Theoretical and Applied Economics
Volume XXX (2023), No. 1(634), Spring, pp. 169-176

The impact of Covid-19 payment moratoria on the Romanian banking system

Eugen-Marian VIERESCU
Bucharest University of Economic Studies, Romania
vierescueugen@gmail.com

Abstract. *This paper shows the impact of the payment moratoria on the Romanian banking system in the first months after the outbreak of the Covid-19 pandemic. In the first part, which presents the synthesis of specialized literature on moratoria, it is described how the pandemic affected the population and the authorities, as well as the banking prudential regulatory measures introduced to reduce the economic effects that threatened the very financial stability of the state. The work continues, in the second part, with a presentation of the data regarding the results of the application of this measure and the impact on the banking sector in Romania. The results suggest that the moratorium tends to be used by companies that were already struggling to meet their obligations to creditors, which led to an increase in the rate of non-performing loans after the grace period expired. They also show that such measures are not viewed with good eyes by the banking sector, as they increase the uncertainty weighing on it.*

Keywords: payment moratoria, Covid-19, non-performing exposures, forborne exposures.

JEL Classification: G21, G28, G35.

Introduction

The Covid-19 pandemic represents an event with a distant precedent, precisely in 1918, against which humanity did not have a perfect solution, and even the one it identified came late, due to the sophisticated medicinal processes that must be completed to create an effective vaccine. All this time, the states of the world had to take emergency measures (for example lockdown, activity restrictions, economic support, etc.).

When the activity restrictions were introduced, the question arose as to what the people who worked in those companies would survive with, or with what they would be able to fulfill their obligations to suppliers or banks. The public authorities tried as much as possible, even at the cost of burdening the state budgets, to come to the support of the people. Credit deferrals were granted, technical unemployment was paid, as well as other measures aimed at taking over the pressure felt by the affected public.

The purpose of this paper is to explore how the measure to postpone the payment of credits, known as the moratorium, impacted the banking system in Romania. The paper begins with the synthesis of specialized literature on the subject, after which, in the second part, I will show, in numbers, how high the degree of recourse to moratoriums was and how much this measure affected the liquidity inflows of the banks. The last part presents the conclusions and recommendations for possible undesirable situations in which moratoria will be used again.

1. The concept of payment moratorium. Synthesis of specialized literature

The Covid-19 pandemic is an event that we can easily fit into what Mervyn King (2020) calls "radical uncertainty". A sanitary shock of unprecedented intensity since the Spanish flu (1918) which, by the need to impose the "great closure" (Dăianu et al., 2020) as a way to prevent the spread of the virus, caused an economic collapse to say the least severe.

Panic over the virus caused the biggest weekly drop in US financial markets since the 2007-2009 crisis, signaling the economic problems ahead. A very good example of the speed with which the new crisis was advancing is the Dow Jones Industrial Average, which was facing a 12% decline after a record high in the same month. This as the markets were not interested in anything but cash. Another example is the unemployment rate, which, in the US, recorded the highest increase in history, 11%, in just 2 months (Bernanke, 2022). Unlike previous crises, this one was happening at an unprecedented speed.

The Covid-19 pandemic has had catastrophic effects on the incomes of families around the world. The economies of both industrialized and emerging countries have struggled to adapt to the new normal, which has put intense pressure on public budgets, difficulties in supply chains and caused, among other causes, the inflationary crisis we are facing today. This *sui generis* war, as the pandemic was called in a Euromonitor report (2020), meant unforeseen and non-permanent expenditures from public budgets to support economic activity, or, in some cases, to compensate for its lack.

In the economic struggle, public institutions supported the activity of companies and maintained financial stability, and the banking system did not stand aside either, bringing crucial support in stabilizing economies since the first months of the lockdown that brought irreversible changes to our society. For many prophets of the financial crisis, the mission of protecting people's incomes and financial stability seemed impossible.

With the support of national banks, which acted without delay, credit institutions provided the necessary liquidity to families and companies and absorbed the shock felt by the entire economy by granting state-guaranteed loans and deferring the payment of installments, a process known as the moratorium. Called by Adrian Vasilescu (2020) "an institution of civil law that is activated in the conditions where it is necessary to take measures to postpone payments from debt contracts", the moratorium does not lead to the reclassification of the credit by the banks, which would imply also making provisions for outstanding amounts.

