CLIFFORD CHANCE

CORONAVIRUS: EBA ISSUES GUIDELINES ON PRUDENTIAL TREATMENT OF PAYMENT MORATORIA

On 2 April 2020 the European Banking Authority published formal guidelines (which are now final, but will not formally apply until they have been translated into all EU languages) on the regulatory treatment of the various coronavirus-related payment moratoria introduced across Europe. These Guidelines aim to formalise and set out in more detail existing statements to the effect that COVID-19 "payment moratoria do not trigger forbearance classification and the assessment of distressed restructuring if they are based on the applicable national law or on an industry- or sector-wide private initiative agreed and applied broadly by relevant credit institutions". In this briefing, we highlight the main features of the Guidelines and their impact on European banks.

Key issues

- Mainly a consolidation and formalisation of measures previously announced.
- Guidelines are now final but will not formally apply until translated into all EU languages.
- Most or all publicly-announced, coronavirus-related moratoria across Europe should qualify.
- Guidelines aim to minimise negative regulatory consequences on banks (including bank investors in securitised exposures) of granting payment moratoria.
- New record-keeping and reporting requirements introduced to benefit from the regime described in the Guidelines.

BACKGROUND

Over the last few weeks, European jurisdictions have put in place a wide-range of measures designed to support their economies through the crisis caused by the COVID-19 pandemic. These have included debt guarantees, central bank liquidity measures and payment moratoria. The payment moratoria relate to a wide-range of types of debt and obligor and may be either legislative (as in Italy, for example) or non-legislative but widely agreed by industry (as with the residential mortgage payment moratorium initially in the UK – albeit encouraged by the authorities).

Following the announcement of these payment moratoria, a number of authorities – including the EBA[1], ESMA[2], the ECB[3] and the Prudential Regulation Authority in the UK[4] – made announcements aiming to address industry concerns that large portions of their books would suddenly be classified as defaulted for the purposes of various accounting and regulatory tests. The general thrust of these announcements was to say that payment moratoria shouldn't broadly be considered forbearance and they should not –

[1] Statement on the application of the prudential framework regarding Default, Forbearance and IFRS9 in light of COVID19 measures

[2] Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9

[3] FAQs on ECB supervisory measures in reaction to the coronavirus

[4] BOE: Dear CEO Letter on Covid-19 IFRS 9 Capital Requirements and Loan Covenants

in and of themselves – cause the affected exposures to become defaulted. It is, however, a slightly delicate line for prudential authorities to tread because there continues to be a need for banks to accurately assess, record and report the credit risk to which they are exposed.

The Guidelines just issued aim to strike a balance between these competing priorities by defining the type of payment moratorium to which the special COVID-19 considerations apply, by setting out in more detail the effects of the qualifying moratoria on regulatory classifications of "default" and "forbearance", and by putting in place documentary and reporting requirements relating to the special treatment in order to allow effective ongoing supervision and transparent application of the COVID-19 regime. They will not formally apply until they can be translated into all EU languages, but national competent authorities are likely to implement them starting before that given that they are already final. Competent authorities formally have until 3 June 2020 to report what measures are in place in their jurisdictions and how they are complying with the Guidelines.

These Guidelines are likely to provide significant additional reassurance to banks in the EU and the UK that they will be able to apply their various national moratoria without the serious impacts on capital resources and requirements and liquidity coverage that might otherwise be expected due to a large and sudden increase in forbearance and defaulted exposures. These impacts would be the result of loss of STS status (where the affected exposures are being securitised now) and of recently introduced deductions from capital for non-performing loans, as well as the high risk-weightings that generally apply when assessing capital requirements for defaulted loans. The Guidelines are likely to assist bank investors investing in securitised debt backed by exposures subject to payment moratoria in a similar way.

At an international level, the Basel Committee on Banking Supervision published technical clarifications to the Basel framework on 3 April, which seek to ensure that banks reflect the risk-reducing effect of COVID-19 related government support measures in their regulatory capital calculations. These include clarifications that that that payment moratorium periods relating to the COVID-19 outbreak can be excluded by banks from number of days past due calculations and that the assessment of unlikeliness to pay should be based on rescheduled payments. We therefore expect to see further actions from supervisors and policy makers around the world to reflect these Basel Committee clarifications.

