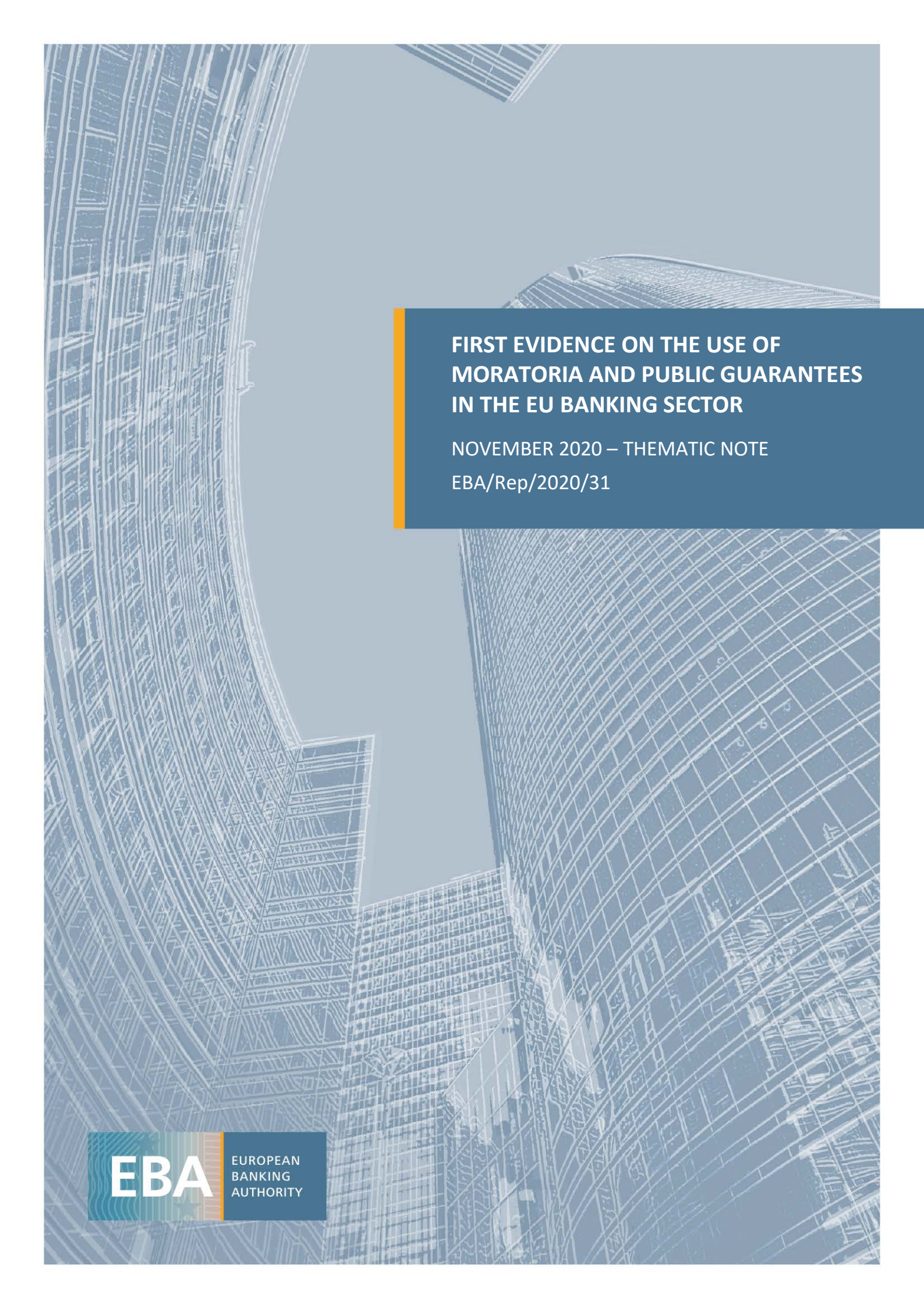




FIRST EVIDENCE ON THE USE OF MORATORIA AND PUBLIC GUARANTEES IN THE EU BANKING SECTOR

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Executive summary

Relief measures were introduced to tackle the effects of the pandemic, and the supervisory community swiftly reacted to these

As coronavirus disease 2019 (COVID-19) spread in Europe and worldwide, Member States deployed relief measures such as moratoria on loan repayments and public guarantee schemes (PGSs), as well as fiscal measures, in order to mitigate the immediate impact of the sudden freeze in economic activity, support new lending and provide breathing space to borrowers. Relief measures, such as moratoria, were also provided by private/industry initiatives. Banks' exposures under moratoria on loan repayments, both legislative and non-legislative, required a common prudential treatment, which was provided by the EBA guidelines on legislative and non-legislative moratoria on loan repayments.

This report provides an overview of the reported data on COVID-19 measures

In order to enable competent authorities and, more generally, market participants to monitor the risks associated with these exposures, the EBA introduced guidelines on the reporting and disclosure of COVID-19 measures. This report provides the first insights into the use of moratoria and public guarantees based on these data, using information available up to 30 June 2020. The use of moratoria and PGS may have evolved in the following months.

Loans under moratoria on loan repayments were significant on average, with high dispersion across countries

As of June 2020, a nominal loan volume of EUR 871 billion was granted EBA-compliant moratoria on loan repayments, comprising around 6% of banks' total loans. EUR 860 billion to households (HHs) and non-financial corporations (NFCs) which is close to 7.5% of total loans to households (HHs) and non-financial corporations (NFCs). The use of moratoria was widely dispersed across countries and banks, with a few banks reporting more than 40% of their total loans to NFCs and HHs were subject to moratoria. Cypriot, Hungarian and Portuguese banks reported the highest share of loans subject to moratoria. French, Spanish and Italian banks reported the highest volumes of loans subject to moratoria.

The SME segment had the highest percentage of loans under moratoria

About 60% (EUR 495 billion) of the loans subject to EBA-compliant moratoria were given to NFCs, while 40% (EUR 365 billion) were given to HHs. In total, 16% of small and medium enterprise (SME) loans were granted moratoria, followed by 12% of commercial real estate (CRE) loans; 7% of residential mortgage loans were granted moratoria on loan repayments.

Expiry of moratoria should be monitored closely to avoid cliff edge effect

As of June 2020, around 50% of the moratoria were due to expire before September 2020, while 85% of the loans were due to expire before December 2020. However, some countries have already announced an automatic extension of the moratoria, beyond the year end.

Loans under moratoria have a high share allocated in stage 2 assets

Banks should remain vigilant and continuously assess the asset quality of these exposures. Stage 2 allocation and non-performing loan (NPL) ratios are key monitoring metrics for assessing potential risks. Around 17% of loans under moratoria were classified as stage 2, which is more than double the share for total loans. The NPL ratio for loans subject to moratoria was 2.5%, slightly lower than the EU average of 2.9% for all loans. This, however, is expected, as many schemes allowed only performing loans to make use of moratoria.

PGSs were mostly related to NFC loans and were material in some countries

As of June 2020, newly originated loans subject to PGSs amounted to EUR 181 billion, representing 1.2% of banks' total loans and 1.6% of total loans to HHs and NFCs. These loans were granted predominantly to NFCs, which are responsible for about 95% of the total loans subject to PGSs. Banks in Spain had the highest share of new loans subject to PGSs relative to total loans, while banks in France, Italy and Portugal also reported material volumes. Banks in other European countries reported very low volumes, and some countries had none.

PGSs have longer residual maturities than moratoria

Around 44% of these loans had guarantees in place with a residual maturity of between 2 and 5 years, while another 34% of loans benefited from guarantees with a residual maturity of between 6 months and 1 year.

PGSs have the potential to significantly reduce banks' risk-weighted assets (RWAs)

The reducing effect of PGSs on RWAs varied significantly across banks and countries. On average, banks reported the RWAs to be 18% of the exposure value for loans subject to PGSs. This compares with an average risk weight of 54% for banks' loans to NFCs.

However, the relief measures also have idiosyncratic and systemic risks

Banks should be cognisant of the risks associated with the affected exposures, and in particular with respect to the phase-out of moratoria and PGSs. The prolongation of the economic downturn reported by most Member States and the appearance of a second wave of COVID-19 throughout Europe could lead to a sudden and significant increase in the level of NPLs in the future.

Supervisors should continue monitoring the developments closely

Although the regulatory treatment set out in the guidelines on legislative and non-legislative loan repayment moratoria was applied to all payment holidays granted under EBA-eligible payment moratoria prior to September 2020, the corresponding moratoria continue to apply. The EBA will be closely monitoring the evolution of moratoria and PGSs in the following quarters.

Measures applied amid the COVID-19 outbreak

In the aftermath of the COVID-19 pandemic outbreak, Member States provided immediate support to their economies. The aim was to maintain adequate liquidity for businesses and HHs, and to mitigate the immediate impact of the sudden freeze in economic activity. Because of the different forms of population confinement, such as lockdown measures and social distancing, a wide range of sectors was affected. The possible liquidity shortages and difficulties in the timely payment of financial and other commitments, for both businesses and HHs, would not only have reduced economic activity but could also have had a significant impact on banks as delays in the repayment of credit obligations lead to a larger number of defaults and increased own-funds requirements. This would possibly have had a second-round effect in the form of potential tensions in the credit market, with a magnified and even stronger adverse effect on the economy.

