CHARACTERISTICS AND IMPLICATIONS OF THE COVID-19 RELATED LOAN MORATORIUM IN BULGARIA

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Abstract

The paper reveals main characteristics of the COVID-19 related loan moratorium in Bulgaria. The implications for non-financial corporations, households and banks are discussed. The recent developments regarding the take-up of the loan repayment deferrals are described and analysed. Suggestions about the possible future path of recovery phase after the expiration of the moratorium are provided.

Keywords: *banks, banking sector, bank management, regulations, loan moratorium*

1. INTRODUCTION

The coronavirus pandemic posed huge challenges in terms of health, social and economic aspects, affecting many countries, sectors, businesses and people. As COVID-19 spread worldwide and in Europe, the EU Member States deployed fiscal and monetary policy measures as well as relief measures such as moratoria on loan repayments and public guarantee schemes (PGSs) in order to mitigate the immediate impact of the sudden freeze in economic activity, support new lending and provide breathing space to borrowers.

Moratoriums on bank loan payments could be an effective tool in case of short-term liquidity difficulties experienced by bank customers. Many companies and citizens experienced such difficulties, because their work was restricted or suspended as a result of the measures against the spread of COVID-19. This, in turn, may pose an adverse effect on credit institutions, as far as under the current regulatory framework, deferred or terminated loan payments lead to additional costs and capital requirements for banks.

The response to the unexpected health, social and economic crisis, posed by the coronavirus, could be described as "firm, substantial and quick" (EBF, 2020). The EU institutions have successfully developed a coordinated action plan, relying on different policy approaches from the policy toolbox. Thus, leveraging from the bitter experience from the Great Financial Crisis from 2007-2008, learning from the previous outcome and relying on prior knowledge regarding actions to be taken.

On the side of the regulatory policy, lawmakers have agreed on a so-called "quick fix" of several regulations and directives in a record time. For example, the ECB supervisory flexibility measures (ECB, 2020) and the loan moratoria scheme designed by the European Banking Authority (EBA, 2020a), introduced in March-April 2020, managed to provide the European banking sector with a substantial relief to keep the level of lending for households and non-financial corporations (NFCs), which, on the other, had got a breather due to the temporary postponement of loan instalments.

In this regard and by a quick reaction, the Association of Banks in Bulgaria (ABB), in collaboration with the industry and national authorities, designed and proposed a procedure for granting moratorium on payments. On 9 April 2020, by a decision of its Governing Council the Bulgarian National Bank (BNB) approved the submitted by the ABB (2020a) *Procedure for Deferral and Settlement of Liabilities Payable to Banks and their Subsidiaries – Financial Institutions* in relation to the measures taken by the authorities of Republic of Bulgaria to limit the COVID-19 pandemic and its consequences (Procedure for deferral).

After its approval, the document constituted a private moratorium within the meaning of the Guidelines of the European Banking Authority on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 *(EBA/GL/2020/02)* (EBA, 2020a). Therefore, the EBA guidelines

introduced a temporary principle that moratoriums on bank loan payments do not lead to reclassification of exposures in the form of restructuring or default, provided that the measures are based on national law and are agreed and implemented at the banking sector level.

The paper is structured as follows: Chapter II reveals main characteristics of the COVID-19 related loan moratorium in Bulgaria. Chapter III provides insights on the implications of the Procedure for defferal in Bulgaria for banks and their customers – NFCs and households. The recent developments regarding the take-up of the loan repayment deferrals are described and analysed, regarding the published statistical data and experience so far. Chapter IV includes suggestions about the possible future path of recovery phase after the expiration of the moratorium. Chapter V concludes the paper.

2. MAIN CHARACTERISTICS OF THE COVID-19 RELATED LOAN MORATORIUM IN BULGARIA

The approved Procedure for deferral provided an opportunity for changes in the schedule for payment of the principal and/or the interest on the liabilities, without changing key parameters of the loan agreement, such as the already agreed interest, which the EBA guidelines do now allow anyway. The Procedure for deferral was adopted by the Executive Board of the ABB and any possible necessary amendments shall be applicable after they are specifically approved by the BNB (ABB, 2020a).