Nor did the regulatory authorities remain passive and made the prudential framework more flexible. As the moratorium has been adopted in several EU jurisdictions, the European Banking Authority (EBA) has issued several guidelines to clarify how banks should apply it, without the need for automatic reclassification of loans as non-performing. Thus, even if any credit restructuring automatically means the application of default status, being associated with the notion of financial difficulty, in the case of moratoriums, whether public or private, "such an operation is not considered a restructuring measure" (NBR Communication, 2020), not being associated with a financial difficulty on the part of the debtor.

What is important so that the measure of introducing a moratorium does not generate a shock in the banking system is the prudential treatment that will be applied to the loans that will benefit from such a measure. In this sense, the EBA supported the banks with clarifications and application guidelines in order to have unitary provisions at the European level.

Immediately after the outbreak of the pandemic, at the beginning of 2020, the EBA came to the support of borrowers and conveyed that a moratorium does not automatically lead to a deterioration in the quality of exposures and, implicitly, to a significant increase in credit risk, taking into account the general exceptional conditions caused by the pandemic. If the purpose of moratoria, be they public or private, is to respond to factors that can cause systemic risks and to reduce potential risks, then it is considered that the moratorium does not address the specific situation of a single debtor, but responds to a broad need, of an extended group of borrowers, with a wide range of purchased banking products. Therefore, the automatic classification of these exposures as distressed restructuring or non-performing strictly for this reason is not envisaged. However, inclusion in the category of non-performing exposures is possible if the moratorium also changes other contractual terms (for example, the interest rate), in this case being pursued more than the change in the repayment schedule.

This specific treatment was transposed by Guideline EBA/GL/2020/02, which precisely states that general payment moratoria introduced as a result of the Covid-19 pandemic do not automatically lead to the conclusion that a restructuring measure caused by financial difficulties has been applied and thus avoid treating these exposures as distressed restructuring in the context of default. It is important to know that this was a treatment specific to the Covid-19 moratoria and produced effects only in the case of those applied before March 31, 2021.

Next, it is the duty of the credit institutions to continuously assess the credit quality for those exposures to which installment deferral has been applied and to identify, as a consequence, any situation in which the debtor could end up in improbability of payment, according to the provisions of the Regulation (EU) no. 575/2013 (CRR). It should be noted that if credit institutions decide to grant new loans to debtors benefiting from the moratorium, this fact does not automatically lead to a restructuring situation following the financial difficulties of the debtors. The classification is made after analyzing the situation of each individual debtor according to the provisions of the CRR.

It is essential to mention that the provisions of these Guidelines do not come to complete the mandatory regulatory framework, but only have the role of clarifying the application of the existing flexibility in the CRR. In this context, according to the prudential regulatory framework, credit restructuring follows idiosyncratic risks and involves granting some facilities to those debtors who are either already experiencing or are about to experience difficulties in repaying their loans, by adopting measures specific to each individual debtor, on the basis of the individual assessment of their financial situation.

Due to the nature of the health crisis and the measures imposed, the highest pressures were, in a first phase, felt at the level of debtors' liquidity.

The Covid-19 pandemic led the Romanian authorities to introduce a series of facilities to support debtors who were facing payment difficulties, as other countries in the region have done. Starting from Guidelines EBA/GL/2020/02, in March 2020 a public moratorium was introduced regarding the suspension of payment of installments for a maximum period of 9 months.

The National Bank of Romania adopted a series of measures aimed at limiting the effects of the crisis on the banking sector and on financial stability. Through monetary policy measures, along with those of a prudential nature, the reduction of interest rates and the preservation of adequate liquidity in the banking system were favored.

The interest in payment moratoria was an early concern for the Romanian economic space, in this sense the work of Marinescu (1924), Payments in Strong Currency – The Moratorium, which describes the general moratorium (commercial or civil companies, banks, merchants, any other persons) was discovered for currency payments, which was granted more than a century ago. As at present, the justification of the general moratorium was based on a generalized crisis that indiscriminately affects all debtors: "The war between the great states that surround us had, from an economic point of view, a strong and immediate impact on us. From the very beginning, two phenomena manifested themselves: the crisis of means of payment and the credit crisis." (excerpt from the Government's Statement of Reasons regarding the Special Law authorizing the taking of exceptional measures, published in Official Journal No. 217 of December 27, 1914).

2. Research methodology

The present research focuses on the impact of payment moratoria adopted during the Covid-19 period on the banking system in Romania. As a method of research, we started from the data reported by credit institutions, synthesized in the financial stability reports issued by the National Bank of Romania, through which we showed what was, in terms of value and number of beneficiaries, the degree of affecting the activity of banks in Romania, as a result of the application of this public facility.