As a quick response to these risks in many jurisdictions, national authorities and banks introduced legislative and non-legislative moratoria on loan repayments for borrowers in financial difficulty, as well as PGs. Macroprudential authorities also released capital buffers, such as countercyclical and systemic risk buffers, and regulators allowed the necessary flexibility for banks to operate below Pillar 2 Guidance (P2G). In addition, central banks expanded their liquidity programmes, such as the European Central Bank's targeted longer-term refinancing operations (TLTRO) III and the pandemic emergency purchase programme (PEPP). All these measures had a common denominator: to enhance liquidity in the economy and to provide the necessary toolkit to banks to enable continued lending to NFCs and HHs. This report focuses on the uses of moratoria on loan repayments and PGs. The report provides initial evidence on the use of these, based on relevant supervisory data, across the EU.

Description of moratoria on loan repayments and public guarantee schemes

Moratoria on loan repayments take different forms, either legislative or non-legislative¹. In addition, various moratoria set different eligibility criteria. For example, these are determined based on the sector or segment of the exposure, residence of the obligor (e.g. only domestic exposures are eligible), performance of the obligor or exposure (e.g. only performing or non-defaulted obligors are entitled) or payment capacity. Whatever the format of the moratoria, they share similar objectives and provide a financial relief to borrowers by allowing suspension or postponement of payments within a specified period.

¹ The EBA publishes [notifications on general payment moratoria by country](#).

Although payment moratoria are effective in addressing short-term liquidity shortages caused by the limited or suspended operation of many businesses and HHs, they should target only temporary problems and should not prevent a timely and accurate recognition of credit risk.

The EBA guidelines on legislative and non-legislative moratoria² clarify which moratoria (both legislative and non-legislative) do not trigger a forbearance classification. Furthermore, the guidelines supplement the EBA guidelines on the application of the definition of default³ with regard to the treatment of distressed restructuring. The guidelines clarify, in particular, the conditions under which moratoria do not automatically trigger the assessment of distressed restructuring under the definition of default. The guidelines stress, however, that banks should continue to adequately identify those situations where short-term payment challenges may turn into long-term financial difficulties and eventually lead to insolvency. Although the EBA decided to phase out the application of the guidelines as of 30 September 2020, the regulatory treatment set out in the guidelines continued to apply to all payment holidays granted under eligible payment moratoria prior to 30 September 2020, thus avoiding cliff edge effect risks of having to reclassify existing loans abruptly.

Member States also widely provide PGSs⁴ to support and maintain the flow of lending to the real economy. In general, the support measures target mostly those businesses in need and those that have limited alternatives to access liquidity from elsewhere, e.g. capital markets. For this reason, the measures of PGSs, in many countries, are designed to specifically support lending to small businesses (including in some cases micro businesses and the self-employed) and SMEs, which are the backbone of the corporate sector in many countries.

Increased reliance on support measures bears risks

Although the application of EBA-compliant moratoria does not automatically trigger either the forbearance classification or the non-performing status of the exposure, banks are required to assess the unlikelihood to pay criterion for classifying the exposures as non-performing. In addition, a loan should be classified in International Financial Reporting Standard (IFRS) 9 stage 2 when its credit risk has increased significantly. Therefore, it is important that the dynamics of the asset quality of loans under moratoria are closely monitored even before the expiry of the moratoria. 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. Banks should carefully assess this in order to tackle the foreseen deterioration of asset quality more effectively in the following quarters.

² [EBA guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis.](#)

³ [EBA guidelines on the application of the definition of default](#)

⁴ [EBA publishes an overview of public guarantee schemes issued in response to the COVID-19 pandemic.](#)

The use of PGSs may have moral hazard issues, as banks and borrowers could be incentivised to ‘misuse’ the guarantee offered by bundling, for example existing NPLs with new loans subject to PGSs, although the eligibility conditions may prevent or at least mitigate this risk.

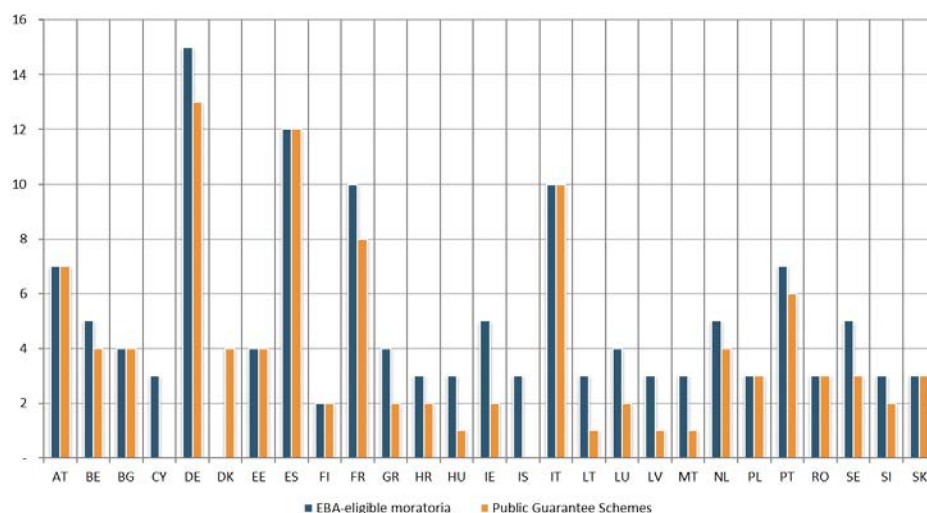
Accurate information is fundamental to monitor the use of support measures and to assess the potential risks associated with exposures under moratoria and public guarantees. In order to enable supervisors, and more generally market participants, to monitor these exposures and promptly identify associated risks, the EBA introduced reporting and disclosure requirements to cover the affected exposures through the guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 measures⁵.

This report is mostly based on these reporting requirements, which required banks to provide a first data set as of June 2020. For banks in some countries, however, the data might not necessarily provide the full picture on the use of public guarantees. This is because of the delayed or partial implementation of the reporting guideline in some countries⁶.

Sample of banks analysed in the report

This report considers moratoria-related data⁷ reported by 132 banks in total (100 at the highest consolidation level)⁸, and PGS-related data reported by 126 banks (99 at the highest consolidation level)⁹. Figure 1 shows the number of institutions that have reported values greater than zero, by country of the reporting entity.

Figure 1: Number of institutions reporting the use of moratoria and PGSs by country



⁵ [Guidelines on COVID-19 measures reporting and disclosure.](#)

⁶ [An overview of compliance with the COVID-19 reporting guideline is available on the EBA website.](#)

⁷ The cut-off date for all moratoria and PGS data submitted by banks was 17 November 2020

⁸ The banks considered in this report represent more than 95% of total loans to HHs and NFCs in the EBA reporting sample ([List of Reporting Institutions for 2020](#)). The list of reporting institutions to the EBA covers about 80% of the total assets of the EU banking sectors.

⁹ Certain data fields were reported by a substantially lower number of institutions. The number of institutions is indicated where appropriate for the relevant indicator or figure.

EBA-eligible moratoria on loan repayments in the EU banking sector

Banks from some countries report high usage of moratoria on loan repayments

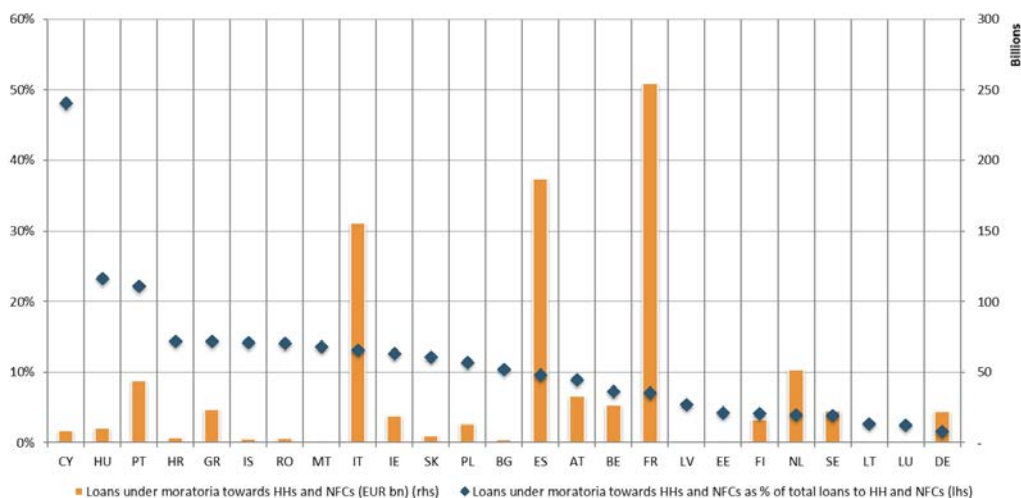
As of June 2020, EU banks reported that close to EUR 871 billion of loans were granted EBA-compliant moratoria on loan repayments, including those that had already expired by this date (or 6% for total loans granted EBA-compliant moratoria as a share of the total loans). EUR 860 billion were towards HHs and NFCs, which represents around 7.5% of the total loans given to HHs and NFCs reported by the banks in the sample¹⁰.