At the start, in April 2020, it was possible to reschedule liabilities initially for a period of up to 6 months ending on 30 September 2020 and, on a later stage, after the first amendments, made in July 2020, until 31 March 2021 and, after the last changes, for a period of up to 9 months ending on 31 December 2021.

According to the conditions, deferred liabilities had to be regularly serviced or overdue for not more than 90 days by 1 March 2020. The Procedure was applicable to loans granted before March 2020, thus making relation with the necessity the clients had to have experienced difficulties due to COVID-19.

Customers must explicitly state to their bank that they wish to take advantage of the Procedure for defferal (opt-in). Three standardized mechanisms were envisaged as follows:

• Mechanism № 1 – deferral of principal and interest for up to 6 months *(initial period)*/9 months (*after the amendments in December 2020)*;

• Mechanism № 2 – deferral of principal for up to 6 months *(initial period)*/9 months *(after the amendments in December 2020)*;

• Mechanism № 3, applicable to revolving products.

The relevant mechanism had to be chosen by mutual agreement between banks and their customers. Of course, banks may negotiate with their clients other individual schemes of deferral or relief, other than those arranged in the Procedure. In such cases, banks will not be able to benefit from the provisional principle introduced by the established moratorium and following the EBA guidelines that deferral or relief does not result in reclassification of exposures in the form of restructuring or default.

With the unfolding of the COVID-19 pandemic, in June 2020, the EBA extended the application date of its guidelines by three months, from 30 June 2020 to 30 September 2020 (EBA, 2020b). On 9 July 2020 the Governing Council of the BNB made a decision that it will comply with the Guidelines *EBA/GL/2020/08*, voted by the EBA, amending Guidelines *EBA/GL/2020/02* on legislative and non-legislative moratoria on loan repayments applied in light of the COVID-19 crisis. They extended by three months, from 30 June 2020 to 30 September 2020, the deadline for application of the moratorium on payments laid down in the EBA Guidelines *EBA/GL/2020/02*.

In the beginning of July 2020, the BNB approved the request by the ABB for an extension of the deadlines of the moratorium on payments, as envisaged by the EBA decision. The changes were related to:

• extension of the deadline for submitting a request by bank customers for deferral of liabilities and their approval by banks – until 30 September 2020 (from end-June 2020);

• extension of the deadline for deferral of liabilities of bank customers - until 31 March 2021 (from end-December 2020).

The extension of the term of the liability deferral procedure applied to exposures for which no request for deferral of payments was submitted before 22 June 2020.

Given the improving state of the economy and the initial expectations for COVID-19 subsiding in the summer months of 2020, on the 21st of September 2020 the EBA communicated the phasing-out of its guidelines (EBA, 2020d). But that decision lasted three months. In December 2020, after closely monitoring the developments of the COVID-19 pandemic and, in particular, the impact of the second COVID-19 wave and the related government restrictions taken in many EU countries, the EBA has decided to reactivate its Guidelines on legislative and non-legislative moratoria. The aim of this reactivation was to ensure that loans, which had previously not benefitted from payment moratoria, could also benefit from them. The EBA extended the final deadline for applications until 31 March 2021 (EBA, 2020e).

In regard to the EBA decision, in December 2020 the proposal of the ABB to extend the deadline for submission of requests by the clients of the banks under the Procedure for deferral until the end of March 2021 was adopted by the Governing Council of the BNB. Thus, the deadline in the Procedure for deferral in Bulgaria was aligned with the new deadline set as per EBA guidelines.

