

# Borrower Relief Measures in ECA region

POLICY NOTE - APRIL 2020



This note is a joint production of the Financial Sector Advisory Center (FinSAC) and the Financial Stability and Integrity (FSI) Unit, which are both part of the Finance, Competitiveness and Innovation (FCI) Global Practice. It has been prepared by Miquel Dijkman (Lead Financial Sector Specialist) and Valeria Salomão Garcia (Senior Financial Sector Specialist).



**WORLD BANK GROUP**  
Finance, Competitiveness & Innovation

Financial Sector Advisory Center (FinSAC)

## Executive Summary

In a bid to preserve viable economic activity, jobs, and livelihoods from the impact of the Coronavirus disease 2019 (COVID-19), policymakers worldwide have been quick to roll out borrower relief programs, most often by temporarily suspending or reducing debt service obligations of borrowers that have experienced a significant drop in income. Policymakers in Europe and Central Asia have so far primarily introduced temporary moratoria, where decisions on which borrowers qualify are usually left to banks.

Under the current extraordinary circumstances, temporary borrower relief measures might be needed to preserve economic activity, but it is critical that their design is carefully thought through to protect the public interest in safe and sound banking systems, and financial stability at large, especially given the inherent uncertainty of this crisis. This message has a special resonance for countries in Europe and Central Asia, many having been hit hard by the 2008 global financial crisis. The global financial crisis left an enduring legacy of high non-performing loans that resulted in many countries becoming stuck in a persistent negative feedback loop between weak financial sector performance and lackluster economic growth that has only in recent years begun to improve. These experiences underscore the importance of circumspect design to safeguard the hard-won gains of the past decade.

As a starting point, it is important that policymakers have a thorough understanding of the financial impact on banks' liquidity and capital of any borrower relief measures. The financial impact on banks needs to be factored into the design of measures, to protect the public interest in banking stability. Policymakers also need to beware of moral hazard associated with willful defaulters (who are financially capable but unwilling to pay), and zombie borrowers (whose difficulties predated COVID-19).

There is no blueprint for the design of borrower relief measures. On the contrary, measures need to be tailored to the specificities of the local economic, financial

sector, institutional, and legal context to be effective. Nonetheless, it is possible to distinguish a set of basic principles that should be factored into the design. It is important that the *exceptional and temporary nature* of borrower relief measures is broadly understood, and that policymakers promptly define exit strategies. It is also critical that measures are undertaken in a *transparent* manner. Banks should be expected to provide banking supervisors with reliable, frequent, up-to-date, and comparable information regarding loans that have benefitted from borrower relief measures, while banks' financial statements need to provide investors and shareholders with sufficient information to understand the quality of the loan portfolio and credit risk control practices.

In this context, it is also important to *preserve Europe and Central Asia countries' hard-won gains of the past decade in aligning loan loss classification frameworks, provisioning requirements, and accounting standards* with international best practices. The easing of regulatory definitions and classification and provisioning requirements should be avoided, as such measures obfuscate banks' true asset quality challenges, undermine comparability within and across countries, distort the veracity of financial information, and blur the distinction between COVID-19-affected borrowers and zombie borrowers. It is also important that banks continue to rigorously apply the unlikelihood to pay criterion, promptly identifying borrowers impacted by COVID-19 whose short-term payment challenges are likely to transpose into long-term financial difficulties. Lastly, the potential benefits of *targeting* need to be balanced with the need for speed in delivery of relief to distressed borrowers. Targeting can help to mitigate problems related to zombie borrowers, moral hazard associated with willful defaulters, and to keep the financial impact of borrower relief measures within manageable proportions, but it can inadvertently cause significant delays in the speed of delivery. A highly practical approach is thus called for. The identification of COVID-19-affected borrowers could for instance be delegated to banks, while regulators may require that banks offer relief measures only to borrowers with a sufficiently strong payment track record.

# FinSAC Policy Brief

## Preliminary lessons from ECA region's experience with borrower relief measures<sup>1</sup>

### Introduction

The outbreak of the COVID-19 pandemic in the first quarter of 2020 has prompted a series of unprecedented emergency measures – including travel bans, mandatory closure of non-essential business, limitations on gatherings, and mandatory home-based work. In a bid to mitigate the economic fallout of an escalating public health crisis, policymakers around the globe have spurred into action with fiscal support measures made available to affected sectors and by rolling out a series of monetary and liquidity measures aimed at stabilizing stressed global funding markets, as well as other financial and economic measures. Within a very short space of time, many borrowers have seen their income flow drastically reduced or dried up altogether due to COVID-19. Borrowers ranging from large corporates to households are already experiencing serious difficulties in staying current on their debt obligations, or may soon do so, as cash buffers dwindle, restrictions on gatherings and mandatory business closures are extended, and prospects for a quick and vigorous economic recovery become uncertain.

The unprecedented economic shock has triggered a spate of exceptional measures. In order to preserve economic activity, livelihoods, and jobs, many countries have quickly introduced measures designed to provide relief to distressed borrowers. There are important differences in the scope and general design of these measures but an overall common denominator is that they introduce temporary concessions to the contractual terms of borrowers' repayment obligations on loans owed to banks. In this way, and in marked contrast to the global financial crisis (GFC) which originated from within the financial system, banks are expected to be able to provide a positive contribution to the mitigation of the economic fallout from COVID-19. At the same time, if taken too far, these measures could lead to stability challenges further down the road, with a weakening banking sector exacerbating the adverse economic impact of COVID-19.<sup>2</sup>

This policy note discusses the broad design features of borrower relief schemes in several countries in the Europe and Central Asia (ECA) region, highlighting some of the basic choices that policymakers face in designing borrower relief measures, and identifying a preliminary and concise set of high-level principles that could be helpful to policymakers in designing such measures. While many countries have reacted quickly and implemented short-term borrower support measures, decisions were often taken in very short order, and possibly without fully considering all the ramifications. This document seeks to support policy makers in identifying the best way to approach these going forward.

The point of departure for this policy note is that, under the current extraordinary circumstances, temporary borrower relief measures might be needed to preserve economic activity, but that their design needs to be carefully thought through to protect the longstanding public interest in safe and sound banking systems, and financial stability at large. This message has a special resonance for World Bank Group (WBG) client countries in the ECA region, which includes many that were hit hard by the GFC.

The GFC left an enduring legacy of high non-performing loans (NPLs) in local bank-dominated financial sectors, which resulted in many countries becoming stuck in a persistent negative feedback loop between weak financial sector performance and lackluster economic growth. It was only comparatively recently that countries began to stage a convincing recovery, as the European economy strengthened and nearly a decade of regulatory, supervisory, and legal reform started to yield growth dividends. These experiences underscore the importance of careful design and a credible exit strategy to safeguard the hard-won gains of recent years.

<sup>1</sup> The authors wish to thank Ismael Ahmad Fontán, Karlis Bauze, Ezio Caruso, Pierre-Laurent Chatain, Krishnamurti Damodaran, Matei Dohotaru, Alfonso García Mora, Tatiana Gispert, Mario Guadamillas, Yira Mascaró, Cédric Mousset and Juan Ortiz (all FCI) for their useful comments and suggestions. The views, thoughts, and opinions expressed in the text belong solely to the authors, and not necessarily to the authors' employer, organization, committee, or other group or individual.

<sup>2</sup> See also Borio and Restoy (2020), who state .... "if taken too far, the adjustments could backfire: a weaker banking sector would weaken the economy. A solid and sound financial system is a prerequisite for sustainable growth." <https://www.bis.org/fsi/fsibriefs1.pdf>

## The starting point: post-global financial crisis banking in Europe and Central Asia region

ECA stands out as the WBG region worst affected by the GFC, albeit with considerable cross-country variations. Many ECA countries experienced credit booms in the years in the run-up to the crisis, when financing from eurozone-based parent banks was plentiful and cheap. Rapid credit growth was accompanied by booming asset and real estate prices and steep increases in household and corporate debt, with aspirations of reaching European Union (EU) living standards running ahead of borrowers' debt-shouldering capacity. When the inflows of financing dried up in 2008, local subsidiaries experienced a funding shock. Credit growth went into a steep decline, asset and real estate booms went bust, and economic growth slowed down sharply, setting the stage for steady increases in NPL ratios across the region (see graph 1). A large stock of unresolved NPLs made it difficult for banks to effectively fulfill their intermediation function in the bank-dominated financial sectors in the region, compromising their capacity to finance new and dynamic sectors, reducing the availability of fresh credit (as illustrated by limited credit growth in most countries in the region), driving up the cost of finance, and weakening economic growth.

