COVID-19 BRIEFING

Insights for Inclusive Finance

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Microfinance and COVID-19: Principles for Regulatory Response

Governments across the globe have taken extraordinary steps to contain the COVID-19 outbreak. Although necessary, public health responses such as lockdowns have imposed serious costs on the real economy and the financial sector. As a result, further policy steps have proven necessary, both within and beyond the financial sector, to mitigate the impacts of the pandemic on businesses and ordinary people. In a previous COVID-19 Briefing (CGAP 2020a), we proposed five guiding principles for regulators to consider. This Briefing applies each principle to country contexts, and specifically addresses what each principle means for regulatory responses to the COVID-19 crisis.

While the COVID-19 pandemic has affected nearly every business sector and region of the world, CGAP is particularly concerned with the implications of the crisis for poor people and micro- and small enterprises (MSEs) in developing countries. This Briefing specifically addresses the regulatory response to the pandemic as it affects microfinance providers (MFPs) and their clients. We focus on regulated MFPs as defined in the CGAP Typology of Microfinance Providers (CGAP 2020b).

In a previous COVID-19 Briefing (CGAP 2020a), we proposed five guiding principles for regulators as they balance immediate damage reduction and relief objectives against medium- and long-term goals for the microfinance sector.[1] These principles are summarized in Box 1 and are further elaborated throughout this paper. While specific to microfinance, the principles largely are consistent with banking sector guidance issued by standard-setting bodies, the World Bank, the International Monetary Fund (IMF), and the European Banking Authority (EBA). For reference and comparison, the Annex provides a summary of that guidance.

1 We use the terms "regulator" and "supervisor" interchangeably in this paper to refer to financial regulatory and supervisory authorities.

The paper spells out what the principles mean for regulatory responses to the COVID-19 crisis. It also aims to:

- Illustrate how specific measures may be guided and assessed in light of the five principles.
- Identify trade-offs authorities may face in applying the principles.
- Assess the extent to which these microfinance-specific principles are consistent with general crisis response guidance.
- Draw lessons relevant to the design of responses to COVID-19 and other crises that may arise in the future.

Our analysis centers on India, Pakistan, Peru, and Uganda, whose challenges are further explored in separate country notes.[2] We complement the main analysis with examples of measures adopted in additional countries,[3] along with broader, non-microfinance-specific guidance in the Annex.

A few caveats are in order. First, although fiscal relief is important in shoring up crisis-affected MFPs and their customers, our analysis is confined to the regulatory/supervisory sphere. Second, our research is limited to publicly available information, such as regulatory documents, and insights gathered through exchanges with stakeholders. While we collected as much material as possible on the four countries of focus, we cannot ensure a complete picture in every case. Details on supervisory responses have been particularly difficult to obtain since they are not always made public. Lastly, the crisis is still unfolding. Countries continue to adapt their initial responses—often devised under extreme pressure—to new developments. Information quickly ages, and rapidly moving events must be understood within the broader sweep of a global crisis.

BOX 1. **Guiding Principles for Regulators**

CGAP envisioned five principles to guide regulators as they respond to the impacts of the COVID-19 crisis on the microfinance sector.

1. **Pro-poor.** Poor customers benefit from effective relief and continued access to services, and they are protected.
2. **Clear and predictable.** Response measures have a clear timeline, scope of application, and exit strategy.
3. **Broad coverage.** Response measures cover all regulated MFPs.
4. **Preserve the safety and soundness of MFPs.** Response measures balance the benefits and risks of regulatory changes.
5. **Adjust supervision.** Response measures reduce supervisory burdens while enhancing risk-based monitoring.

2 Our selection of countries is purely illustrative. They may not necessarily exhibit best practices, but they do cover a wide range of responses that have impacted the microfinance sector.

3 See https://www.cgap.org/research/data/microfinance-covid-19-examples-regulatory-responses-affecting-microfinance-providers.

Applying the five principles to country contexts

PRINCIPLE 1: PRO-POOR.

POOR CUSTOMERS BENEFIT FROM EFFECTIVE RELIEF AND CONTINUED ACCESS TO SERVICES, AND THEY ARE PROTECTED.

A pro-poor regulatory response would:

- Directly reach low-income households and MSEs, or reach them through the MFPs that serve them.
- Tailor relief measures to address the distinct challenges of poor people, especially women.
- Protect poor customers against risks arising from or heightened by the pandemic—and from the measures taken to address it.

Reaching poor people

Even when poor households and MSEs are not the specific focus, regulatory responses should be inclusive enough to cover these groups. However, this may prove difficult since poor people face the highest levels of financial exclusion. Moreover, they often depend on nonbank MFPs, which may not automatically benefit from crisis measures. It is important for regulatory relief to cover all types of regulated MFPs that serve or potentially serve poor people. Our discussion of Principle 3 focuses on the scope of MFP coverage.

Where MFPs fail as a result of the pandemic, it is critical to ensure service continuity and protect small depositors. While often not systemically important from the regulator perspective, MFPs are the backbone of the extended financial services network that reaches those unserved or underserved by conventional banking, especially women. Some MFPs serve a large number of poor customers and MSEs and may be the predominant or sole provider in a region. In this regard, they can be considered “systemic.” Without special targeting, systemic MFPs may not receive the level of supervisory attention necessary to protect poor customers—especially depositors—from the worst effects of institutional failure. Principle 5 addresses the issue of early action and orderly resolution.

Regulation and supervision set key conditions for the nonregulatory (e.g., fiscal) crisis response that targets poor people. Where a framework is adverse it may hamper the distribution of fiscal benefits to the poorest individuals or heighten the risk of exposure to the virus. This scenario arises where social benefits are distributed only through bank branches, when agents are not permitted to stay open during the pandemic, or when unbanked beneficiaries cannot remotely open accounts.[4] Moreover, providers may be tempted to use government guarantees to lend to large or medium-size businesses rather than MSEs and poor customers—thereby partly defeating the purpose. Avoiding undesired outcomes requires monitoring by financial authorities of how providers are using fiscal support to reach poor people.

4 Jenik, Kerse, and de Koker (2020) discusses regulatory tools for rapid account opening during the pandemic.

Tailoring relief measures to poor people

Ensuring that poor people are reached is not enough. Certain measures need to be tailored to account for the special profiles and circumstances of poor customers. For instance, it is vital to provide MFPs with the flexibility to define business hours or to change operational procedures (e.g., group meetings, loan approvals, savings withdrawals) during the pandemic, especially for those active in rural or peri-urban areas.

Customized debt relief measures may be necessary. Payment moratoria have often been applied equally across customer segments. While poor people may be covered, they likely are more vulnerable than other borrowers. Some specific vulnerable segments may benefit from blanket moratoria with clear opt-outs that ensure borrowers have a choice.[5] Regulators should also consider instituting "full payment holidays," i.e., moratoria with no interest capitalization or accrual. Another aspect to consider is including in relief programs borrowers who were delinquent even before the crisis. Principle 4 addresses this type of scenario.

Customer choice: Tailored pro-poor approaches present trade-offs. For instance, it may not be possible to offer customers the choice to continue paying off loans under original loan terms and ensure that those who need immediate debt relief receive it. Requiring customers to apply for relief or make such a choice before receiving a benefit may mean that many do not get it, including those most vulnerable such as women who depend on agricultural livelihoods (Koning, Anderson, and Bin-Humam 2020). To ensure respect for customer choice, moratoria can be applied on an opt-in basis, as in India, Pakistan, Uganda, and many other countries.

