Box 1.2

USE IN 2023 OF THE CODES OF GOOD PRACTICE INTRODUCED BY ROYAL DECREE-LAWS 6/2012 AND 19/2022

Seeking to protect vulnerable households or those at risk of becoming vulnerable due to the rise in inflation and the subsequent interest rate increases to mitigate it, Royal Decree-Law 19/2022 on the application of codes of good practice (CGPs) and other facilities for mortgagors was ratified in November 2022.

This legal rule introduced two main changes.[1] First, it reformed the CGP[2] in force since 2012 to broaden the definition of eligible vulnerable households. Second, it established a new temporary code (in force until December 2024) aimed at protecting households that, while not yet vulnerable, are potentially vulnerable[3] due to the changing economic environment. Lenders sign up to the CGPs voluntarily, but the codes are binding thereafter. For a more detailed analysis of the content of Royal Decree-Law (RDL) 19/2022 and its economic and financial implications, see the special feature in the Spring 2023 FSR.

This box sets out the empirical evidence available for 2023 thus far in relation to the reformed version of the 2012 CGP (ref. CGP 2012) and the temporary CGP (NCGP 2022). Admittedly, only a short period of time has elapsed and the analysis will become more complete with time. However, an understanding of the initial measurable effects is useful.[4]

CGP applications and transactions

Chart 1 shows developments in applications and the rate of successful applications[5] for the old CGP 2012 (OCGP 2012) up to 2022, and for ref. CGP 2012 and NCGP 2022 in the first seven months of 2023. In 2022, the cumulative volume of outstanding debt linked to forbearance applications under OCGP 2012 amounted to €589 million (corresponding to around 5,800 loans), while to July 2023 the aggregate for ref. CGP 2012 and NCGP 2022 was €5,367 million (close to 42,800 loans). Applications under ref. CGP 2012 accounted for 54% (€2,910 million, approximately 23,100 loans), with the rest (46%) made under NCGP 2022 (€2,458 million, around 19,700 loans). This reveals significant momentum in terms of mortgagors resorting to the CGPs (in the first seven months of 2023 ref. CGP 2012 recorded more applications than OCGP 2012 in all of 2022 and around the same number that the latter recorded annually in the post-global financial crisis years, when it was introduced), due to both the broader definition of vulnerable households and potentially vulnerable households also becoming eligible for the first time under NCGP 2022.

According to the empirical analyses conducted,[6] unemployment and disposable income are the main determinants of a mortgagor's probability of default and, therefore, of applying for measures under the CGPs. The positive labour market performance, with agents' income underpinned by a declining jobless rate and rising employment, presumably helped prevent a higher number of applications. In any event, financial pressure tends to act on ability to pay with some lag.

Turning to successful application rates, these were similar for ref. CGP 2012 (9%) and NCGP 2022 (8.9%) in the first seven months of 2023. Both are lower than recorded by the OCGP 2012 in its last few years in force. However, one conditioning factor is the brief time period elapsed. Indeed, the final acceptance of applications, once the eligibility criteria have been verified, can take several months since it typically entails a process of interaction

1 RDL 19/2022 also envisages additional support measures for mortgagors, such as a temporary waiver of fees for converting a mortgage loan from a variable interest rate to a fixed one, among others.

2 This code was approved in March 2012 to mitigate the effects of the global financial crisis on vulnerable mortgagor households. See Royal Decree-Law 6/2012 (in Spanish only).

3 Both the notion of "vulnerable household" and "potentially vulnerable household" are precisely defined for each CGP and are based on socio-economic indicators such as household income and loan-to-income ratio. See the special feature in the Spring 2023 FSR.

4 The analysis in this box is based on data for deposit-taking institutions, so it does not include specialised lending institutions. However, the number of loans linked to forbearance applications under the CGPs for this type of lending institution is very low (accounting for approximately 1% of all applications).

5 The ratio of the outstanding amount of loans for which measures in the CGPs have been implemented to the outstanding amount of loans for which an application has been made in the period. It is possible that some applications are made in one period and measures are implemented in a later period. In any case, the rate of successful applications when looking at the cumulative volume of accepted applications shows a similar trend.

6 For Spain, see José María Casado and Ernesto Villanueva. (2018). "Spanish household debt defaults: results of the Spanish Survey of Household Finances (2002-2014)". Financial Stability Review, Banco de España, 35 pp. 149-168; and Jorge E. Galán and Matías Lamas. (2023). "Beyond the LTV ratio: Lending Standards, Regulatory Arbitrage, and Mortgage Default". Journal of Money, Credit and Banking. https://doi.org/10.1111/jmcb.13041.