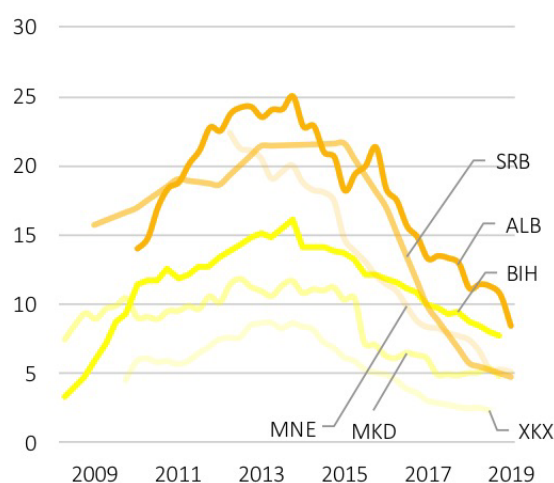
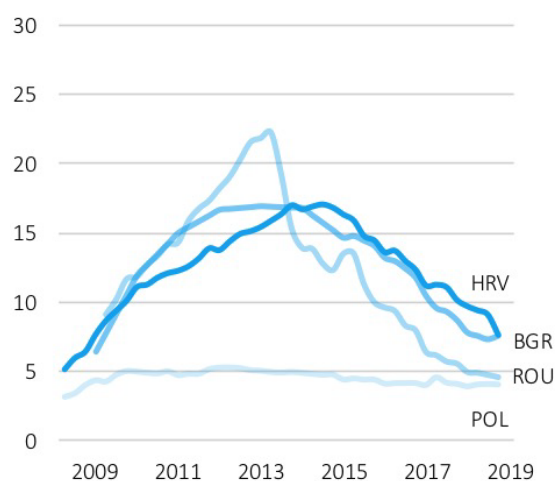
As was the case in the EU, it took policymakers and banks in the ECA region several years to realize that the mere passage of time would not improve outcomes, and that a higher level of ambition was urgently called for. Many ECA countries embarked on EU-inspired reforms, including aligning regulatory definitions of NPLs and forbore exposures with applicable EU standards, and clearer

supervisory expectations regarding the identification, management, measurement, and write-off of NPLs, inspired by European Central Bank (ECB) guidance to banks on NPL resolution. With various degrees of success, ECA countries also embarked on much-needed legal, institutional, and taxation reforms to strengthen insolvency frameworks, establish out-of-court mechanisms, and promote the write-off of fully provisioned NPLs.

Eventually, these measures, together with an improving economic outlook in the EU and an acceleration in credit growth, helped to set the stage for a gradual improvement, with NPL ratios receding from their post-GFC peaks. With the notable exception of Ukraine<sup>3</sup>, reported NPL ratios in most ECA countries were at single digit levels at the end of 2019. Despite the encouraging trends of the past years, there are, however, lingering questions about the sustainability of the improvement in banks' reported asset quality indicators, as the decrease in NPLs has not been matched by a similar strengthening of the financial position of banks' borrowers. The WBG commissioned several corporate health studies in the region in 2018 and 2019, which highlighted that large corporates (which typically account for the bulk of the outstanding credit stock in the economy) continued to suffer from high levels of indebtedness, and a generally weak financial condition. This outcome needs to be seen against a backdrop of relatively few liquidations of distressed corporates, with financially weak companies often kept afloat thanks to a combination of low interest rates and generous and frequent financial restructuring.

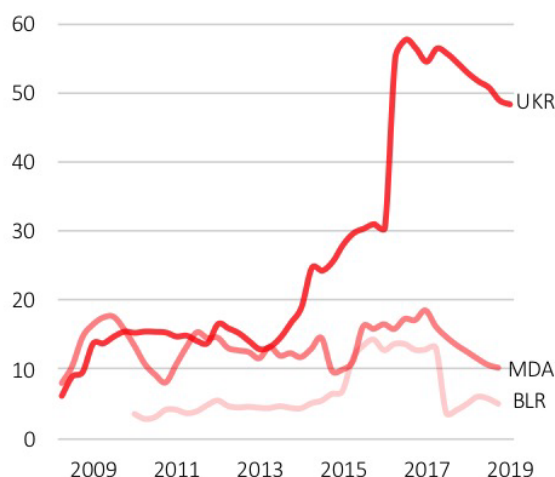
**Graph 1: NPLs in selected ECA countries**

NPLs as a share of total bank loans (%)



<sup>3</sup> Ukraine experienced a severe banking crisis in 2014–2016 when more than half of the country's 180 banks had their license revoked. The aftermath of a cumulative 16 percent real GDP decline in 2014–2015, lingering security tensions, and downward pressure on the national currency continued to drive up the NPL ratio, which reached 55 percent of gross loans at the end of 2017. Thanks to concerted government action and support from international financial institutions, there have since been moderate improvements.





## COVID-19-related borrower relief measures

In recent weeks, authorities around the world have taken a flurry of emergency measures to mitigate and slow down economic disruptions, facilitate future recovery, avert a dislocation in financial markets, and preserve financial stability.<sup>4</sup> Governments that have fiscal space are approving large relief packages, including cash hand-outs, tax holidays, and deploying guarantees and funding resources to be intermediated by banks, while central banks are lowering policy rates, providing massive liquidity support, and even offering direct support to affected sectors through credit facilities and asset purchase programs.

Countries have also undertaken a series of regulatory and supervisory measures. These measures can be grouped in three buckets: (i) measures that are ready to be used under existing regulatory frameworks and that do not entail a material increase in financial stability risks, including by releasing available capital buffers (conservation and countercyclical) and other macroprudential measures, e.g. debt-to-income, and loan-to-value ratios); (ii) measures that can be applied at the discretion of the supervisor, including revised enforcement approaches, recognition of public credit guarantees to reduce bank risk weighted assets and capital needs, and bans on dividends, share buy-backs, and bonuses ahead of any regulatory breaches; and (iii) unprecedented borrower relief measures, allowing the real sector to preserve cash flows to sustain the continuity of economic activities.

Policymakers in the EU and in ECA countries have in recent weeks introduced various types of borrower relief measures. These measures need to be seen against a backdrop of often limited fiscal and monetary policy space, restricting the capacity of countries to use traditional macroeconomic policy tools in easing the burden on distressed debtors. As of early-April, the situation is still evolving rapidly, as many countries are deliberating new borrower relief measures or are in the process of implementing them. Rather than documenting in detail the measures undertaken by individual countries, the section below highlights several basic choices that policymakers face in designing borrower relief measures, based on examples from across ECA and the EU.