In contrast, an opt-out approach prioritizes immediate provision of relief. Peru has allowed lenders to reschedule loans in bulk without the borrower's prior agreement or knowledge. Borrowers may opt out by contacting their lender. Another rapid relief approach allows MFPs to apply moratoria based on an informal agreement with the borrower (such as via a phone call) and obtain their signature only after the loan has been rescheduled. The Uganda Microfinance Regulatory Authority (UMRA) has adopted this type of policy. Another possible approach would simply apply moratoria to poor borrowers without prior notice and adopt a targeted approach for other clients.

Each option has its benefits and drawbacks. No empirical evidence exists to show which works best for poor people. Customization and targeting could introduce delays. The regulator's decision should take into account factors such as the urgency of providing relief to certain customer segments; the likelihood of poor customers being aware of and having the ability to apply for a moratorium (e.g., given patchy telecom and transport networks); and their capacity to understand and compare options. Regulators may also exercise flexibility in reviewing and adjusting measures based on the results of early implementation.

Deferred interest: The regulator's approach to interest accrual and capitalization is also of deep importance to poor people. Moratoria often suspend principal and interest payments, but interest still accrues. Borrowers gain immediate relief but must later pay

5 This has also been described as a moratorium "by default" in "Consumer Protection and COVID-19: Borrower Risks as Economies Re-Open" (Rhyne, forthcoming).

back an increased balance. Another option is to suspend interest accrual throughout the moratorium, i.e., provide a payment holiday. Here the borrower gains maximum relief but the cost of the moratorium is increased for MFPs. Table 1 illustrates measures taken in India, Pakistan, Peru, and Uganda.

TABLE 1. **Measures on interest accrual and deferment**

India	Interest shall continue to accrue during the moratorium. For term loans, payment of interest accrued during the moratorium may be deferred or capitalized. For working capital facilities, initially, accrued interest immediately had to be recovered at the end of the moratorium. The Reserve Bank of India (RBI) later allowed lenders to convert the accumulated interest into another loan, repayable no later than March 31, 2021 (RBI 2020).
Pakistan	Interest shall continue to accrue during the moratorium.
Peru	Interest may continue to accrue or accrual may be suspended as a part of the moratorium and other loan restructurings the MFP is permitted to perform.[a]
Uganda	For Tier 1–3 institutions, accrual continues during the moratorium and deferred interest payments can be capitalized and amortized during the loan period. UMRA has not addressed this issue as it applies to Tier 4 institutions.

a. Peru's Superintendence of Banking, Insurance and Pensions (SBS) issued specific instructions for the accounting treatment of interest accrued during the pandemic for both retail and nonretail loans.

Note: Information on all measures discussed in this Briefing was up to date as of 31 July 2020 to the best of our knowledge.

Table 1 illustrates the approaches taken on three points: (i) whether interest is accrued during the moratorium over the unchanged principal; (ii) how accrued interest is paid after loan repayments are resumed; and (iii) whether MFPs capitalize deferred interest payments, thus charging interest on the sum of interest accrued during the moratorium. Poor borrowers and MSEs may not be able to meet the significant increase in their obligations when the moratorium lapses. This in turn may damage their credit history and reduce their future access to finance. Paying deferred amounts in a lump sum immediately after a moratorium ends can be particularly difficult for customers and at the same time heighten MFPs' credit risk and financial soundness. Borrowers also may not fully understand the consequences of deferment. These issues require regulatory guidance, and none of the four focus countries has fully addressed them. Regulatory guidance ideally would provide maximum relief for the most vulnerable borrowers by limiting sudden additional burdens at the end of a moratorium.

Customer relief is not always consistent with keeping MFPs afloat. The greater the relief extended to borrowers during and after a moratorium, the more MFPs themselves need parallel relief, including repayment moratoria from creditors, liquidity support from the central bank or government, and adjustment of prudential requirements. Principle 4 further discusses the potential risk of debt relief and related measures on the safety and soundness of MFPs.

Digitization: Digital channels enable continuity by allowing access to services when restrictions on movement and branch closures are implemented for health reasons.

Authorities in India and Uganda have encouraged the general public to use digital channels. Peru has increased transaction and account balance limits for basic accounts. Pakistan has waived interbank charges, simplified client authentication, increased transaction and balance limits, and enabled digital onboarding of agents. In Uganda, the central bank has allowed the largest mobile money provider to waive customer fees—a practice that in normal times may be considered anti-competitive. In countries such as Rwanda and Kenya, regulators have reduced or eliminated mobile money transaction fees.

Not all MFPs are linked to a country's digital rails and many low-income customers may not be connected at all. Some countries still lack digital networks. In these contexts, measures that significantly limit in-person or cash transactions can disproportionately hurt poor people and those unable to conduct digital transactions for other reasons.[6] Measures to facilitate digital transactions are generally worth considering, as well as measures to address the related risks and problems facing poor customers (e.g., weak connectivity, digital illiteracy, limited privacy), especially poor women and other vulnerable groups.

Protecting poor customers

Regulatory responses and business practices in the context of the pandemic raise a host of consumer protection issues. This section briefly addresses several.[7]

Protective measures so far adopted include:

- Deferring debt collection.
- Prohibiting lenders from charging fees for crisis-related loan restructuring.
- Protecting the borrower's credit score from downgrades based on crisis-related restructuring.
- Requiring providers to act in the borrower's interest when restructuring loans.
- Temporarily prohibiting fees on accounts opened for government-to-person (G2P) payment purposes.
- Forbidding increases in the interest rate or extra collateral for restructured loans.

Each of the four focus countries has adopted one or more of the measures noted above.

Clarifying the rules on deferred principal and interest should ease the repayment burden for poor borrowers and MSEs while helping cushion the impact of deferral on the health of MFPs (see Principle 4). Prohibiting MFPs from discriminating against borrowers who benefit from debt relief (a step Mexico has taken) would offer further protection. If regulators do not issue official guidance, they should at least monitor how MFPs address deferred payments and take action, if warranted. Authorities should watch for signs of stress due to increased loan obligations among low-income borrowers and MSEs. It may be useful to engage civil society and consumer advocates and to require MFPs to communicate proactively and clearly with borrowers (e.g., informing customers of options and likely consequences), as suggested in Rhyne (2020).

6 This concern has led the UK's Financial Conduct Authority (FCA) to closely monitor access to cash by underserved communities since the start of the pandemic.

7 CGAP is conducting further research on consumer protection issues facing borrowers as a result of the pandemic.

The trade-offs between providing urgent relief and upholding consumer protection rules are reflected in a number of adopted measures. In Peru, to facilitate COVID-19-related G2P transfers, financial institutions are temporarily permitted to open accounts in bulk without customer choice or consent. E-money issuers are also temporarily exempt from fund safeguarding rules—a measure aimed at easing account openings and digital transactions during the pandemic.

It is important to mitigate the consumer risks introduced by crisis measures. The Peruvian regulator has prohibited financial institutions from imposing fees (for one year after G2P disbursements) on accounts opened without prior customer consent. A further safeguard may be to place the burden on MFPs to confirm the client's intention to keep the account open immediately upon complete fund withdrawal or perhaps within the year following. Increased monitoring could help regulators decide on additional measures to mitigate the risk of relaxing fund safeguarding rules for e-money accounts.

