BANCO DE **ESPAÑA**
Eurosistema

**30.04.2020**

# FAQs

Supplement to the briefing note of 30/03/2020 on the use of the flexibility envisaged in the accounting standards in view of the shock caused by COVID-19

Updated: 30/04/2020

---

## 1. What are the consequences of a modification in a loan being deemed to be refinancing or restructuring transactions as opposed to a rollover or renegotiation?

The main difference between refinancing or restructuring (hereafter, forbearance) and a rollover or renegotiation is that in the former the institution considers that *the borrower is experiencing or likely to experience **financial difficulties**.*

This difference has implications in several areas:

- ***Supervisory financial reporting**:* only granting concessions to a borrower deemed to be in financial difficulties is reported as forbearance, according to the definition of the European Banking Authority (EBA).
- ***Accounting criteria***: the accounting classification for credit risk of forborne exposures will depend, among other factors, on the assessment of the effect of the borrower's financial difficulties on the ability to repay the debt under the new conditions agreed, bearing in mind the applicable accounting framework.
- ***Prudential:*** the capital requirements on exposures will depend, inter alia, on their classification or not as a default, according to the significance of the changes in the contractual conditions, bearing in mind prudential regulations and EBA guidelines.

## 2. What accounting effects do the legal moratoria granted under the situation caused by COVID-19 have?

The legal moratoria do not, per se, give rise at the time of their application to any change in the accounting classification of the loan for credit risk.

They do, however, have implications for the ***calculation of the arrears*** of the debt, which is made in accordance with the new payment schedule. Specifically, the amounts suspended by legal moratoria are not considered claimable and, therefore, nor are they considered past-due. Thus, the payments included in the term of the legal moratoria shall not be considered for the purposes of classification of the exposures as non-performing due to arrears.

Borrowers classified as performing as of the date of the moratorium may remain classified under this category, insofar as there are no doubts about the repayment of the debt under the new schedule and it is not considered that there has been a significant increase in credit risk.

**3. What impact is there on the accounting classification for credit risk of ICO (Official Credit Institute)-backed financing granted to a customer affected by the situation caused by COVID-19 with whom the institution has other loan transactions? What is the appropriate treatment in such cases in which some of these transactions already had amounts past-due by more than 30 days?**

The institution will have to analyse, when the ICO-backed financing is granted, if there has been a significant increase in credit risk in the pre-existing transactions with the borrower, taking into account the effect that the ICO-backed financing has on the latter's financial situation. If this is not the case, the pre-existing transactions shall be considered viable and shall not need to be reclassified as Stage 2 (performing exposures under special monitoring) solely as a result of application of the public support measures; this will be the case insofar as there has been no event evidencing a significant increase in credit risk.

Given the time elapsed between the onset of the situation caused by COVID-19 and the possible date of signing of the new transactions, if there are amounts past due by more than 30 days in the pre-existing transactions, this will not determine their classification as Stage 2 (performing exposures under special monitoring), provided there are no other events that evidence a significant increase in credit risk.

**4. What is the appropriate accounting treatment for a modification of the contractual term and conditions of a loan transaction agreed bilaterally between an institution and a customer affected by the situation arising from COVID-19?**

The institution will have to analyse whether the contractual amendment is considered to be forbearance or, otherwise, a rollover or renegotiation; in other words, whether it considers that the borrower has or will foreseeably have financial difficulties in repaying the loan. In any event, the borrower will be understood to have financial difficulties if the modified transaction is classified as non-performing or if there is a partial derecognition (e.g. an acquittance) of the transaction.

In the event of a modification of terms and conditions, the credit risk at the time of origination is compared with the credit risk under the new terms and conditions and, if no other event has occurred that would lead to reclassification under the institution's policies, the exposure may continue to be classified as Stage 1 (performing) if: i) the modification is granted as part of a programme (and not as a result of the existence of financial difficulties specific to the customer), ii) the borrower is current on payment iii) there has been no partial derecognition of existing transactions, and iv) the agreed maturity extension is short (up to 12 months). Where these conditions are met, the exposure is considered viable and does not have to be reclassified solely as a consequence of the modification; this will be the case insofar as there has been no other event evidencing a significant increase in credit risk.