### 1. WHAT KIND OF MEASURES ARE BEING USED?

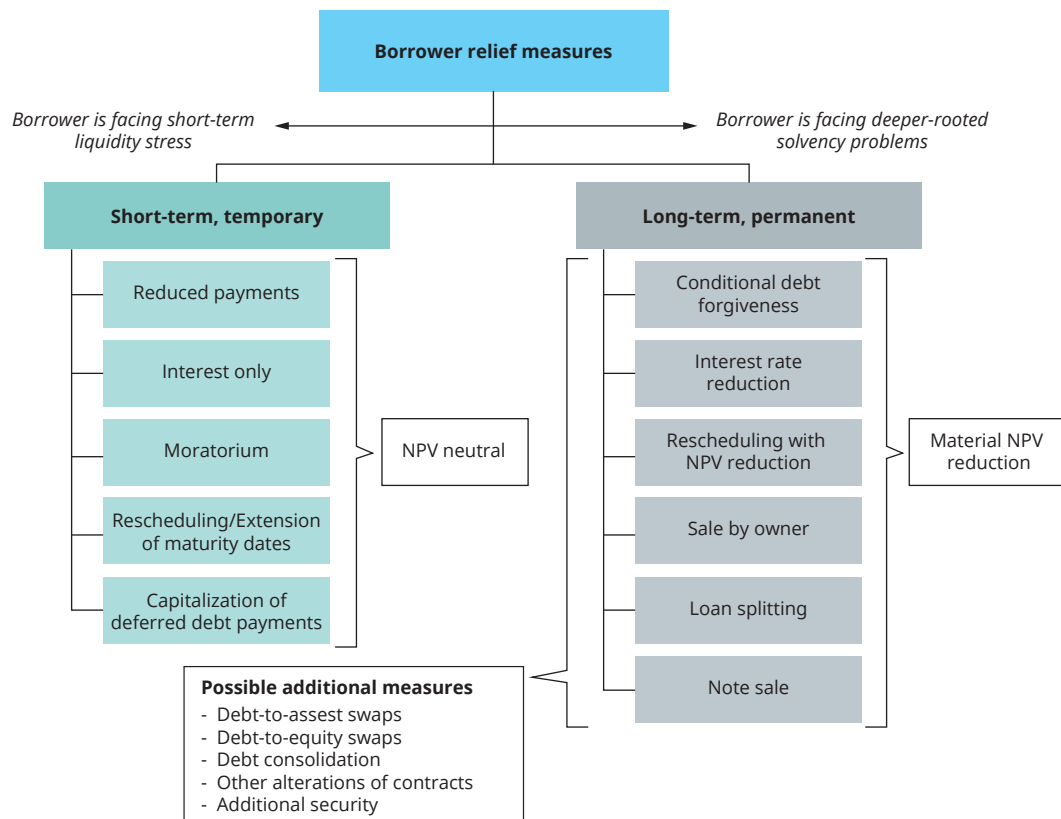
The common element of the borrower relief measures introduced in the EU and in ECA countries is that they provide temporary debt service relief for borrowers affected by the COVID-19 pandemic by allowing suspension or postponement of payments for a specified period of time, after which borrowers revert to their previous payment schedule. Borrower relief has been provided through short-term, temporary measures highlighted in figure 1, typically addressing the existing stock of loans only. The figure schematically summarizes the most common types of borrower relief (with a more detailed explanation of each of the measures in the figure included in annex 1).

<sup>4</sup> There are several publicly accessible databases that track policy measures at the country level. The IMF's policy tracker is available at <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>. In addition, the Yale Program on Financial Stability's database can be found at <https://som.yale.edu/faculty-research-centers/centers-initiatives/program-on-financial-stability/covid-19-crisis>

**Moratoria** are the most commonly used instrument. Moratoria suspend all principal and interest payments for a predetermined period. While the moratorium is in force, banks are prohibited from charging penalties and fees on loans to which the moratorium applies.<sup>5</sup> Temporary moratoria were introduced across the EU and ECA region in countries including Albania, Hungary, Italy, Montenegro, Serbia, Slovenia, and Spain, but with important differences in overall design, scope, and duration (see point 2). Banks have also been providing milder forms of relief to borrowers with difficulties through rescheduling and restructuring, including through temporarily **reduced payments** (i.e. the borrower continues to pay interest on loans but temporarily makes partial principal repayments), or a temporary switch to **interest-only payments** (i.e. the borrower is temporarily relieved from making principal repayments). To limit the effect on borrowers' debts in Net Present Value (NPV) terms, countries have been using these measures in combination with **extended maturities** and **capitalization of deferred payments**. Note that in order to fully neutralize the effect of the deferment of debt service obligations, the total sum of future additional future payments would need to exceed the total sum of deferred debt service obligations, to account for the time value of money.

As illustrated in figure 1, a conceptual distinction can be made between short-term measures, designed to help borrowers weather temporary liquidity difficulties, and long-term measures, where the borrowers' debt-shouldering capacity is permanently affected, and in most cases results in a material reduction of NPVs. While this dichotomy provides a useful conceptual framework for considering which forms of borrower relief are suitable given the circumstances, in practice, the difference is often not clear-cut. As a consequence, the distinction between temporarily liquidity-distressed borrowers and debtors that are facing deeper-rooted solvency problems can be very difficult to make. In the current situation, this difficulty is amplified by a fundamental uncertainty regarding when and how emergency measures (such as mandatory business closures, social distancing, and travel restrictions) will be lifted, and regarding the timing and vigor of the economic recovery. Similarly, some measures, such as loan restructurings, can be considered short-term or long-term depending on whether they lead to a material reduction in a borrower's debt in NPV terms.

**Figure 1: A schematic overview of borrower relief measures**



Source: Adaptation from Handbook for MSME NPL Management and Workout.  
<https://www.bsi.si/en/publications/other-publications/handbook-for-msme-npl-management-and-workout>

5 In terms of credit reporting, two opposing approaches have emerged. One approach ("suppression") is not to reflect participation in a moratorium as negative information. The alternative approach, recommended by the International Committee on Credit Reporting (ICCR) is that data on payment delays, created under forbearance or deferred payment arrangements due to a crisis, should be submitted with the necessary safeguards to ensure minimal or no effect on a good borrower's credit report and score. <http://pubdocs.worldbank.org/en/972911586271609158/COVID-19-ICCR-Credit-Reporting-Policy-Recommendations-for-distribution-6346.pdf>

## 2. HOW ARE BORROWER RELIEF MEASURES BEING TARGETED?

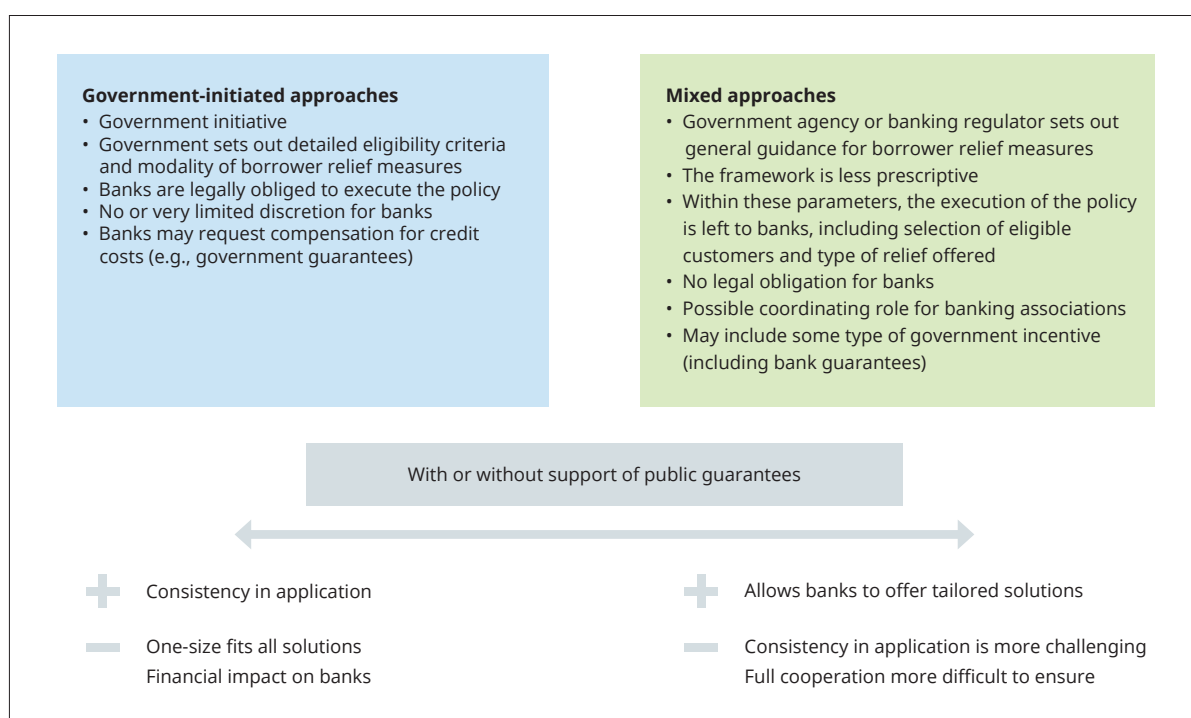
With a few notable exceptions, most countries have tried to target measures at borrowers whose debt-shouldering capacity has been severely affected by COVID-19. The two exceptions are Montenegro<sup>6</sup> and Serbia<sup>7</sup>, which introduced a general moratorium that applies to all debtors – individuals, farmers, entrepreneurs, and companies – and imposes a standstill period in repayment for at least 90 days. This means that debtors can defer repayments under bank loans and leases during this period. In Serbia, the opt-in was automatic. All borrowers were offered the moratorium and, unless they declined to accept it within 10 days, it was considered accepted.