Loans under EBA-compliant moratoria represented a significant share of total loans given to HHs and NFCs by banks in many countries across the EU. French, Spanish and Italian banks dominated the loan volumes that were granted moratoria at a consolidated level. French banks reported EUR 255 billion of loans under moratoria towards HHs and NFCs (7% of their total loans for HHs and NFCs); this was followed by Spanish banks (EUR 187 billion, 10% of total loans for HHs and NFCs) and Italian banks (EUR 156 billion, 13% of total loans for HHs and NFCs). It should be noted that these exposures include loans to counterparties of all regions that are granted moratoria and, therefore, for some countries, these exposures may be particularly driven by their banks' presence in other countries (including non-European Economic Area countries) through their subsidiaries.

The use of moratoria on loan repayments was widely dispersed across countries. For example, Cypriot banks reported that almost 50% of their total loans to HHs and NFCs were under moratoria. Banks in Hungary and Portugal also reported extended use of moratoria, as more than 20% of their reported loans to NFCs and HHs were under moratoria. On the contrary, banks in Germany, Luxemburg and Latvia reported the lowest share of loans subject to moratoria (Figure 2).

¹⁰ The note focuses on the comparison of loans subject to moratoria against total NFCs and HHs loans.

Figure 2: Volumes of loans to HHs and NFCs granted moratoria (EUR billion) and loans to HHs and NFCs granted moratoria as a percentage of total loans to HHs and NFCs by country – June 2020

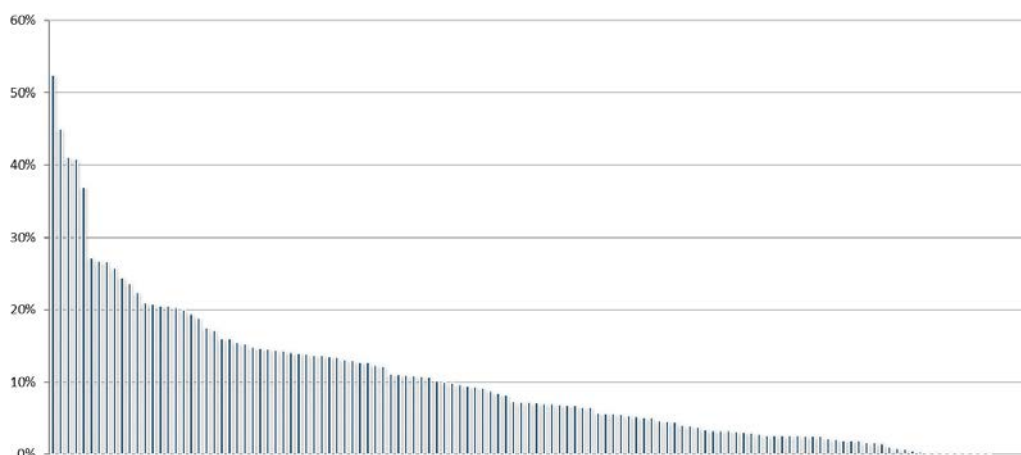


Source: EBA supervisory reporting

Dispersion was also wide at a bank-by-bank level, with four banks reporting that more than 40% of their loans to HHs and NFCs were under moratoria on loan repayments and 18 banks reporting that more than 20% of their loans were under moratoria. In total, 25% of the banks in the sample reported that less than 2.6% of their relevant exposures were under moratoria (Figure 3).

Banks with a high share of loans under moratoria may face challenges in thoroughly assessing the credit quality of these exposures on a case-by-case basis, as required under the existing regulation. There could also be incentives to reduce banks' risk assessment and recognition of risks for all exposures under moratoria. As such, upon the expiry of moratoria, these banks may face a cliff edge effect risk. In addition, these banks may face resource limitations, as it is genuinely difficult to thoroughly assess all exposures under moratoria and to provide amicable forbearance solutions in a proactive manner, in order to limit the deterioration of the asset quality of these exposures.

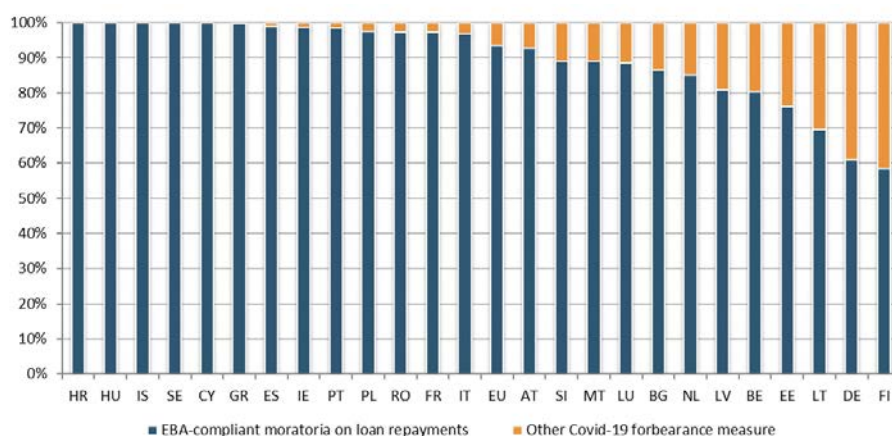
Figure 3: Loans to HHs and NFCs granted moratoria as a percentage of total loans to HHs and NFCs by bank – June 2020



Source: EBA supervisory reporting

Among those measures included in the EBA reporting templates, EBA-compliant moratoria on loan repayments was the most commonly used measure by COVID-19-impacted borrowers. However, banks also used other forbearance measures. In fact, other COVID-19-related relief measures provided by EU banks, such as non EBA-compliant payment moratoria, contractual modifications or refinancing (e.g. a change in interest rate or extension of the maturity of the loan), amounted to around EUR 60 billion. While EBA-compliant measures in Germany were less relevant than in other EU countries (Figure 2), German banks reported the largest amount of loans with other COVID-19-related forbearance measures (EUR 14 billion, or 1% of total loans). In addition to banks in Germany, banks in Finland, the Netherlands and the Baltics reported the highest percentage of other COVID-19-related forbearance measures. Banks in these countries reported a lower than average take-up of moratoria on loan repayments as a share of total loans (Figure 2). Upon the expiry of EBA compliant-moratoria and their prudential treatment, and as banks further engage with their clients to provide suitable forbearance measures, the use of contractual modifications is expected to increase in the following quarters.

Figure 4: Allocation of loans with COVID-19-related forbearance measures – June 2020



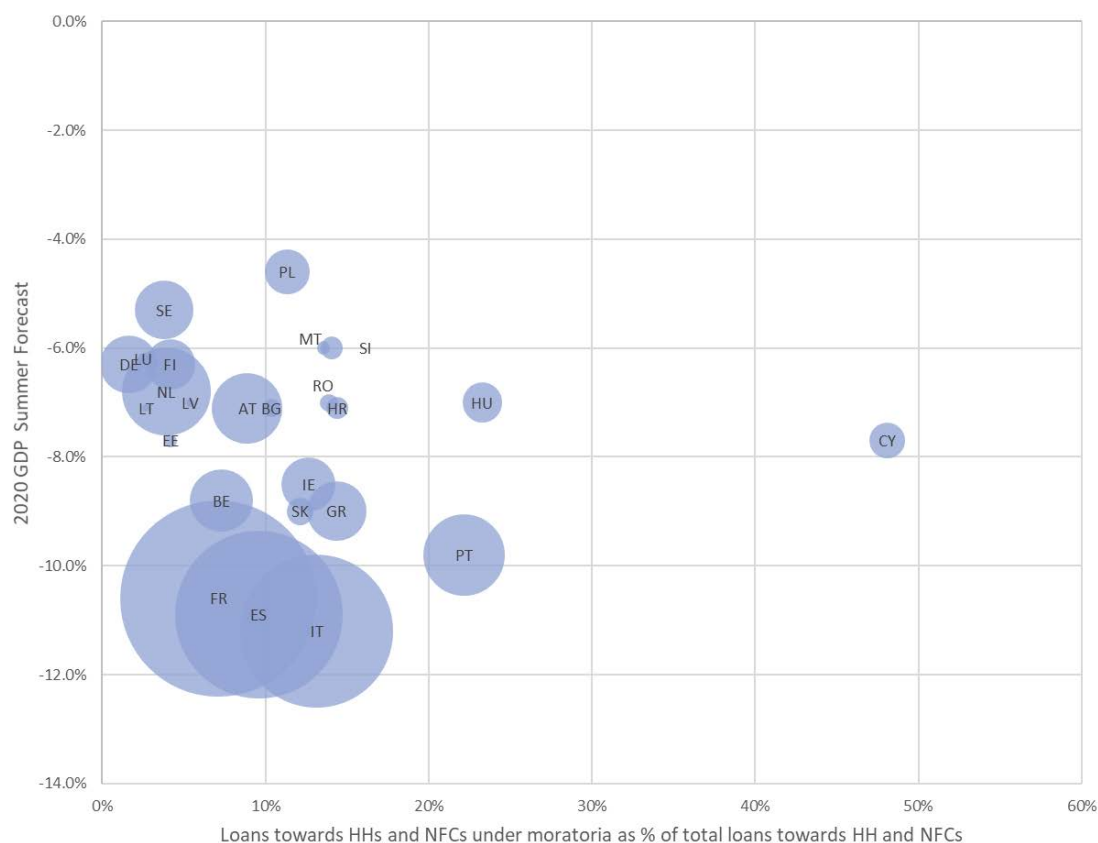
Source: EBA supervisory reporting

The differences in magnitude of the impact of the COVID-19 pandemic across countries explains, to some extent, the differences in take-up of moratoria across countries. Figure 5 shows that the relationship between the GDP impact for each country and the percentage of loans granted moratoria is not linear¹¹. It could therefore be inferred that parameters other than the economic impact might also drive borrowers' decisions to implement an extensive use of moratoria schemes. In fact, of the three countries that reported that at least 20% of their total loans to HHs and NFCs were granted moratoria, only Portugal is expected to have a higher contraction in 2020 than the EU average (-8.7%). Other factors that may explain an increased use of moratoria are the banks' willingness to extend moratoria, the level of borrowers' indebtedness in the economy, the debt service-to-income ratio distributions across different countries and, in global terms, the communication approaches to the pandemic at the national level, which may have prompted different precautionary reactions from economic agents. The level of dependence of some countries (e.g. southern countries on the hospitality sector) and the exposure of their banks to

¹¹ For countries that have banks with significant international presence the relation to the country's GDP is not directly comparable.

sectors that have been most affected by the COVID-19 crisis could also be an explanatory factor in the higher use of moratoria. In addition, the absence of PGs in specific countries may also explain to some extent the increased take-up of moratoria.

