PAYMENT DEFERRAL & STATE GUARANTEE IN THE CONTEXT OF THE COVID-19 CRISIS

Operational readiness and financial resilience of the Belgian banking sector

INTRODUCTION

The lockdown put in place to contain the spread of COVID-19 has triggered a sudden halt in the economy, with the impact felt intensely more or less across all sectors. So far, the policy response from governments, central banks and bank supervisors has been swift and far reaching, in order to contain the economic fallout and any risks to financial stability.

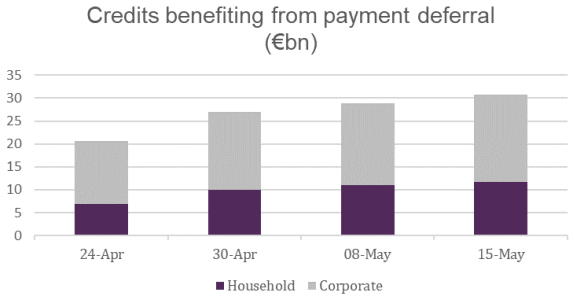
In that context, the banking sector also has its role to play in bridging short-term liquidity needs until the sanitary situation improves and the economy can resume its normal course.

In Belgium, the Federal Government, the National Bank of Belgium (NBB) and Febelfin have organised payment deferral and state guarantee programmes to support the finances of non-financial companies, SMEs, self-employed professionals, non-profit organisations and households during this pandemic.

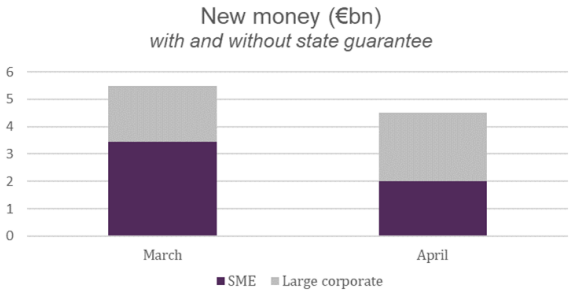
The measures adopted by the banking sector consist of two pillars:

> A moratorium whereby banks agreed to offer a payment deferral to those with payment problems as a result of COVID-19, involving deferral of payments of principal and, potentially, interests. This measure may be applicable under certain conditions on all credit obligations that fall between 1st April and 31st October at the latest (maximum 6 months).

> A state guarantee scheme covering, under certain conditions, new bank loans and credit facilities granted between 1st April and 30th September, with a maximum duration of 12 months.



Source: Febelfin, Coronamonitor



Source: Febelfin, Coronamonitor

On 1st May, the NBB and the Economic Risk Management Group conducted a survey of corporations and self-employed persons that confirms an increasing risk of bankruptcy – particularly for certain business sectors already at high risk – and thereby justifies the need to take action to support the economy.

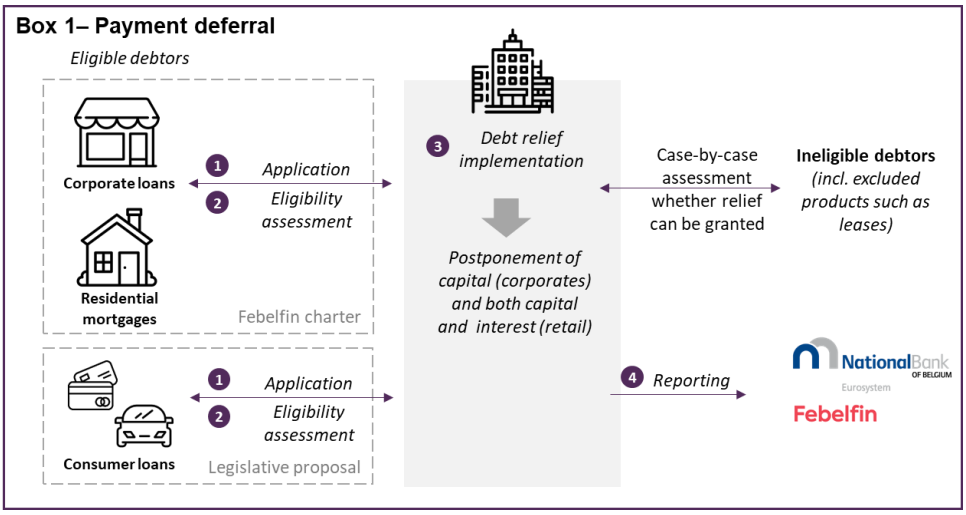
However, data published by Febelfin suggests the demand for payment deferrals and new loans under state guarantee has been underwhelming so far. Indeed, with around EUR 10 billion of new money in two months, it is notable that new loans under state guarantee are not attracting crowds.