Within the larger group of countries that have sought to target borrower relief measures, there are important differences in the adopted approach. A conceptual distinction can be made between government-initiated and mixed approaches. Under government-initiated approaches, banks have a legal obligation to execute government orders, with detailed instructions as to who qualifies and what type of relief is to be offered. By contrast, under mixed approaches banks are encouraged to provide borrower relief but within a less prescriptive

framework that leaves banks considerable discretion with respect to borrower selection and relief measures offered, often with a coordinating role for banking associations.<sup>8</sup> In practice, countries in the EU and in ECA have used both approaches.

Either approach can be combined with a full or partial public guarantee. The availability of public guarantees is a risk mitigant for possible credit losses that occur when borrowers that have benefitted from borrower relief measures fail to revert to their original payment schedule once the measures expire. Public guarantees also help to free up capital space for new lending through a reduction in risk weights, as banks can take into account sovereign risk weights for loans with a public guarantee. In the case of government-initiated approaches, public guarantees may be provided to compensate the banking sector for the risk associated with executing government policy – e.g. the risk that borrowers who have benefitted from temporary relief measures fail to revert to their original payment schedule once the measures have expired. Under mixed approaches that lack formal coercion mechanisms, public guarantees can be used as a tool to incentivize risk-averse banks to provide relief to distressed borrowers.

**Figure 2: Different approaches to borrower relief measures**



<sup>6</sup> <https://www.karanovicpartners.com/news/covid-19-central-bank-montenegro-moratorium/>

<sup>7</sup> <https://www.karanovicpartners.com/news/national-bank-of-serbia-introduces-moratorium-on-loans-and-leasing-due-to-covid-19-outbreak/>

<sup>8</sup> Note that even with official borrower relief measures in place, banks are contractually free to bilaterally renegotiate loan conditions with their borrowers, subject to applicable prudential requirements.

Italy is an example of a government-initiated approach. It launched borrower relief programs for households' mortgage payments and for micro, small, and medium-sized enterprises (MSMEs). Both were wrapped in a special COVID-19 decree ("Decreto Cura"), specifying which type of loans qualify, and setting out detailed eligibility criteria that borrowers seeking relief need to meet. Under this approach, banks have a legal responsibility to offer relief to any borrower that meets the eligibility requirements. Their role is thus to execute the law, rather than selecting eligible borrowers and tailoring solutions to the particular situation of debtors. The moratorium on mortgages allows for a deferment of debt payments of up to 18 months. It applies only to retail mortgage loans with an outstanding amount below € 250,000. Borrowers seeking a temporary moratorium on their mortgage loans need to meet pre-established requirements, such as loss of employment, a reduction in working hours for salaried workers, or a significant reduction in invoicing for the self-employed. Banks can reclaim a part of the interest forgone through a solidarity fund, that pays up to 50 percent of the interest payments due (excluding any borrower-specific risk premia). The moratorium for MSMEs allows such companies to defer any debt payments, including bullet payments, to end-September. Banks are also prohibited from revoking previously committed open-ended credit facilities. In order to be eligible, companies must be formally considered an MSME<sup>9</sup>, while companies with loans and leasing obligations that are more than 90 days-past-due (DPD) are excluded. Italy has also introduced a 33 percent public guarantee covering the payment obligations falling under the MSME moratorium. The public guarantee extends for 18 months after the expiration of the moratorium. Before calling on the state guarantee, financial intermediaries must make recovery efforts themselves.

Examples of mixed approaches include Bosnia and Herzegovina, Moldova, and Ukraine. In these countries, banking regulators have issued general guidance (in the form of a regulation in Bosnia and Herzegovina and Moldova, and a letter to banks in Ukraine) to reconsider the contractual terms of borrowers that have been affected by COVID-19, while leaving the execution of the poli-

cies to banks. Within the framework set out in the general guidance, banks are free to decide which borrowers are to benefit, and what kind of borrower relief measures are offered, provided that the measures fit within the general framework set out by the regulator. Among the preconditions set out in the general framework are requirements that relief measures be offered to borrowers whose difficulties are related to COVID-19 and that have a sufficiently strong repayment track record prior to the COVID-19 outbreak, and that banks report to the regulator on the measures that they have agreed.

While countries in ECA have rolled out various kinds of public guarantees, these are generally small in scale (reflecting fiscal space limitations) and mostly designed to support new lending, rather than supporting borrower relief measures. The Czech Republic for instance allocated CZK 5 billion (€ 180 million) to a guarantee program which anticipates CZK 30 – 35 billion (€ 1,08- 1,26 billion) of loans to MSMEs for the payment of operating expenses, valid for three years, and guaranteeing up to 80 percent of the loan. Other countries, including Poland and Slovenia, have also expanded guarantees for MSMEs through domestic development banks.

### 3. HOW LONG WILL MEASURES BE IN PLACE?

Most measures were introduced in the second half of March. Countries have generally explicitly stated that the borrower relief measures are designed to be temporary, but – reflecting the unusually uncertain outlook – there are considerable differences as to how long the measures are expected to be in place. Most countries have established explicit sunset clauses. On the short end of the spectrum is Kosovo, where banks can defer debt obligations until the end of April, while the moratorium on Italian mortgages is in force for up to 18 months. Other countries have stressed the temporary nature of the borrower relief measures but avoided committing to an exact date. The borrower relief measures in Bosnia and Herzegovina, for instance, are covered in a temporary regulation that will be revoked as soon as economic and financial circumstances permit.

<sup>9</sup> MSMEs are companies with fewer than 250 employees and with a turnover of less than € 50 million, and a balance sheet total of less than € 43 million.



#### 4. WHAT, IF ANY, ARE THE IMPLICATIONS FOR LOAN LOSS CLASSIFICATION, PROVISIONING, AND ACCOUNTING?

Over recent years, many banking supervisory agencies in the ECA region have made a concerted effort to align definitions with the European Banking Authority's (EBA) implementing technical standards, and the Basel Committee on Banking Supervision's (BCBS) guidance on the prudential treatment of problem assets. The regulatory definition as to what constitutes an NPL<sup>10</sup> includes a hard 90 days past due (DPD) backstop, as well as a qualitative unlikelihood to pay (UTP) criterion, where full repayment of principal and interest is unlikely without realization of collateral, irrespective of the number of DPD. The EBA and BCBS also introduced harmonized definitions of forbearance, which takes place when the financial difficulties of the borrower prompt the lender to make concessions (irrespective of whether the borrower has incurred arrears). A more detailed description of international standards is included in annex 2.

##### **Loan loss classification and provisioning**

While most countries have left their regulatory definitions of NPLs and forbore exposures unchanged, Turkey and North Macedonia have temporarily eased regulatory definitions. North Macedonia issued an amendment to the regulation on credit risk management wherein the 90 DPD criterion was relaxed to 150 DPD, while Turkey introduced a temporary 180 DPD criterion. Both countries also temporarily relaxed definitions of restructured loans. Turkey lifted a previous requirement that restructured loans on which new arrears occur are automatically considered an NPL.