Figure 5: Total volumes of loans to HHs and NFCs granted moratoria on loan repayments (bubble size), loans granted moratoria as a percentage of total loans to HHs and NFCs by country and summer 2020 GDP forecasts for the year 2020 – June 2020



Sources: EBA supervisory reporting and summer 2020 European economic forecast.

The SME segment had the highest percentage of loans under moratoria

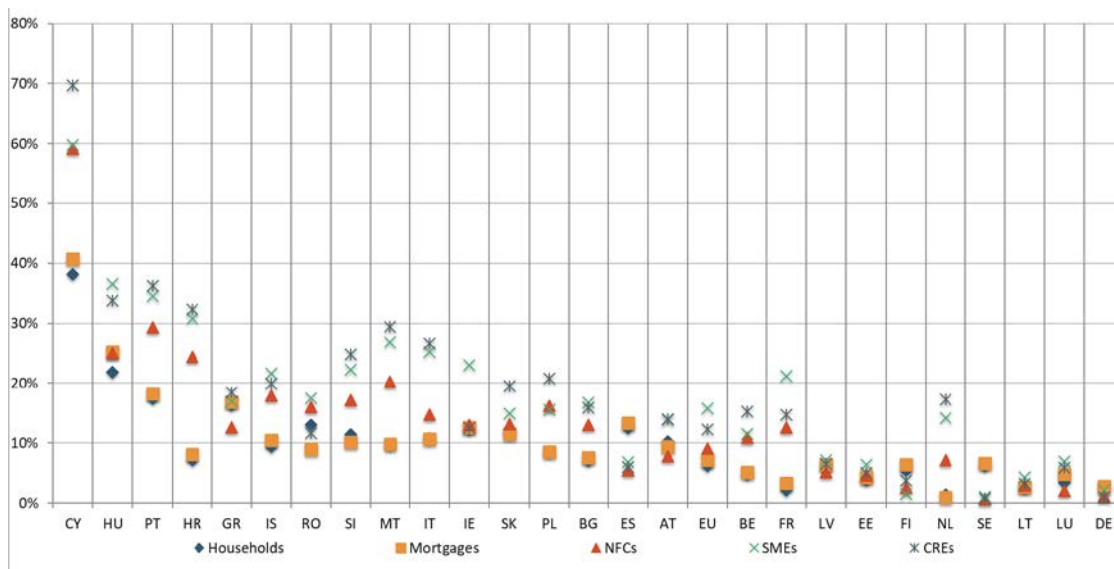
The highest share of loans under EBA-compliant moratoria was found among those granted to NFCs. As of June 2020, the total amount of NFC loans under moratoria stood at EUR 495 billion. Of these, more than EUR 337 billion of loans were granted to SMEs. HH loans under moratoria amounted to EUR 365 billion, of which EUR 268 billion were collateralised by residential real estate.

Compared with total loans for each segment, NFC lending had a slightly higher moratoria take-up than HH lending. While 9% of total NFC loans were under moratoria, only 6% of HH loans had a payment break. SMEs had the biggest take-up of moratoria schemes. As of June 2020, around 16% of the total SME loans were reported to be under moratoria; while the share stood at less than 5% for loans to large corporates. For loans collateralised by CREs, banks reported 12% of loans to be

subject to moratoria. With respect to HH loans, around 7% of total mortgage loans were under moratoria.

At a country level, there were some notable differences in the use of moratoria for NFC and HH exposures. In some countries, the use of moratoria is higher for NFC lending than for HH lending. This is particularly the case, for example, for banks in Croatia, Cyprus, France, Malta and Portugal, which report at least a 10 percentage point difference between NFCs and HHs. On the contrary, the share of HHs using the relief measure for banks in Greece, Spain and Sweden is significantly higher than the share of NFCs using the relief measure. Different distributions may be due to different access conditions for moratoria between countries and between segments. For example, in some countries only HHs with a loss of income were eligible for moratoria, a condition not applicable to NFCs. In addition, the availability and extended use of PGSs, which are mostly available to and used by NFCs, may explain the fact that moratoria take-up is higher for HHs in some countries (Figure 6).

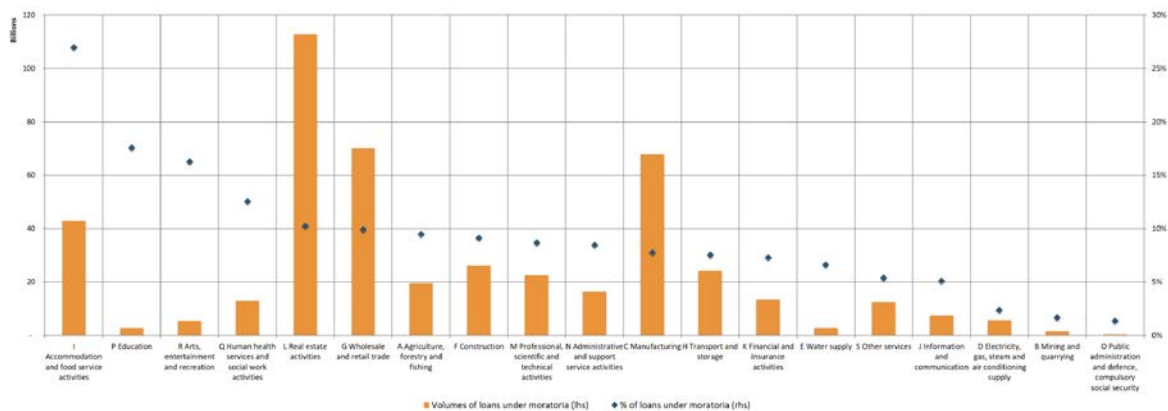
Figure 6: Loans under moratoria as a percentage of total loans by segment and country – June 2020



Source: EBA supervisory reporting

The COVID-19 crisis had a heterogeneous impact across sectors. The sectors generally impacted the most by the measures applied by various countries to mitigate the spread of COVID-19 also had the highest shares of loans under moratoria. The percentages of loans under moratoria in the hospitality, education and entertainment sectors were significantly higher than the average percentage of loans under moratoria in the NFC segment. In particular, 27% of loans in the accommodation and food service sector were under moratoria, the highest across all sectors. In the education, entertainment, human health services and real estate sectors, as well as in the wholesale and retail trade sector, more than 10% of loans were under moratoria (Figure 7).

Figure 7: Total volumes of loans under moratoria on loan repayments by sector (EUR billion) and loans under moratoria as a percentage of total loans in each sector – June 2020

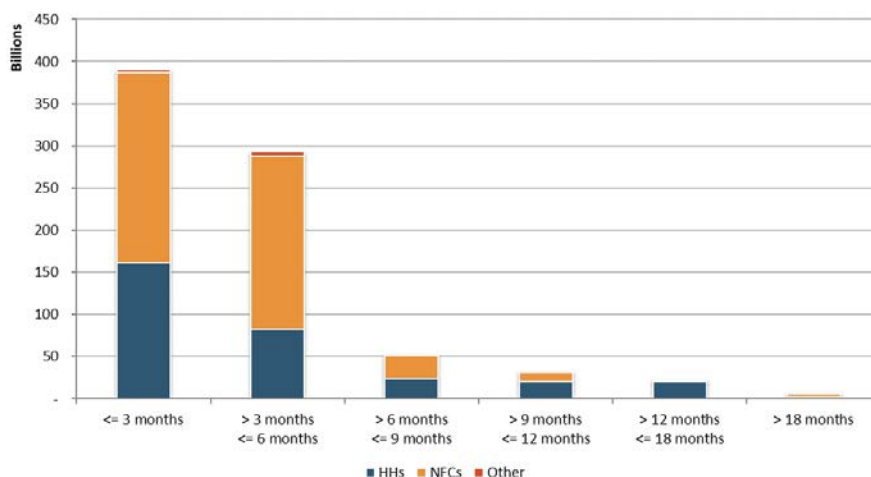


Source: EBA supervisory reporting

Most moratoria expire within 3–6 months

As of June 2020, close to EUR 79 billion of moratoria had already expired (of these around 45% were reported by Spanish banks), while at the same time around EUR 83 billion had their maturity extended. The moratoria for around 50% of the loans were due to have matured within 3 months (i.e. by September 2020), and around 85% of the loans will mature before December 2020. While the moratoria on loans to NFCs will mostly expire before December 2020, the maturity of the moratoria for loans to HHs is spread over a longer period (Figure 8).