During the course of the pandemic, poor customers may be more vulnerable to the heightened risk of abuse and scams linked to transaction accounts and digital transactions, for example, charges improperly deducted from G2P payments (Boeddu et al. 2020). They may not be aware of or have access to complaint procedures. Protective measures could include prohibiting deductions from G2P payments, requiring immediate reimbursement of unauthorized transactions up to a certain value, enhanced monitoring of bulk account openings, warning people how to identify and act on scams, and participating in cross-border enforcement actions (Medine 2020).

Ensuring a pro-poor crisis response means upholding existing consumer protection regulations, except in limited cases. It includes continued enforcement of rules against unauthorized fees, discrimination, overly aggressive lending, insurance sales, and debt collection practices. It also requires MFPs to effectively address consumer complaints.[8]

PRINCIPLE 2: **CLEAR AND PREDICTABLE.** RESPONSE MEASURES HAVE A CLEAR TIMELINE, SCOPE OF APPLICATION, AND EXIT STRATEGY.

Clarity and predictability mean that response measures should be unambiguous and should state which institutions and services are covered in the scope of application. Predictability requires clear timeframes, end dates or sunset clauses, and rules for reestablishing the precrisis status quo (i.e., an exit strategy). There may be a trade-off between quick crisis response and clarity and detail in the adopted measures. But improvements and clarifications can be made after response measures are first announced.

Response measures in the four focus countries largely have been unambiguous, but gaps do exist. For example, conflicting decisions at the national and state or local levels in India have created confusion about which types of institutions can operate during lockdown. It also has been unclear whether MFPs in India can charge fees or require extra collateral

8 There is evidence from the Philippines that complaints have increased significantly during the crisis. More generally, complaint channels appear to have taken relatively low priority in the crisis response, and they may have become less accessible.

for restructuring, and whether nonbank MFPs are considered beneficiaries of bank debt relief. In Uganda, uncertainty arose on the question of whether UMRA-regulated MFPs were allowed or mandated to apply a moratorium. Levels of detail in regulatory guidance have also varied. For example, not all countries have spelled out prudential and accounting treatment for loans that benefit from moratoria or special restructuring.

Lockdown periods and extensions have been unpredictable as they necessarily shift with the course of the pandemic. In light of this, two main approaches to moratoria have emerged: a relatively short, renewable moratorium (e.g., one month) or a longer-term moratorium that provides a fixed sunset date and is less likely to require multiple renewals (e.g., one year). There is no consensus on which approach is better.

The focus countries diverge on approaches to moratoria. India uses the short, renewable approach. The effective period for moratoria or loan restructuring by MFPs is tied to implementation schedules, including renewals, of virus containment measures at the national level (e.g., lockdowns and restrictions on movement). Pakistan and Uganda take the second approach, with some variations in detail. In Pakistan, loan extensions provided by September 30, 2020 can last up to one year. In Uganda, loan extensions can span the 12 months beginning April 1, 2020, or be granted (and terminated) at any time during that period. Peru takes an intermediate approach: Financial institutions may grant moratoria up to six or 12 months (depending on whether relief is granted before or after May 29, 2020), beginning any time lockdown is in effect.

Cutoff dates for determination of prerelief loan status (e.g., current, delinquent) have been clearly stated in all four focus countries. However, not all have determined an exit strategy or a date by which to reestablish modified regulations.

PRINCIPLE 3: **BROAD COVERAGE.**
RESPONSE MEASURES COVER ALL REGULATED MFPs.

Broad coverage means inclusion of all regulated MFPs, on equal terms, to the greatest extent possible. This creates a level playing field for MFPs and ensures that microfinance customers continue to be served and to benefit from crisis relief.

A level of customization is important when measures cover a diversity of MFPs. Providers could, for example, be given the flexibility to set crisis-period service hours that differ across regions. Further, some could gain priority in liquidity support allocation according to systemic relevance, scope of activity, and other factors. While central bank liquidity support is usually limited to banks, the Bank of Uganda (BOU) created a specific instrument to support the deposit-taking nonbank MFPs under its purview. Zambia adopted a similar measure. In Uganda and Peru, all MFPs, including cooperatives that serve rural and very low-income customers, have been permitted to operate since the start of the national lockdown. In contrast, millions of nonbank MFP customers in India and Pakistan had zero access to microfinance services during early phases of the crisis.

The case for differentiation in coverage is clearest where risk variation is most significant. Supervisory monitoring and resolution procedures should be adjusted to reflect the risk profile of each MFP and the extent to which poor communities depend on its services. Further, bank supervisors usually have more current and detailed data on the loan portfolio, liquidity, and capital of their MFPs than nonbank MFP supervisors. This may affect the nonbank supervisor's ability to take timely action and guide the industry through a crisis, including early interventions that would minimize the impact on poor customers.

Broad coverage on the basis of uniform risk-based principles strongly contrasts with haphazard treatment driven by a patchwork of regulatory domains. Where different types of MFPs fall under separate authorities or departments within an authority, unequal treatment may result from a lack of coordination in crisis response. In India and Pakistan, for example, banks were declared essential services while nonbank MFPs were subject to state-level lockdown decisions. As a result, many remain closed. In Pakistan (but not India), nonbanks fall under a different regulator than banks. By contrast, while measures in Uganda were largely the same for MFPs under BOU and UMRA, BOU has provided a greater level of detail, increasing clarity and predictability.

PRINCIPLE 4: **PRESERVE THE SAFETY AND SOUNDNESS OF MFPs. RESPONSE MEASURES BALANCE THE BENEFITS AND RISKS OF REGULATORY CHANGES.**

Regulators need to strike a balance between urgent relief and core long-term priorities such as preserving the safety and soundness of MFPs, repayment culture among borrowers, and transparency in financial disclosures by MFPs. These priorities apply both before and after relief has been granted. Regulators can achieve a balance by strictly monitoring portfolio quality and requiring MFPs to continuously assess borrower repayment capacity and recovery prospects. Further, while the regulator can offer temporary flexibility in applying prudential standards, this should be balanced by strict limitations on discretionary MFP payments, for example, dividends and bonuses. These steps are justifiable in the context of crisis but must be temporary—and counterbalanced by special risk-management and monitoring measures.[9]

International financial institutions, standard-setting bodies, and supervisory authorities such as EBA have issued guidance for regulatory response to COVID-19 (the Annex provides a summary). Although the guidance addresses commercial lending, it may be a useful reference for regulatory responses in the microfinance sector as well. We use the World Bank's guidance as a reference point in analyzing debt relief measures (see Box 2). The guidance emphasizes flexibility in treating crisis-affected borrowers while highlighting the need to uphold prudential fundamentals, for example, definitions of nonperforming loans (NPLs).

The four focus countries do not consistently practice the guidance noted in Box 2. In some cases, the first point in the guidance may be unrealistic. MFP supervisors in developing countries (and in some emerging markets) may not have current, detailed data to estimate the impact of relief measures. This data gap adds to the time pressure. The World Bank urges governments to obtain prior input from financial regulatory authorities. Coordination is key for a common, consistent, clear message, especially to borrowers, about the exceptional nature of the measures.