Box 1.2

USE IN 2023 OF THE CODES OF GOOD PRACTICE INTRODUCED BY ROYAL DECREE-LAWS 6/2012 AND 19/2022 (cont'd)

Chart 1
Applications under the CGPs and successful application rate (a)

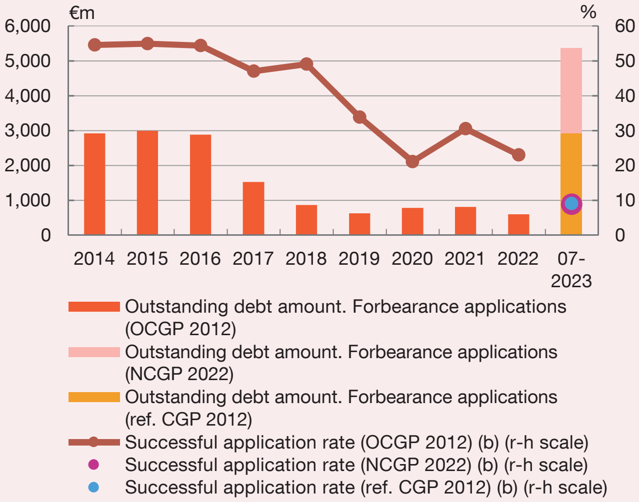


Chart 2
Potential scope of the new CGPs within the eligible population. 2023 H1. (a) (c) (d)

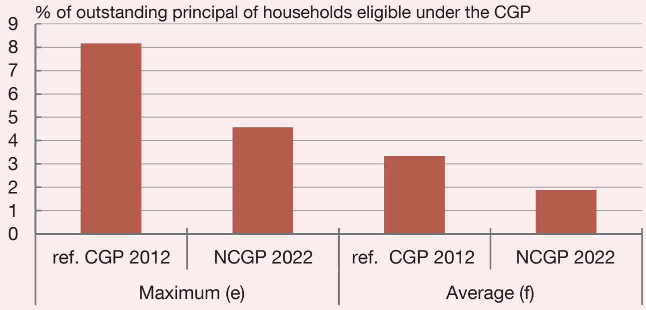


Chart 3
Mortgage loan credit status (a) (g)

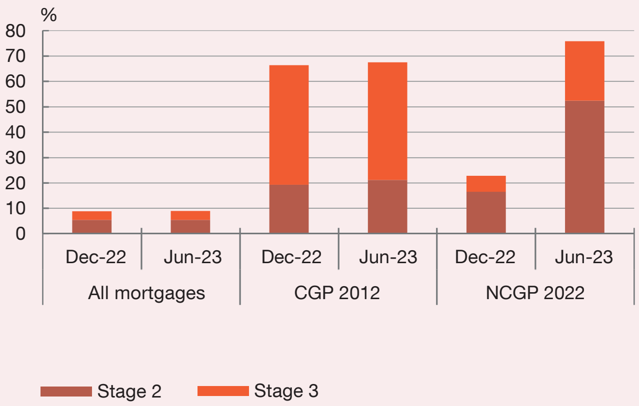
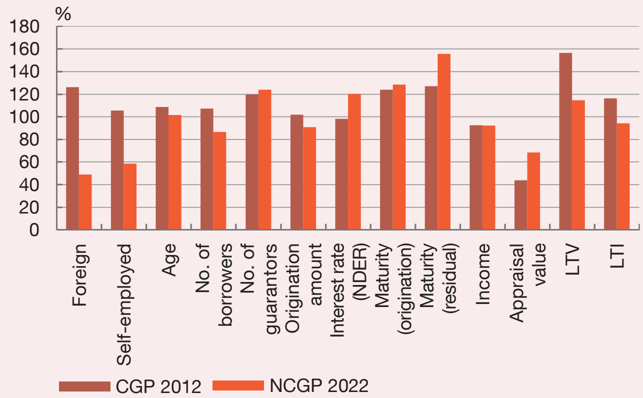


Chart 4
Characteristics of loans forborne under CGP 6 2012 and NCGP 19 2022. June 2023 (a) (h)



SOURCES: Banco de España, CCR and EFF (2020).