Figure 8: Distribution of loans subject to moratoria by residual maturity of moratoria – June 2020



Source: EBA supervisory reporting

Banks in France and Spain, the countries with the largest amounts of loans under moratoria, the majority of the moratoria were due to expire by September 2020 (> 60%), with only a small percentage of loans under moratoria due to expire beyond the end of 2020. Banks in Portugal, in contrast, reported an even distribution for the maturity of their loans under moratoria over the next 12 months. Lastly, banks in Sweden (58%) and Finland (36%) had the biggest allocation of exposures maturing in the second half of 2021 (e.g. bucket > 12 months <= 18 months). As specific

countries have already announced the automatic extension of the moratoria for a pre-specified period, this aspect should be closely monitored at the next reporting dates (Figure 9 and Figure 10).

Figure 9: Volumes of loans under moratoria by residual maturity of moratoria (EUR billion) and loans towards HHs and NFCs under moratoria as a percentage of total loans to HHs and NFCs by country – June 2020

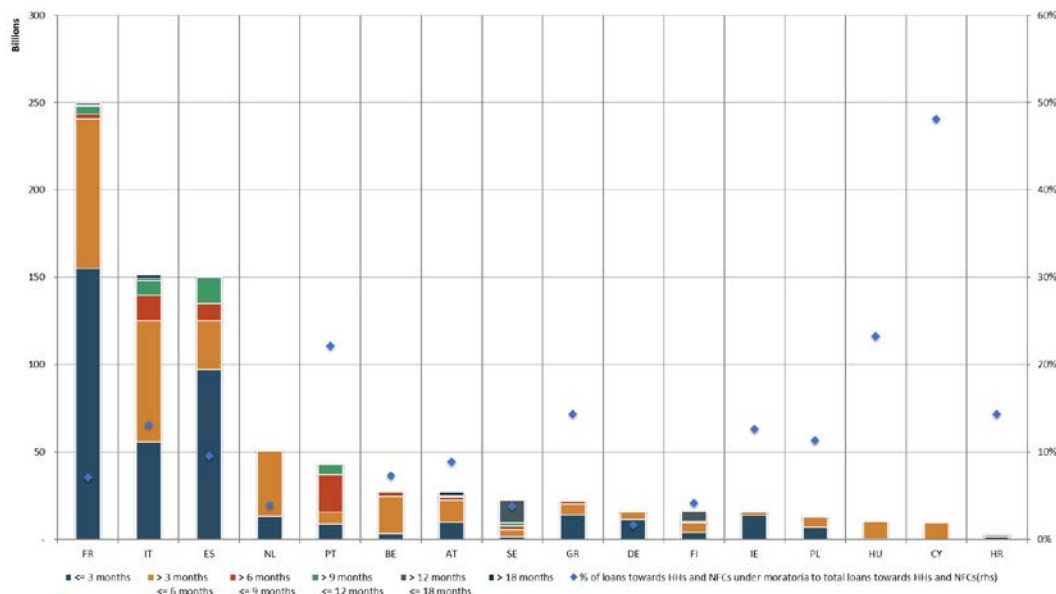
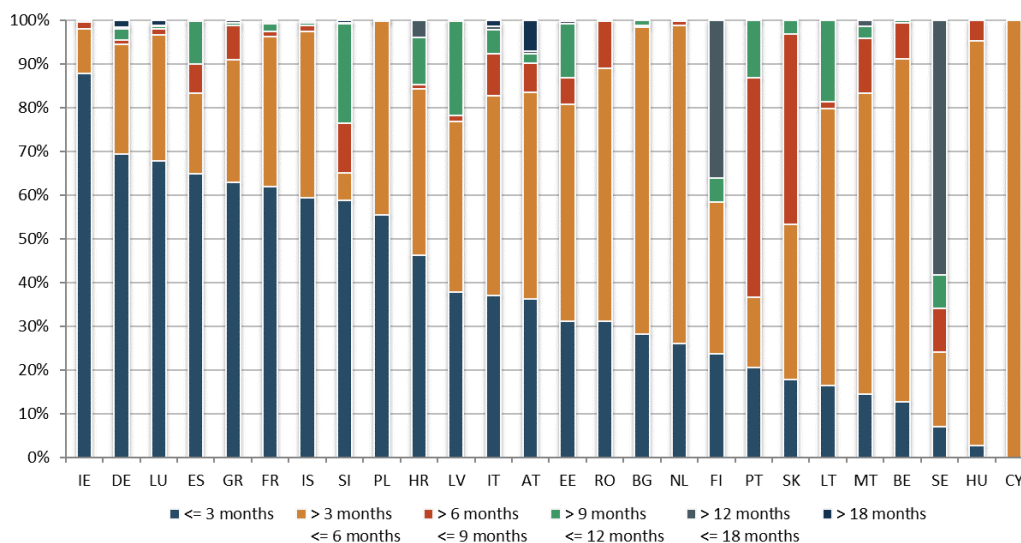


Figure 10: Distribution of loans under moratoria by residual maturity and country – June 2020



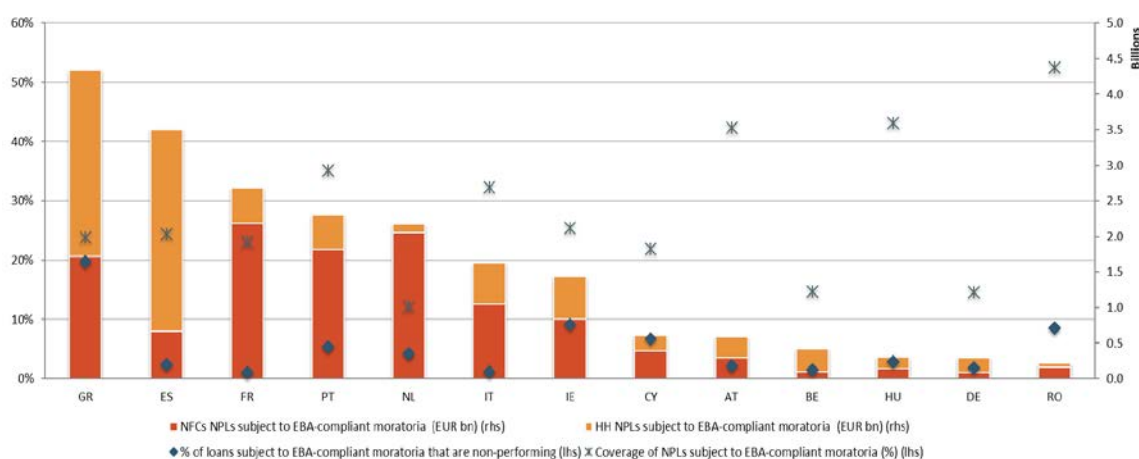
Source: EBA supervisory reporting

Non-performing loans under moratoria are not yet significant

According to the EBA guidelines, the application of general moratoria on loan repayments does not automatically trigger either the forbearance classification or the non-performing status of the exposure. Nevertheless, banks are required to assess the unlikelihood to pay criterion for classifying the exposures as non-performing. Around EUR 20 billion of loans under non-expired moratoria were classified as non-performing, resulting in an NPL ratio of 2.5% for loans under non-expired

moratoria. This compares slightly favourably with the EU NPL ratio for all loans of 2.9%. As many schemes only allowed performing loans to be subject to moratoria on loan repayments, entering into the crisis loans under moratoria were most probably performing. The use, however, of moratoria may signal an increased risk and a higher probability of unlikeness to pay which is probably not reflected in the NPL ratio reported. The volumes of NPLs were evenly distributed between HHs and NFCs. This was driven by the higher percentage of HH loans under moratoria classified as NPLs in Greek and Spanish banks, the two countries reporting the highest volume of NPLs. Greek banks reported the highest NPL ratio (20%), followed by Irish and Romanian banks (9%), the latter had also the highest coverage ratio of NPLs under moratoria (Figure 11).

