STATISTICS

Special Series on COVID-19

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The Treatment of Restructured Loans for FSI Compilation

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This note clarifies the treatment of restructured loans for the compilation of Financial Soundness Indicators (FSIs). Part I describes current regulatory practices for classifying restructured loans into performing and nonperforming and proposes supplementary tables to collect additional information to help assess the impact of restructured loans on the banking sector. Part II reviews existing accounting and regulatory practices related to loan loss classification and provisioning for restructured loans, as well as relevant 2019 FSI Compilation Guide (the Guide, here therein) compilation advice.[1,2]

BACKGROUND

In response to the COVID-19 pandemic, countries are enacting several economic policies.[3] Some countries (e.g., Australia, India, Indonesia, Italy, Nigeria, Russia, Spain, Turkey) have also started to engage in loan forbearance in response to customers' financial difficulties associated with the pandemic-induced economic shock.[4] Restructurings could be an important tool for managing this shock by providing borrowers breathing room and allowing them to resume loan repayments as the severe effects of the shock ease. At the same time, the effects of restructuring should be properly reflected in the compilation of FSIs to track adverse trends related to forbearance.

[1] Please direct any questions and comments on this note to STAFIAST@imf.org.

[2] https://www.imf.org/~/media/Files/Data/2019/2019-fsi-guide.ashx?la=en.

[3] IMF maintains a website covering policy responses to COVID-19.

[4] According to IMF COVID-19 Policy Tracker, 53 countries have already initiated loan restructuring (including moratorium) in various forms. Please find detailed information for selected countries in Annex 1.

PART I. RESTRUCTURED LOANS

The BCBS (2017) defines loan forbearance as a situation in which (1) a counterparty is experiencing financial difficulty in meeting its financial commitments, and (2) a bank grants a concession that it would not otherwise consider, whether or not the concession is at the discretion of the bank and/or the counterparty.[5] The *Guide* defines restructured loans as loans arising from rescheduling and refinancing of the original loan. Therefore, all forbearance measures are loan restructuring, but not all loan restructurings are forbearance measures.[6]

Recently, in response to COVID-19 shock, the BCBS (2020) has clarified that when borrowers accept the terms of a payment moratorium (public or granted by banks on a voluntary basis) or have access to other relief measures such as public guarantees, these developments may not automatically lead to the loan being categorized as forborne.[7] At the same time, banks would still need to assess the likelihood of the borrower's rescheduled payments after the moratorium period ends. Regardless, all loans under payment moratorium fall under the restructured loans definition of the *Guide* and should be closely monitored by the national supervisors.

The COVID-19 outbreak represents a severe negative economic shock that might translate into a sharp increase in banks' nonperforming loans (NPLs). Due to asset quality problems, banks' provisioning requirements are expected to increase significantly.[8] Additionally, the capital adequacy ratio of banks would be affected through higher risk-weighted assets[9] while the increase in provisioning and reduction in interest income would reduce net income thereby reducing further regulatory capital.

The *Guide* defines NPLs as loans for which (1) payments of interest or principal are past due by 90 days or more; or (2) interest payments equal to 90 days or more have been capitalized (reinvested into the principal amount), refinanced, or rolled over (payment delayed by agreement); or (3) evidence exists to reclassify them as nonperforming even in the absence of a 90-day past due payment, such as when the debtor files for bankruptcy.

Restructured loans do not necessarily mean NPLs. A bank may decide to restructure a performing exposure. At the same time, when restructuring a performing exposure, the bank needs to ensure that, even when the restructuring resulted in a new exposure, it does not wind up falling into any of nonperforming criteria.[10] Also, a nonperforming exposure that is restructured should automatically not be categorized as performing, automatically.

[5] https://www.bis.org/bcbs/publ/d403.pdf.

[6] Restructuring may be granted because the borrower is facing financial difficulties, or it may be commercially motivated.

[7] https://www.bis.org/press/p200403.htm. The International Accounting Standards Board (2020) has also noted that the extension of payment holidays to all borrowers in particular classes of financial instruments should not automatically result in all those instruments being considered to have suffered a significant increase in credit risk.

[8] These include significant increase in credit risk and impairment both requires lifetime expected loss calculation under IFRS 9 compared to standard loans where only 12-month expected losses need to be calculated. In response to COVID-19 shock, the BCBS (2020) further noted that while estimating expected credit losses, banks should not apply the standard mechanistically and should use the flexibility inherent in IFRS 9.

