FINANCE

COVID-19: EBA Guidelines on Payment Moratoria

21 May 2020

The European Banking Authority (EBA) has confirmed that loans in respect of which a COVID-19 payment moratorium has been granted will not be re-classified as non-performing solely as a result of that moratorium.

In March 2020, three-month payment breaks were announced by the five Irish retail banks and eight other regulated non-bank lenders and credit servicers for personal and business customers impacted by the COVID-19 pandemic. The extension of those payment breaks by a further three months was announced on 30 April 2020 (see our briefing here: COVID-19: Payment breaks extended to six months).

We highlighted, in our first briefing on those payment breaks (COVID-19: Supports announced for affected customers of banks and other lenders), the importance of receiving confirmation from the EBA that loans in respect of which COVID-19-related payment moratoria are granted will not be re-classified as non-performing solely as a result of those moratoria.

On 2 April 2020, the EBA published its Guidelines on legislative and non-legislative moratoria on loan repayments applied in light of COVID-19 (the **Guidelines**).

In the Guidelines, the EBA helpfully clarified the circumstances in which the granting of a COVID-19-related moratorium on principal repayments and/or interest payments will:

- not trigger a forbearance classification for the relevant loan[1]; and
- not be treated as a distressed restructuring of the relevant loan.[2]

Scope of the Guidelines

The Guidelines are addressed to banks and their competent authorities. As such, they are relevant to the five Irish retail banks that agreed to grant payment breaks to customers impacted by the COVID-19 pandemic.

The Guidelines do not apply to the regulated non-bank lenders and credit servicers that agreed to make similar payment breaks available to their customers.

The Guidelines apply to both:

- "**non-legislative moratoria**": industry-wide or sector-wide schemes agreed either by the banking industry in a particular EU Member State, or by a material part of that banking industry. Participation in the scheme must be open, and the measures taken by the relevant banks must be similar. The payment breaks granted by the five Irish retail banks as part of the joint plan agreed between them in March 2020 were "**non-legislative**" in nature; and
- "**legislative moratoria**": payment moratoria granted by banks in EU Member States pursuant to COVID-19-related legislation.

IMPACT OF THE GUIDELINES

The Guidelines clarify that when a COVID-19 moratorium scheme (such as the non-legislative payment breaks granted by the five Irish retail banks) meets the criteria necessary to be deemed to be a "general payment moratorium" for the purposes of the Guidelines, the granting of a moratorium under that scheme to a borrower will not, of itself:

- trigger a forbearance classification for the relevant loan; or
- be treated as a distressed restructuring of that loan.

1 Under the EU Capital Requirements Regulation, **forbearance** is where a bank grants a concession to a borrower who is having difficulties meeting its financial commitments, or who is likely to have difficulties doing so. A concession may take the form of a change to the terms and conditions of the loan (such as a temporary moratorium on repayments of principal and/or payments of interest) or a refinancing of the debt.

2 Under the EBA Guidelines on the application of the definition of default, where forbearance measures are extended to a borrower, this should be considered **distressed restructuring** which is an indication of unlikeliness to pay if it leads to a diminished financial obligation.

What is a "General Payment Moratorium"?

CRITERIA FOR A GENERAL PAYMENT MORATORIUM	
Criterion	Detail
Legislative or Non-Legislative	The moratorium can be either legislative or non-legislative. The COVID-19-related payment breaks agreed to by the Irish retail banks are non-legislative in nature.
COVID-19	The moratorium must have been launched in response to the COVID-19 pandemic.
Timing	The moratorium must have been introduced before 30 June 2020 (this date may be extended by the EBA).
Scope	The moratorium can only amend schedules for principal repayments and/or interest payments. It cannot amend other loan terms (such as the interest rate).
Application	The moratorium must apply to a large group of obligors. The composition of that group must be based on broad criteria[3] which should allow a borrower to benefit from the moratorium without an assessment of its creditworthiness.
Limitations	The moratorium may, but does not have to, be limited to performing obligors who were not experiencing payment difficulties before the moratorium was introduced. The moratorium cannot be limited to obligors who were experiencing financial difficulties before the outbreak of the COVID-19 pandemic.
Consistent Conditions	The same conditions must be available to all in-scope loans, even if an in-scope obligor does not have to avail of it.
Restriction – New Loans	The moratorium cannot be granted in respect of a new loan advanced after the moratorium was announced.