9 In addition to allocating zero risk weight to loans backed by government credit guarantee schemes, the only other permanent prudential measure we have documented among the four focus countries is Pakistan's decision to raise the exposure limit for banks on loans to SMEs from $800,000 to $1.1 million.

BOX 2. **World Bank guidance on COVID-19-related borrower relief measures**

- Regulators should have a thorough understanding of the financial impact of relief measures prior to adoption
- Relief should be temporary and exceptional, with a clear exit strategy
- Regulators should avoid extending the life of "zombie" borrowers and rewarding the moral hazard of willful defaulters
- Regulators should uphold fundamental prudential standards and definitions
- Lenders should provide supervisors with reliable, frequent, up-to-date, and comparable information on loans that have benefitted from relief measures
- Financial statements should provide sufficient information on the quality of the loan portfolio and credit risk control practices

Source: Dijkman and Salomão Garcia (2020)

Zombie borrowers and willful defaulters

According to the World Bank (Dijkman and Salomão Garcia 2020), borrower relief should target those with strong payment records who have been temporarily unable to repay loans exclusively due to the pandemic. The intent is to mitigate the risks related to (i) willful defaulters, i.e., those who have the means to repay but refuse to do so and (ii) "zombie borrowers," i.e., those who were delinquent prior to the crisis and are unlikely to repay. Thus, special prudential treatment should be limited to loan restructuring that directly results from moratoria. Relief policies need to avoid extending flexibility to most other kinds of restructuring, including of past-due loans. Table 2 summarizes debt relief measures in the four focus countries.

In this sample, Pakistan, Peru, and Uganda have extended the scope of special prudential treatment (e.g., permission not to downgrade a loan) to loan restructuring beyond the application of moratoria. A different example comes from Mexico, where the regulator has encouraged MFPs to consider additional relief such as forgiving interest owed. While regulators should not allow lenders to extend the lives of loans that were unlikely to be repaid from the start of the pandemic,[10] an excessively strict interpretation of the World Bank guidance could pose problems. For example, it would not permit restructuring that could provide greater relief to poor borrowers under a moratorium, such as suspension of interest accrual or noncapitalization of interest accrued during the moratorium.

Past due loans in the four focus countries can benefit from moratoria under the following conditions:

- India: Loans past due and NPLs classified as "standard" as of the date of the granting of the moratorium
- Pakistan: Loans past due for up to 180 days as of June 30, 2020
- Peru: Loans past due for up to 15 days as of February 29, 2020, and loans past due for up to 30 days as of May 29, 2020, for the moratorium granted on or after this date
- Uganda: Loans past due as of April 1, 2020

10 Avoiding what is known as "window dressing" or "evergreening."

TABLE 2. **Measures of borrower relief during COVID-19: India, Pakistan, Peru, and Uganda**

India	RBI has permitted financial institutions, including nonbank MFPs, small finance banks, and cooperative banks, to: • **Grant moratoria** on term loans classified as standard as of February 29, 2020 (including past due and NPLs classified as standard), for three months starting March 1, 2020 (later extended to August 31). • **Defer interest payments** on working capital facilities according to the same timeline. • **Relax conditions for drawdown** on working capital facilities by reducing margins until August 31, 2020 (to be restored by March 31, 2021), or reassessing the working capital cycle until March 31, 2021.
Pakistan	The State Bank of Pakistan (SBP) has allowed banks and Development Finance Institutions, upon borrower request made by June 30, 2020 (later extended to September 30), to: • **Grant moratoria of up to one year on principal payments**, including loans up to 180 days past due (excluding loans that became past due before December 31, 2019). Deferment of interest payments is subject to borrower request and SBP approval. • **Restructure loans** if the borrower requires relief beyond the one-year deferment. The Securities and Exchange Commission of Pakistan (SECP) has allowed nonbank MFPs to: • **Grant moratoria of up to one year on principal payments**, provided that interest continues to be paid. • **Reschedule or restructure loans** if the borrower requires relief beyond one-year deferment and the request is received by the SECP within 90 days of the loan becoming overdue.
Peru	SBS has allowed financial institutions (including banks, credit unions, and microfinance institutions) to take the following steps unilaterally or upon borrower request: • **Grant moratoria (also known as "special rescheduling")** of up to six months for loans that were current or up to 15 days past due as of February 29, 2020. The measure was expanded on May 29, 2020, to allow for suspension of loan payments up to 12 months after this date and to include loans 30 days past due. Permission was initially valid while the state of emergency remained in place. On May 29 the deadline was extended to June 30. • **Modify loan contract conditions**, including extension of contract term, suspension of interest accrual, reduction of interest rate, and other conditions. SBS additionally allowed **suspension of counting of days past due for loans more than 15 days** late as of February 29, 2020. Initially the suspension was set to last until the end of the state of emergency. A sunset date of July 31 was later adopted.
Uganda	BOU has permitted Tier 1, 2, and 3 institutions to: • **Grant moratoria and restructure loans** on a case-by-case basis, including those past due, for up to 12 months starting April 1, 2020, and ending March 31, 2021. UMRA has permitted Tier 4 institutions to: • **Grant moratoria and restructure loans** on a case-by-case basis, including those past due, within 12 months starting April 1, 2020.

These loosely targeted policies reflect trade-offs in locales where relief must urgently be adopted. Such an approach presents potentially important advantages for microfinance in the crisis context. It enables relief to reach borrowers in outlying areas and those who may not receive notification quickly enough to opt in. This method further can provide immediate support to cash strapped MSEs and informal workers who have suddenly lost income. It can accommodate any borrower whose delinquency is a direct result of their inability to pay due to lockdowns.

There also may be country-specific reasons to include MFP borrowers who were delinquent before the pandemic hit, within limits. First, farmers affected by floods and locust invasions in Uganda prior to the outbreak, for example, may be as likely to recover as those whose loans were current when the COVID-19 crisis hit. Second, microfinance borrowers in a given area may expect equal treatment by the same MFP or even all MFPs that serve a community. Furthermore, low-income borrowers (even those with a perfect repayment record) may decide to hold onto scarce liquidity as a hedge against uncertainty instead of paying off their loans. Some urban MFP customers in Uganda have reportedly taken this approach. Technically these examples would be considered zombie borrowers or willful defaulters, as defined by the World Bank, even though their situation may not lead to default post-crisis.

Upholding prudential and transparency standards

Borrower relief programs may be difficult to reconcile with the normal practices that fully uphold prudential and transparency standards. The four focus countries have kept loan risk classification and provisioning rules largely unchanged while allowing flexibility in the regulatory treatment of moratoria. Flexibility is necessary to shield MFPs from sudden major increases in loan loss provisions and capital requirements, which would further reduce liquidity and undermine their capacity to support recovery among low-income segments.

Under the regulations of our focus countries, the granting of relief does not automatically trigger loan reclassification. In all cases, the moratorium suspends the counting of days past due for purposes of NPL classification for affected loans.[11] To balance flexibility with prudential safeguards in India, RBI imposed a uniform provision of 10 percent for all loans benefiting from moratoria. Any excess provisioning can be offset later against actual loan performance. Table 3 summarizes the prudential treatment of moratoria and crisis-related restructuring in the focus countries.