Figure 11: Volumes of loans under non-expired moratoria classified as NPLs by segment (EUR billion) and loans under moratoria as a percentage of total loans by country – June 2020

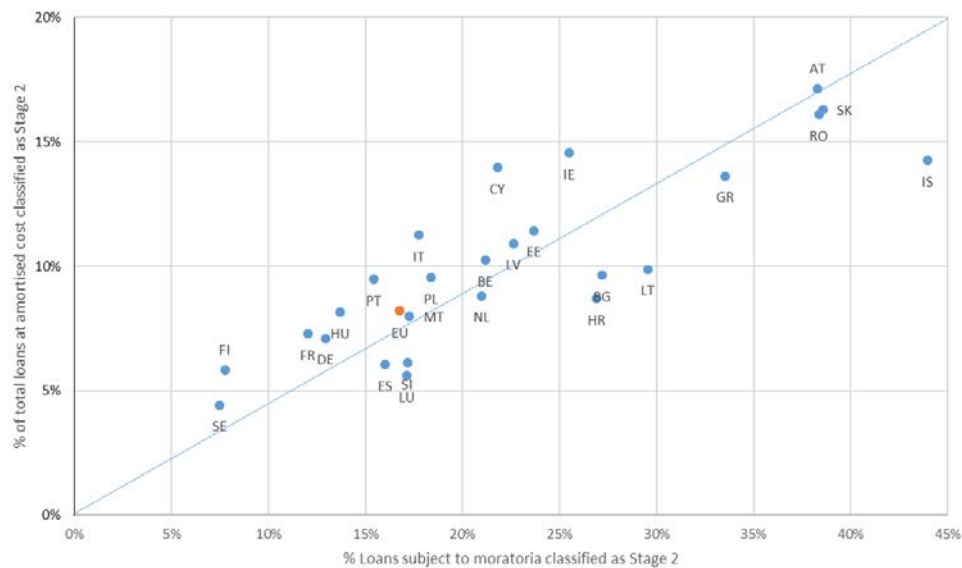


Source: EBA supervisory reporting

The ratio of coverage with provisions of loans under non-expired moratoria classified as NPLs was close to 25%, which is significantly lower than the total coverage of NPLs at EU level (45%). NPLs were mostly concentrated in Greek, Spanish and French banks, which together reported around 50% of loans under non-expired moratoria classified as NPLs, and a coverage of around 25%. The EU coverage of performing loans subject to non-expired moratoria was less than 1.5%, yet significantly higher than the EU average coverage ratio for total performing loans (less than 0.5%), with only banks in Romania (4.7%), Bulgaria (3.5%), Greece (3.2%) and Croatia (3.0%) having a coverage ratio of performing loans higher than 3%.

A sign of increased credit risk is the classification of an exposure in stage 2. Despite the moratoria status of these exposures, only EUR 131 billion (or 17%) of the loans under moratoria were classified as stage 2 loans. However, this is more than double the share of stage 2 allocations for all loans. With only a few exceptions, this 2:1 rule seems to hold for most countries. Banks in France and Spain, which reported the highest volumes of loans under non-expired moratoria, had an average share of stage 2 allocations above 10%. The highest share of loans under moratoria classified as stage 2 was reported by banks in Iceland (44%), followed by Slovakia and Romania (39% and 38% respectively) (Figure 12).

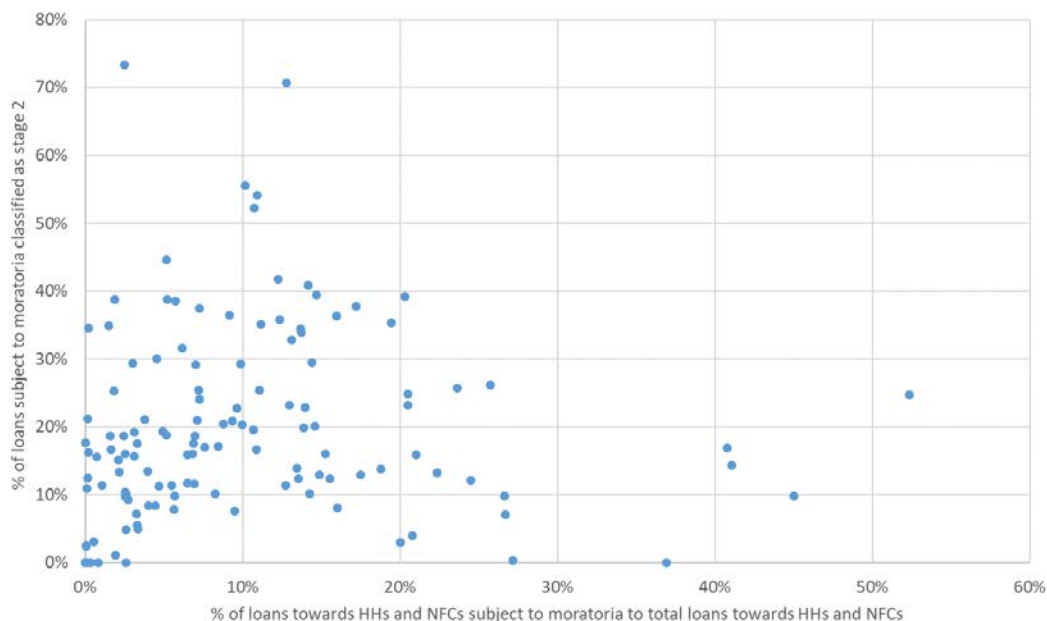
Figure 12: Percentage of loans subject to non-expired moratoria classified as stage 2 vs percentage of total loans classified as stage 2 – June 2020



Source: EBA supervisory reporting

The recognition of loans subject to moratoria on loan repayments may result in a higher allocation being classified as stage 2. Although this holds in general, with a few banks allocating more than 40% of the exposures subject to loan moratoria to stage 2, there are also a few outliers. Some banks with an increased use of moratoria reported that less than 10% of these exposures were classified as stage 2 (Figure 13).

Figure 13: Percentage of loans to HHs and NFCs subject to moratoria vs percentage of loans subject to moratoria classified as stage 2 – June 2020



Source: EBA supervisory reporting

Banks estimate their economic loss as close to 0.05% of their equity

The estimation of economic loss provides an indication of whether or not banks assume any losses from the moratoria, e.g. as a result of missing interest because of postponements of payments. This represents the difference between the net present value of the renegotiated or modified contractual cash flows and the net present value of the cash flows before granting the measure. Despite the freeze in the income of these loans, banks reported an economic loss of less than EUR 0.74 billion, or around 0.05% of their equity¹². Banks expect a significantly higher economic loss from loans under moratoria to HHs and a lower loss from loans to NFCs. In particular, around 70% of the total economic loss comes from HH loans. Despite the relatively low impact on economic loss, given the ongoing uncertainty with regard to economic recovery and the resurgence of COVID-19 in many countries throughout Europe, further assessments of economic loss as a result of moratoria, as performed by the banks, could potentially reveal further downsides.

Public guarantee schemes

As of June 2020, loans subject to PGSs in Europe amounted to EUR 181 billion. This volume represents 1.2% of all loans that were reported by the banks in the sample or 1.6% of all loans to HHs and NFCs. The vast majority of these loans (98%) were newly originated loans. Only 2% of those loans were reported as restructured loans (i.e. loans that were not initially covered by the public guarantee and that therefore were restructured to become eligible).

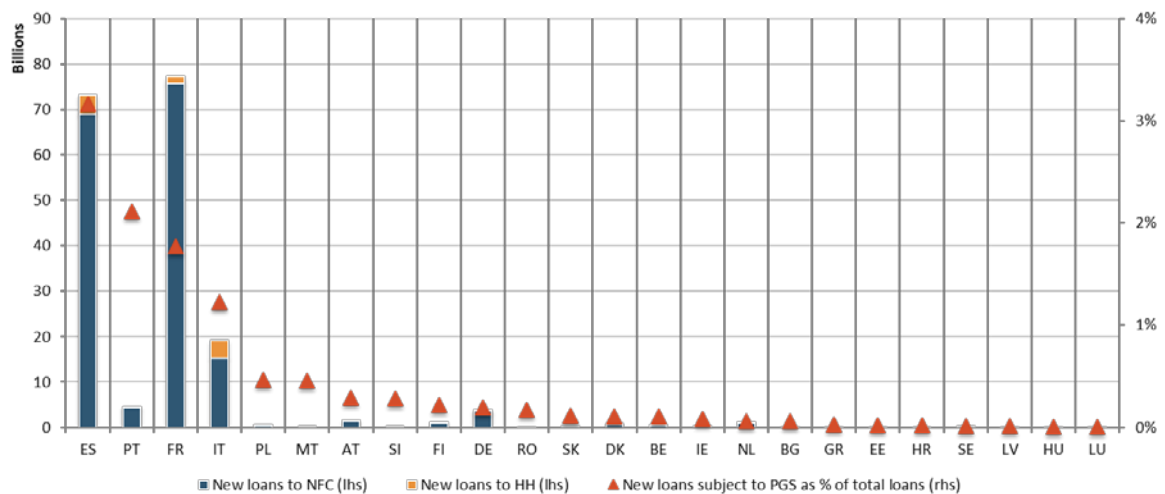
PGSs had a very uneven impact across European countries. While PGSs were absent or not significant in most European countries¹³, their impact on banks' lending in Spain, Portugal, France and Italy was rather significant. For banks in some countries, however, the figures might not necessarily provide the full picture on the use of public guarantees. This is due to the partial or delayed implementation of the COVID-19 reporting guidelines in some countries (see also page 8) and the fact that banks applying the IFRS might derecognise loans that are fully guaranteed, as the risks and rewards would remain with the guarantee provider.

By far the biggest volumes of loans subject to PGSs were reported by banks in France and Spain. French banks reported that EUR 78 billion (1.8% of banks' total loan volume) of newly originated loans were subject to PGSs. Spanish banks reported newly originated loans subject to PGSs of around EUR 73 billion, representing 3.2% of total loans. Loans subject to PGSs were also significant for banks in Italy (EUR 20 billion, 1.2% of total loans) and, in terms of the share of total loans, for banks in Portugal (EUR 2 billion, 2.1% of total loans) (Figure 14).

¹² The total economic loss and the ratio to the total equity were calculated for only 41 banks.

¹³ In some countries the amount of provided public guarantees (in GDP %) is lower than in other countries, which affects the amount of loans.

