South African Reserve Bank

Prudential Authority

Ref.: 15/8/1/3

**To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies**

**Proposed directive issued in terms of section 6(6) of the Banks Act 94 of 1990**

**Matters related to the treatment of restructured credit exposures due to the Coronavirus (Covid-19) pandemic**

## Executive summary

**The spread of Covid-19 is having an increasingly significant impact on global economic activity and has placed the local economy under immense strain. As part of the measures employed to address the impact of Covid-19, government as well as business have called upon the banking sector to continue to extend credit to sectors in need, particularly households and small businesses, and to provide relief measures to reduce the strain on these sectors in an effort to sustain the local economy and maintain financial stability. The Prudential Authority (PA) is supportive of Covid-19 relief initiatives, such as payment holidays being offered by banks in order to provide relief to certain borrowers in the retail (including SME retail) sector in an effort to mitigate the impact of the pandemic. The PA has therefore decided to amend the requirements specified in Directive 7 of 2015 to provide temporary relief on the minimum capital requirements for banks, controlling companies and branches of foreign institutions (hereinafter collectively referred to as 'banks') relating to credit risk during this time.**

## 1. Introduction

1.1 The Covid-19 pandemic, which is having a significant impact on financial markets, global economic activity, as well as the South African economy, may invariably also impact the ability of borrowers to meet their obligations in accordance with contractual terms.

1.2 The PA is supportive of Covid-19 related relief initiatives, such as payment holidays being offered by banks, in order to provide relief to certain borrowers in the retail (including SME retail) sector in an effort to mitigate the impact of the pandemic. The PA also recognises that these initiatives are not driven by profit incentives, but by banks' corporate responsibility and their application of sound risk management practices to provide relief to South Africans during this period in order to minimize the adverse economic impact. Consequently, the PA has considered measures to ensure that these initiatives do not result in unintended consequences such as inappropriate higher capital requirements.

1.3 Directive 7 of 2015 (D7/2015)[1] provides clarity on how banks should identify restructured credit exposures and how these exposures should be treated for purposes of the definition of default. This proposed directive should be read in conjunction with D7/2015.

1.4 Paragraph 2.4 of D7/2015 states the following: "*Where the loan is not in arrears at the time of the restructure and the terms and conditions were changed in order to prevent the obligor from going into arrears, this should also be regarded as an indication of financial distress of the obligor and the restructure should be classified as a distressed restructure.*"

1.5 In response to potential pressure on banks' capital demand brought about by the Covid-19 pandemic and the associated relief initiatives, the PA is implementing measures to provide suitable temporary relief on the minimum capital requirements for banks relating to credit risk.

1.6 These measures are intended to provide relief to banks by enabling banks to continue to extend credit to the real economy during this period of financial stress without the need for inappropriate higher capital requirements. The intention is to assist banks to continue to serve their borrowers under difficult circumstances, thereby reducing the impact of the pandemic on the local economy. The intention of this directive is not to promote an environment within which banks can inappropriately lower their lending standards, resulting in a build-up of increased credit risk in the medium to long term.

1.7 It is the PA's intention to reinstate the requirements of D7/2015 in full after the impact of Covid-19 has subsided and economic conditions have normalised. This would be communicated in writing by the PA at an appropriate time.

## 2. Directive relating to treatment of Covid-19 related credit restructures

Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks are hereby directed as follows:

2.1 As from the effective date of this directive, when a loan is being restructured, the following should be considered:

2.1.1 Based on all reasonable and verifiable information available at the date of restructuring of a loan, where the restructure is being considered due to Covid-19 related factors, the bank must determine whether that loan was up to date prior to the restructure and is expected to remain in an up-to-date status once the relief period ends, all other factors remaining constant. These restructured loans will be classified as Covid-19 related restructures.

2.1.2 If however, there is an adverse change in other circumstances which are not expected to be temporary in nature over and above the relief provided (e.g. a mortgage debtor is retrenched or an SME enters business rescue or suffers losses that put into question its ability to repay the outstanding balance), such

[1] http://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/6716/D7%20of%202015.pdf

circumstances are indicators of distress, warranting the loan to be treated as overdue/non-performing.

2.2 Therefore, banks must ensure that only loans classified as retail (including SME retail) as per regulation 23 of the Regulations relating to Banks (Regulations), that are expected to remain up to date after the relief measure period ends and economic conditions have normalised (i.e. Covid-19 related retail restructured loans) would not be regarded as distressed restructures as defined in paragraph 2.4 of D7/2015. Those loans that are not expected to remain in good standing or those loans that despite the relief measures, still exhibit signs of distress, must be treated in terms of the existing requirements respectively specified in regulations 23 and 24 of the Regulations read with D7/2015 to determine the relevant minimum required amount capital and reserve funds to be held against the bank’s credit risk exposure. Therefore, restructures due to sustained financial distress beyond the crisis period and restructured loans to obligors other than retail (including SME retail) should still be regarded as distressed restructures and treated in terms of the requirements of D7/2015.

2.3 When calculating the minimum required amount of capital and reserve funds relating to credit risk under the standardised approach for credit risk respectively specified in regulations 23(6) to 23(9) of the Regulations, the risk weight assigned to the Covid-19 related retail restructured loans must be the same risk weight assigned to the loan before the said restructure occurred, as if these loans are not considered to be distressed. Furthermore, the classification of Covid-19 restructures in accordance with regulation 24(5)(c) of the Regulations should remain the same and cannot be classified to be of better quality than before the Covid-19 restructure.

2.4 When calculating the minimum required amount of capital and reserve funds relating to credit risk under the internal ratings-based approach for credit risk respectively specified in regulations 23(10) to (14) of the Regulations, the probability of default (PD) assigned to Covid-19 related retail restructured loans must not be decreased, that is, the PD assigned to the restructured loan may be similar to, but not lower than the PD assigned before the restructure of that loan, if these loans are not considered to be distressed.

2.5 Where Covid-19 restructures result in an increase in general provisions (i.e. stage 1 and 2 provisions in terms of International Financial Reporting Standard 9) due to an increase in the underlying risk assumptions, such increase in general provisions should not be taken into account in determining the amount of general provisions that qualify for inclusion as part of tier 2 qualifying capital and reserve funds.

2.6 In order for the PA to monitor the extent and impact of Covid-19 related retail restructured loans, additional reporting requirements may be specified in writing by the PA as part of its ongoing supervisory processes.

## 3. Invitation for comment

3.1 Banks are hereby invited to submit their comments with respect to the proposed directive to SARB-PA@Resbank.co.za and margaux.noble@resbank.co.za for the attention of Ms Margaux Noble by no later than 3 April 2020.

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

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