

CORONAVIRUS: PRUDENTIAL TREATMENT OF PAYMENT MORATORIA IN LUXEMBOURG

As a consequence of the COVID-19 pandemic, many businesses and private individuals now face liquidity shortages and difficulties in timely payment of their financial and other commitments. This in turn impacts credit institutions, as delays in the repayment of credit obligations lead to a larger number of defaults and increased own fund requirements. In this context, Member States and/or institutions have introduced moratoria on payments of credit obligations, with the aim of easing the operational and liquidity challenges borrowers are facing. Such measures have however raised questions regarding their legal effect on the current prudential framework, especially in the context of the application of the definition of default and classification of forbearance. In order to provide clarifications thereon, the European Banking Authority (EBA) has published statements, guidelines and a report in this context. The CSSF has followed by updating its Covid-19 FAQ and issuing dedicated circulars to adopt/implement such EBA publications.

PRUDENTIAL TREATMENT AS CLARIFIED BY THE EBA

The CSSF has informed credit institutions, via its circular CSSF 20/741 (as amended by Circular 20/749), that it complies with and applies the EBA guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis¹ (EBA guidelines on moratoria) and that it has integrated them into its administrative practice and regulatory approach.

The EBA guidelines on moratoria apply in relation to the application of the definition of default² and classification of forbearance³ in accordance with the Capital Requirements Regulation (CRR).

Indeed, a moratorium generally triggers an assessment of forbearance⁴, as the latter applies where a credit institution grants a concession (e.g.

Key aspects

- The general legislative and non-legislative moratoria on payments of credit obligations that fulfil the EBA conditions will not be considered forbearance and distressed restructuring under the CRR and the consideration of diminished financial obligation will not be applicable to these obligations.
- This does not remove the requirement for institutions to carefully assess the credit quality of exposures benefiting from these measures and identify any situations in which borrowers are unlikely to pay for the purpose of the definition of default.

This briefing speaks as of 28 July 2020.

¹ EBA/GL/2020/02 (as amended by the EBA guidelines EBA/GL/2020/08)

² Article 178 CRR.

³ Article 47b CRR.

⁴ Article 47b CRR.

temporarily postpone capital and/or interest payments of a loan) when it identifies that a borrower is experiencing or is likely to experience financial difficulties in repaying loan(s). If the forbearance measures qualify as distressed restructuring (i.e. they result in a diminished financial obligation), the restructuring would correspond to an unlikelihood-to-pay event that triggers a classification in default⁵.

The EBA guidelines on moratoria therefore intend *inter alia* to clarify the following in the context of the COVID-19 pandemic: (i) the criteria that payment moratoria have to fulfil not to trigger forbearance classification and (ii) the application of the prudential requirements in the context of these moratoria.

Criteria for general payment moratoria

In order not to be considered forbearance, a general legislative or non-legislative moratorium has to fulfil the following conditions:

- **It was launched in response to the COVID-19 pandemic and is effectively applied by 30 September 2020.** This deadline may be revised in the future depending on the evolution of the current situation.
- **It has to be broadly applied.** The proposed treatment applies to moratoria that are similar in economic substance, regardless of whether they are legislative or non-legislative. Given that legislative moratoria apply to all institutions within a given jurisdiction, a similarly broad scope of application also has to be ensured for non-legislative moratoria. A private moratorium initiated by a single institution is not deemed sufficiently broad, therefore not qualifying as an eligible moratorium in the sense of EBA guidelines on moratoria. In Luxembourg, as of 16 April 2020, an eligible industry-wide private moratorium initiative has been set up under the coordination of the Luxembourg Bankers' Association (ABBL). It broadly applies to loans to corporate clients, SMEs and individual professionals established in Luxembourg.
- **It applies to a large group of obligors.** It is necessary to ensure that the change of the schedule of payment does not address specific financial difficulties of specific obligors, as this would meet the definition of forbearance. Therefore, in order to benefit from the treatment specified in the EBA guidelines on moratoria, the moratorium has to be available to a large, predefined group of obligors, regardless of the assessment of their creditworthiness.
- **The same moratorium offers the same conditions.** The moratorium has to offer the same conditions for the changes of the payment schedules to all exposures subject to the moratorium, even if the application of the moratorium is not compulsory for obligors.
- **It changes only the schedule of payments**, namely by suspending, postponing or reducing the payments of principal amounts, interest or of full instalments, for a predefined limited period of time; no other terms and conditions of the loans, such as the interest rate, should be changed.
- **It does not apply to new loans granted after the launch of the moratorium.** It has to be ensured that the moratorium addresses a specific issue arising as a result of the COVID-19 pandemic and is not used for

⁵ Article 178(3)(d) CRR and EBA/GL/2016/07.

new lending granted after the outbreak. The use of existing credit lines or renewal of revolving loans is not considered a new loan.