Despite their relative success, these measures are far reaching in scope and are materially affecting the conduct of banks' business now - and in the months to come. Implementation also raises several challenges for banks from an operational and financial perspective – the objective of this paper is to shed some light on challenges faced by banks in implementing these measures.

1. PAYMENT DEFERRAL AND STATE GUARANTEE: KEY PRINCIPLES

PAYMENT DEFERRAL

The banking sector agreed on conditions for a moratorium (or "payment deferral") on both business and residential mortgage loans. At the time of writing this paper, a moratorium covering consumer loans is also in the pipeline following a legislative initiative. While more details are expected, the mechanism should not differ widely from the current application of the moratorium for business and residential mortgage loans.

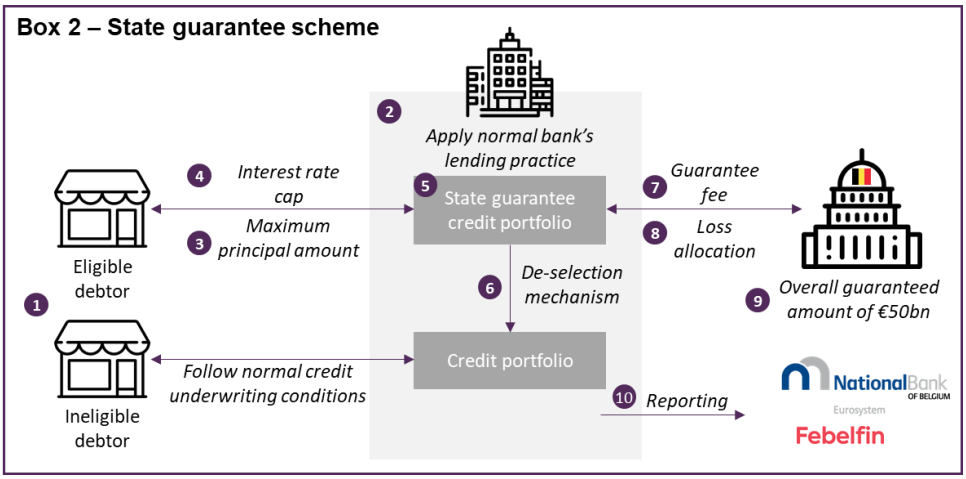


In essence, the payment deferral consists of granting viable counterparties with liquidity problems caused by the COVID-19 pandemic an extension, for a maximum of 6 months, of the scheduled repayments of principal and interests that fall due between 1st April until 31st October 2020.

1. The payment deferral is not granted automatically but upon request from the borrower.
2. Banks must assess eligibility of received requests according to the Febelfin charters that define the conditions under which an extension of the scheduled repayments can be demanded.
3. Banks implement in their system the payment deferral for eligible clients.
4. Banks report to Febelfin and the NBB on the volume of deferrals granted.

STATE GUARANTEE

The Belgian state activated a guarantee scheme for new loans and credit facilities for a maximum duration of 12 months[1] granted to viable corporates, SMEs, self-employed professionals and non-profit organisations between 1st April 2020 until 30th September 2020.



1. The royal decree of 15th April 2020 granting a state guarantee for certain credits in the fight against the effects of COVID-19 (the royal decree), defines the eligibility criteria for borrowers to be considered under the state guarantee scheme.
2. Banks must apply the same lending practices in terms of obtaining guarantees as before the entry into force of the royal decree.
3. Banks can lend up to the maximum of (i) EUR 50 million per counterparty or group of connected counterparties; and (ii) the company's liquidity needs for its activities in the next 18 months (SMEs) or 12 months (larger corporates) as self-certified by the borrower in connection with its credit application.[2]
4. The interest rate charged by banks cannot exceed 1.25% on in-scope loans and credit facilities.
5. Banks compose their reference portfolio following the warehousing period of April-September.
6. The deselection mechanism allows banks to deselect up to approximatively 15% of in-scope loans. Deselected loans are not covered by the state guarantee and the guarantee fee does not need to be paid.
7. The state guarantee, applying at loan portfolio level, is structured according to the following loss-sharing scheme:

Loss rate (%)	Private sector	Government
0-3	100%	0%
3-5	50%	50%
5-100	20%	80%

The structure makes it clear that banks retain the first-loss to limit moral hazard and promote healthy credit standards, while providing a (partial) backstop against tail risks.

