



9 July 2020

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

TREATMENT OF LOANS IMPACTED BY COVID-19

Early in the current COVID-19 pandemic, many authorised deposit-taking institutions (ADIs) chose to grant temporary support to large numbers of affected customers by allowing them to defer loan repayments for several months. To date, data reported by the 20 largest ADIs indicates that roughly \$266 billion or 896,000 loans have been granted such deferrals.

To help facilitate ADIs supporting their customers through this period, APRA announced in March a temporary capital treatment for a period of up to six months for loans where the ADI has granted a repayment deferral. Specifically, where an ADI provided a broad class of otherwise non-impaired loans with a repayment deferral, the period of deferral does not need to be treated as a period of arrears, nor do the loans need to be regarded as restructured. This approach has been adopted by peer prudential regulators in many other jurisdictions. This temporary capital treatment is scheduled to end six months from when the deferral was initially granted.

Regardless of the capital treatment, it is the responsibility of ADIs to determine the most appropriate response when borrowers encounter a period of financial hardship. APRA does not preclude or require a particular period of deferral or other form of loan modification or restructuring. Regulatory capital requirements do not affect an ADI's obligations when offering hardship arrangements.

Updates to the temporary capital treatment

As announced yesterday, given the continuing economic uncertainty and to ensure an orderly transition of the portfolio whilst supporting borrowers, APRA will extend its temporary capital treatment to provide ADIs with additional time to work with their affected customers through the COVID-19 period. Additionally, APRA will adjust the capital treatment of loans that are restructured to facilitate ADIs returning borrowers to a sustainable financial position.

APRA expects ADIs to proactively engage with affected borrowers between now and the end of the current deferral period to determine whether to grant an extension on the deferral period, to restructure or to recognise a loan as impaired. ADIs should be encouraging borrowers that can restart repayments to do so, and to identify, monitor and manage those loans where this is not possible. APRA will be engaging closely with ADIs on their credit risk management practices for affected loans.

APRA's proposed approach is summarised below, with further details set out in Attachment A.

Extension of the current approach to loans granted repayment deferrals

For loan repayment deferrals provided prior to 30 September 2020, ADIs may continue to apply the temporary capital treatment to a further period of deferral until the earlier of:

- an aggregate period of deferral totalling ten months; or

- 31 March 2021.

For new loan repayment deferrals that ADIs provide for the first time after 30 September 2020, the temporary capital treatment may be applied until 31 March 2021.

While ADIs are free to choose to extend repayment deferrals beyond these dates, they may not apply the temporary capital treatment after these dates.

For repayment deferrals offered after 30 September 2020 (including extensions to existing deferral arrangements), the temporary capital treatment may only be applied where the ADI has undertaken an appropriate credit assessment of the borrower and is satisfied that they have a reasonable prospect of being able to repay the loan (on original or restructured terms) when the repayment deferral period ends.

Modifications to the treatment of restructured loans

In many cases and dependent upon the circumstances of a customer, it may be more appropriate for an ADI to offer to modify or 'restructure' the terms of a loan instead of providing a further repayment deferral. To facilitate ADIs transitioning impacted borrowers to a regular repayment schedule, APRA is proposing to adjust temporarily the capital requirements so ADIs may restructure the borrower's facilities and return the borrower immediately to non-impaired status, provided that the restructure occurs on or before 31 March 2021.

Credit management

ADIs should ensure that they take a prudent approach to the assessment and management of loans with repayment deferrals. At a high-level, APRA expects that ADIs will:

- **develop a comprehensive plan** for how they will manage the borrower assessment process, including enhancements that need to be made to oversight, borrower review processes, customer engagement, capabilities and resourcing. This should be approved by the relevant Accountable Person and provided to APRA and the Australian Securities and Investments Commission (ASIC) by end-August 2020;
- **conduct an appropriate credit assessment process** to review borrowers' particular circumstances and determine the appropriate lending decision (return to performing, restructure, extension of deferral period or default/impairment);
- **monitor, manage and report** on loans that have been restructured or granted a repayment deferral, to ensure the risk of these loans is clearly understood and closely tracked at a portfolio and loan level;
- **ensure adequate policies, processes, resourcing and systems** are in place to monitor arrears and for problem loan management during a period of heightened activity, including collection strategies, collateral management and hardship support;¹ and

¹ ADIs are obliged, under consumer laws and banking codes, to consider hardship variations to credit contracts for borrowers experiencing temporary financial difficulty. The management of hardship should not focus solely upon rapid resolution and recovery of a defaulted loan, but rather strive to support the longer-term financial position of both the borrower and the ADI.

- **reliably measure and record** the impact of repayment deferrals on provisions and regulatory capital, and consider the forward-looking implications for risk profile, capital projections and stress testing.

AASB 9 Financial Instruments expected loss provisioning continues to apply to ADIs, including for loans with repayment deferrals and restructured loans. ADIs should continue to monitor borrowers closely and undertake regular credit risk assessments, and on a best endeavours basis continue to grade and re-rate borrowers through the period ahead.