Most countries have followed recent BCBS<sup>11</sup> and EBA<sup>12</sup> guidance with respect to the prudential treatment of moratoria and other temporary borrower relief measures. The guidance states that payment delays are based on a modified schedule of payments, i.e. taking into consideration the rearranged debt obligations after factoring in the specific borrower relief measures. Consequently, while a moratorium is in place (and debt obligations are temporarily suspended), the number of DPD on a loan effectively freezes. Similarly, banks' assessment of the UTP criterion should be based on their assessment of whether the borrower is unlikely to repay

the *rescheduled* payments. There is thus no requirement that loans that are subject to a moratorium be *necessarily* classified on account of the UTP criterion. What is important, however, is that banks are still required to apply the UTP criterion to borrowers whose short-term payment challenges are likely to transpose into long-term financial difficulties. As long as banks are satisfied that borrowers' payment difficulties are temporary and can be addressed through a rescheduling of payments, loans can remain in the same classification category.

The BCBS and EBA have also stated that there is no requirement that loans subject to a moratorium be considered as forbore, although the EBA requires that moratoria meet a series of requirements:

- *The moratorium was launched in response to the COVID-19 pandemic*, i.e. the scope and time of application are limited and apply only to specific measures taken in response to the COVID-19 pandemic. It also requires that the moratorium is announced and in force by 30 June 2020.
- *The moratorium must be broadly applied*. The EBA requires that moratoria not be used to provide relief to individual distressed borrowers, but as a broader tool to mitigate the economic impact of COVID-19. This requires consistency in application, which can be a challenge in countries that have opted for a bottom-up, bank-led approach.
- *The moratorium must apply to a broad range of obligors*. Examples of broad criteria include particular exposure classes (e.g., retail, private individuals, MSMEs, or corporates), a specific product range (e.g., mortgage loans), or borrowers from specific regions or certain industry sectors that are severely affected. It is not acceptable for the moratorium to target only borrowers that were already facing financial difficulties prior to COVID-19. Nonetheless, it is possible for the scope of application of the moratorium to be limited to performing obligors who did not experience any payment difficulties before the application of the moratorium. However, where the moratorium applies to exposures that were already classified as forbore or defaulted at the moment of the application of the moratorium, this classification must be maintained.

<sup>10</sup> In line with the EBA's definition, NPLs include nonperforming loans and advances, while Non-Performing Exposures (NPEs) also include debt securities in addition to loans and advances. The term "Non-Performing Assets" is frequently used to also include foreclosed assets.

<sup>11</sup> <https://www.bis.org/bcbs/publ/d498.pdf>

<sup>12</sup> [https://eba.europa.eu/sites/default/documents/files/document\\_library/Publications/Guidelines/2020/Guidelines%20on%20legislative%20and%20non-legislative%20moratoria%20on%20loan%20repayments%20applied%20in%20the%20light%20of%20the%20COVID-19%20crisis/EBA-GL-2020-02%20Guidelines%20on%20payment%20moratoria.pdf](https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20legislative%20and%20non-legislative%20moratoria%20on%20loan%20repayments%20applied%20in%20the%20light%20of%20the%20COVID-19%20crisis/EBA-GL-2020-02%20Guidelines%20on%20payment%20moratoria.pdf)

- *The same moratorium offers the same conditions*, i.e. the same conditions have to apply or be offered to all clients subject to the moratorium. It is however possible that different moratoria exist in parallel, each of which applies to a different segment of exposures or class of borrowers, giving banks the possibility of participating in different moratoria, depending on their business model.
- *The moratorium changes only the schedule of payments*. Temporary suspensions, postponements, or reductions of principal, interest, or both are acceptable, provided that the loan's NPV does not materially change. This can be achieved by extending the duration of the loan, or by temporarily increasing debt payments after the expiration of the moratorium. Other terms and conditions applicable to the loan, such as the interest rate, should remain unchanged.<sup>13</sup>
- *The moratorium should not apply to new lending*. The EBA requires that moratoria and other temporary borrower relief measures are designed to apply to the outstanding credit stock at the moment of the outbreak of COVID-19, not to support new lending going forward. New lending should follow normal credit policies and will be based on the assessment of the creditworthiness of the clients taking into account borrowers' repayment capacity without special measures, but including any committed public guarantees.

### Accounting

The application of accounting principles in light of COVID-19 has emerged as an area of high interest in the EU and the ECA region, where most countries have adopted International Financial Reporting Standards (IFRS) 9 or are in the process of doing so. IFRS 9 requires that loans and receivables are classified into three categories: performing (Stage 1), underperforming (Stage 2), and non-performing (Stage 3). Under IFRS 9, banks are expected to cover one year of expected losses for loans at Stage 1, but the lifetime of expected losses for loans at Stages 2 and 3. The criteria and triggers used for classifying loans as underperforming or non-performing is thus critical. The general principle is that loans are moved from performing to underperforming in the event of a significant increase in credit risk, with a rebuttable presumption that a loan that has been 30 DPD should be

transferred to that category, as well as some forbore loans. A loan becomes non-performing once payments are more than 90 DPD, or when it becomes unlikely to be repaid.

Against the backdrop of a highly uncertain economic outlook, the current concern is that banks may need to reclassify a significant share of their loan book from performing to underperforming, or even non-performing. In addition, banks may need to recalibrate their credit risk parameters to reassess their expected losses according to the new economic expectations. Both may trigger a surge in loan loss provisions, resulting in sizable bank losses and capital depletion, that would undermine their capacity to support the economic recovery with credit. This highlights the potential tension between the need for pragmatism (to avoid a significant tightening in credit conditions) while upholding the spirit of IFRS 9 accounting requirements, which is predicated on a more forward-looking approach towards recognizing and provisioning for credit losses.

Some countries have therefore provided guidance aimed at avoiding such procyclicality. In the EU, the EBA has stated that participation in moratoria or other types of borrower relief schemes should not automatically be considered a default under IFRS 9. It also asserted that banks should consider the high degree of uncertainty and changes that might result in impacts over the life of financial instruments. The ECB recommends that banks should avoid procyclical assumptions in their models and opt for IFRS 9 transitional rules. Similarly, in Bosnia and Herzegovina, the Banking Agencies have clarified that banks are not obliged to reclassify loans that have benefitted from any borrower relief measures as underperforming or non-performing, provided that the rescheduled loans comply with applicable regulations. The IFRS Foundation acknowledged the difficulty in incorporating the effects of COVID-19 into estimates on a "reasonable and supportable basis", but changes in economic conditions should be reflected in macroeconomic scenarios used in those estimates. Lastly, the ECB also indicated that the reassessments of lifetime expected credit losses can be undertaken at the portfolio level, without the need to identify which individual financial instruments have suffered a significant increase in credit risk (SICR).

<sup>13</sup> While some general payment moratoria have been accompanied by public guarantees, the EBA has stated that the use of these guarantees should be considered a change in terms and conditions.

## A few preliminary guiding principles

The previous section highlights how policymakers in the EU and in the ECA region have responded to the COVID-19 outbreak with borrower relief measures. Due to the speed with which COVID-19's economic impact affected borrowers' debt servicing capacity, governments sought to react quickly in rolling out supportive measures. The question arises, however, whether in the rush to respond policymakers were able to think through the design of borrower relief measures sufficiently carefully.

### PREREQUISITES AND RISKS

As a starting point, and prior to embarking on any borrower relief measures, policymakers should have a thorough understanding of the financial impact of such measures on banks. It is critical that in designing borrower relief measures, policymakers have fully assessed how the measures are likely to financially impact the banking sector in the near term. Given the uncertainties surrounding the current scenario, techniques such as scenario analysis, stress-testing, and other quantitative tools might be particularly useful to gauge the impact. More generally, it is imperative that technical insights from banking supervisory agencies regarding the financial impact of borrower relief measures are properly taken into consideration by policymakers when deciding on the design of such borrower relief measures. This is particularly important under government-initiated approaches wherein banks have little discretion with respect to borrower selection and type of relief offered. Political pressures can arise that simply present the banking sector with a *fait accompli*, without a serious effort to understand and curb the impact of the measures on banks' liquidity and solvency.