8. The guarantee is associated with a fee calibrated in line with the State Aid rules, of respectively 0.25% for SMEs and 0.5% for large corporates.
9. A total amount of EUR 50 billion (in principal) may be covered under the state guarantee scheme. This envelope will be shared across the banks, based on their market shares as of 31st December 2019.
10. Banks report to Febelfin and the NBB the volume of credits for which state guarantee was granted.

At the time of writing this paper, there are many questions still raised by the financial sector on the technical implementation of these measures. These are currently being answered by the NBB through a dedicated Q&A.

[1] Loans and credit facilities granted for an undetermined period or period longer than 12 months are also in scope, provided that the bank has the discretionary right to terminate in the first 12 months.
[2] Decision to grant an amount higher than €50Mios may be agreed by the Council of Ministers but that amount can never exceed the second condition.

2. THE RACE FOR OPERATIONAL READINESS

Banks had no other choice but to implement these measures as a matter of priority. While it is too early to draw conclusions, it is already clear that their operationalisation raises many challenges in terms of

(i) processing a staggering volume of payment deferral and loan application requests at short notice;
(ii) overseeing the IT implementation while controlling related operational risks; and
(iii) assessing the viability and debt sustainability of borrowers in a context of high uncertainty regarding the timing and strength of the economic recovery.

Based on conversations with banks, we provide below a non-exhaustive list of operational challenges that the banking sector is facing – or will be facing – in the coming weeks or months.

THE NEED FOR FURTHER IT INFRASTRUCTURE FLEXIBILITY

The crisis was sudden and the containment measures to limit the economic fallout were not delayed. Some credit institutions faced – or are facing – difficulties in implementing these measures due to the lack of flexibility in their IT infrastructure. For some of them, it requires costly IT development – or workarounds prone to operational mistakes.

Indeed, not all banking systems allow for a deferral of both principal and interest: for those banks, the workaround was to manually create fictive credits with a 0% interest rate, without amortising on the first 6 months.

Implementing the state guarantee is another challenge for the banking sector. The royal decree provides that a certain percentage of eligible credits can be removed from the guarantee scheme (deselection mechanism). Typically, banks contemplate deselecting good quality credits in order to avoid paying a guarantee fee for credits with a low likelihood of default. While this should be driving the deselection decision, in many instances the flexibility of the IT infrastructure goes into the equation. The decision of deselecting a credit is often taken based on IT development time and cost of implementing the guarantee scheme for a given product, rather than on economic reasoning.

Banks relying on agile IT infrastructure definitely have an advantage compared to the competition, since they are able to adapt with fewer costs – and can better keep up the pace of regulatory and customer demands.

RELYING ON EFFECTIVE BCBS 239 CAPABILITIES: THE ACID TEST

The acid test was developed in the 18th century and was used by gold prospectors to confirm that a find was gold. The COVID-19 crisis in many regards can be viewed as an acid test confirming BCBS 239 principles (Principles for effective risk data aggregation and risk reporting) are not just wishful thinking – but a reality.

Effective risk data aggregation and risk reporting is more than ever relevant, as risk departments must be active stakeholders in providing analysis to inform decision making – and in responding to supervisory demands within reduced timeframes (almost 'real time' or at least 'intraday'). The current situation requires, indeed, banks to run a multitude of scenario analysis (stress tests) requiring a large quantity of data and a vast number of underlying calculations of varying complexity. The complexity lies in considering multiple factors, including

- the impact of the crisis on the business sector; and
- the recovery scenario
- the application of payment deferral and/or the State Guarantee;

From a credit risk management perspective, risk management departments are expected to perform the following analysis taking into the new environment imposed by the containment measures:

- Identification and assessment of the credit portfolios impacted by the COVID-19 crisis, differentiating between borrowers facing temporary difficulties and those likely to be impacted durably;
- Monitoring over time the products, segments, business sectors and geographic areas most affected, with identification of possible risk concentrations;
- Definition and evaluation of forward-looking scenarios covering risk concentrations identified, based on macro-economic assumptions.