Application of the prudential requirements in the context of these moratoria

- **Definition of forbearance.** A general payment moratorium that meets the requirements of the EBA guidelines on moratoria would not in itself lead to a reclassification under the definition of forbearance. However, institutions should continue to categorise the exposures as performing or non-performing in accordance with the applicable requirements. In particular, as a general principle, before granting a forbearance measure, credit institutions should carry out an individual assessment of the repayment capacity of the borrower and grant forbearance measures tailored to the specific circumstances of the borrower in question.
- **Definition of default.** In accordance with the EBA guidelines on moratoria on the application of the definition of default⁶, where forbearance measures were extended towards the borrower, this should be considered distressed restructuring, which, in accordance with CRR⁷, is an indication of unlikelihood to pay if it leads to diminished financial obligation. Given that the application of a general moratorium is not a forbearance measure, it should also not be considered distressed restructuring and the consideration of diminished financial obligation is not applicable.
- **Assessment of unlikelihood to pay.** Even where the general payment moratoria are not classified as forbearance measures, this does not remove the obligations for institutions to carefully assess the credit quality of exposures benefiting from these measures and identify any situations in which borrowers are unlikely to pay for the purpose of the definition of default. Credit institutions should in particular continue identifying any situation in which borrowers are unlikely to pay for the purpose of the definition of default. Accordingly, credit institutions should continue to apply their normal policies for the regular reviews of indications of unlikelihood to pay during the time of the general payment moratoria and classify their exposures in accordance with the applicable provisions on default. It is expected that credit institutions will apply these policies in a risk-based manner, paying particular attention to and prioritising the assessment of those obligors who are most likely to experience payment difficulties.

Report on the implementation of EBA guidelines on moratoria

The EBA has also published a report⁸ on the implementation of selected COVID-19 policies, which intends to clarify the implementation of its guidelines on moratoria by addressing a number of interpretative questions and presenting an overview of the general payment moratoria in place in the EU based on notifications sent to the EBA. In addition, the report includes considerations on the COVID-19 issues which can arise in applying the operational risk framework. The report sets out common criteria intended to provide clarity on the supervisory and regulatory expectations regarding the treatment of COVID-19 operational risk losses in the capital requirement calculations. The report also encourages credit institutions to collect

⁶ EBA/GL/2016/07.

⁷ Article 178(3)(d) CRR.

⁸ EBA/REP/2020/19.

information on data losses, even when these are not expected to be part of the setting of capital requirements.

FURTHER CSSF'S CLARIFICATIONS

The CSSF has further stressed that:

- All entities that have adhered to general payment moratoria effectively implemented by 30 September 2020 and that are willing to benefit from this prudential treatment should comply with the EBA guidelines on moratoria.
- Institutions that would like to benefit from the dedicated prudential treatment, have to become party to an eligible moratorium initiative. In that case, all obligors in scope of the moratorium can request the application of the moratorium and the institution is obliged to grant the moratorium.
- Where moratoria are implemented in Luxembourg with the view to benefit from the above-described treatment, the CSSF considers that such moratoria may only cover performing obligors who did not experience payment difficulties before the application of the moratorium. In addition, exposures that had already been subject to forbearance measures at the moment of the application of such moratoria cannot be reclassified (upgraded) as a result of applying a moratorium.
- Credit institutions are (i) required to collect specific information on exposures where the moratorium has been applied and to report certain information to the CSSF and (ii) are expected to make use of general payment moratoria in a transparent manner.

ADDITIONAL REPORTING AND DISCLOSURE OBLIGATIONS

The CSSF has issued another circular CSSF 20/748 to inform all credit institutions designated as Less Significant Institutions under the Single Supervisory Mechanism and all branches of non-EU credit institutions that it complies with and applies the EBA guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis⁹ (EBA guidelines on reporting).

The EBA guidelines on reporting have introduced reporting and disclosure requirements in the context of measures taken by credit institutions in response to the COVID-19 crisis, covering both payment moratoria on existing loans and public guarantees on new lending exposures. They introduce reporting templates, including in relation to forborne exposures, where such measures are not captured in the existing supervisory reporting framework.

All in-scope entities are therefore required to report the relevant exposures and disclosure information to the CSSF in accordance with such guidelines. In particular, Less Significant Institutions and branches of non-EU credit institutions have the obligation to submit on a quarterly basis certain templates if they apply the industry wide moratorium in Luxembourg as coordinated by the ABBL for related exposure and/or if they have signed the convention with the Luxembourg State Treasury to originate loans covered by the Luxembourg

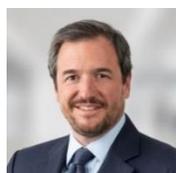
⁹ EBA/GL/2020/07.

State Guarantee in the context of the COVID-19 pandemic. Additional reporting may be requested by the CSSF.

The CSSF has stressed that these reporting and disclosure requirements are put forward strictly in the context of the COVID-19 crisis and are therefore expected to be limited in time.

Furthermore, for the purpose of assessing the need for additional reporting, such entities are also required to notify the CSSF by 3 August 2020 at the latest, or on a timely basis at any subsequent dates, where they apply or intend to make use of the measures described in the EBA guidelines on reporting in other jurisdictions.

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