Unwinding COVID-19 Policy Interventions for Banking Systems

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Monetary and Capital Markets
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Issues to consider in unwinding COVID measures

Outline

1. Initial policy responses and estimates of pandemic impact
2. General considerations on unwinding
3. Unwinding regulatory measures
4. Actions to promote financial stability
### Issues to consider in unwinding COVID measures

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Initial response measures vary across countries

**Moratoria on**
- Debt repayments
- Foreclosures and auctions (as well as eviction of tenants behind on rent)
- Insolvency proceedings (both new filings and existing cases)

**Credit support**
- Public guarantee schemes
- Term funding to banks to lend to firms
- Purchase of corporate commercial paper, bonds and asset-backed securities

**Prudential and accounting rules**
- Use of capital buffers
- Dividend restrictions
- Reduced liquidity requirements
- Suspension of changes to credit risk grades/classification and/or underwriting standards
- Allowing full recognition of loan interest income accrued but not collected

**Other measures**
- Lower interest rates
- Quantitative easing programs
- Outright fiscal support/tax moratoria
Solvency distress a substantial policy challenge
Share of debt at firms with solvency stress

Source: GFSR Chapter 1, April 2021 – analysis of 19,500 firms (half are SMEs) in 29 countries

NPLs above this level can weigh on Financial Stability
Some industry sectors are in deep distress

Proportion of debt at mid-sized firms with elevated solvency stress

Source: GFSR April 2021
ASEAN: The share of firms with weak debt service capacity is expected to have increased significantly in 2020

ASEAN-6: Firm-at-Risk by Industry

(Percent share of firms generating earnings not enough to cover interest payment)

Sources: S&P Global Market Intelligence; and IMF staff estimates

Source: Kim, Xin, and Yoo (Forthcoming)
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Identifying the ‘safe path’ to unwinding support

Insolvencies

No Policy Intervention
1. Spike in insolvencies
2. Economic & fiscal shock
3. Social stability pressures
4. Financial crisis

Non-performing credit becomes Systemic

Policies help ‘flatten the curve’

- At what level do NPLs have systemic impact on financial systems?
  - When they threaten viability of most banks (i.e. deplete capital, costs exceed income)
  - 15 percent of gross loans during Asian crisis
  - 5 percent considered high in EU, but 10+ percent may threaten viability
Continued support needed in many cases, but trade-offs are needed given fiscal and debt constraints.

Replace blanket moratoria with targeted support

Timebound based on needs

Should promote private investment & credit discipline

Lead to enterprise restructuring with fair burden sharing

Financial systems should not become de-facto safety nets through use of long-term and blanket moratoria.
When holistic unwinding strategies are needed: Quantifying and calibrating the policy support

Enterprise + Household Distress Levels

- Recent observations
- Economic forecasts
- Business forecasts

Triage

Viable

Viable with Restructuring

Unviable

Support needed to avoid NPLs becoming Systemic
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Reminder: Overall Objectives of the Regulatory and Supervisory Measures

Support economy and provision of credit, liquidity and other financial services

Preserve financial stability and a healthy and sound financial system

Maintain international framework
Wide range of measures implemented, sometimes against Fund advice

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Encourage use of capital and liquidity buffers
Ease macroprudential measures
Restrict capital distributions
Suspend automatic triggers for supervisory actions
Additional flexibility for capital / liquidity restoration plans
Postpone new regulation
Relax capital requirements that were above Basel standards
Defer the impact of ECL provisioning on regulatory capital
Postpone regulation that was supposed to have been already implemented
Lack of exit strategy
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Delay due supervisory actions

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General considerations on regulatory measures

- Trade-offs to be addressed:
  - Credit support (e.g., moratoria): help avoid deeper economic effects vs. resources are allocated to unviable activities
  - Using the flexibility embedded in the regulatory framework provides near-term relief but may create an expectation that more accommodative interpretations will be introduced
  - Restrictions on dividend distributions: preserve capital vs. impair investor confidence
  - Relaxation of rules helps buy time but compromises transparency

- Several key questions:
  - Covid-19 policy measures worked as intended?
  - Impact of the measures already taken on overall financial stability?
  - Impact/implication of the reversal of Covid-19 policies on the shape of the recovery?
  - Fiscal and monetary space remains available?
Deciding on exceptional regulatory measures

What are the key questions?