While the banking sector has made great progress, data quality, timely risk aggregation and reporting remains a challenge – currently many banks still face (i) important data quality issues e.g. lack of reconciliation of risk and accounting data; and (ii) cumbersome, manual and hugely time consuming stress testing processes.

GRANTING CREDITS TO CUSTOMERS IN A WORLD FULL OF UNCERTAINTIES

In this crisis, banks are expected to play a part in containing the economic fallout. That means also supporting part of the financial impact – an impact that banks will be trying to mitigate. The payment deferral and state guarantee measures are eligible to viable counterparties – but determining whether a borrower is facing payment difficulties as a result of the COVID-19 pandemic can be a complicated question.

Current scoring models cannot rely on a borrower's 2019 end of year situation, as the lockdown was imposed on the first quarter – and the economic spill over will only materialise in the months to come.

Customers should be ready to provide a 2020 provisional treasury plan considering COVID-19-related scenarios as part of their credit application file and can expect more prudence from banks which will definitely apply their credit granting process zealously.

It should be noted that the royal decree explicitly precludes banks from structuring a facility with the sole objective of avoiding the state guarantee. More generally, a robust internal control framework should be implemented to ensure anti-abuse provisions included in the royal decree are well respected.

DEALING WITH THE INCREASING NUMBER OF PAYMENT DEFERRAL APPLICATIONS

Weekly updates by the Febelfin indicate a steady flow of payment deferrals granted to both households and corporates. In this context, banks rapidly had to put in place new processes to react to customers' demands, which implied developing:

- External communication processes with customers or regulators;
- Internal process between departments, head office and branches.

With work-from-home conditions being imposed by the lockdown, implementing these processes could prove to be a challenge.

While still a moving target, for planning purposes banks should define rough estimates at least, based on the size of the population of clients who meet the eligibility criteria and behavioural assumptions required under the incentive in order to apply for the respective programmes.

Based on this, banks would be able to better calibrate the magnitude of the framework and processes they need to develop in order to respond to internal queries and external demands from customers and regulators.

3. A TEST IN RESILIENCE: QUALIFYING THE FINANCIAL IMPACTS

The economic impacts of COVID-19 challenge the financial resilience of banks, predominantly due to the direct and indirect pressure exerted on earnings and asset quality. In particular, loan loss provisioning is widely expected to soar in the coming months, to cope with the deterioration of both households' and corporates' balance sheets.

Depending on the estimated volumes at stake[3], payment deferral measures may themselves materially affect the financial results of banks.

However, on this occasion, banks entered the crisis with significant capital and liquidity buffers. Additionally, regulators and supervisors have provided the necessary relief[4] to ensure banks have the available headroom to run down their capital ratios if needed to support the provision of credit to impacted firms and households. However, the crisis exists alongside a backdrop of low profitability in the sector and a low interest rate environment.

This section therefore discusses some of the challenges in financial planning, accounting, reporting and disclosures – as well as practical considerations relating to the implementation of the moratorium and state guarantee schemes and their impact on those issues.

P&L IMPACTS

From a revenue perspective, the outlook is particularly challenging as credit losses accumulate and the 'lower for longer' interest rate scenario is confirmed.

The accommodative monetary policy implemented by the ECB and other central banks to mitigate the economic impacts of COVID-19 will continue to exert downward pressure on market interest rates and interest margins for the foreseeable future. In parallel, tighter market conditions have raised the cost of funding on wholesale markets as credit spreads remain relatively elevated.

The expected deterioration of asset quality will lead to a surge in the cost of risk, particularly under the IFRS 9 accounting standards that force banks to be forward looking and recognise loan losses much sooner. Quarterly earnings already turned negative for many banks during the first quarter, primarily as a result of higher loan loss provisions (up to 2 or 3 times as high as what had recently prevailed).

As further discussed in Box 3, uncertainties surrounding the economic fallout raise a number of implementation issues regarding IFRS 9. In that context, banks may need to adjust their approaches to forecasting and measuring expected credit losses to reflect the current environment.

In any case, loan loss provisions are set to gradually increase throughout the year – in the short term primarily through an increase in Stage 2 provisions to reflect the deteriorated economic outlook and over time through an increase in Stage 3 provisions to cope with actual defaults.