Special prudential treatment of debt relief covers loans that were past due before the COVID-19 outbreak hit. In Uganda, relief measures seem to have frozen risk classifications for the duration of relief granted irrespective of changes in the borrower's payment capacity. This could mean a freeze in loan classification for up to one year in that country. Credit profiles also have been protected. A combination of these measures unfortunately could put at risk both the repayment culture among microfinance borrowers and the safety and soundness of MFPs. In Pakistan and Uganda, where relief can be granted during a defined timeframe, it is not clear whether the same loan can be restructured more than once within

11 In Peru, suspended counting of days past due for a limited period was also granted to loans that did not receive a moratorium.

TABLE 3. **Prudential treatment of loan moratoria and special restructuring**

India	**Risk classification:** Moratorium does not trigger automatic loan reclassification and will not qualify as default for supervisory reporting purposes. **Provisioning:** Loans under a moratorium require general provision of 10 percent, which later can be offset. **NPLs:** The moratorium period is excluded from counting days past due for loans considered standard on March 1, 2020, and excluded from the deadline for lenders to implement a resolution plan for NPLs. **NBFCs (nonbank financial companies):** Since NBFCs follow Indian accounting standards they are required to follow the guidelines of their boards and advisories from the Institute of Chartered Accountants of India for recognition of impairments.
Pakistan (SBP-regulated institutions)	**Risk classification:** A moratorium does not trigger reclassification. Loans restructured within 180 days after the due date will not be treated as past due. If the deferment/restructuring is not successfully executed within the 180-day period, the loan will be classified as “doubtful.” **NPLs:** A moratorium suspends the counting of days past due. The deadline for implementing IFRS 9[a] was postponed to August 31, 2020 (mid-2021 for SECP-regulated institutions).
Peru	**Risk classification:** A moratorium does not trigger reclassification. For loans more than 15 days past due as of February 29, 2020, the moratorium suspends the repayment timetable and freezes risk classification. If a loan under moratorium becomes delinquent, further modification to the contract must be recorded as a downgraded loan refinancing, in other words, standard rules apply. **NPLs:** The moratorium period is excluded from counting days past due for loans up to 15 days past due. For loans over 15 days past due as of February 29, 2020, and benefiting from a temporary suspension of the count, beginning August 31, 2020, financial institutions must report the lesser of (i) the actual number of days past due at the end of August or (ii) the sum of days past due as of February 29, 2020, plus days past due beginning August 1.
Uganda	**Risk classification:** For Tier 1–3 institutions, risk status at the time of restructuring remains unchanged for the duration of the relief granted. **NPLs:** No provision exists in relief measures on suspension of counting days past due or on IFRS 9 implementation.

a. IFRS 9 requires that provisions be constituted to cover expected losses over one year or the lifetime of a loan, depending on loan classification. Other countries, including Zambia, have also delayed IFRS 9 implementation. Details on IFRS 9 can be found at https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/.

that period. We would normally expect subsequent restructurings to fall within standard forbearance rules, i.e., triggering reclassification and higher provisioning.

Two approaches to credit reporting have emerged (FinRegLab 2020). The first, suppression, has MFPs *not* reporting the application of relief such as moratoria. In Uganda, for example, credit reporting was suspended for Tier 1–3 institutions during the moratorium period. This could create an information gap that negatively impacts borrowers in the future and reduces the credibility of credit information. The second approach calls for data on relief granted to be reported (e.g., a special standardized flag or code), with the necessary safeguards to neutralize the effect on a good borrower's credit. This allows the credit information system to reflect a borrower's true position.[12]

For Tier 4 institutions, Pakistan, Peru, and Uganda have determined that relief should not negatively affect a borrower's credit profile. However, these countries have stopped short of detailing how relief reporting—if any—must be carried out. In Peru, information reported to the SBS credit register must include details on loans that benefit from a moratorium but it should not negatively impact a borrower's credit rating.[13] While it may be difficult to ensure that borrowers will not be affected in the future due to reporting, regulators should consider the potential risk of not requiring any reporting at all. (Risk may be difficult to address if the credit information system provides only default information as opposed to both negative and positive information.) Moreover, not reporting or flagging relief granted may be seen as unfair to borrowers who continue repaying loans during a moratorium.

In the area of public disclosure, only India has issued guidance for reporting the impact of debt relief measures in the financial results of regulated entities. Specific disclosures (e.g., criteria applied to moratoria on large loans) are to be included in the notes section of financial statements. By contrast, MFPs in Mexico are required to disclose within financial statements the accounting standards used for granting relief—along with results that *would have been achieved* had standard prudential rules been applied to affected loans.[14] As previously noted, the Peruvian regulator set up an off-balance sheet subaccount to record figures on principal, interest, and accrual, along with write-offs. It has yet to issue rules for public disclosure.

Other prudential measures

India, Pakistan, and Peru have taken other prudential measures, such as temporary relaxation of liquidity and reserve requirements and release of capital buffers. These countries have also reduced risk weights for loans guaranteed by the government. Pakistan reduced collateral requirements, increased the maximum debt burden ratio, and permanently increased bank exposure limits on SME loans. All four focus countries have coupled prudential relaxation with limits to discretionary distributions such as dividend payments, share buybacks, bonuses, and increases in executive compensation. Only in Peru do these limitations apply to all MFPs. India applies the limitations only to banks, while Pakistan and Uganda apply them to central-bank-regulated banks and nonbanks.

As far as exit strategies, Table 4 shows how India has defined a schedule for restoring prudential ratios to precrisis levels. Brazil has taken a similar approach.

12 This is to uphold the General Principles on Credit Reporting (World Bank 2011). The International Committee on Credit Reporting (ICCR) has made specific recommendations for the treatment of debt relief extended in the context of the COVID-19 pandemic (ICCR 2020).

13 In the United States, loans deferred under the COVID-19 relief (CARES) Act are not to be reported as past due (FinRegLab 2020).

14 Most financial authorities worldwide have yet to issue specific rules for public disclosure on borrower relief measures in the context of the COVID-19 pandemic. Some recently have done so, such as EBA, which on June 2, 2020, imposed temporary additional reporting and disclosure templates for payment moratoria and forbearance measures (EBA 2020c), in addition to preexisting rules for disclosure of nonperforming and forborne exposures (EBA 2018).

TABLE 4. **Major COVID-19 "relaxation" measures in India and schedule for restoration**

Liquidity requirements	Reduction of the liquidity coverage ratio (LCR) for banks from 100 percent to 80 percent. LCR shall be gradually restored: 90 percent by October 1, 2020, and 100 percent by April 1, 2021. Increase in accommodation under the marginal standing facility (MSF) from 2 percent to 3 percent until June 30, 2020.
Stable funds requirements	Implementation of the net stable funding ratio (NSFR), originally planned for April 1, 2020, has been deferred to October 1, 2020.
Reserve requirements	Reduction of the cash reserve ratio (CRR) of banks, including small finance banks, from 4 percent to 3 percent of net demand and time liabilities until June 26, 2020. Reduction of minimum daily CRR balance maintenance from 90 percent to 80 percent until June 26, 2020.
Capital buffers	Implementation of the last tranche of 0.625 percent of the capital conservation buffer deferred from March 31 to September 30, 2020.
Risk weights	Reduced risk weight for loans to NBFCs guaranteed by the RBI-sponsored guarantee program. No timeline.
Large exposure limits	The large exposure limit was increased from 25 percent to 30 percent through June 30, 2020.