Once policymakers have clarity, they also need to make sure that the financial impact of borrower relief measures do not present an unacceptable risk to banks' financial soundness. Even though borrower relief measures undertaken so far by countries in the EU and ECA region have focused on temporary, short-term relief through the deferment of borrowers' debt obligations, such measures can have a potentially significant impact on banks' financial position. As an illustration, postponing borrowers'

debt service obligations reduces banks' cash flows and could affect liquidity through a reduction in available cash buffers. In general terms, the financial impact on the banking sector depends on the scope, breadth, and duration of the measures. The expected financial impact needs to be compared with banks' financial shock-absorbing capacity, including available liquidity and capital buffers over and above regulatory minimum standards. Clearly, countries with banking sectors that were already in a weak financial condition prior to COVID-19 have less room to maneuver, as the financial burden of borrower relief measures could compromise safety and soundness in the banking sector.

Policymakers should also be wary from the outset of unintended side effects of borrower relief measures. Of particular concern are (i) moral hazard, associated with so-called "willful defaulters", i.e. borrowers who are financially capable of paying, but are unwilling to do so, and (ii) the so-called "zombie borrowers". Regarding (i), care needs to be taken to ensure that borrower relief measures do not inadvertently give a free pass to creditworthy borrowers who are financially capable but unwilling to pay. This message has a particular resonance in ECA, where several countries in the aftermath of the GFC experienced serious challenges in ensuring that borrowers continued to repay to their full capacity. Problems related to strategic defaulters occurred due to weaknesses in legal frameworks (allowing debtors to default with near impunity<sup>14</sup>), aggravating already severe pressures on banks' asset quality, distorting banks' lending decisions, and reducing firms' and households' access to finance. As to (ii), policymakers should also beware heavily indebted and poor-performing corporate debtors who were already in difficulties prior to COVID-19. These so-called zombie borrowers<sup>15</sup> will likely try to benefit from borrower relief measures to get a fresh lease of life. If given the chance to do so, zombie borrowers will lock up the credit stock in stagnant and underperforming economic sectors and continue to drive the demand for credit at the expense of more dynamic borrowers. Considering the sobering outcomes of corporate health studies undertaken in the ECA region, policymakers should give serious consideration to ways to mitigate these possible side effects.

<sup>14</sup> E.g., due to cumbersome and time-consuming foreclosure procedures.

<sup>15</sup> Zombie firms are usually defined as companies that are unable to cover debt servicing costs from current profits over an extended period.

## FOUR HIGH-LEVEL PRINCIPLES

There is no standard blueprint for the design of borrower relief measures. On the contrary, relief measures need to be tailored to the specificities of the local economic, financial sector, institutional, and legal context to be effective. It is, however, possible to distinguish a set of basic principles that in our view should be factored into the design.

### 1. TARGETING:

Most ECA countries that have introduced borrower relief measures have set up schemes with the explicit objective of supporting borrowers whose repayment capacity has been negatively affected by COVID-19. As explained above, targeting can help to mitigate moral hazard associated with willful defaulters, avoid giving a fresh lease of life for zombie borrowers, and keep the financial impact of borrower relief on banks within manageable proportions.

The relevant question though is whether it is feasible to provide borrower relief in a targeted manner without inadvertently introducing delays in the provision of relief measures to distressed borrowers. With many borrowers facing acute payment difficulties, it is critical that relief measures reach intended beneficiaries as quickly as possible. The potential benefits of targeting thus need to be balanced with the need for maintaining speed in delivery. For countries that do decide in favor of targeting, a highly practical approach is called for, avoiding cumbersome and time-consuming verification processes, and steering clear of excessive detail in eligibility requirements, which can jeopardize speed in delivery.

In this context, banking regulators may in general terms require that relief measures benefit borrowers that are adversely affected by COVID-19, while giving banks discretion on how the assessment is conducted (and with light-touch monitoring of practices through day-to-day supervision). Given the prevalence of relationship banking in the EU and in ECA, banks have a natural advantage in understanding their customers' financial challenges and will thus be best-placed to select eligible borrowers, while filtering out improper use by willful defaulters.

Conversely, zombie borrowers can be filtered out relatively easily by requiring that banks only provide borrower relief measures to borrowers with a sufficiently strong repayment track record prior to the outbreak of COVID-19. Several regulators have, for instance, prohibited banks from providing relief measures to borrowers with loans that were already classified as NPLs at the onset of COVID-19.

Another question is whether the borrower relief measures should also apply to any new lending granted while the measures are in force. Most countries have opted to apply the measures to the outstanding credit stock only, signaling that the objective of the measures is solely to deal with the impact of COVID-19 on existing loans rather than supporting new lending.<sup>16</sup> While banks are encouraged to continue lending, they are expected to follow normal sound credit policies that match repayment obligations with borrowers' cash flows, but banks may take into account any possible public guarantees that many governments have set up.

### 2. EXIT STRATEGIES:

Expectations need to be explicitly managed upfront; that the borrower relief measures are of a temporary nature and that they will be unwound as soon as circumstances allow. Most countries have also clearly communicated upfront sunset clauses. Extensions exacerbate expectations that the borrower relief measures constitute a "new normal", making it increasingly difficult to revert to the status quo pre-COVID-19. It is therefore important that policymakers start thinking about exit strategies early on in the process, to develop a view on the circumstances in which the exceptional measures can be unwound (e.g., a clear indication that the pandemic is under control, suspension of emergency measures to stop the spread of the disease, or a sustained period of positive economic growth). Public communication about these preconditions for revoking the borrower relief measures is important to manage expectations, ensuring that the temporary nature of the measures is well understood by borrowers and banks alike. In addition to deciding on the timing of the withdrawal of borrower relief measures, banking supervisors need to consider the prudential impact of reverting to pre-COVID-19 norms.

<sup>16</sup> Note that existing credit lines, renewal of revolving loans, working capital loans, and overdrafts are often not considered new lending.

### 3. SUPERVISORY REPORTING AND TRANSPARENCY:

It is essential that banks produce reliable, frequent, up-to-date, and comparable information regarding loans that have benefitted from borrower relief measures including impacts on profit and loss accounts.<sup>17</sup> Such information is necessary for policymakers to assess whether the measures are having the desired effect, and for banking supervisory agencies to be able to closely monitor the impact on banks' asset quality, capital, and overall financial standing. Banks should thus be required to tag loans that have benefitted from borrower relief measures, perform periodic assessments, and report a set of standard indicators for assessing the credit risk of such loans (e.g., collateral and repayment behavior). Such information would also be useful input for prudential reports in which banking supervisory agencies may give special attention to the monitoring and analysis of loans that have benefitted from borrower relief measures. A balance between specificity and simplicity needs to be achieved, aimed at avoiding unnecessary administrative burdens on banks and taking into consideration banks' constraints in terms of management information systems, technology, and human resources, while ensuring that legitimate banking supervisory information needs are met.

Information on banks' borrower relief measures not only matters to policymakers, but also to bank depositors, investors, and shareholders. These actors must have access to reliable, updated, and consistent financial information about banks' exposure to credit risk, in order to inform their decisions. In recent years, the EBA has significantly stepped up disclosure requirements, to give users of financial statements an understanding of loan portfolio quality and credit risk control practices.<sup>18</sup> While underscoring the importance of transparency, the EBA announced that it will provide specific requirements on public disclosures at a later point in time.