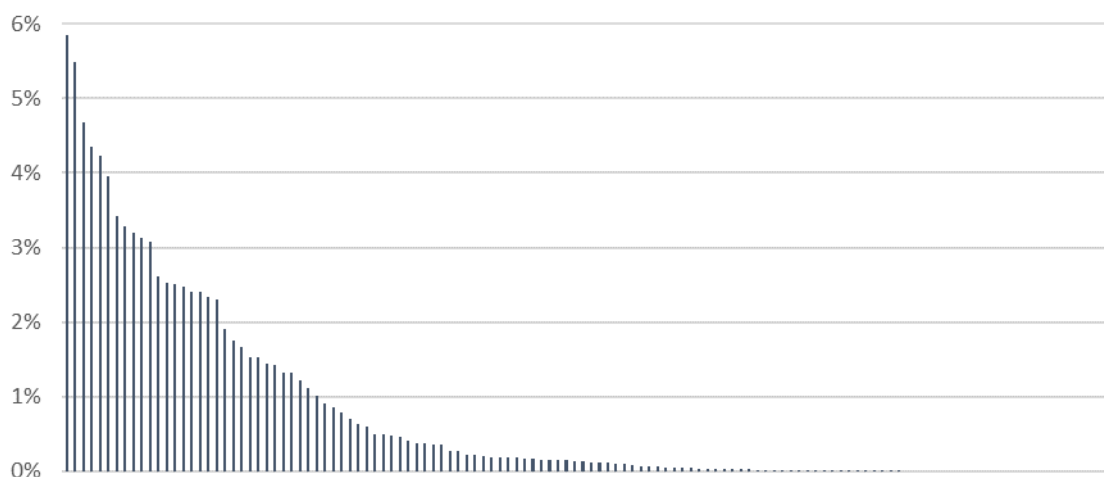
Figure 14: Newly originated loans subject to PGSs as a percentage of total loans (rhs) and loan volumes (lhs) by country – June 2020



Source: EBA supervisory reporting

Data at a bank-by-bank level confirm the wide dispersion (Figure 15). Of the banks that submitted PGS-related data, 95 reported that newly originated loans subject to PGSs comprised less than 1% of total loans (87 of which were below 0.5%). Another 20 banks reported the share of loans subject to PGSs to be between 1% and 3% of total loans, and only 11 banks reported this share to be higher than 3%.

Figure 15: Newly originated loans subject to PGSs as a percentage of total loans by bank – June 2020



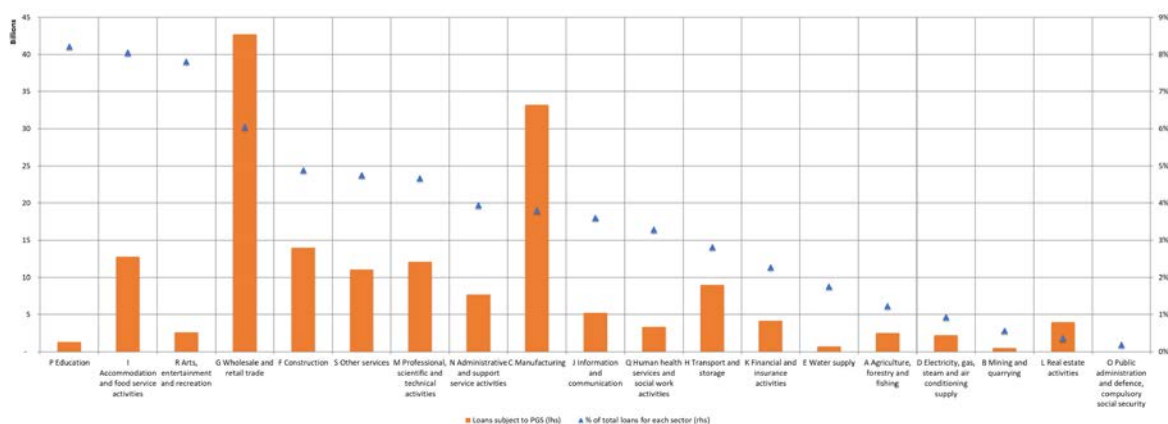
Source: EBA supervisory reporting

As of June 2020, public guarantees were granted predominantly to loans given to NFCs, which made up around EUR 169 billion or 94% of all new loans subject to PGSs. EUR 10 billion of new loans subject to PGSs were granted to HHs, representing 6% of all loans subject to PGSs.

Similar to the findings on moratoria on loan repayments, some corporate sectors were particularly affected by the containment measures put in place in response to the COVID-19 pandemic and received the largest share of public guarantees. Wholesale and retail trade (EUR 43 billion or 6% of

all loans in this sector) and manufacturing (EUR 33 billion or 4% of all loans in this sector) topped the list of sectors in terms of volume of public guarantees received. Other sectors that significantly benefited from public guarantees included the accommodation and food service, education and arts and entertainment sectors, all of which accounted for a share of public guarantees close to 8% of total loans (Figure 16).

Figure 16: Newly originated loans subject to PGSs (EUR billion) and loans subject to PGSs as a percentage of total loans by sector – June 2020



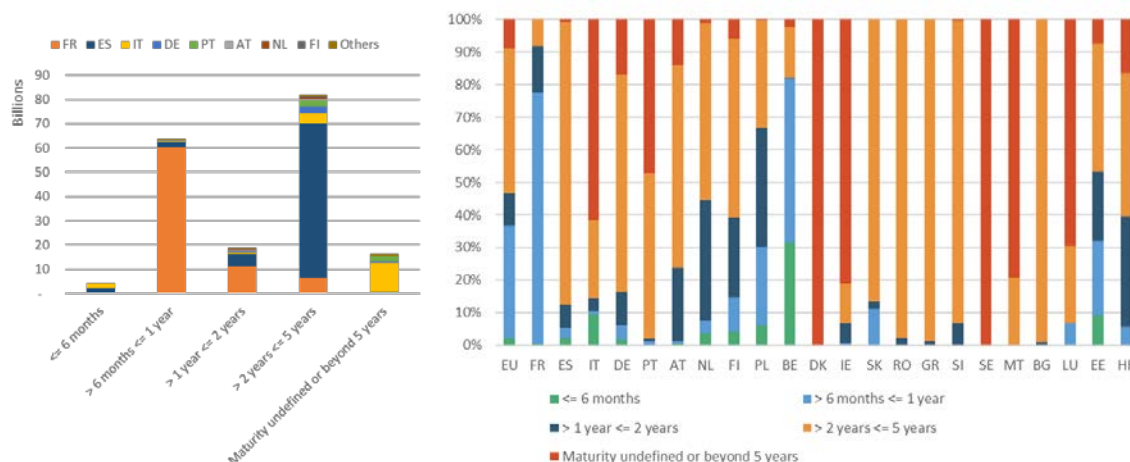
Source: EBA supervisory reporting

A significant share of public guarantees expire by June 2021

In general, PGSs have longer residual maturities than moratoria. Around 44% of loans had guarantees in place with a residual maturity of between 2 and 5 years, while another 34% of loans benefited from guarantees with a residual maturity of between 6 months and 1 year (Figure 17). The split between these two maturity buckets is driven by banks with the largest volumes, which are those in Spain and France. While Spanish banks reported guarantees with predominantly longer maturities (90% of loans maturing in more than 2 years), the vast majority of French banks' guarantees mature within the next 6–12 months¹⁴. Some PGSs, however, allow for maturities beyond 5 years. In these cases, banks were unable to provide details due to the lack of a corresponding maturity bucket in the reporting guidelines. In total, 9% of newly originated loans subject to PGS were not allocated to any maturity bucket and are shown as 'Maturity undefined or beyond 5 years' in Figure 17.

¹⁴ In France, all state-guaranteed loans include a 1-year grace period at the end of which the borrower is entitled to decide on the repayment period of the loan (between 1 and 5 years). Therefore, the guarantee could be extended to cover the additional period.

Figure 17: Residual maturity of public guarantees by country – June 2020



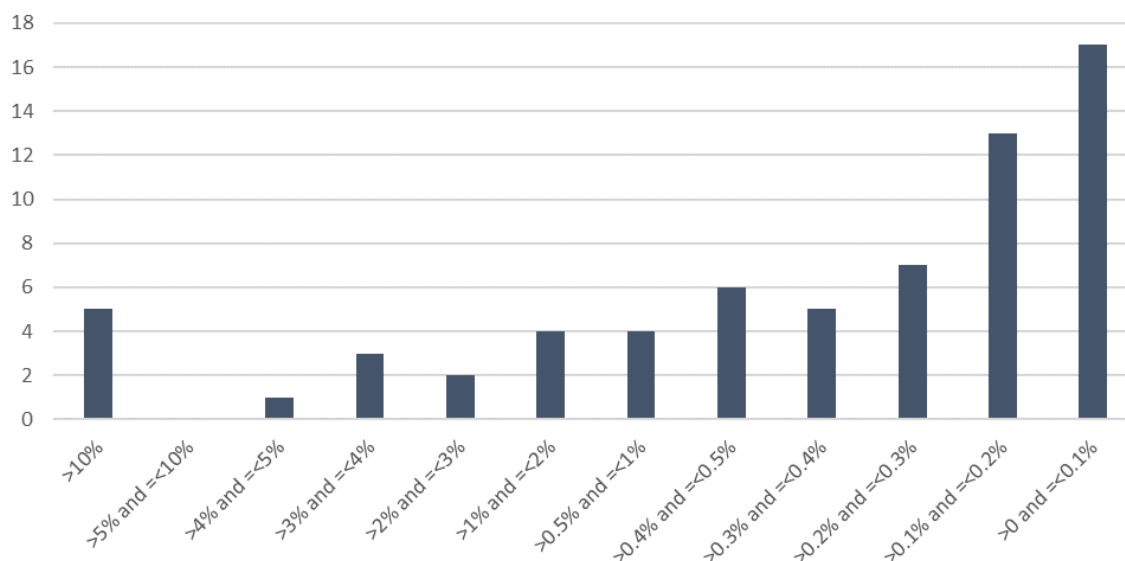
Source: EBA supervisory reporting

The maturity profile of loans with PGs is important to determine the remaining time span during which banks can benefit from the public guarantee. Banks and supervisors should be cognisant of a potential maturity mismatch between the duration of the guarantee and the underlying loan, which would result in shift of credit risk back to the originating bank due to the expiration of the public guarantee. However, the reported data do not provide the necessary details to make such an assessment.