The last changes in the Procedure for deferral, in addition to preserving the capacity of banks to grant new loans, enabled banks, within favourable regulatory treatment, to provide relief to borrowers to service their loans until December 31st, 2021, by deferring their obligations for not more than 9 months if they have submitted a request on time. After this period, bank customers should return to the normal scheme of loan repayment. According to the conditions of the Procedure for defferal, the amounts outstanding on the initially agreed maturity dates shall be repaid in installments after the expiry of the grace period, according to the respective deferral mechanism. A new repayment plan should be prepared.

Every bank customer may request deferral no later than 23 March 2021, and the bank must make a decision by 31 March 2021 (ABB, 2020a). The request may include both installment payments that were overdue before filing of the request, and installment payments not yet due. If the customer is not overdue as of the date of the deferral request, the deferral shall be applied only to future payments – to installment payments not yet matured. Exposures for which a deferral was agreed under this Procedure before 30 September 2020 may be additionally deferred, for a total period of deferral which should not exceed 9 months. Thus, the ending period, if a customer took advantage of the maximum defferal period, was set on 31 December 2021.

3. IMPLICATIONS OF THE COVID-19 RELATED LOAN MORATORIUM IN BULGARIA

According to the BNB data, many Bulgarian companies and households affected by the pandemic have benefited from the measure.

As of 30 June 2020, three months after the introduction of the Procedure for defferal, 118,584 applications were filed consisting total amount of loans of BGN 9.772 billion as 98.499 applications for loans at the amount of BGN 8.117 billion were approved, representing approximately 10% of the total bank loan portfolios. Corporations submitted 15,068 applications amounting to BGN 7.539 billion, as 13,156 of them amounting to BGN 6.207 billion were approved. Households submitted 103,516 applications for BGN 2.233 billion, of which 85,343 amounting to BGN 1.91 billion were approved (ABB, 2020b, p.19).

The first assessment of the EBA showed a significant use of COVID-19 moratoria and public guarantees by banks in the EU. As of June 2020, a nominal loan volume of EUR 871 billion was granted moratoria on loan repayments, comprising about 6% of banks' total loans and close to 7.5% of total loans to households and NFCs on an aggregate European level (EBA, 2020c).

The use of moratoria was widely dispersed across countries and banks, with a few banks reporting that almost 50% of their total loans to NFCs and households were subject to moratoria. Banks in Cyprus,

Hungary and Portugal reported the highest share of loans subject to moratoria. French, Spanish and Italian banks reported the highest volumes of loans subject to moratoria. As of June 2020, around 50% of the loans under moratoria were due to expire before September 2020, while 85% of the loans were due to expire before December 2020. However, due to the second wave of COVID-19, some countries have already announced an automatic extension of the moratoria beyond the year-end (EBA, 2020c).

In total, according to EBF estimates, more than 8 million individuals have benefitted from the deployment of national moratoria schemes in Europe. More than 5 million households have been able to postpone their payments with the aid of their banks, while more than 2 million companies also benefitted from moratoria conditions on their loan payments. Overall, more than 85% of the borrowers' requests for postponement of payment schedules were accepted by the banking sector (EBF, 2020).

As of 30 September 2020, 124,950 applications were filed consisting total amount of loans of BGN 9.998 billion as 106,481 applications for loans at the amount of BGN 9.023 billion were approved. Corporations submitted 14,343 applications amounting to BGN 7.711 billion, as 13,165 of them amounting to BGN 6.976 billion were approved. Households submitted 110,607 applications for BGN 2.267 billion, of which 93,316 amounting to BGN 2.047 billion were approved (ABB, 2020b, p.20).