QUALIFYING MORATORIA

The list of conditions a moratorium has to fulfil to come within the scope of these Guidelines is non-exhaustive, but includes the following:

- **The moratorium was launched in response to the COVID-19 pandemic:** including a requirement that the moratorium is announced and applied before 30 June 2020
- **The moratorium has to be broadly applied:** but is explicitly permitted to be legislative or non-legislative, provided that it is applied sufficiently broadly
- **The moratorium has to apply to a broad range of obligors:** specifically, it has to be available to a large, predefined group of obligors, regardless of the assessment of their creditworthiness –

although moratoria may benefit from the Guidelines even where they are limited to obligors who apply for a payment holiday and/or obligors who were performing prior to the application of the moratorium in question

- **The same moratorium offers the same conditions:** But multiple different moratoria may be applied by the same institution and all of them may benefit, e.g. a different moratorium may apply depending on the customer classification (such as individual vs. SME) or product type (such as residential mortgage loan vs. credit card)
- **The moratorium changes only the schedule of payments:** the moratorium should not affect other conditions of the loan, in particular the interest rate, unless such change only serves for compensation to avoid losses which an institution otherwise would have due to the delayed payment schedule under the moratorium, which would allow the impact on the net present value to be neutralised
- **The moratorium does not apply to new loans granted after the launch of the moratorium:** the use of existing credit lines or renewal of revolving loans is not considered a new loan

While Clifford Chance has not undertaken an exhaustive assessment of all of the COVID-19 moratoria against these criteria, practically speaking they appear very broad and we would not expect any of the publicly-announced schemes related to COVID-19 to have trouble meeting them.

EFFECT OF THE GUIDELINES FOR QUALIFYING MORATORIA

Where payments related to a bank's exposure are reduced or delayed because of a qualifying moratorium, the Guidelines make clear that:

- Regardless of whether the exposure was performing or not prior to the application of the payment moratorium, the application of the moratorium should not, in and of itself, lead to the reclassification of the exposure as forborne (with the consequence that the payment holiday is not a "distressed restructuring" for the purposes of the regulatory definition of "default").
- For purposes of the regulatory definitions of "default" and "non-performing exposure", payments should be considered "due" on the date determined under the revised payment schedule resulting from the application of the qualifying moratorium, with days past due counted from that revised date.
- Institutions are not relieved of their ongoing obligations to make assessments of whether their obligors are likely to pay, however. Where an exposure is unlikely to be paid, that exposure should still be reclassified as defaulted, even if it has benefitted from a qualifying moratorium.
- During the application of the qualifying moratorium to the exposure, institutions are instructed to prioritise the assessment of likelihood of payment for obligors for whom the effects of the COVID-19 pandemic

are most likely to develop into long-term financial difficulties or insolvency.

- Following the end of the application of the qualifying moratorium, institutions should prioritise assessment of likelihood of payment where obligors have payment delays or where any forbearance measures are applied, in each case shortly after the end of the moratorium.
- All assessments of likelihood of payment should be based on the applicable revised payment schedule, but should not take account of additional COVID-19 public support measures such as government guarantees (though these may affect capital calculations if they meet the requirements for credit risk mitigation) if such measures don't have a direct effect on the likelihood the specific obligor will pay.

RECORD-KEEPING AND REPORTING REQUIREMENTS

In order to help the EBA keep track of all of these measures as well as to promote transparent application of the COVID-19 measures and the new EBA Guidelines, there are a number of reporting and record-keeping requirements in the Guidelines. Broadly:

- institutions should report to their national competent authority any non-legislative moratorium they are applying with certain specified details;
- national competent authorities should report to the EBA any legislative and non-legislative moratoria in their jurisdictions along with certain specified details; and
- institutions should collect certain details and have them readily available to report upon request, including: the obligors to whom the moratorium was offered, the obligors to whom the moratorium was applied, the amount of the exposures affected by the application of the moratorium, and any economic loss resulting from the application of the moratorium and associated impairment charges.

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