On top of this, the consequences of the payment deferral and state guarantee on interest income should not be neglected:

- Under the moratorium interest payments on mortgages and soon consumer loans can be deferred, unlike corporate loans for which interests remain due. While the monthly payments will be adjusted thereafter to compensate this shortfall over the life of the loans, this will impact the P&L in 2020. In the case of clients with lower incomes, the interest income is foregone altogether, as banks have committed in supporting the most vulnerable.
- With regard to the state guarantee, it must be remembered that the scheme is of a mandatory nature[5] for qualifying loans – and bears a remuneration cap to ensure that new loans are granted on favourable terms[6]. In practice, this mechanism may restrict the product offering to products or credit facilities that are economical at this price point, considering the risk transfer (see below).

Cost discipline and efficiency programmes will be key to cope with all those profitability challenges. Looking forwards, the current crisis is likely to force a reconsideration of travel and office costs – and the economic downturn pushes back any hope of an exit from low interest rates and may represent a tipping point, especially for smaller banks.

[3] While still a moving target, banks should define for planning purposes at least rough estimates based on the size the population of clients that meet the eligibility criteria and behavioural assumptions with respect to the incentive to apply for the respective programmes (e.g. candidate drivers could be income distribution and demography for households and size and economic sector for corporates).

[4] Release of countercyclical buffers, frontloading of CRDV provision regarding the composition of Pillar 2 requirements, usability of Pillar 2 Guidance, postponement of Basel III

[5] To the exception of the 'deselection' mechanism through which up to 15% of qualifying loans may be withdrawn from the scope of the state guarantee.

[6] i.e. max 1.5% for SMEs and 1.75% for corporates (including the guarantee fee).

Box 3: Accounting for expected credit losses under IFRS 9

Generally speaking, IFRS 9 requires the use of all reasonable and supportable information to define forward looking scenarios and assess expected credit losses (ECL). Due to COVID-19, significant uncertainties prevail in terms of economic outlook – in particular, regarding the depth of the contraction and the timing and strength of the subsequent recovery.

Many institutions, including standards setters (IASB) and prudential and securities regulators (EBA, ECB, ESMA, EC), have provided guidance on the use of IFRS 9. While it remains the responsibility of banks to implement the standards – and therefore to set provisions at appropriate levels – regulators emphasize the flexibility available within IFRS 9 to avoid undue procyclicality.

In particular, key judgement is required around economic scenarios and their translation in credit risk parameters. Under IFRS 9, those drive both the staging through the occurrence of a 'significant increase in credit risk' (SICR) as well as the measurement of ECL.

In terms of economic scenarios, outstanding questions relate to the short-lived nature of the current economic shock and the speed at which conditions then return to a longer-term trend – notably, how to factor in the impact of the supporting fiscal and monetary policies. With regard to scenarios, the ECB[7] clarified its expectations with respect to the due consideration of long-term macro-economic forecasts and the use of its own projections (Eurosystem/ECB staff) as 'anchor points'.

In terms of credit risk parameters, considerations should be given to the robustness of relationships established in benign economic conditions to the current environment. For example, how confident can one be about a linear relationship between credit risk and economic variables such as GDP growth when contemplating a double-digit contraction in 2020? Eventually, applying existing approaches in a mechanical manner may lead to irrelevant outcomes from an economic perspective, so that top-down adjustments and other management overlays would be required – in particular, the wide disparities at sectoral level should be accounted for (e.g. think of the contrast between airlines and streaming services).

In practice, available disclosures from banks as part of their Q1 results communication indicate a range of practice, including applying a 100% weight to pre-COVID-19 adverse scenario, updating all macroeconomic scenarios to reflect the current outlook and applying a flat provision overlay on top of regular estimates.

MORATORIUM

With regard to the accounting treatment of the moratorium, the NBB indicated following the EBA guidance that it should not lead in itself to trigger a SICR. The EBA[8] also rapidly confirmed that a general payment moratorium would not result in automatic classification in forbearance[9] – only because not borrower-specific in their design – nor in default under the CRR. Indeed, the revised payment schedule implies a reset of the 'days past due' criterion, which affects both the 30-days rebuttable assumption to consider a SICR, as well as the 90 days past due to consider a default of the borrower both under the accounting and regulatory regimes. The 'unlikely to pay' (UTP) criterion should also not automatically be considered to be met whenever a client applies for the moratorium, although there is no exemption granted and it should be assessed regardless on a case-by-case basis. In any case, the end of the scheme in October 2020 will be a 'moment of truth' as the ability to pay will be revealed.