a This chart includes four variants of the CGP, as follows. OCGP 2012: the CGP approved under RDL 6/2012 until its reform by RDL 19/2022; Ref. CGP 2012: the CGP approved under RDL 6/2012 following its reform by RDL 19/2022; CGP 2012: the CGP approved under RDL 6/2012, ignoring the temporary differences before/after its reform; NCGP 2022: the CGP approved under RDL 19/2022.
b Ratio between the outstanding debt associated with forbearance implemented and that associated with forbearance applications in the period. Some forbearance may have been requested in one year and implemented the next. In any event, the rate of successful applications as a proportion of cumulative applications shows a similar pattern.
c Eligible households under ref. CGP 2012 will, generally speaking, also be eligible under NCGP 2022, having the option to choose between one or the other. Accordingly, to construct the denominator, it is assumed that households eligible for the more structural mechanism will have chosen this option. Households eligible under the temporary mechanism are all those that satisfy the eligibility conditions excluding those that are eligible for (and indeed are assumed to opt for) the structural mechanism.
d Assuming that the 500 bp increase in the mortgage reference rate is fully passed through to the cost of variable-rate debt.
e To construct the numerator, it is assumed that the maximum number of households whose applications under the CGPs are ultimately implemented is equal to the total number of applications received for each mechanism.
f To construct the numerator, it is assumed that the number of households that are eligible to benefit from either of the two CGPs is proportional to the average percentage of successful applications under the OCGP 2012 in the period 2014-2022.
g Percentages shown in terms of the outstanding amount drawn for all outstanding loans at each date. In the case of the CGP 2012, the credit status of loans subject to measures under the code at each date is reported. In the case of the NCGP 2022, the credit status at December 2022 of loans benefitting from the code in the 2023 reference period is reported, even if they were not yet subject to those measures at end-2022.
h For each loan, its average value weighted by the loan amount has been calculated and relativised using the average value of the stock of mortgage loans not benefiting from any CGP. Thus, a value above 100 would indicate that, in that particular category, the weighted average for mortgages under CGP 2012 or NCGP 2022 is higher than that for all other mortgage loans. The characteristics are measured at June 2023. The average reference values for mortgage loans as a whole (i.e. those taking base = 100) are as follows: foreign (%) 7.8; self-employed (%) 19.4; age (oldest borrower, years) 39.11; origination amount (€) 185,384.4; maturity at origination (years) 28.1; residual maturity (years) 17.0; LTV (%) 77.77; LTI (ratio of income) 3.97; income (in 2020, €); 43,253; interest rate (NDER, %) 3.25; appraisal value (€) 239,148.

between borrower and lender. In fact, the rejection rates[7] in this period for ref. CGP 2012 and NCGP 2022 (both around 40%) are lower than those recorded in recent years for OCGP 2012 (around 60%), with the vast majority (around 90%) owing to failure to meet the objective eligibility requirements. In any event, acceptance rates have been on a rising trend in recent months.[8]

To approximate the potential impact of these programmes, Chart 2 shows (as a percentage of the total principal of potentially eligible households) the outstanding principal of households that could have benefited from either of the two mechanisms in the first six months of 2023 assuming a 500 basis point (bp) increase in the mortgage reference rate (some 30 bp more than the increase since the start of 2022).[9] In the first two columns, it is assumed that all applications received are ultimately successful. Under this assumption, around 8.2% of the outstanding principal of households eligible for the structural mechanism would benefit from measures under ref. CGP 2012, while this figure would stand at 4.6% in the case of NCGP 2022.[10]

Not all households applying for forbearance measures under either of the mechanisms will ultimately benefit from them. In fact, a significant percentage of rejections has already been observed. Accordingly, an adjustment is made to the percentage of applications that will ultimately be accepted. To do this, aggregate annual information on the percentage of applications ultimately leading to measures under the OCGP 2012 has been used, given that the successful application rates under ref. CGP 2012 and NCGP 2022 remain low due to the short time they have been in force. Thus, in the last two columns of Chart 2 it is assumed that the number of households eligible to benefit from the CGPs is proportional to the average percentage of successful applications in the period 2014-2022. Under this assumption, and given a 500 bp increase in the reference interest rate, the percentage of outstanding principal of eligible households (see footnote 9) that would have benefited from the structural and temporary mechanisms amounts to 3.3% and 1.9%, respectively.

Credit quality of CGP loans

As regards the risk profile of such loans, the information available in the Central Credit Register (CCR) can be used to compare the credit quality of mortgage loans under the CGPs between December 2022 and June 2023, distinguishing in this case between vulnerable debtors (combining OCGP 2012 and ref. CGP 2012, shown here as CGP 2012, despite the eligibility criteria not being exactly the same) and potentially vulnerable households (NCGP 2022).

Chart 3 shows the credit risk classification of the total stock of mortgage loans and of loans under each programme. As can be seen, in December 2022 the mortgages benefiting from the NCGP 2022 and, above all, those benefiting from the CGP 2012 had higher percentages of Stage 2 and Stage 3 (non-performing loans (NPLs)) credit than the overall stock of mortgages. This is to be expected given that they are geared towards vulnerable and potentially vulnerable households. Furthermore, a significant portion of the loans benefiting from NCGP 2022 were reclassified to Stage 2 or to Stage 3 in the period from December 2022 to June 2023. However, much of the increase in the volume of Stage 3 credit under the CGPs is accounted for by loans classified as non-performing for subjective reasons (i.e. for reasons other than objective non-payment). Loans may be reclassified to a higher category if suitable progress is made in their repayments.