PRINCIPLE 5: **ADJUST SUPERVISION.**
RESPONSE MEASURES REDUCE SUPERVISORY BURDENS WHILE ENHANCING RISK-BASED MONITORING.

Crisis-hit MFPs have been exposed to potential liquidity shortfalls, sharp drops in loan repayments, and runs on deposits. While response measures are meant to alleviate the pressure, the risk of instability and failure remains high. Supervisors should monitor key safety and soundness indicators, following a risk-based approach. They should be ready to intervene proactively before an institution becomes troubled. Yet the reality is that supervisors themselves are operating on contingency arrangements, with most staff working from home. Many MFP supervisors also lack the reliable data that are crucial for early problem detection. Overall, supervisory processes need to be adjusted to reduce nonessential burdens on authorities as well as MFPs.[15]

Reduce or defer nonessential supervision activities

Both MFPs and financial authorities are focused on dealing with the immediate crisis. MFPs may be conducting stress tests that trigger actions by senior management or their board, including discussions with the supervisor and creditors. They have activated contingency plans to ensure continuity with fewer on-premises staff while complying with restrictions on in-person client interactions. Many have enhanced physical and digital security protocols. These and other activities beyond the normal scope make MFPs less available to respond to supervisory demands.

All focus countries except Uganda have publicly announced measures to reduce the burden on MFPs—which often lightens the supervisor's burden as well:

15 See Toronto Centre (2020) guidance on business continuity for supervisors during the COVID-19 pandemic.

- RBI in India and Peru's SBS have extended timelines for submitting regulatory returns.
- Pakistan's Securities and Exchange Commission extended deadlines for nonbank MFPs to hold annual general meetings and may accept delays in submitting regulatory returns upon request.

Tighten monitoring

Supervisory relief should be balanced with enhanced scrutiny in key areas. This is necessary to protect the stability of the microfinance sector, the safety and soundness of MFPs, and the interests of depositors and borrowers. Measures include enhanced monitoring of MFP liquidity and portfolio quality (Peru, Uganda), with specific reporting of deferred and restructured loans (India, Peru), and frequent communication with MFPs (Uganda). In Peru, SBS has requested that institutions submit a "management plan" that classifies loans by risk (i.e., low, medium, high but viable, high unviable), by type (e.g., corporate, consumer), and by moratorium status (i.e., individually granted, in bulk, or nonrescheduled). Institutions must also set a schedule for reviewing and identifying loan quality deterioration.

As Principle 1 notes, it is important to closely monitor consumer protection issues during the pandemic. This enables authorities to address the increased risk of scams and fraud, aggressive sales and debt collection, and other abuses. None of the four focus countries has publicly announced supervisory measures in this regard. However, the Peruvian regulator has relaxed deadlines for providers to respond to consumer complaints while prioritizing resolution of complaints that financially impact consumers. This may come at a cost to consumers, diminishing their input to consumer protection authorities. Heightened risk in this area is highlighted by actions such as Peru's (SBS) issuance of four consumer warnings on fraudulent schemes, including pyramids.

A special challenge for microfinance supervision is the disparity sometimes noted in the levels of expertise and resources between bank and nonbank supervisors. This difference may exist even when entities are under the same authority. Obtaining timely and accurate data may be more difficult for nonbank supervisors, especially in developing countries. In these contexts supervisors often oversee small MFPs that have low levels of digitization. While larger institutions justifiably attract greater supervisory scrutiny, MFP supervisors may be especially constrained in their ability to monitor MFP loan portfolios affected by the COVID-19 crisis. Here, the issue is not equal treatment but managing expectations and effectively allocating resources.

Lastly, proactive monitoring is critical for anticipating and minimizing the impact of MFP failures. Many MFPs across the globe were weak prior to the pandemic while others have since become troubled. Orderly resolution of MFPs is essential to protect small depositors and ensure service continuity.[16] Preparedness requires not only proactive supervisory monitoring but agreed-upon powers, procedures, and coordination mechanisms for

16 "Resolution," as employed here, includes (i) recovery by action of the troubled institution (as required by the supervisory authority); (ii) the intervention of a resolution authority to ensure continuity of critical functions, secure funds to reimburse depositors, and wind up the entity; and (iii) liquidation. For MFPs, it is particularly important for the supervisor to be authorized to take early action to intervene and conduct the resolution as an administrative matter (i.e., not as a formal legal proceeding).

resolution. The limitation here is that the implementation of resolution frameworks is often focused on systemic banks, which means that most MFPs would go straight into the liquidation phase. But, as previously noted, MFPs often provide essential services to a certain segment of the population or a particular region and may be critical for financial inclusion. It may be worth considering the application of some elements of resolution regimes, in principle designed for systemic institutions, to the most important of these MFPs to reduce the negative impacts of failure on poor consumers. A special concern is increasing the supervisor's ability to detect problems that are brewing while they still can be fixed. Where a deposit-taking MFP is not covered by a deposit insurance scheme, there is further reason to consider this step.

The way forward

The five principles discussed in this Briefing are intended not as a blueprint but as a series of guideposts for regulators. They offer decision criteria for the many instances where emergency response potentially clashes with the objectives of financial inclusion and a credibly regulated and supervised microfinance sector. Decisions must be made on trade-offs and about how to serve long-term goals and values while taking the urgent short-term steps that may contradict them. The principles will prove their value to the extent they aid stakeholder thinking on the adoption of crisis response measures, the adjustment (and eventual phase out) of measures over time, and the potential to incorporate measures into contingency plans.

The principles offer a way forward, but it must be acknowledged that the COVID-19 crisis poses serious challenges. Indeed, especially in developing countries, longstanding unresolved issues have often exacerbated the impact of the crisis and make it difficult to follow the principles. Preexisting issues include:

- Regulatory and supervisory fragmentation without sufficient collaboration among different regulatory authorities or departments within the same authority.
- Lack of depositor protection mechanisms for MFP depositors.
- Shortfalls in supervisory capacity and data.
- Low levels of digitization in the microfinance sector.
- Weak linkages between MFPs and other financial and payment services providers.
- Inadequate contingency plans and business continuity arrangements for MFPs and microfinance supervisors.

These points of vulnerability need to be understood in order to fairly assess the results of current crisis measures and to plan for the next phases.

It is clear that certain vulnerabilities are inherent to emergency regulatory measures. First and most obviously, regulation by itself can solve only a limited set of problems. Fiscal measures such as government loan guarantees and liquidity facilities are equally important—perhaps even more so in the short term. In addition, the nonregulated microfinance sector is largely beyond the reach of regulatory measures, which raises the question of whether some large unregulated institutions should become regulated. Second, regulatory relief—particularly that directed to borrowers—poses significant risk in terms of abetting the deterioration of portfolio quality, reducing the transparency of financial disclosures, and weakening incentives for borrowers to repay loans.

Looking forward, there are also prospects for positive change. The COVID-19 crisis has exposed numerous constraints and vulnerabilities. Microfinance stakeholders across the globe now have tremendous opportunities for improvement and for learning. Seizing these opportunities should strengthen responses not only in the current crisis, but in emergencies that arise, inevitably, later on.

Successfully navigating the hazardous landscape of the pandemic, as we have argued, requires guideposts. These include such principles as ensuring that emergency measures are clear and predictable, provide broad coverage, and are consistent with safety, soundness, and consumer protection objectives.