Impact on recovery
Are measures effective?
What would be the impact of reversal?

Risk to financial stability
Path of future losses?
Risk of having lower prudential standards?
Impact on confidence in the banking system?
**Fund recommendations in 2020**

Reverse measures not compatible with international standards

Keep restrictions on capital distributions, with adjustments

Use stress tests to inform decision making

Maintain flexibility to restore capital levels in case of breach

Rebuild buffers once the recovery is firmly under way

**How to unwind capital measures?**

- **Use embedded flexibility and uphold risk standards**
  - Encourage use of capital and liquidity buffers
  - Ease macroprudential measures
  - Restrict capital distributions

- **Relax capital requirements that were above Basel standards**
  - Reduce minimum risk weights
  - Reduce capital requirements below international minima
  - Facilitate capital distributions

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INTERNATIONAL MONETARY FUND
What about countries that have not implemented Basel III?

-> consider the nature of the prudential rule that has been eased

Buffers are macrofinancial in nature

- Reintroduce pre-crisis prudential requirements when the shock has been absorbed by banks
- Consider the benefit of explicitly incorporating capital buffers in the regulatory framework

Buffers reflect institutional weaknesses

- Start progressively restoring pre-crisis requirements (with a phasing-in period)
On grounds of prudence, supervisors should continue to limit capital distributions

High uncertainty

Need to increase resilience and capacity to support the economy

➢ Temporarily halt banks dividends and share buybacks
➢ across the banking sector

Unwinding COVID-19 interventions

Banks remain well capitalized

But uncertainty still elevated

Appropriate to continue restricting distributions

➢ Step-by-step adjustments could be considered
  ▪ Use stress tests to assess potential policy adjustments
  ▪ Be careful when loan loss recognition is postponed
  ▪ Ability to challenge banks' capital plans
Maintain guidance compatible with international standards

Reverse measures relaxing accounting standards

Intensify supervisory monitoring

Timely identification of NPLs
Supervisory priorities

- **Early intervention** remains critical to address problems not caused by the COVID-19 pandemic

- Supervisors should continue to **adjust their priorities** and focus on the most meaningful risks (most likely credit risk, operational resilience, liquidity risk)

- Nonessential activities that have been postponed in the early phase of the crisis should be **progressively reintroduced** in the regular supervisory cycle

- **Supervisors should reactivate stress testing programs**
  - Challenges still high but more manageable
  - Sensitivity analysis, reverse stress tests may complement ST
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Recommended actions to promote financial stability – bank resolution considerations

Operational Challenges & Increased Risk
- Uncertainty with asset valuations
- Identifying credible resolution options
- Capital/funding/governance structures
- Managing sales processes
- Ability to deploy several specialist teams

Continue

Resolution Plans
Recommended actions to promote financial stability – National Financial Stability Committees

- Monitor bank health
- Upgrade financial safety net
- Prepare contingency plans
- Ensure effective operating arrangements
- Holistic NPL management strategy
Translating a holistic unwinding strategy into a prioritized interagency action plan

Example actions include
Thank You

For MCM published notes, please see: https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes#mfp

IMF COVID-19 Publications relevant to this work


“A Firm-Level Assessment to Better Target Future Policy Support”, Chapter 1, April 2021 GFSR.


Loan classification

Calculation of days past due

- **BCBS**
  - Payment moratorium periods relating to the Covid-19 outbreak can be excluded by banks from the counting of days past due

- **Bank of England**
  - The BoE does not consider the use of a Covid-19 related payment holiday by a borrower to trigger the counting of days past due or generate arrears

- **European banking Authority**
  - In the case of moratoria permitting suspension or delays in payments, the 90 days past due criterion is modified, as the delays are counted based on the modified schedule of payments

Two criteria used to classify borrowers as defaulted: (i) number of days past due and (ii) unlikeliness to pay
Loan classification

Calculation of days past due

March 15
End of the moratorium

April 1
Debtor missed the first payment scheduled after the moratorium

No payments are made

90 days

But: The assessment of unlikeliness to pay during and after the moratorium should be based on whether the borrower is unlikely be able to repay the rescheduled payments.

July 1
Borrower classified as defaulted