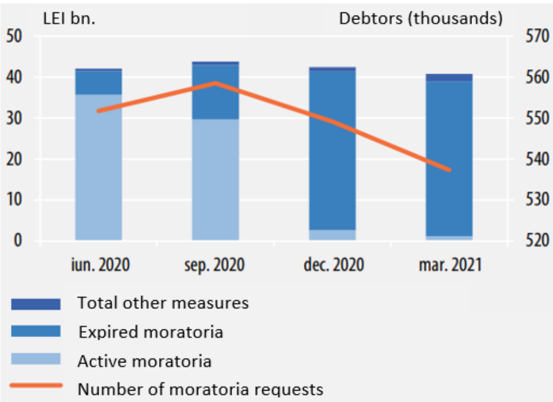
The objective of the research was to observe the level of attractiveness towards this type of facility for Romanian debtors and to determine the period of maximum use of it. The starting point is the idea that the payment moratoria during the Covid-19 period had a positive influence on debtors, achieving their goal, that of reducing the pressure on incomes caused by the restrictive measures imposed, although at the level of credit institutions, the underlying premise is that measures of this type are burdensome and cause uncertainty.

3. Results and discussions

The purpose of the moratorium introduced in March, by GEO no. 37/2020 was to moderate the impact on debtors' liquidity. A number of 16.4 thousand companies had requested the postponement of installments until June 5, 2020, equivalent to 21% of all companies with loans. For the majority of suspended amounts, representing 3.2 billion of the total 3.6 billion, suspension requests were submitted for periods between 6 and 9 months.

The data for March 2021 show that the call for the moratorium was a massive one, in the number of 537 thousand debtors, representing a volume of 38.9 billion lei, equivalent to 12.7% of the total credits granted.

Graphic 1. *Evolution of payment moratoria requests*

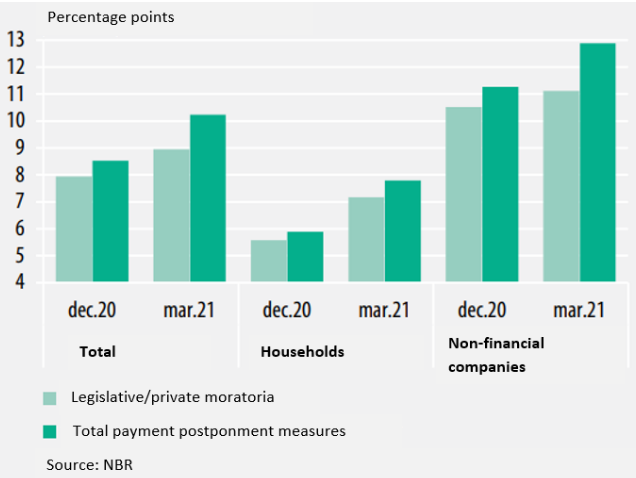


Source: NBR

Most requests to postpone installments came from companies providing services to the population and those active in the real estate field (46%, respectively 23%), at the opposite pole being those active in fields such as commerce or utilities. Despite the extension of the deadline for appealing to the moratorium until March 31, 2021, requests have dropped considerably, with less than 1% of debtors being the beneficiaries of this facility, which heralded the first signs of the resumption of economic activity.

The expiration of grace periods for loans that benefited from the moratorium led to an increase in the rate of non-performing loans, up to 3.9% (the EU average was 2.5% in March 2021), but also in the restructuring rate, up to 2.8%, compared to the EU average of 2%. For non-financial companies, the loan default rate was 12.3% as of March 2021, as opposed to 5.2% for companies that did not use the moratorium. For individual borrowers, this value was 7.4% and 3.1%, respectively. Thus, the support measure also led to a possible manifestation of moral hazard, with high-risk loans resorting to moratoriums to a greater extent.

Graphic 2. *NPL rate after Covid-19 payment moratoria*



In this context, it becomes extremely important that risk assessment continues to be conducted in a prudent manner that accurately reflects the quality of credit portfolios. But the banking system began to take precautionary measures, and the degree of coverage of non-performing loans by provisions increased to 63.8%, compared to only 44.7% at the EU level (March 2021). Moreover, according to the data as of December 2021, approximately 50 percent of the loans that resorted to moratoriums are classified in stages 2 or 3 of impairment according to IFRS 9, with banks recognizing an increased risk in their case.