As of 31 December 2020, 108,211 applications were filed consisting total amount of loans of BGN 8.76 billion as 89,478 applications for loans at the amount of BGN 8.074 billion were approved. Corporations submitted 13,506 applications amounting to BGN 6.365 billion, as 12,354 of them amounting to BGN 6.365 billion were approved. Households submitted 94,705 applications for BGN 1.94 billion, of which 77,124 amounting to BGN 1.709 billion were approved. Compared to April 2020, the total number of approved applications by corporations and households increased by 52,267, and the gross amount of approved liabilities subject of the private moratorium, within the meaning of the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID19 (EBA/GL/2020/02), increased by BGN 4.65 billion. The BNB data includes the borrowers that applied for, and subsequently voluntarily gave up using the benefits under the moratorium, and also those for whom the grace period had expired (ABB, 2021b, p.19).

Figure 1 shows the total number and total sum of approved defferals of non-financial corporations.

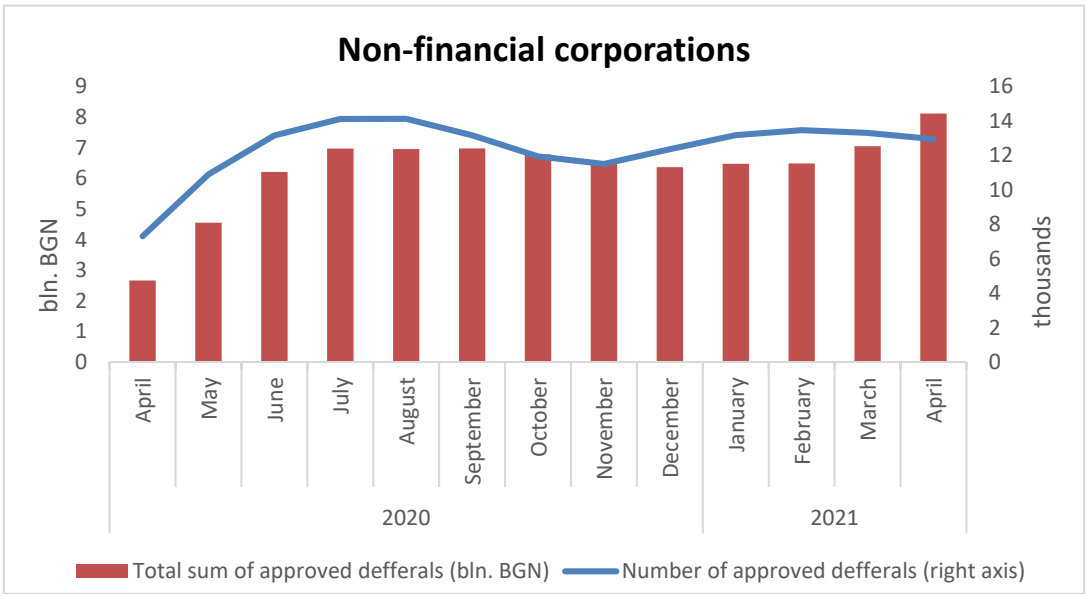

Fig. 1. Number and total sum of approved defferals of non-financial corporations

Source: BNB.

Figure 2 shows the total number and total sum of approved defferals of households. Figure 3 shows the total number and total sum of approved defferals of NFCs and households.