Lastly, derecognition would not be appropriate as the modification is not considered material (i.e. there is no substantial change in the contractual cash flows before and after), unless the transaction should be classified as non-performing, in which case

derecognition would be appropriate, in accordance with the institution's policies (paragraph 117 of Annex 9 of Circular 4/2017 of 27 November 2017).

5. **What factors should be considered to determine whether a customer is experiencing temporary and exceptional liquidity problems as a result of the situation caused by COVID-19 or, in contrast, whether there has been a significant increase in credit risk which would lead to classification of the exposure in Stage 2 (performing exposures under special monitoring)?**

   In order to determine whether there has been a significant increase in credit risk, it is necessary to consider the probability of default over the ***entire life of the transaction***. That is to say, the extent to which sudden changes in the short term in payment behaviour have a significant impact on credit risk over the whole life of the transaction must be analysed.

   Use of the flexibility embedded in the accounting framework entails, inter alia, ***avoiding the mechanical use of classification factors***; while these may be reasonable in normal situations, they may not be reasonable under exceptional circumstances not envisaged by such framework.

   Moreover, taking into account the current uncertainty and until reliable forecasts become available, it is reasonable when estimating the probability of default to give greater weight to more stable forecasts based on past experience.

   The decisions taken by institutions in relation to their policies for identifying significant increases in credit risk must be explained in the notes to the annual accounts, as must any policy decisions requiring a high degree of judgement on the part of managers.

6. **Under what circumstances may the presumption that amounts past due by more than 30 days lead to classification of an exposure in Stage 2 be rebutted?**

   Use of the flexibility embedded in the accounting framework entails, inter alia, avoiding the mechanical application of credit risk classification factors.

   Consequently, if no other event has occurred that would lead to reclassification under the institution's policies, exposures with amounts past due by 30 days ***will not automatically be required to be classified*** in Stage 2.

7. **What impact do public guarantees have on the estimation of expected credit losses?**

When calculating the credit loss on exposures covered by public guarantees, institutions shall consider all the features of the transaction to estimate cash flows. This means cash flows obtained from the enforcement of such public guarantees should be taken into account. Thus, irrespective of the credit risk category in which the exposure is classified during its life, the amount of the associated expected credit loss will be reduced by the positive impact of the ***cash flows expected to be recovered from the guarantor***.

Consequently, the estimated amount of coverage for exposures with public guarantees will be reduced by the amount of possible forgone cash flows that is covered by the public guarantee (irrespective of the classification of the exposure as performing, performing under special monitoring or non-performing).

8. **What are the implications of giving more weight to more stable scenarios in expected loss estimates?**

   The accounting standards require that all reasonable and supportable information available, including forward-looking information, be taken into account to estimate expected credit losses. This entails considering not only past and present events, but also projections of future economic developments.

   To generate forward-looking scenarios, the direct effects of COVID-19 and also the effects of the exceptional and far-reaching public support measures approved in recent weeks to mitigate those effects must be considered. However, in the present setting, it is extremely difficult to assess all these effects. In consequence, while this uncertain and volatile situation continues, it is reasonable that when estimating expected losses, institutions should give more weight to more stable projections drawing on past experience.

   In this way, institutions' forward-looking scenarios will reflect more stable conditions, in which the effects of sudden fluctuations arising in an environment with constant changes in the very short term will be mitigated. Subsequently, when the economic situation begins to stabilise and reasonable and supportable information becomes available, institutions will be able to make more reliable projections that reflect macroeconomic scenarios and their associated probabilities.