[7] ECB letter to Sigificant Institutions "IFRS 9 in the context of the coronavirus (COVID-19) pandemic", April 1st 2020.
[8] Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02).
[9] Under the regulatory framework, forbearance designates *concessions that have been extended towards a debtor facing or about to face difficulties in meeting its financial commitments*.

BALANCE SHEET IMPACTS

From a balance sheet perspective, the moratorium will lead to lower inflows for the duration of the programme. This will slightly weight on liquidity metrics including the Liquidity Coverage Ratio (LCR) although the impact should be moderate[10]. The impact on the NSFR, which considers a 1-year horizon, should be negligible.

In terms of capital requirements, the impacts of the moratorium are limited to a standstill of the credit exposures for the duration of the payment break (where it would have otherwise gradually matured over time) and an extension of the maturity adjustments for IRB banks.

The provision of new loans and other credit facilities to support the liquidity of corporates will contribute to increase risk-weighted assets. In that regard, it should be noted that the reduction of capital requirements as a result of the state guarantee appears to be quite limited (see Box 4) and provides limited incentives in itself to grant additional loans. In the prudential framework, the state guarantee is assimilated into a synthetic securitisation for the purpose of measuring the capital relief. Not all Belgian banks may be familiar with the securitisation framework, which is quite complex under Basel III, adding to the implementation challenges in practice.

Among the measures put in place to support bank lending in the context of COVID-19, the European Commission put forward on 28th April 2020 a legislative proposal, including targeted amendments of the CRR and CRR2. The initiative intends to fast track the revised SME supporting factor, initially due to apply in June 2021. The revised implementation would lead to a decrease in the capital requirements needed for loans granted to SMEs, even for an exposure greater than EUR 1.5 million.

As part of the package, the Commission also proposed revisiting the IFRS 9 transitional arrangement, so as to mitigate the impact of a sudden increase in expected credit losses on regulatory capital. More specifically, the revised definition allows banks that opt-in to fully neutralise the increase in stage 1 and stage 2 provisions, compared to the pre-COVID-19 situation. The ECB recommended all banks under its remit to apply that phase-in, and many have already announced their intention to do so.

Finally, the Commission proposed to grant preferential treatment to loans subject to a state guarantee implemented in the context of COVID-19 for the purpose of the statutory prudential backstops with regard to non-performing loans ("NPL backstop").

However, in the context of the Belgian state guarantee programme, the maturity constraint makes it unlikely to be used, as a deduction from regulatory capital could only arise after the third year of an exposure being classified as non-performing.

[10] Inflows from non-financial customers typically represent a small portion of total inflows and contribute to a limited extent to the overall ratio. See for example figure 16 (p24) of the , Oct 2018EBA Report on Liquidity Measures under Article 509(1) of the CRR, Oct 2018.

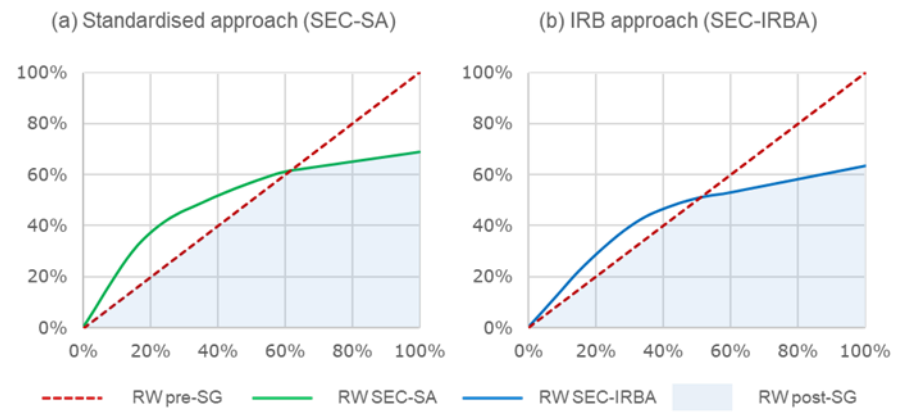
Box 4: Risk weighting exposures subject to the State Guarantee

From a prudential perspective, the state guarantee programme is expected to be recognized as an eligible credit risk mitigation (CRM). More precisely, the tranching structure of the guarantee is akin to a synthetic securitisation and the capital requirements are to be determined under the new securitisation framework[11].