### 4. UPHOLDING LOAN LOSS CLASSIFICATION, PROVISIONING, AND ACCOUNTING REQUIREMENTS:

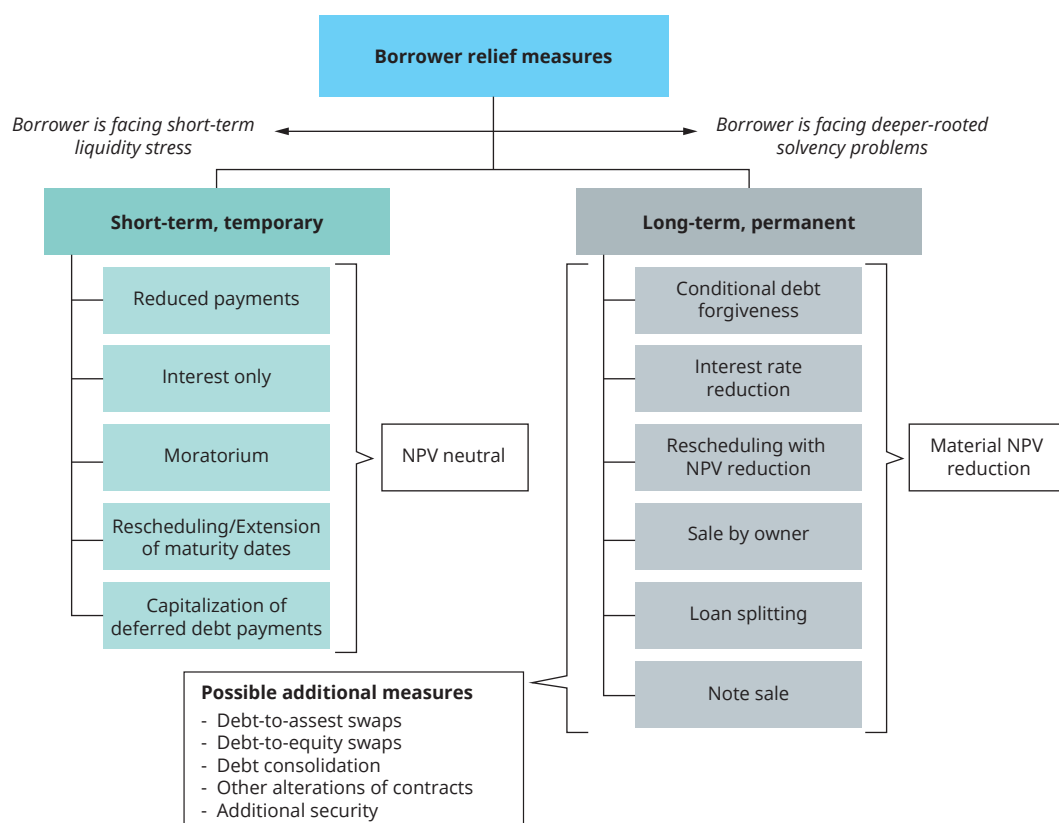
Over the past years, many ECA countries made a considerable effort to align regulatory definitions of NPLs and forbearance with EBA and BCBS standards. Although the work is far from finished, the use by banks and supervisors of internationally agreed definitions of non-performing and forborne exposures is critical for monitoring and assessing banks' asset quality in a consistent manner, both within and across jurisdictions, as well as to facilitate timely action to address rising asset quality problems. It is important that these hard-earned gains are preserved. In this regard, the easing of regulatory definitions, even on a temporary basis, should be avoided. The relaxation of regulatory definitions for NPLs and forborne exposures and classification and provisioning requirements, including those related to accounting standards, obfuscates banks' true asset quality challenges. This undermines market discipline and comparability within and across countries, distorting the veracity of financial information and blurring the distinction between borrowers negatively affected by COVID-19 and zombie borrowers. These measures may also prove difficult to unwind, as industry pressures will likely resist the prospect of recognizing a significant spike in NPLs and the corresponding increase in provisioning charges. Similarly, it is important that banks continue to rigorously apply the UTP criterion to borrowers whose repayment capacity has been permanently affected by COVID-19. While these borrowers may benefit from moratoria and other short-term support measures, banks would need to continue to signal and appropriately address situations where borrowers' short-term payment challenges are likely to transpose into longer-term financial difficulties.

<sup>17</sup> Note that this applies to any rescheduled or restructured loan, i.e. not only to loans that have benefitted from borrower relief measures.

<sup>18</sup> See EBA/GL/2018/10, Guidelines on disclosure of non-performing and forborne exposures. <https://eba.europa.eu/sites/default/documents/files/documents/10180/2531768/be41637e-41db-4fa1-b1e3-a2463711ffe2/Final%20GLs%20on%20disclosure%20of%20non-performing%20and%20forborne%20exposures.pdf?retry=1>



## Annex 1: Borrower relief measures



Source: Adaptation from Handbook for MSME NPL Management and Workout.

<https://www.bsi.si/en/publications/other-publications/handbook-for-msme-npl-management-and-workout>

A distinction can be made between short-term measures<sup>19</sup>, aimed at providing temporary relief to borrowers following a short-term disruption in income and cash flows, and longer-term measures designed to reduce a borrower's debt. **Short-term measures** are appropriate to use when there is a reasonable expectation that the borrower's sustainable cash flow will be strong enough to allow the resumption of its existing payment schedule at the end of the forbearance period. This is admittedly a challenging proposition at this point in time, while the economic impact of COVID-19 is still unfolding, and it is often not yet clear whether a particular borrower suffers from short-term liquidity challenges, or whether repayment capacity is permanently impaired. Notwithstanding, the short-term measures in the figure above can be used in combination with longer term solutions such as an extension of maturity, revision in terms, and additional security. Specific short-term measures to consider include:

- **Reduced payments** – the company's cash flow is sufficient to service interest and make partial principal repayments.
- **Interest only** – the company's cash flow can only service its interest payments, and no principal repayments are made during a determined period of time.
- **Moratorium** – an agreement allowing the borrower to temporarily suspend payments of principal and/or interest for a clearly defined period, usually not to exceed 90 days. This technique is also often used in the beginning stages of a workout process (especially with multi-bank borrowers) to allow the bank and other creditors time to assess the viability of the business and develop a plan for moving forward.
- **Rescheduling/extension of maturity** - extension of the maturity of the loan (i.e., of the last contractual loan installment date) allows a reduction in installment amounts by spreading the repayments over a longer period.
- **Interest and repayment capitalization** – adds deferred payments and/or deferred interest to the outstanding principal balance for repayment under a sustainable revised repayment program.

<sup>19</sup> Note that short-term measures can also be used to give time for banks to assess the situation and determine an appropriate course of action, thus leading the way for longer term measures.

**Longer-term/permanent** options are designed to permanently reduce the borrower's debt. Most borrowers will require a combination of the options mentioned below to ensure repayment. In all cases, the bank must be able to demonstrate (based on reasonable documented financial information) that the borrower's projected cash flow will be sufficient to meet the restructured payment terms. Specific options to consider include:

- **Conditional debt forgiveness** - involves the bank forfeiting the right to legally recover part or the whole of the amount of an outstanding debt upon the borrower's performance of certain conditions. This measure may be used when the bank agrees to a "reduced payment in full and final settlement", whereby the bank agrees to forgive all the remaining debt if the borrower repays the reduced amount of the principal balance within an agreed timeframe. Banks should apply debt forgiveness options carefully since the possibility of forgiveness can give rise to moral hazard, weaken the payment discipline, and encourage "strategic defaults". Therefore, institutions should define specific forgiveness policies and procedures to ensure strong controls are in place.
- **Interest rate reduction** - involves the permanent (or temporary) reduction of the interest rate (fixed or variable) to a rate that is more sustainable for the borrower. This option could be considered when the evolution of interest rates has resulted in the borrower receiving finance at an exorbitant cost, compared with prevailing market conditions. However, banks should ensure that the lower interest rate is sufficient to cover the relevant credit risk.
- **Rescheduled payments** - the existing contractual payment schedule is adjusted to a new sustainable repayment program based on a realistic assessment of the borrower's cash flows, both current and forecasted. The rearranged payment schedule usually leads to a reduction in debt in NPV terms. Rescheduled payments are usually combined with an extension of maturity. In addition to normal rescheduling, additional repayment options can include:
  - a) **Partial repayment** - a payment is made against the credit facility (e.g., from a sale of assets) that is lower than the outstanding balance. This option is used to substantially reduce the exposure at risk and to enable a sustainable repayment program for the remaining outstanding amount. This option is generally preferable, from the creditor's standpoint, to the balloon, bullet, or step-up options described below.
  - b) **Balloon or bullet payments** - are used in the case of more marginal borrowers whose sustainable cash flow is insufficient to fully repay the loan within the rescheduled tenor. A balloon payment is a final installment substantially larger than the regularly scheduled installments. As a rule, it should not exceed 30 percent of the original principal amount of the loan. Bullet loans carry no regular installment payments. They are payable in full at the maturity date and frequently contain provisions allowing the capitalization of interest (payment in kind interest) throughout the life of the loan.
  - c) **Step-up payments** - should be used when the bank can ensure and demonstrate that there is a good reason to expect that the borrower's future cash flow will be sufficient to meet increases (step-up) in payments.
- **Sale by owner/assisted sale** - this option is used when the borrower agrees to voluntarily dispose of the secured assets to partially or fully repay the debt. It is usually combined with the partial repayment option or conditional debt forgiveness. The borrower must be monitored closely to ensure that the sale is conducted in a timely manner and the agreement should contain a covenant allowing the owner to conduct the sale if the borrower fails to do so within the specified timeframe.
- **Loan splitting** - is used to address collateral and cash flow shortfalls. In this option, the debt is split into two parts: (i) the portion representing the amount that can be repaid from sustainable cash flow is repaid in equal installments of principal and interest (with a maturity not to exceed 5 years); and (ii) the remaining portion represents "excess debt" (which can be subordinated). This portion may be further split into several parts/tranches (which may be non-interest bearing or payment in kind notes) and is frequently used in combination with payments from the sale of specific assets or bullet payments at maturity.
- **Note sale** - individual note sales are most commonly used when a new investor wishes to restructure a company's overall debt burden on commercially acceptable market terms. This option is usually combined with conditional debt forgiveness and requires that the purchase price be equal to or greater than the current NPV of the restructured loan.

**Additional measures** are not considered to be viable stand-alone restructuring/forbearance options as they do not result in an immediate reduction in the loan. However, when combined with one or more of the previously identified options, they can provide incentives for repayment or strengthen the bank's overall position.

- **Debt-to-asset swap** – converts the loan, or a portion of the loan, into “other assets owned” where the ultimate collection of the original loan requires the sale of the asset. This technique is generally used in conjunction with conditional debt forgiveness or partial loan repayment and maturity extension options. The management and sale of real estate properties also requires specialized expertise to ensure that the bank maximizes its returns from these assets.
- **Debt-to-equity swap** – converts the loan, or a portion of the loan, into an equity investment. Generally used to strengthen the capital structure of large highly indebted corporate borrowers. Like the debt-to-asset swap above, this option may also require the bank to allocate additional resources for managing the new investment.
- **Debt consolidation** – combines multiple exposures into a single loan or a limited number of loans (more common for retail exposure). This solution should be combined with other measures addressing existing arrears. This option is particularly beneficial in situations where combining collateral and secured cash flows provides greater overall security coverage for the entire debt than individually. For example, by minimizing cash leaks or by facilitating re-allocation of cash flow surplus between exposures.
- **Other alterations of contract/covenants** – when entering a restructuring agreement, it is generally necessary to revise or modify existing contracts/covenants to meet the borrower's current financial circumstances. Examples might include revising ratios, such as minimum working capital, or providing additional time for a borrower to sell excess assets.
- **Additional security** - additional liens on unencumbered assets (e.g., pledge on a cash deposit, assignment of receivables, or a new/additional mortgage on immoveable property) are generally obtained as additional security from a borrower to compensate for the higher risk exposure or cure existing defaults in loan-to-value ratio covenants.

## Annex 2: International initiatives to harmonize regulatory definitions of non-performing loans and forbearance<sup>20</sup>

The development of a set of internationally consistent and harmonized standards for defining problem exposures is a relatively recent phenomenon. The EBA was at the forefront of the endeavor in 2013 when it introduced harmonized criteria for two key asset quality concepts, non-performing exposures (NPEs) and forbearance.<sup>21</sup> The BCBS followed suit in 2017.<sup>22</sup> The definition of NPEs includes a broader range of bank assets than NPLs. It includes a quantitative threshold (a hard 90 dpd backstop) as well as qualitative criteria (unlikeliness to pay), the latter encompassing exposures for which there is evidence that full repayment of principal and interest is unlikely without realization of collateral, regardless of the number of DPD. Banks are required to have clearly defined indicators of unlikeliness to pay which are implemented homogeneously in all parts of the banking group. Banks are also expected to regularly assess the creditworthiness and repayment capacity of their customers to identify whether unlikeliness to pay indicators are present. In addition, the EBA standard introduces additional aspects in terms of the pulling effect. If a bank has on-balance sheet exposures that exceed 20 percent of the gross carrying amount of all on balance sheet exposures of a particular debtor, then all on and off-balance sheet exposures should be considered non-performing. Lastly, the availability of collateral has no influence on the categorization of an exposure as non-performing. When an exposure becomes non-performing, it should be classified as such, even if the collateral value exceeds the past due or non-past due exposure amounts outstanding.

The BCBS defines forbearance as “a concession granted to a counterparty for reasons of financial difficulty that would not be otherwise considered by the lender.” Similarly, the EBA states that “forbearance measures consist of concessions towards a debtor that is experiencing or about to experience difficulties in meeting its financial commitments”. Irrespective of whether a loan is past due, forbearance takes place when the financial difficulties of the borrower prompts the lender to make concessions.

Not all concessions result in a reduction of the actual amount to be paid, and therefore not all concessions result in losses to the lender, although that is often the case. Concessions can include changes in the schedule of payments, granting of grace periods, extending maturities, and decreasing interest rates. It can also include granting additional loans, lowering collateral requirements, release of collaterals, converting debt to equity, deferring collections, or forgiving, deferring, or postponing principal, interest, and fees etc. A critical element to be considered is that forbearance should not be used to merely postpone the recognition of inevitable losses, but should only be provided to borrowers that can reasonably be expected to meet their payment schedule, taking into consideration the forbearance measures.

Forborne exposures can be included in the performing or non-performing category, depending on the status at the time when forbearance is extended and the counterparty's payment history or creditworthiness after the extension of forbearance. Allowing forborne exposures in the performing category may feel somewhat counterintuitive, but there are valid circumstances where an exposure would remain in the performing bucket, for example when the debtor approaches the bank to request forbearance before entering financial difficulty. Banks are, however, expected to perform a detailed assessment to ensure that no financial difficulty exists. Specific criteria focused on sustainability need to be met before an exposure can be upgraded from non-performing forborne to performing forborne classification. Typically, these include a minimum of 12 months principal and interest repayments, no past due amounts on the exposure, other exposures not considered as impaired or defaulted, and the bank having dispelled all concerns regarding full repayment under the post forbearance arrangements and being satisfied that unlikeliness to pay indicators are absent, including no reliance on collateral to repay the debt in full.

<sup>20</sup> This annex is based on the policy brief “Regulatory and supervisory developments for non-performing loans” that is available on the FinSAC website. <http://pubdocs.worldbank.org/en/685901527523168861/Regulatory-and-supervisory-developments-for-NPLs.pdf>

<sup>21</sup> <https://eba.europa.eu/sites/default/documents/files/documents/10180/449824/a55b9933-be43-4cae-b872-9184c90135b9/EBA-ITS-2013-03%20Final%20draft%20ITS%20on%20Forbearance%20and%20Non-performing%20exposures.pdf?retry=1>

<sup>22</sup> <https://www.bis.org/bcbis/publ/d403.htm>