Where the payment breaks granted by the Irish retail banks meet the above criteria, the fact that a payment break is granted should not:

- change the existing classification of the relevant loan; or
- of itself, cause the relevant loan to be re-classified as being in forbearance. As the EBA will not treat "non-legislative moratoria" or "legislative moratoria" as forbearance measures if they meet the above criteria, the EBA also confirmed that those moratoria should not trigger a distressed restructuring classification.

What if a borrower avails of a payment break and also draws-down a new loan?

The EBA has confirmed that this will not automatically lead to a forbearance classification, but the relevant bank must carry out a case-by-case assessment to see whether such a classification is appropriate.

Counting "*days past due*"

For the purposes of counting "*days past due*" when determining:

- whether a default is deemed to have occurred in respect of a borrower under Article 178[4] of the Capital Requirements Regulation (CRR); or
- when an exposure should be classified as non-performing under Article 47a[5] of the CRR,

banks should base this calculation on the revised schedule of repayments that results from the grant of a moratorium under a general payment moratorium.

Assessments of unlikeliness to pay

The EBA has confirmed that, during the moratorium, banks should assess the potential unlikeliness to pay of those obligors that are subject to the moratorium in accordance with their usual policies and procedures (including where these assessments are based on automatic checks).

Where manual assessments of unlikeliness to pay are being carried out in respect of individual obligors, banks should prioritise assessments for those obligors who are most likely to suffer longer-term financial difficulties as a result of the COVID-19 pandemic. These assessments should be based on the schedule of repayments that resulted from the general payment moratorium.

Additional public support measures that are available to the obligor can also be factored into the assessment, where they might affect the obligor's creditworthiness. However, any credit risk mitigation provided to the bank by a third party will not absolve the bank of the requirement to assess creditworthiness, and should not affect the outcome of those assessments.

Notification Obligations

Where a bank applies a non-legislative

3 Such as exposure or sub-exposure class, industry sector, product ranges or geographical location

4 Which deals with when a default is considered to have taken place in respect of an obligor.

5 Which deals with the classification of exposures as non-performing.

general payment moratorium, it must notify its competent authority. That notification must contain information on the application date of the moratorium, the selection criteria, the number of in-scope obligors, the in-scope exposure amounts, the conditions on which the moratorium was offered, and details of the distribution of obligors and exposures across rating grades (or equivalent).

Available Information

In-scope banks must also retain certain information, and have it readily available, that clearly identifies the exposures or obligors in respect of which the moratorium was offered and also those to whom it was granted. That information must also cover the amounts that were rescheduled on foot of the moratorium, any economic loss resulting from the application of the moratorium to individual exposures, and any associated impairment charges.

IFRS9

The EBA had already issued a statement on 25 March 2020 (here) in connection with IFRS 9.[6] It expressed the view that the application of payment moratoria designed to address the impact of the COVID-19 pandemic should not, of themselves, trigger a conclusion that a significant increase in credit risk has occurred for the purposes of the impairment requirements set out in IFRS 9.

The EBA does, however, expect banks to distinguish between obligors whose creditworthiness is unlikely to be significantly impacted in the long-term, and those who are unlikely to regain a strong level of creditworthiness. Its view was consistent with that expressed by ESMA in its statement of the same date (here).

Subsequent Developments

The Guidelines provided welcome clarity to the banking industry in respect of the various moratorium schemes introduced across the EU following the onset of the COVID-19 pandemic.

The Guidelines were promptly followed by:

- clarification from the EBA on the application of the Guidelines to securitisations (EBA statement on additional supervisory measures in the COVID-19 pandemic (22 April 2020));
- the European Commission's Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending in the context of the COVID-19 pandemic; and
- targeted 'quick-fix' amendments to the CRR (Coronavirus response: Banking Package to facilitate bank lending-Supporting households and businesses in the EU).

These will be the subject of further briefings shortly.

6 IFRS 9 sets out, among other matters, how banks should classify and measure financial assets and financial liabilities. It also requires banks to recognise impaired assets and, depending on how impaired they are, there will be an adverse capital impact for the relevant bank.

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