APRA together with ASIC will be engaging with ADIs on better practice in the credit assessment and management process for the review of loans subject to COVID-related repayment deferral. For many ADIs, this will require an uplift in capabilities, processes and oversight, to ensure they are well positioned to manage the transition for this part of the credit portfolio. APRA will also be developing additional reporting obligations in relation to these exposures, to monitor their volume and performance.

Public disclosure

In this uncertain environment, transparency is important to sustain investor and community confidence in the banking system. ADIs choosing to apply this alternative capital treatment will be required to, as well as report to APRA, provide public disclosures on the extent and nature of loans granted repayment deferrals, and information regarding loans that have been restructured. APRA will issue specific requirements on minimum expectations for these disclosures in the coming weeks.

Next steps

Repayment deferrals continue to be an important element of managing borrower circumstances through the COVID-19 period. APRA will continue to engage regularly with ADIs to stay informed on progress and risks, and to ensure that there is an appropriate transition back to borrowers making repayments where possible. In due course APRA will formalise these capital measures and disclosure requirements through a temporary legislative instrument.

Yours sincerely

John Lonsdale
Deputy Chair

ATTACHMENT A – TEMPORARY CAPITAL TREATMENT

Extension of repayment deferrals

- (1) In line with the treatment detailed in APRA's letter of 25 March 2020, the treatment outlined below can be applied to a broad class of otherwise performing loans on which ADIs grant repayment deferrals. This includes loans that are less than 90 days past due and not impaired at the time deferral was granted.
- (2) Under the temporary capital treatment, the period of deferral does not need to be treated as a period of arrears for APRA reporting purposes, nor do the loans need to be regarded as restructured or impaired. The counting of days past-due is paused when the repayment deferral is granted.² This temporary capital treatment is available until the earlier of either:
 - a. ten months from when the initial repayment deferral was granted, e.g. where a borrower was initially granted a repayment deferral on 31 March 2020, the treatment expires on 31 January 2021; or
 - b. 31 March 2021.

The temporary capital treatment ends on 1 April 2021 for all loans, irrespective of when the repayment deferral was initially granted or the period remaining on a deferral.

- (3) Where an ADI grants a repayment deferral to a borrower from 1 October 2020, or extends the initial deferral beyond six months, the ADI must conduct an appropriate credit assessment of the borrower prior to granting the deferral, having regard to the individual circumstances of the borrower. As part of this credit assessment, the ADI must be satisfied that there is a reasonable prospect of the borrower being able to repay the loan on appropriate terms at the end of the deferral period. If the borrower already has the capacity to make repayments on some basis, a further deferral may not be in the best interests of the borrower.
- (4) For loans granted repayment deferrals, an ADI must resume the counting of arrears for APRA reporting purposes at the end of the deferral period from the number of days past-due at the time the initial deferral was granted, unless the loan is modified in accordance with the requirements set out below.
- (5) Notwithstanding anything set out in this section, where an ADI determines that a borrower is unlikely to repay it must treat the loan as impaired.³

Restructured loans

- (6) Upon a restructure, as defined in paragraph 28 of *Prudential Standard APS 220 Credit Quality* (APS 220), an ADI can return a loan for a borrower impacted by COVID-19 to non-impaired status where it satisfies all of the following criteria:
 - a. the ADI and the borrower have formally agreed to the modified terms;

² For the purpose of the 90 days past-due criterion in paragraph 26(a) of APS 220, the days past-due of such loans will remain unchanged throughout the repayment deferral period.

³ Indicators of unlikelihood to repay are detailed in paragraph 26 of APS 220 and paragraph 77 of Attachment A to APS 113.

- b. the ADI expects the borrower will perform in accordance with the modified terms so that it will receive in a timely manner the full amount of cash flows now contracted to be received;
- c. no further repayment deferral periods are provided to the borrower;
- d. the borrower must be part of a portfolio where the ADI has granted repayment deferrals under paragraph 1 of this Attachment; and
- e. the borrower has only been returned to a non-impaired status under this treatment once.

Loans may be returned to non-impaired status under the above treatment only prior to 1 April 2021. Where a restructure does not meet the above criteria, the loan must satisfy the conditions in paragraph 34 of Attachment A to APS 220 to be returned to non-impaired status.

Other consequential amendments

- (7) For the purpose of *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk*, loans that meet the treatment set out in paragraphs 2 or 6 of this Attachment do not need to be treated as 90 days past-due or impaired.
- (8) For the purpose of *Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (APS 113)*, loans that meet the treatment set out in paragraph 2 of this Attachment do not need to be treated as 90 days past-due.
- (9) For the purpose of paragraph 80 of Attachment A to APS 113, loans may be immediately re-rated to a non-defaulted grade upon a modification of terms in accordance with paragraph 6 of this Attachment.
- (10) Loans modified in accordance with paragraph 6 of this Attachment may be considered performing loans for the purpose of calculating the required stable funding requirement under paragraphs 36 and 37 of Attachment C to *Prudential Standard APS 210 Liquidity*.