Adhering to the pro-poor principle may pose the stiffest challenges. These range from the difficulty of targeting poor people, to the relatively low levels of connectivity among poor people and service providers, and the weakness of consumer protections in crisis measures. To address these challenges it will be important to gather insights from MFP customer databases, collecting data on the difficulties consumers face and on the effects of crisis measures. Client views can then be brought into the ongoing process of adjusting emergency response and forward-looking policy, regulatory, and supervisory development. Regulators should also consider a more customer-centric approach to consumer protection, where their focus shifts from reactive enforcement of provider compliance with prescriptive rules to proactive assessment of customer results or outcomes generated by providers (Izaguirre 2020).

Finally, heightened vigilance is critical for containing the crisis and ensuring recovery. This means slimming down nonessential supervisory processes while concentrating on monitoring key indicators, especially leading indicators of MFP financial health and consumer protection indicators. One challenge we find is that the nonbank supervisors who oversee most MFPs appear less equipped than their banking counterparts to exercise the necessary vigilance. To the extent that robust data collection and close monitoring are possible, trouble could be detected and treated early. The resultant understanding of the crisis and its outcomes can then be shared at the policy level, helping drive the effort to “build back better” toward a more resilient microfinance sector.

Annex

A SUMMARY OF RELEVANT GUIDANCE FOR REGULATORY RESPONSE (NOT SPECIFIC TO MICROFINANCE)

This Annex summarizes relevant guidance issued by international standard-setting bodies, the World Bank, the International Monetary Fund, and the European Banking Authority. The guidance focuses on the regulatory treatment of debt relief measures, such as moratoria granted by banks to borrowers, and regulatory response measures such as the release of capital buffers. It mainly focuses on the stability of the banking sector and the economic recovery of countries. While the guidance is not designed to cater to microfinance and does not adopt a customer perspective, it is a useful reference. The underpinning principles, including the need to uphold prudential definitions for protecting safety and soundness, are largely applicable to crisis responses in microfinance.

The summary is an amalgam of excerpts from the original documents referenced below. Our intent is to capture and highlight the spirit of the guidance texts rather than to create a comprehensive overview. Any discrepancies with the original documents are the sole responsibility of the authors of this Briefing.

Basel Committee on Banking Supervision and Bank for International Settlements

The Basel Committee on Banking Supervision (2020) has issued guidance on how to consider payment deferrals in assessing credit risk under applicable accounting frameworks to avoid a procyclical approach by banks, for instance, tightening lending policies, which would further exacerbate the COVID-19 crisis.

a. The risk-reducing effect of measures should be recognized in risk-based capital requirements:

- Sovereign risk weight should be used for loans subject to government guarantee.
- Payment moratorium periods can be excluded from counting days past due for classification as a nonperforming asset (NPA).
- Assessment of whether the borrower is unlikely to repay should refer to rescheduled payments (amounts due after the moratorium period ends).
- A borrower's acceptance of a moratorium or access to relief such as public guarantees should not automatically lead to the loan being categorized as forborne.

b. Extraordinary support measures should be taken into account when banks calculate expected credit losses (ECL):

- Relief measures 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.
- ECL should reflect the mitigating effects of the economic support and payment relief measures put in place.

- Banks should not mechanistically apply the standard and should use the flexibility inherent in IFRS 9.
- Regulatory capital treatment of ECL should follow the amendments to the transitional arrangements.

The Bank of Institutional Settlements (2020) additionally has stated that on one hand, prudential policy needs to support bank lending during the crisis. On the other hand, it needs to preserve the ability of the financial system to contribute to a swift economic rebound. This depends on the availability of usable prudential buffers. Release of buffers can complement and enhance the effect of fiscal and monetary policies if banks are willing and able to expand their balance sheets—a trade-off affected by the extent of risk-sharing with the public sector.

Financial Stability Institute

a. General principles for regulatory response (FSI 2020a). See Table A-1.

- **Principle 1.** Adjustments should be effective in supporting economic activity, at least for the crisis period but ideally beyond, by establishing the basis for a solid recovery. Regulatory policy response should seek to support economic activity while preserving soundness of the financial system and ensuring transparency.
- **Principle 2.** Adjustments should preserve the health of the banking (financial) system. Banks should remain sufficiently well capitalized, liquid, and profitable to underpin sustainable growth.
- **Principle 3.** Adjustments should not undermine the long-term credibility of financial policies. From this perspective, adjustments should be (and be seen as) temporary. Transparency is key in meeting this principle.

TABLE A-1. **Trade-offs in payment deferrals programs**

		Longer-term risks to financial stability	
		Higher	Lower
Degree of borrower relief	Maximum relief	Mandatory bank participation Deferral of principal interest Flexible borrower eligibility criteria Longer duration	
	Moderate relief		Voluntary bank participation Deferral of principal only Strict borrower eligibility criteria Shorter duration
		No public guarantees	Public guarantees

Source: FSI, 2020d, p. 3.

b. Discretionary payments

- Recommendations that banks make full use of capital and liquidity buffers should go hand-in-hand with restrictions on dividends and bonuses, and clarity concerning the process for rebuilding buffers (FSI 2020a). Supervisory initiatives that provide capital relief should be augmented by severe constraints on the payment of dividends, bonuses, and share buybacks (FSI 2020b).

c. Government guarantees (FSI 2020a)

- Releasing buffers for banks is not enough as they disincentivize banks from lending.
- One disincentive may be a lack of clarity on the supervisor's expectations, including realistic deadlines for banks to rebuild the buffers used during the crisis.
- Another disincentive is related to distribution restrictions. Adjustments can include a blanket distribution restriction across the banking sector that is unrelated to the size of the buffer.
- Issuing supervisory guidance avoids excessive conservatism concerning assessment of banks' asset quality, allowing flexible interpretation for reclassification of restructured loans.
- Forms of government credit guarantee—carefully designed to limit moral hazard—are a crucial complement to measures that bolster bank capital.
- Government guarantees are essential, but their design needs to strike a balance between promptly responding to the pandemic and maintaining a sufficient level of prudence. Key features include target beneficiaries, coverage of the guarantee, loan and pricing terms, and program length. Guarantees are subject to operational challenges and fiscal capabilities (FSI 2020c).

d. Guidance for payment deferral programs

- Payment deferral programs must balance near-term economic relief benefits with longer-term financial stability considerations (FSI 2020d).
- Government guarantees reduce the risks of payment deferral programs (FSI 2020d).
- Banks should assess where each borrower falls in the spectrum: solvent and unaffected, solvent but affected (illiquid), or insolvent (FSI 2020d).
- Flexibility in loan classification criteria for prudential and accounting purposes should complement sufficient disclosure on the criteria banks use to assess creditworthiness. A balance between the impact on procyclicality and a transparent recognition of bank asset valuations is needed (FSI 2020a).
- National suspensions of IFRS 9 should be uniform so they do not impair comparability (FSI 2020a).
- Publication of detailed guidance on the application of expected loss provisioning rules, combined with sensible transitional arrangements, may constitute a balanced approach to mitigating the unintended procyclical effects (including on regulatory capital) or the credibility of new accounting standards (IFRS 9) (FSI 2020a).