In a nutshell, where a significant risk transfer is achieved, the revised securitisation framework relies on the capital charge associated with the loan pool had it not been securitised, respectively K_{SA} and K_{IRB} depending on the bank's approach towards the asset class of those assets. The subordination between the different tranches is then taken into account to determine the risk weight according to regulatory formulas.

Considering the structure of the state guarantee, simulations point towards limited savings in terms of capital requirements. The following figures represent the risk weight attached to the portfolio in scope of the state guarantee as a function of its risk weight assuming no credit enhancement.

Simulation of applying the State Guarantee on the average risk weight of the in-scope portfolio, resp. under the standard or IRB approach



For example, a portfolio of SME exposures qualifying as 'retail' under the standard approach would see its risk weight reduced from 75% to around 64%. The step-by-step breakdown is presented as follows:

Tranche	RW computed under SEC-SA	Cap on the senior tranche (CRR 267)	Recognition of the State Guarantee	Tranche-weighted average
0-3%	1250%	1250%	1250%	64.25%
3-5%	1250%	1250%	625%	
5%-100%	92.11%	75%	15%	

Generally speaking, the higher the risk profile of the underlying portfolio, the more risk is shifted under the state guarantee and leads to a reduction in capital requirements. On the contrary, for low-risk portfolios the exposure at risk is concentrated in the first tranche, where losses are essentially borne by banks. For those, the conservatism embedded in the securitisation capital framework actually leads to higher capital requirements compared to the underlying pool before application of the cap (CRR Art 268).

In terms of timing, any capital relief through synthetic securitisation may only be claimed once the reference portfolio has been composed, i.e. following the warehousing period of April-September.

[11] See CRR Art 234 and Regulation 2017/2401.

The unfolding of the crisis as well as its impact on market conditions and regulatory changes have overturned previously established funding and capital plans. The new environment will force banks to think about the necessary 'tweaks' to their funding structure amid elevated credit spreads compared to the pre-COVID-19 situation. The frontloading of the CRD V provision regarding the composition of the Pillar 2 requirements (P2R) notably raises the relevance of AT1 and Tier 2 instruments in meeting overall regulatory requirements, whereas the short-term flexibility signalled by the SRB regarding MREL, also considering the transition to the BRRD2/SRMR2 regime, will impact the build-up of eligible debt and the appropriate level of subordination.

Evolving rules will then affect how to manage the liability structure and the (strategic and tactical) decisions to issue and/or to call (or not) existing subordinated, senior unpreferred and preferred debt instruments. Effective communication with investors and rating agencies regarding the impacts of the crisis and the reliance on relief measures is also an area of focus in the months to come (see also Box 5 for the associated disclosure requirements regarding asset quality).

Overall, sound forecasting capabilities, scenario analysis and capital planning will be key to navigate through the crisis and ensure the sufficient flexibility to accommodate an uncertain economic outlook. In parallel, banks should ensure adequate room for manoeuvre and revisit their contingency and recovery planning arrangements, if not already done. Identified management actions in the planning phase should be reassessed in terms of availability and effectiveness given the current circumstances; not all options may be actually usable at the moment (e.g. think of limiting new lending), some may have already been used (e.g. suspend dividends) and new inputs require consideration, for example the accommodative monetary policy (extended collateral framework, reduced haircuts, TLTRO/PELTRO).

Box 5: Disclosure requirements – Higher transparency on asset quality

It is to be expected that investors and other market participants will require a high degree of transparency on banks' balance sheet and risk profile, as well as detailed disclosures regarding the accounting and prudential treatment of their credit portfolios.

In that context, it is reminded that as part of the NPL Action Plan of the European Council in 2017, the EBA was mandated to prepare enhanced disclosure requirements on asset quality and non-performing loans. New templates were issued in December 2018[12] and introduced under the Pillar 3 requirements as from December 2019.

