process and makes a clear discrepancy between cooperative and non-cooperative borrowers with the focus on a consensual and voluntary restructuring.
- Intended to support and facilitate a meaningful interaction between ACIs and borrowers with the ultimate goal of achieving a fair and sustainable restructuring where possible.

Arrears Management Strategy (AMS): shall be adopted by each ACI (in accordance with a specific framework aka the "Framework") and all firms should comply with the principles encompassed in that context.

- The strategy shall include:
 - A clearly defined approach for each of the main category of credit facilities that it serves.
 - An operational plan covering the main components of arrears management e.g. Segmentation, Policy & Debt Restructuring Solutions, Organization and Capabilities etc.
- Portfolio segmentation: a key part of the AMS as it enables the ACIs to adopt and tailor different restructuring solutions to different segments of the loan book and analyzing them in granular detail.
- Strategy Monitoring: ACIs should also test the sturdiness of the AMS at least once a year and its underlying hypothesis and assumptions and submit their revised strategy to the CBC.
- Other main components of the AMS include:
 - Restructuring Options of Credit Facilities, Processes & Systems, Organization & Capabilities and Measurements.

Restructuring of Credit Facilities

- ACIs are required to implement tools and mechanisms to identify, communicate and manage borrowers with the risk of running into financial difficulties so as to deal with pre and early arrears e.g. decision trees, a list of restructuring options, tracking system.
- ACIs shall develop and implement a suitable restructuring framework of credit facilities, a sustainable pricing policy and provide borrowers with robust and sustainable restructuring solutions in the long term.

Organizational Structure and Operating Model

- ACIs shall clearly define the blueprint of the organizational structure, level of resources and capabilities and systems and processes required to effectively implement and monitor AMS.
- ACIs shall implement a robust operating model that encompasses all systems, processes and procedures in order to support the effective management of arrears of borrowers with financial difficulties.
- ACIs shall implement an in-depth assessment of their internal capabilities in relation to arrears management, debt restructuring and expertise in the different sectors of the market.
- Resource planning: targeted at determining the most optimal, efficient and effective combination of resources required by the ACI to manage current and future arrears and deal with borrowers.

- ACIs shall establish an independent Arrears Management Unit (AMU), which will specialize in the various categories of credit facilities so as to monitor arrears, troubled cases and restructurings of borrowers.
- ACIs shall ensure process efficiency in the management of arrears and handling of borrowers through the implementation of best policies, procedures and practices e.g. lean thinking, caseload management, sharing of best practices, culture of continual improvement and through the development of a management information system (MIS).
- ACIs should implement relevant safeguard measures to ensure that all procedures are effectively in operation and that sustainable solutions are delivered to the borrowers e.g. regular credit reviews, quality assurance, key performance indicators (KPI).

Measurements

- ACIs shall implement internal systems and processes in alignment with the CBC directives and Circular Letters, which will effectively identify and monitor credit risk and assess AM performance.

Appeals Process

- Shall be established by each ACI for appeals process submitted by borrowers vis-à-vis debt restructurings.
- Includes the establishment of an “Appeals Committee”, independent from the credit granting, monitoring and restructuring functions so as to handle the loan facilities in an unbiased manner without any conflicts.
- These processes must be in line with the provisions made of the Code.
- ACIs should occasionally communicate the process of the appeals process to the CBC with a summary of the claims explained.

Section 1: Assessment of Reasonable Standard of Living

- All ACIs should develop a policy to ensure fairness, appropriateness and equality and communicate it to all employees involved in the restructuring of credit facilities by implementing specific guidelines.

Section 2: Approach to Multiple Creditors

- ACIs are advised to incorporate in their policies international best practices such as the “Eight Principles” approved by the INSOL International in 2000 when dealing with borrowers who have various debts with multiple creditors.

Section 3: Debt Restructuring Options

- Out-of-court debt restructuring
 - Involves changing the composition and/or structure of assets and liabilities of borrowers in financial difficulty without resorting to judicial intervention and with the objective of promoting efficiency, restoring growth and minimizing the costs associated with the borrower’s financial difficulties.
- Short Term Solutions (less than 5 years)
 - E.g. interest only, reduced payments, arrears and/or interest capitalization, grace period, interest rate reduction.
- Long Term Solutions (more than 5 years)
 - E.g. extension of maturity, capture surplus cash, additional security, sales by agreement/assisted sale, split mortgage, trade down mortgage, forbearance of penalties in loan agreements, alteration of covenants, rescheduling of payments etc.

B. Code of Conduct in the Handling of Borrowers in Financial Difficulties

PART I

Introduction & Objective

- ACIs should abide by the Code when it comes to borrowers in financial difficulties or where relevant, their guarantors across all categories of credit facilities.
- Aim: enhance the level of cooperation between ACIs and borrowers.

General Principles

- ACIs should also abide by the general obligation and responsibilities for arrears management (AM) and debt restructuring.
- ACIs should be able to demonstrate to the CBC their full compliance with the provisions of this Code.

General Approach to Restructuring

- Follow steps of: effective communication with the borrower, obtain financial and other information, assessment of the borrower's financial position, consideration of suitable restructuring options, presentation of restructuring solution and appeals process.

Communication with the borrower

- Communication at different stages: pre-arrears communication, mid arrears communication, serious arrears communication.

Financial Information

- ACIs have the right and the obligation to have access to adequate, complete and accurate information of the borrower and where appropriate the guarantors' entire financial circumstances.
- ACIs shall set the necessary timeframe for the submission of financial information and they shall inform the borrower fully for the kind of information needed, where the Personal Financial Statement (PFS) most often used is included as Part III of the Code in the original directive document (excel snapshots).

Assessment

- ACIs should imperatively assess the following regarding to the borrower and the guarantor: financial position, collateral, guarantees and assessment of restructuring options.

Restructuring Solutions

- ACIs shall propose sustainable solutions to all borrowers and they shall demonstrate integrity and prevent undertaking any actions that might be detrimental to the position of the borrower.
- ACIs shall communicate to the borrower the final decision within 10 working days in an arranged meeting with a letter of offer if its a positive decision and the ACIs shall avoid taking any legal recourse in the case of a negative one.

PART II

Transparency of borrowers' and guarantors' rights and responsibilities

- ACIs shall provide borrowers with a document that lays down the respective rights and responsibilities of both borrowers and ACI whereupon the borrowers sign that they have received adequate and full explanation thereof.

PART III

Personal financial statement

- A template of a financial statement required from the borrowers and guarantors by the ACIs (found on the original directive document in excel snapshots).