Joint recommendations by IMF and World Bank (2020) staff on responses to COVID-19

a. Use the flexibility in the regulatory and supervisory framework while upholding minimum prudential standards and preserving consistency with international standards.

b. Facilitate well-designed public and private support interventions that target affected borrowers and sectors through timely prudential guidance.

c. Ensure that policy responses minimize opportunities for moral hazard and maintain adherence to sound credit risk management practices while facilitating the effective allocation of new credit.

d. Provide guidance on asset classification and provisioning, building on guidance from standard-setting bodies. Refrain from relaxing the regulatory definition of nonperforming exposure.

e. Maintain transparency and provide, where necessary, additional guidance on risk disclosure.

f. Suspend the automaticity of corrective supervisory action triggers.

g. Review supervisory priorities and maintain close dialogue with industry stakeholders.

h. Actively coordinate with other supervisors, domestically and internationally, and other authorities.

i. Ensure the smooth functioning of critical market infrastructure (IMF-World Bank 2020).

World Bank principles for borrower relief measures (Dijkman and Salomão Garcia 2020)

a. **Targeting.** Target borrowers whose repayment capacity has been negatively affected by COVID-19 to mitigate moral hazard related to willful defaulters, to avoid extending the life of zombie borrowers and to limit the financial impact on banks. Banks should be given discretion to elect borrowers.

b. **Exit strategies.** Communicate measures as temporary—to be unwound as soon as circumstances allow and define what this involves. Upfront sunset clauses to revert to prepandemic norms.

c. **Supervisory reporting and transparency.** Banks should produce reliable, frequent, up-to-date, and comparable information on affected loans, including impact on profit-and-loss accounts. Supervisory agencies may pay special attention to the monitoring of such loans.

d. **Uphold loan loss classification, provisioning, and accounting requirements.** Easing regulatory definitions, even on a temporary basis (e.g., NPLs, forborne exposures, classification, and provisioning) should be avoided as it obfuscates a bank's true asset quality challenges, undermines market discipline and comparability, distorts the veracity of financial information, and blurs the distinction between borrowers temporarily affected by COVID-19 and zombie borrowers.

European Banking Authority guidance on the treatment of moratoria

The European Banking Authority provided detailed guidance on the application of the definition of default and classification of forbearance in the context of the general payment moratoria applied before September 30, 2020—a timeline which may further be extended (EBA 2020a, 2020b). The guidance defines "general moratoria," which do not automatically meet the definition of forbearance (for purposes of classification).

a. **Definition of forbearance in the current regulatory framework.** Financial institutions grant a concession such as a temporary postponement of capital and/or interest payments of a loan when a borrower is identified as experiencing or likely to experience financial difficulty. Concessions are specific to the borrower's financial circumstances and the loan. In accordance with applicable requirements, institutions continue to categorize exposures as performing or nonperforming. Extension of forbearance should be considered distressed restructuring, which in turn, is an indication of unlikeliness to pay if it leads to diminished financial obligation.

b. **General legislative and nonlegislative moratoria.** These moratoria are preventative in nature, not borrower-specific, as they aim to address systemic risk. They should not be considered forbearance as defined above, nor distressed restructuring. Consideration of diminished financial obligation does not apply. Hence, reclassification as forborne exposure is not automatic unless the exposure was subject to forbearance (i.e., classified as forborne or defaulted) prior to the application of general moratoria. In such cases the prior classification is maintained. Treatment of nonlegislative moratoria should be consistent with treatment of legislative moratoria.

c. **Specific criteria/conditions that permit general moratoria *not* to be considered forbearance:**

   - Moratorium was launched in response to the COVID-19 pandemic and is limited in scope (only applies to specific measures taken in response to the economic situation) and time (announced and applied before September 30, 2020).
   - Moratorium is based on national law or on an industry- or sector-wide private initiative agreed on and coordinated within the industry or a material part of it.
   - Moratorium is broadly applied by the industry. An initiative of a single institution without industry-wide coordination is not sufficiently broad to benefit from special prudential treatment.
   - Moratorium applies to a broad range of obligors:
     - A payment schedule is not changed to address specific difficulties of specific borrowers and does not depend on their creditworthiness.
     - Moratorium applies to a large, predefined group of borrowers.
     - Selection criteria are sufficiently broad, such as specific exposure classes or subexposure classes, a product range, or borrowers from specific regions or industry sectors.
     - Moratorium can be limited to performing borrowers who did not experience payment difficulty before the COVID-19 crisis began.

    - Moratoria must not be obligatory for borrowers, but rather based on borrower application. Application assessment must not involve assessment of payment capacity or creditworthiness, and conditions of the moratorium are standardized and available to all borrowers within its scope. Decisions on applications must be made prior to September 30, 2020.

- The same moratorium offers the same conditions, although it is possible that different moratoria criteria apply to different exposure segments.

- Moratorium changes only the schedule of payments by suspending, postponing, or reducing principal, interest, or both within a limited time period. This may lead to increased payments after the moratorium or to an extended loan duration. Moratoria should not affect other conditions, such as interest rates, in order to neutralize the impact on present value. Application of public guarantees is not considered a change to terms and conditions.

- Moratorium does not apply to new loans granted after its launch. Existing credit lines or revolving loans are not considered new loans.

d. **Tailor-made measures.** When institutions use individual measures or renegotiations that take into account a borrower's specific situation rather than general moratoria, they need to assess whether the individual measures meet the definition of forbearance. Reclassification is on a case-by-case basis, not automatic. If measures are classified as forbearance and lead to a diminished financial obligation, the borrower should be classified as defaulted.

e. **Definition of default.** Institutions should count days past due based on a revised payment schedule resulting from the application of general moratoria.

f. **Continued assessment of unlikeliness to pay.** Institutions are obliged to assess the credit quality of exposure even with moratoria not classified as forbearance. This helps identify situations where borrowers may face longer-term financial difficulties and classifies them according to standard rules, including the definition of default. The existence of risk mitigation should not exempt an institution from performing assessments as these evaluations do not affect a borrower's payment capability. Institutions should use their normal policies to regularly review indications of unlikeliness to pay in a risk-based manner. When verification is manual rather than automatic, institutions should prioritize borrowers most likely to experience difficulty. The following cases should be given priority at the end of a moratorium:

   - Borrowers experiencing payment delays shortly after the moratorium ends

   - Forbearance measures that apply shortly after the moratorium ends

g. **Reporting and public disclosure.** In June 2020, EBA issued reporting and disclosure requirements for exposures that were subject to measures applied in response to the COVID-19 crisis (EBA 2020c). Since these payment holidays did not change the preexisting classification of exposures they are not captured in the supervisory reporting framework. Such frameworks ask for additional reporting requirements for supervisory purposes and call for specific guidance on public disclosure for purposes of market discipline and transparency. The requirements noted below are expected to be in force for 18 months beginning June 2020, with semi-annual reporting. The guidelines comprise a set of templates subject to the principles of proportionality and supervisory flexibility when applied by the European national authorities. The templates are divided into:

- Reporting requirements that monitor the use of payment moratoria and the evolution of the credit quality of exposures
- Disclosure requirements for exposures subject to payment moratoria
- Reporting requirements for new loans subject to specific public guarantees set up to mitigate the effects of the crisis
- Disclosure requirements for new loans subject to specific public guarantees set up to mitigate the effects of the crisis
- Reporting requirements on other forbearance measures applied in response to the crisis

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