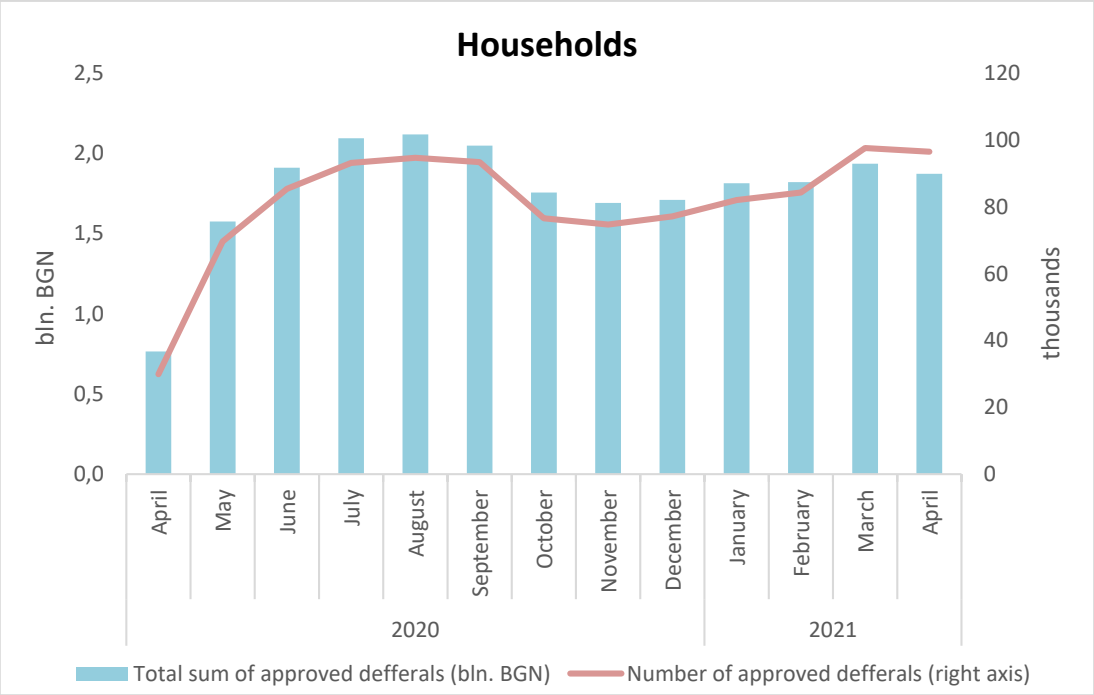

Fig. 2. Number and total sum of approved defferals of households

Source: BNB.

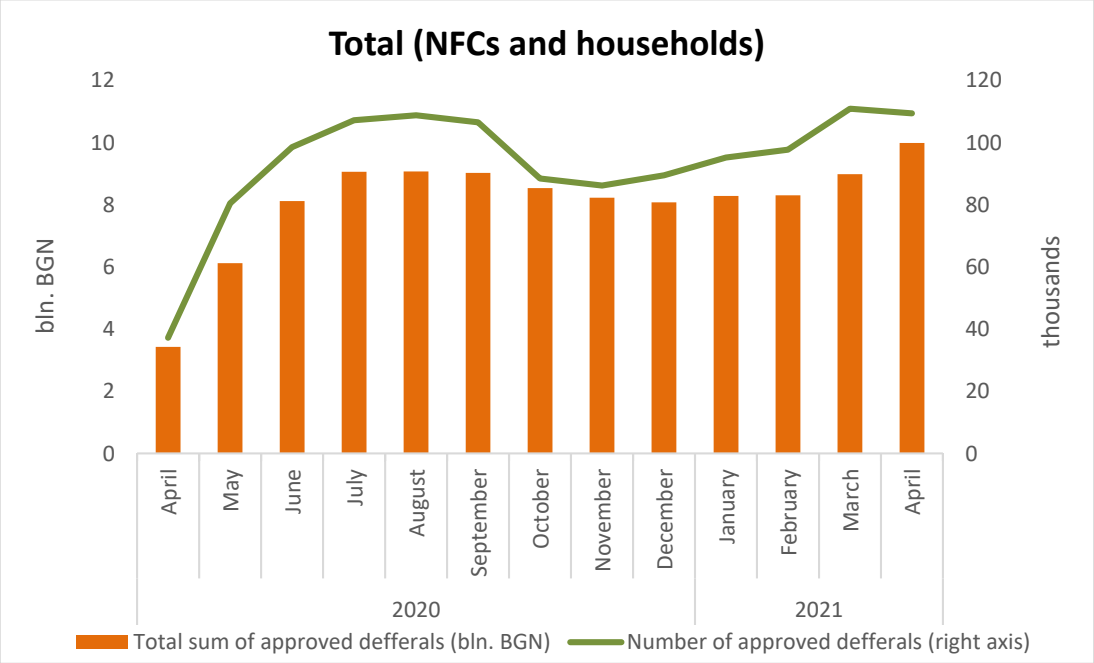

Fig. 3. Total number and total sum of approved defferals of non-financial corporations and households

Source: BNB.