The moratorium on installment deferrals was complemented by other legislative initiatives to extend the applicability and benefits to affected borrowers, which led to increased uncertainty in the banking system, with negative effects in particular on NPL provisions and bank profitability. The challenge of legislative changes is a constant one for the banking system, at least in recent years. In addition to the facility granted to debtors to defer payment of installments, introduced by GEO no. 37/2020 and extended by GEO no. 227/2020, we count the amendments made to Law no. 77/2016 regarding payment and changes to the effective annual interest ceilings for loans granted to natural persons.

Another negative effect can also be reflected on the credit risk, through the delayed recognition of the negative effects of the shock felt by borrowers, which can become permanent.

The measure of suspending the payment of installments can generate an effect of the type of self-fulfilling prophecy. Thus, the uncertain economic and social climate can be enhanced by measures that indirectly confirm the population's fears. At the same time, the operational capacity of credit institutions will be affected by new exceptional rules, which must be introduced shortly into the operational infrastructure. The suspension of delinquent days makes it difficult to take a prudent risk-based lending approach at the borrower level, given a new window of missing data.

4. Conclusions and recommendations

The present research sought to evaluate the impact that the measure to postpone the payment of credits, known as the moratorium, had on the banking system in Romania. The moratorium for deferring the payment of loans is a support measure addressed to both companies and individuals, which has become better known and studied following the Covid-19 pandemic. This allowed borrowers faced with the shock of a sudden drop in income to postpone their payment obligations for a limited period, during which they could obtain the necessary liquidity.

The main conclusion that emerges from the data analysis is that this measure enjoyed extensive use, with hundreds of thousands of applicants, from most fields of activity, the main one being that of services addressed to the population.

Another conclusion is that legislative initiatives such as payment moratoria, even if they come with the aim of supporting debtors in difficulty, increase the risk of uncertainty and may have negative effects on the prudential situation of credit institutions, by affecting their ability to carry out financial intermediation.

Given the poor financial quality of borrowers who have applied for moratorium, credit institutions are forced to continuously assess borrowers' ability to honor their loan agreement after the end of the grace period, as there is an increase of the rate of non-performing loans among these borrowers.

Despite some clear disadvantages (e.g. the uncertainty created in the banking sector, depriving banks of an important part of short-term liquidity), the moratorium is a measure with a strong positive social impact, which has proven its usefulness in times of deep crisis. However, this must be accompanied by continuous assessments of credit risk, in order to minimize possible situations of default.

References

Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the Covid-19 crisis, 2020. Available at https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-legislative-and-non-legislative-moratoria-loan-repayments-applied-light-covid-19-crisis> [Accessed on 07.10.2022].

Jiménez, G., Asenjo, E., Vegas, R. and Trucharte, C., 2021. Support measures in the banking sector: loan moratoria. [pdf] Madrid. Available at <https://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/InformesEstabilidadFinancera/21/1_Moratorias_FSR.pdf> [Accessed on 12.10.2022].

National Bank of Romania, 2021. O revenire economică puternică are loc, însă lupta cu pandemia continuă. [pdf] Bucharest. Available at: <https://www.bnr.ro/Studii,-analize,-puncte-de-vedere-4009.aspx> [Accesed on 25.11.2022].

National Bank of Romania, 2020. Economia și pandemia: de la suferință la redresare. [pdf] Bucharest. Available at: <http://www.bnr.ro/DocumentInformation.aspx?idInfoClass=30485&idDocument=36975&directLink=1> [Accessed on 28.11.2022].

National Bank of Romania, 2022. Ieșirea din pandemie, dar intrarea într-un nou război rece. [pdf] Bucharest. Available at: <https://www.bnr.ro/Studii,-analize,-puncte-de-vedere-4009.aspx> [Accessed on 03.12.2022].

National Bank of Romania, 2020. Comunicat de presă al Comitetului de Supraveghere al Băncii Naționale a României. Bucharest. Available at <https://www.bnr.ro/page.aspx?prid=17639> [Accessed on 05.12.09.2022].

Voican, M., 2020. Adrian Vasilescu (BNR) ne spune unde au greșit guvernele ultimilor ani. Available at: <https://www.money.ro/adrian-vasilescu-bnr-ne-spune-unde-au-gresit-guvernele-ultimilor-ani/> [Accessed on 12.12.2022].