Specifically, for mortgage loans forborne[11] under the 2012 CGP (totalling €1,201 million at June 2023), the percentage

7 The ratio of the outstanding amount of loans for which an application under the CGPs has been rejected to the outstanding amount of loans for which an application has been made in the period. It is possible that some applications are made in one period and rejected in a later period.

8 For instance, the cumulative successful application rates to June stood at 7.7% for ref. CGP 2012 and 7% for NCGP 2022, compared with 9% and 8.9%, respectively, to July.

9 Eligible households under ref. CGP 2012 will, generally speaking, also be eligible under NCGP 2022, and can choose one or the other. Accordingly, to construct the denominator of this proportion, it is assumed that households eligible for the more structural mechanism will have chosen this option. Households eligible under the temporary mechanism are all those that satisfy the eligibility conditions excluding those that are eligible for (and indeed are assumed to opt for) the structural mechanism.

10 The outstanding principal of households eligible for the structural mechanism amounts to some €22 billion, while that figure for those eligible for the temporary mechanism is €30 billion. These estimates are based on information drawn from the Spanish Survey of Household Finances (EFF by its Spanish acronym) for 2022, since no granular information is available on households that have applied for measures under the CGP 2022.

11 This box uses the terms forbearance and forborne loans in line with the terminology in RDL 6/2012. The consideration of a loan as forborne for loan loss provision purposes depends on specific legislation which is separate from RDL 6/2012. See the Special Feature of the Spring 2023 FSR.

Box 1.2

USE IN 2023 OF THE CODES OF GOOD PRACTICE INTRODUCED BY ROYAL DECREE-LAWS 6/2012 AND 19/2022 (cont'd)

in Stage 2 increased slightly during 2023 H1 to 21.1% (from 19.2%). Conversely, the percentage of Stage 3 loans declined to 46.4% in June 2023 (vs 47.1% in December 2022). In any event, a significant share of these are NPLs for subjective reasons (63.7% of total Stage 3 loans in December 2022 and 57.1% in June 2023).

Meanwhile, most (77.2%) of the mortgage loans forborne under NCGP 2022 during 2023 H1 (amounting to just over €150 million in June 2023) were classified as performing in December 2022, while just 24.2% remained performing in June 2023. Conversely, the percentage of such loans in Stage 2 grew to 52.3% in June 2023 (from 16.5% in December 2022) and the percentage in Stage 3 rose to 23.5% (from 6.3% in December 2022). Again, much of this increase in NPLs was accounted for by those classified as non-performing for subjective reasons. Thus, in December 2022 subjective NPLs represented 84% of Stage 3 loans under NCGP 2022, compared with 98% in June 2023.

Other attributes available in the CCR have also been used to study the characteristics of loans forborne under CGP 2012 and NCGP 2022 as compared with the total stock of mortgages at June 2023 (see Chart 4).

The exercise shows similar levels of household income (proxied by average household income in the postcode of the property used as collateral, according to the INE's Atlas of household income distribution) for mortgages forborne under each of the two above-mentioned CGPs. These levels are somewhat lower than those for other mortgage loans, which is to be expected given that household income above a certain level would disqualify borrowers from the programmes.

Furthermore, the mortgages benefiting from one of the two CGPs are arranged on homes of lower value as compared with the overall stock of loans (this is particularly true of CGP 2012). The eligibility criteria also include an upper limit on the value of the property. Conversely, only in the case of the NCGP 2022 is the loan amount below the average for all mortgage loans. In addition, loans under the two CGPs have longer initial and residual maturities. Lastly, mortgages forborne under CGP 2012 have higher loan-to-income (LTI) and loan-to-value (LTV) ratios, but those under NCGP 2022 also have a somewhat higher LTV ratio than the total stock of mortgages.

Conclusion

The volume of forbearance applications under the CGPs was relatively high in the first half of 2023, based on past experience with the OCGP 2012. The percentage of measures implemented remains low, possibly due, at least in part, to the short period of time elapsed. Rejection rates are lower than recorded in recent years for OCGP 2012, and therefore the measures may prove more effective in the medium term. Further, as compared with the average for total mortgage loans, there have been some indications of higher credit risk among the loans ultimately benefiting from the codes, which is consistent with the borrowers' lower solvency profile.

In any event, the reformed CGP framework came into force just a short time ago, which limits the conclusions that can be drawn from the data. Further monitoring will be required over the coming quarters to determine more clearly the impact of the measures on the stock of mortgages.