Figure 4 provides insights about the total number and amount of denied applications compared to the number and amount of approved applications. The share of approved applications gradually increased, in comparison with the take-up in the first two-three months of the application of the Procedure for defferal.

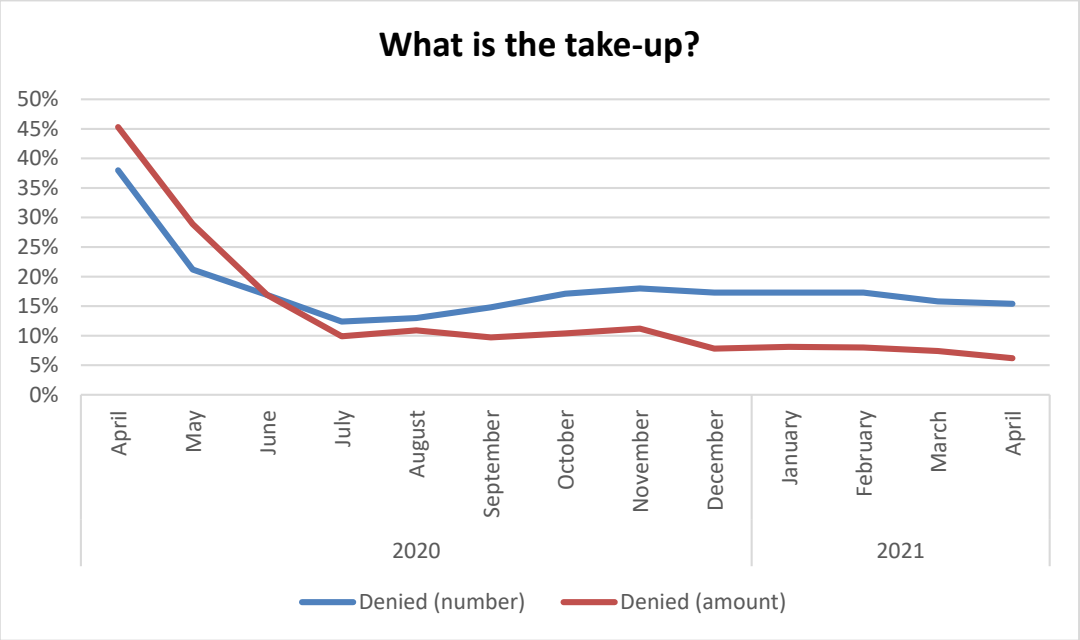

Fig. 4. Total number and amount of denied applications compared to the number and amount of approved applications

Source: BNB, own calculations

After the last amendments of the Procedure for defferal, extending the deadline for deferral of liabilities of bank customers to 31 March 2021, by the approaching of the deadline, deferral applications increased significantly, especially for households, as observed on Figure 1, 2 and 3, in the period January-March 2021.

Towards the end of April 2021 over 109 thousand requests of companies and households with a total value of over BGN 9.9 billion were approved. Compared to December 2020, when the BNB Governing Council approved the latest changes in the Procedure for deferral, the number of approved requests increased by approximately 19,900 and the total value – by over BGN 1.9 billion (ABB, 2021a, p.19).

Reflecting the gradual expiry of the extended moratorium on bank loan repayments, the BNB (2021b, p.7) expects additional growth moderation in credit to NFCs and households. Following the expiry of the deadline for deferring obligations of bank clients, according to the BNB, the share of non-performing loans (NPLs) in bank portfolios is likely to increase, which would reflect in higher interest rates on new loans.