A few banks reported sizable non-performing loans subject to PGs

Given that loans subject to PGs were originated during the course of the first half of this year, it might be too early to form a comprehensive view on the asset quality of these loans. However, 67 banks (around half of the banks in the sample) reported at least some loans that were non-performing as of June 2020. The total volume of NPLs reached almost EUR 1.1 billion, 95% of which were loans to NFCs. The resulting NPL ratio of 0.6% for loans subject to PGs compares with an average NPL ratio of 2.9% for banks' total loans and 4.5% for banks' total NFC loans. Despite the relatively low NPL ratio for loans subject to PGs at a European level, a limited number of banks reported a significantly higher ratio for loans subject to PGs (Figure 18). Most notably, four banks reported a NPL ratio of between 3% and 5% and another five banks reported ratios above 10%. Where NPL ratios for loans subject to PGs exceed average NPL ratios for individual banks, banks and supervisors should investigate whether a proper credit assessment was performed at loan origination.

Figure 18: Distribution of banks by NPL ratios of loans subject to PGs – June 2020



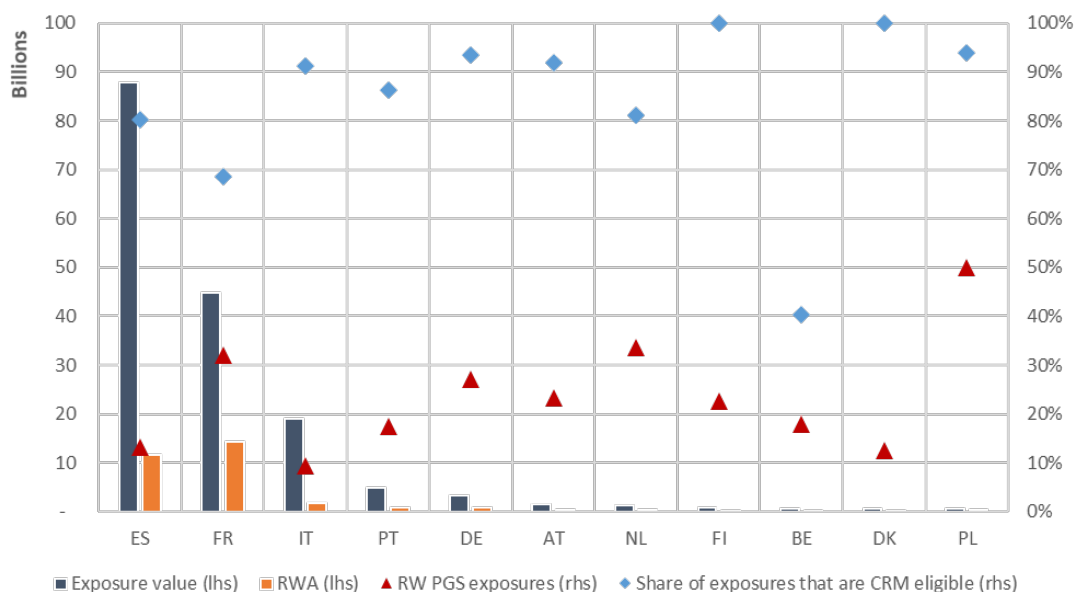
Source: EBA supervisory reporting

PGs significantly reduce banks' RWAs

As part of the June 2020 data submissions, banks disclosed details about the prudential treatment of loans subject to PGs¹⁵. Banks reported RWAs of EUR 29 billion for exposures of EUR 162 billion. The average implied risk weight is hence around 18% (calculated as the RWA divided by the exposure value). This compares with an average risk weight for banks' NFC exposures of 54% (risk weight of 89% for those banks applying the standardised approach, and 41% for banks using the internal ratings-based approach). Public guarantees therefore had a significant impact on banks' RWA calculations. The impact can be approximated by applying the average risk weight for banks' NFC exposures of 54% to banks' exposures subject to PGs. The results suggest an RWA reduction of around EUR 58 billion, or 70bps for the banks that formed part of this analysis.

¹⁵ However, only 78 banks (about half of the total sample) provided these details.

Figure 19: RWAs and implied risk weight for PGS exposures by country – June 2020



Source: EBA supervisory reporting

Figure 19 highlights that there were significant differences by country between the exposure amounts and the RWAs of exposures subject to PGSs¹⁶. For example, banks in Italy reported RWA of only 9% of the PGS-related exposure value, and banks in Spain and Denmark reported risk weights of 13%. On the other side of the spectrum, banks in Poland reported an average risk weight of 50% for PGS-related exposures. The main reasons for the observed differences were variations in the credit risk mitigation (CRM) eligibility of exposures subject to PGSs (the share of CRM-eligible exposures ranges from 40% for banks in Belgium and 69% for banks in France to 100% for banks in Finland and Denmark) and in the terms and conditions of PGSs (e.g. coverage level, the effective application of the public guarantee only after a specific period after loan origination¹⁷). Therefore, for some banks, a substantial part of these exposures might not have been subject to CRM and the resulting RWA-reducing impact in June 2020.

In addition, several guarantee providers are counterparties that are not recognised as public sector entities and as such do not receive a risk weight of 0%. In other cases, banks are still assessing whether certain public guarantees qualify as eligible for CRM purposes according to the Capital Requirements Regulation (CRR) and have not assumed any CRM in their June 2020 RWA calculations. Moreover, given the continuing growth of the volume of loans subject to PGSs, the RWA-reducing impact might be higher in the following quarters.

¹⁶ This figures shows values for countries with exposure values of at least EUR 500 million

¹⁷ In France, for example, the state guarantee becomes effective only 2 months after loan origination.

Conclusions

The full impact of the COVID-19 pandemic has yet to be determined, especially given the observed resurgence of the crisis in Europe during recent months. The support and relief measures had a clear objective, which was to provide breathing space for borrowers and capacity for lenders to further support the economy at this challenging juncture. The measures have provided the necessary means to meet liquidity and operational needs during a crisis of unprecedented magnitude and reach. In addition, PGSs have supported the flow of lending during a period of heightened uncertainty with increased risk perspective. In this regard, the launch of support and relief measures has been successful, as they have widely reached borrowers and especially those most in need, such as SMEs.

The purpose of this report is to document the use of the support measures and start monitoring possible consequences in terms of their maturity, potential disruptions due to a cliff edge effect and the evolution of asset quality of these exposures. It is evident that the use of moratoria, by providing the necessary liquidity and removing the pressure of loan repayments during a period of increased liquidity needs, has avoided, to a great extent, liquidity shortages. Nonetheless, the disruption caused in some sectors by the COVID-19 pandemic and the confinement measures will inevitably drive the default rates higher in the coming months. At the same time, despite the generous fiscal envelope to support employment provided widely by governments, unemployment is expected to rise further in the future. This, in turn, will affect the asset quality of HH exposures. For these reasons, banks need to engage early with their clients in order to assess the situation of each borrower and apply sound and proactive policies to fairly assess the risk profile of debtors and, where suitable, take appropriate actions. Early recognition of problematic exposures and proactive engagement with clients have proved effective in the past at tackling the deterioration in asset quality. It should be stressed that banks with a heightened share of loans under moratoria need to be extra vigilant, as they are highly vulnerable to cliff edge effect risks once moratoria expire.

Going forward, competent authorities should closely monitor the trajectory of the exposures under moratoria and PGSs and evaluate possible cliff edge effects or other associated risks, considering further potential measures that may need to be adopted if the length and magnitude of the crisis turn out to be worse than expected. A consequence of public measures is the increase in the sovereign-bank nexus, due to the increased exposure to sovereigns caused by loans subject to public guarantees.

Transparency and the flow of information in a timely manner are paramount to enable relevant stakeholders to be well informed and provide adequate information for proper assessment of the identified risks. To achieve this, the EBA transparency exercise, which will be published before the year end, will provide data at a bank-by-bank level on EBA-eligible moratoria, other forbearance measures and asset quality.

Although the regulatory treatment of moratoria set out in guidelines on moratoria on loan repayments has ceased to apply for new payment moratoria applied after 30 September 2020, the effects of existing moratoria and PGSs will remain in the following quarters. The EBA will be closely monitoring the evolution and asset quality of these exposures at least for the next few quarters, as Europe is set to go through a second wave of the COVID-19 pandemic.

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