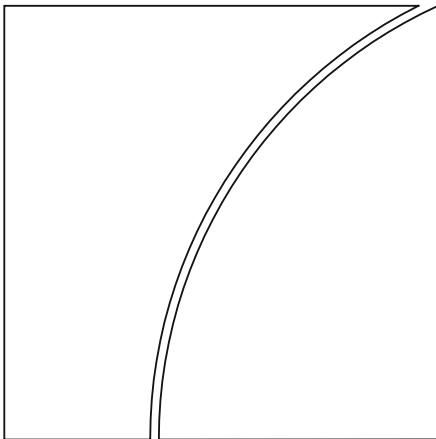


Basel Committee on Banking Supervision



Measures to reflect the impact of Covid-19

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Introduction

Governments and banks in many jurisdictions have introduced extraordinary measures to alleviate the financial and economic impact of Covid-19. The relief measures include a range of different payment moratoriums and government guarantees. The Basel Committee on Banking Supervision has agreed that the risk-reducing effects of the various extraordinary support measures taken in its member jurisdictions should be fully recognised in risk-based capital requirements. The Committee has also discussed the impact of Covid-19 on the expected credit losses (ECLs) of banks. The Committee agreed that the extraordinary support measures should be taken into account by banks when they calculate their ECLs. It also agreed on some amendments to the transitional arrangements for the regulatory capital treatment of ECLs. This document sets out guidance on these issues.

Treatment of extraordinary support measures related to Covid-19

1. What is the risk-based capital treatment of loans that are subject to government guarantees that have been made in response to the Covid-19 outbreak?

Answer: When determining a bank's credit risk requirement for loans that are subject to sovereign guarantees, the relevant sovereign risk weight should be used, as set out in CRE22 and CRE32 of the Basel Framework.

2. What is the capital treatment of loans subject to payment moratoriums initiated in response to the Covid-19 outbreak?

Answer: The Basel Framework applies higher capital requirements to loans that are categorised as past due or defaulted.¹ A criterion that is used in these categorisations is whether payments on the loans are past due by more than 90 days.² The Committee has agreed that when jurisdictions apply this criterion, payment moratorium periods (public or granted by banks on a voluntary basis) relating to the Covid-19 outbreak can be excluded by banks from the counting of days past due. Another criterion used is whether a bank considers that the borrower is unlikely to pay its credit obligations. The Committee has agreed that this assessment should be based on whether the borrower is unlikely to be able to repay the *rescheduled* payments. That is, for borrowers that are not making payments as permitted by a payment moratorium, the assessment should be based on likelihood of payment of amounts due after the moratorium period ends.

3. How should the Committee's guidance on non-performing assets³ be applied in relation to loans subject to payment moratoriums initiated in response to the Covid-19 outbreak?

Answer: Similar to the capital framework, the Committee's guidance on the definition of non-performing assets uses the 90 days past due and the unlikely to pay criteria. The Committee has agreed that payment moratorium periods (public or granted by banks on a voluntary basis) relating to the Covid-19 outbreak can be excluded by banks from the number of days past due,

¹ See CRE20.26 of the Basel Framework for the treatment of loans that are classified as past due under the standardised approach for credit risk and CRE36.69 for the treatment of loans that are classified as defaulted under the internal ratings-based approach.

² Under the internal ratings-based approach, in the case of retail and public sector entity obligations, for the 90 days figure, a supervisor may substitute a figure up to 180 days for different products, as it considers appropriate to local conditions.

³ For the definition of "non-performing exposures" see www.bis.org/bcbs/publ/d403.pdf.

and agreed that the assessment of unlikeliness to pay should be based on whether the borrower is unlikely be able to repay the *rescheduled* payments.

4. How should the Committee's guidance on exposures subject to forbearance⁴ be applied in relation to loans subject to relief measures, such as payment moratoriums or public guarantees, initiated in response to the Covid-19 outbreak?

Answer: The Committee has agreed that when borrowers accept the terms of a payment moratorium (public or granted by banks on a voluntary basis) or have access to other relief measures such as public guarantees, this should not automatically lead to the loan being categorised as forborne.

Expected credit loss accounting

1. How should banks consider the impact of the Covid-19 pandemic in the measurement of ECL under IFRS 9?

Answer: There are high levels of uncertainty currently surrounding the forward-looking information relevant to estimating expected credit losses (ECLs) and to applying the IFRS 9 assessment of significant increases in credit risk (SICR). IFRS 9 is a principles based standard and requires the use of experienced judgement. At present, information available that is both reasonable and supportable on which to assess SICR and to measure ECL is limited. Regarding the SICR assessment, relief measures to respond to the adverse economic impact of Covid-19 such as public guarantees or payment moratoriums, granted either by public authorities, or by banks on a voluntary basis, should not automatically result in exposures moving from a 12-month ECL to a lifetime ECL measurement.

Where banks are able to develop forecasts based on reasonable and supportable information, the Committee expects ECL estimates to reflect the mitigating effect of the significant economic support and payment relief measures put in place by public authorities and the banking sector. While estimating ECL, banks should not apply the standard mechanistically and should use the flexibility inherent in IFRS 9, for example to give due weight to long-term economic trends.⁵

Transitional arrangements for expected credit loss accounting

In light of the Covid-19 pandemic, the Committee has agreed on the following amendments to the existing transitional arrangements⁶ for the regulatory capital treatment of ECLs:

1. Jurisdictions may apply the existing transitional arrangements, even if they were not initially implemented when banks first adopted the ECL model. They may also choose to apply the alternative transition set out in point (4) below.

⁴ For the definition of "forbearance" see www.bis.org/bcbs/publ/d403.pdf.

⁵ For further information on accounting for IFRS 9 ECLs in the light of current uncertainty resulting from the covid-19 pandemic see the following guidance published by the International Accounting Standards Board: <https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-9/ifrs-9-ecl-and-coronavirus.pdf>

⁶ See CAP90.7 of the Basel Framework for the transitional arrangements for expected credit loss accounting. These will be updated in due course to reflect the changes set out in this document.

2. Jurisdictions may permit banks to switch from the static approach to the dynamic approach to determine the transitional adjustment amount (even if they have previously switched the approach that they use).
3. In addition to the two existing approaches to calculate the transitional adjustment amount (the static and dynamic approach), jurisdictions may use alternative methodologies that aim to approximate the cumulative difference between provisions under the ECL accounting model and provisions under the prior incurred loss accounting model.
4. Irrespective of when a jurisdiction initially started to apply transitional arrangements, for the 2 year period comprising the years 2020 and 2021, jurisdictions may allow banks to add-back up to 100% of the transitional adjustment amount to CET1.⁷ The “add-back” amount must then be phased-out on a straight line basis over the subsequent 3 years.

Consistent with the existing transitional arrangements, banks should disclose: (a) whether a transitional arrangement is applied; and (b) the impact on the bank’s regulatory capital and leverage ratios compared to the bank’s “fully loaded” capital and leverage ratios had the transitional arrangements not been applied.

⁷ Jurisdictions that have already implemented the transitional arrangements may choose to add back less than 100% during 2020 and 2021, or take other measures to prevent the add-back from including ECL amounts established before the outbreak of Covid-19.