So far changes in the economic environment from the pandemic have not resulted in deterioration of the main indicators of asset quality (BNB, 2021a, p.10). The data shows a continuation of the downward trend of the share and the volume of NPLs. Among the reasons contributing to the drop in the share of non-performing loans were loan write-offs and sale operations, deferral of obligations under the private moratorium and various lending facilities in support of the pandemic response (BNB, 2021a, p.12).

At the end of Q1 2021, according to the BNB data, the share of NPLs in Bulgaria remained below the limit of 5% (excluding central banks and credit institutions; over 90 days), with a higher degree of coverage with impairment of gross non-performing loans (62.7%), compared to the average level for

the countries from the EU. The sector continues to be characterized by a significant capital surplus, above the regulatory requirements for capital adequacy and liquidity coverage ratios, compared to the EU and euro area averages (ABB, 2021c, p.2).

The data confirms the assessment of high resilience of the Bulgarian banking system, even in the context of the crisis caused by COVID-19 and reaffirms the preparedness to couple with unexpected challenges ahead.

4. DISCUSSION

Since the implementation of moratorium schemes across the board, loans under moratoria were associated with potential increase of credit risk. The EBA expects that upon expiry of EBA-compliant moratoria there might be increases in forborne loans and NPLs. Therefore, institutions and supervisory authorities should monitor closely this effect.

Risks of a cliff edge effect at the expiry of moratoria, coupled with the prolongation of the economic downturn, might lead to a sudden significant increase in the level of NPLs. The continuation or persistence of moratoria may also have the side effect of potential systemic risk for financial stability, as borrowers may develop a "non-paying" culture. [EBA report, p.7] Banks are carefully assessing this in order to tackle the possible deterioration of asset quality more effectively in the following quarters.

In early 2021, the EBA, under whose *Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02 of the 2nd of April 2020), amended by EBA Guidelines (EBA/GL/2020/08 of the 25th of June 2020), amending Guideline EBA/GL/2020/02 and by EBA Guidelines (EBA/GL/2020/15 of the 2nd of December 2020) amending Guideline EBA/GL/2020/02*, the Procedure for deferral has been established in Bulgaria, although closely monitoring the developments, indicated that it does not envisage new changes to its Guidelines, but that the focus of the industry and stakeholders should shift to the recovery phase of the economy.

In this regard, and despite the fact that they operate in an environment unusual for all economic sectors in the country, accompanied by restrictive measures taken in connection with the COVID-19 pandemic, banks continue to support their customers. Banks are currently negotiating individually the specific options for restructuring customer liabilities, in which case loans are classified in accordance with the current supervisory framework.

5. CONCLUSIONS

Against the background of weakened economic activity in 2020 and early 2021, due to the global pandemic caused by the spread of COVID-19, as well as the uncertainties related to the pace of economic recovery, the banking sector expresses its readiness to continue providing support for businesses and households (ABB, 2021c, p.1).

The timely response of global, European and national regulators by taking measures to counteract the negative effects of the pandemic, combined with the contribution of banks, allowed to maintain high liquidity and ensure credit growth, even in the most challenging months of the pandemic (ABB, 2021c, p.1).

The moratoria on payments provided the necessary flexibility as well as certainty as regards to the regulatory framework, in light of significant number of actions taken by banks to support their customers as exceptional lock-down measures were put in place in the course of 2020 and in the beginning of 2021. The preserved and continued ability for banks to provide lending was of key importance.

Positioning their role in the stage of economic recovery, banks will continue with their active policy and presence in terms of lending and various forms of financial intermediation, as well as the diversification of products and services they offer. High technology, innovation, the development of digital channels and other modern ways to maintain a closer relationship with customers and a better understanding and

satisfaction of their individual needs will continue to be a key topic for the banking activities. (ABB, 2021c, p.3).

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DISCLAIMER

The views expressed by the author in this paper are his own and do not necessarily represent the views of the Association of Banks in Bulgaria, neither engage the organization nor its members in either way.

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