The objective is to provide further transparency to market participants on the quality of banks' assets and, in the case of more troubled banks, the distribution of the problematic assets and the value of the collateral backing those assets. Proportionality is introduced through additional templates applicable to significant institutions that report a gross NPL ratio superior to 5% for at least two consecutive quarters:

Templates under EBA/GL/2018/10		All	SI & NPL >5%
Forbearance	Template 1: Credit quality of forborne exposures	✓	✓
	Template 2: Quality of forbearance		✓
Non-performing exposures	Template 3: Credit quality of performing and non-performing exposures by past due days	✓	✓
	Template 4: Performing and non-performing exposures and related provisions	✓	✓
	Template 5: Quality of non-performing exposures by geography		✓
	Template 6: Credit quality of loans and advances by industry		✓
Collateral valuation	Template 7: Collateral valuation - loans and advances		✓
Changes in the stock of NPLs	Template 8: Changes in the stock of non-performing loans and advances		✓
Foreclosed assets	Template 9: Collateral obtained by taking possession and execution processes	✓	✓
	Template 10: Collateral obtained by taking possession and execution processes – vintage breakdown		✓

The frequency is set on a semi-annual basis for credit institutions that qualify as G-SII or O-SII and those that are significant and have a gross NPL ratio of 5% or above, and on an annual basis for all other credit institutions.

Finally, and while no timing has been announced, the EBA is set to publish disclosure requirements regarding the use of general payment moratorium such as the one implemented in Belgium.

[12] EBA published in December 2018 its Guidelines on disclosure of non-performing and forborne exposures (EBA/GL/2018/10)

4. CONCLUSION

It has become increasingly clear in recent weeks that the economic recovery will be uneven and gradual, even following the phase-out from the lockdown. Policy measures from the government, central banks and banking supervisors have sought so far to protect banks' ability to continue lending throughout the pandemic and bridge the liquidity gap at a time when businesses and households need it most. Having said that, it is to be expected that financial difficulties may not be as short-lived as the state support for all borrowers.

As economic expectations turn from a 'V' to a 'U' or even 'L'-shaped recovery, throwing short-term liquidity lifeline - which the payment moratorium and the state guarantee are designed for – may not be the adequate response for many borrowers anymore. Beyond the underwhelming use of the state guaranteed loans, another sign that more solvency support is also required is the recent (8th May) extension by the European Commission of its "Temporary Framework" for State Aid control to also cover recapitalisation and subordinated debt measures. In Belgium, the government is discussing additional support measures to SMEs such as extending the tax shelters but no decision has been taken yet. The design of the state guarantee programme may also be revisited, in particular with regard to the cap on the maturity at twelve months.

For the banking sector, this crisis is an opportunity to play a role of shock-absorber rather than itself contributing to the downturn. It will not come out of it unscathed however. Banks' already low profitability is being further squeezed between a 'lower for longer' interest rate environment and higher loan loss provisions. Operational challenges relating to the implementation of the moratorium and state guarantee have also stressed the importance of investing in agile IT systems and pursuing digital transformation efforts. While regulators and supervisors have rather been supportive so far, headwinds will resume in the medium term, in particular with the transposition of the final Basel III standards. Inevitably this will revive – once again – speculation about a consolidation of the sector in Belgium and more generally in the Eurozone.

AUTHORS

François Delcourt
Senior Manager
Tel +32 2 880 03 20
Mobile +32 494 15 57 11
f.delcourt@reply.com

David Denayer
Manager
Tel +32 2 880 03 20
Mobile +32 498 68 00 36
d.denayer@reply.com

About AVANTAGE REPLY

With operations in Amsterdam, Brussels, Frankfurt, Lisbon, London, Luxembourg, Milan, Munich, Paris, Rome and Turin, Avantage Reply is the Reply Group financial services consulting practice employing more than 300 specialized consultants and drawing on the wider capabilities of Reply's 7,500+ people. Avantage Reply delivers advisory and management consulting services to financial services institutions with respect to Risk and Compliance, Finance (including Capital Management and Regulatory Reporting), and Treasury. Since its establishment in 2004, Avantage Reply has been committed to industry specialization (financial services) offering insights and in-depth experience. Avantage Reply works with board members, CROs, CCOs, COOs and CFOs, senior and mid-management finance and risk executives of leading financial services institutions across the Eurozone and the United Kingdom. We provide advisory and management consulting services to help financial institutions address the risk, finance and compliance challenges arising from changes in regulation and strategic and organizational change, including technology.