9. **Some institutions are resorting to the alternative solutions provided for in the Banco de España's accounting circular for collective estimates of credit loss allowances. Can they continue to do so, without making any further adjustments to factor in the effects of COVID-19?**

   The accounting circular provides alternative solutions for collective estimates of credit loss allowances on ***business in Spain***. These alternative solutions have been estimated drawing on the experience of the Banco de España, its information on the Spanish banking sector and projections of future economic developments.

   The institutions that are using these alternative solutions may continue to do so, without making any adjustments to the amounts obtained. In this way they are able to sidestep rapid, volatile fluctuations that would make it impossible to generate reliable forecasts given the current extreme uncertainty and absence of reasonable and supportable information.

   When the Banco de España has reasonable and supportable forward-looking information available, allowing it to make robust projections, it will be able to generate macroeconomic scenarios that take into account the changes in the economic situation and the support measures granted by governments and public authorities. Once these new scenarios are available, the calibration of the alternative solutions will be analysed. For this purpose, the centralised scenarios that the ECB intends to provide will also be considered.

10. **How should exposures directly affected by COVID-19 be identified in institutions' risk management and accounting systems?**

    Exposures directly affected by any of the support measures introduced to mitigate the economic effects of COVID-19 (moratoria, public guarantees and bilateral agreements between institutions and their customers amending terms and conditions) should be

duly documented and identified in institutions' risk management and accounting systems, thus facilitating their traceability.

In particular, institutions should keep the information necessary to know, at all times, the type of measure applied and how the exposures affected have evolved, to allow for their correct monitoring and internal control.

Institutions will flag these transactions with the corresponding identifiers in their accounting records. These identifiers will subsequently be included in their reporting to the Central Credit Register (CIRBE), in accordance with the instructions to be issued by the Banco de España.

**11. How do the ECB's prudential recommendations affect the less significant credit institutions?**

Several of the measures announced by the ECB in its public statements also apply to the less significant credit institutions directly supervised by the Banco de España.

First, if institutions' capital falls below the level needed to comply with the capital conservation buffer requirement and a compliance plan has to be submitted, the Banco de España will be flexible in processing approval of the plan.

Second, as the current situation may cause liquidity stress, it is expected that institutions will draw down their liquid asset buffers, even though this may take them below the minimum liquidity coverage ratio (LCR) levels. If this occurs, they will have to submit a compliance restoration plan to the Banco de España, which it will process in a flexible manner.

Lastly, given that the public health crisis may affect institutions' ability to meet their non-performing loan reduction targets, the Banco de España will take this circumstance into account when reviewing the implementation of non-performing asset reduction plans.

**12. What is the accounting classification according to credit risk of moratoria that meet the conditions set out in the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02)?**

Pursuant to the EBA Guidelines EBA/GL/2020/02 (and the EBA's replies to any questions that may arise on their implementation), the moratoria are not considered forbearance for the purposes of Article 47(b) of Regulation (EU) No 575/2013 (CRR) and nor shall they have to be identified as such for the purposes of financial reporting under Circular 4/2017 of 27 November 2017, unless the exposures were already identified as forborne at the time of granting of the moratoria. This applies both to the legislative and the other moratoria envisaged in the EBA Guidelines EBA/GL/2020/02 (e.g. moratoria granted in the framework of a scheme promoted by a professional association).

Among other conditions, the above-mentioned moratoria are granted as part of a scheme that is available to borrowers that satisfy certain general conditions. In other words, they are not granted on the basis of analysis of the borrower's specific situation, and they do not depend on whether the borrower is facing financial difficulties.

Exposures that are classified as performing on the date on which a moratorium is granted in accordance with EBA Guidelines EBA/GL/2020/02 may continue to be

classified as performing, insofar as no other event has been identified evidencing a significant increase in credit risk.

There shall be no improvement in the classification of exposures that are classified as performing under special monitoring or non-performing on the date on which one such moratorium is granted owing to the mere fact of receipt of the corresponding deferral of payment.