[9] Increase in NPLs could also increase the risk-weighted assets and therefore decrease capital adequacy ratios. For instance, under Basel II standardized approach for credit risk, unsecured portion of loans net of specific provisions that are more than 90 days past due and with provisions exceeding 20 percent of the outstanding amount carries a 100 percent risk weight and when provision is below 20 percent, the risk weight is increased to 150 percent.

[10] According to IFRS 9, the accounting treatment of restructured loans depends on whether the modification of loan terms is substantial. If the modification is substantial, the original asset is derecognized, and the modified asset is considered a new exposure. Please refer to IFRS 9 for additional details on the definition of the term "substantial."

Loan restructuring, when conducted in large scale, can create uncertainty on the viability of the bank because it may take place in tandem with a spike in nonperforming loans across the board. Potential risks on the viability of the bank might ease when, at the end of the moratorium, contract enforcement resumes without negative implications or when the nonperforming restructured loans can be reclassified as performing. The probation period to reclassify a nonperforming loan as performing can vary from a minimum of three months to two years, depending on a jurisdiction's policies.

According to BCBS (2017) an exposure ceases to be nonperforming and can be recategorized as performing when all the following criteria are simultaneously met: (1) the counterparty does not have any material exposure of more than 90 days past due; (2) repayments have been made when due over a continuous repayment period as specified by the supervisor of at least three months. A longer repayment period can be required for nonperforming forborne exposures; (3) the counterparty's situation has improved so that the full repayment of the exposure is likely, according to the original or, when applicable, modified conditions; and (4) the exposure is not "defaulted" according to the Basel II standard or "impaired" according to the applicable accounting framework.

Restructured loans that are impaired should normally be aggregated into nonperforming loans data. FSI users would benefit from collecting additional bank-level information on restructured loans to gauge their impact on the stability of the banking sector. Tables 1 and 2 provide examples of such data collection.

The information in Tables 1 and 2 (based on the *Guide's* definition of restructuring) is not aimed at collecting additional information by the IMF Statistics Department but rather, to guide FSI compliers about supplementary information they may want to collect to derive additional indicators to gauge the implications of restructured loans on the financial soundness of deposit takers. For instance, the ratio of nonperforming restructured loans to total gross loans and the ratio of new NPLs due to nonperforming restructured loans to increase in existing NPLs could help spot asset quality problems stemming from restructured loans.[11] In calculating these indicators, FSI compilers are advised to consider the issues raised in the Part II of this note.

TABLE 1. Stock of Restructured Loans

	Principal Amount	**Accrued Interest**	**Provisions**
Restructured loans classified as performing			
- **of which, granted due to COVID-19**			
Restructured loans classified as nonperforming			
- of which, granted due to COVID-19			

[11] The *Guide* provides further details on the calculation of *nonperforming loans to total gross loans*.

TABLE 2. Nonperforming and Restructured Loans Transition Matrix

	Nonperforming Loans		Provisions	
	Outstanding Amount	Accrued Interest	Outstanding Amount	Accrued Interest[12]
Opening balance				
Increase in existing NPLs				
New NPLs				
- ***of which, restructured loans***				
Decrease in NPLs due to				
- **Write-off**				
- **Reclassification as performing loans**				
- **of which, restructured NPLS reclassified as performing loans**				
- **of which, NPLs transferred to asset management companies**				
- **Others (e.g., Direct sale, Asset protection scheme)**				
Closing balance				
Memorandum item				
Existing NPLs that have been restructured during the period				

[12] Accrued interest on nonperforming loans reversed through provisions (only for relevant jurisdictions).

PART II. TREATMENT OF NONPERFORMING LOANS AND PROVISIONS

The Accounting and Regulatory Treatment of Loan Loss Provisioning

Provisions (line 18.ii of Table 5.1 in the *Guide)* are defined as specific loan loss provisions against NPLs, derived from IFRS9's expected credit loss model or using an approach consistent with national supervisory guidance. For jurisdictions that do not allocate expected credit loss (ECL) to general and specific provisions, they would have to report only the portion of ECL that is apportioned to NPLs as specific provisions. The remaining portion would be reported in other liabilities (Line 27 of the current report form) until the new FSI reporting forms, with a separate line for general and other provisions (line 30 of Table 5.1 in the *Guide*), are implemented. Therefore, when calculating FSIs on nonperforming loans net of provisions to capital and provisions to nonperforming loans, provisions (line 18.ii of Table 5.1 in the *Guide*) should only include those on nonperforming loans. NPLs and specific provisions are defined in paragraphs 5.94–5.96 and paragraph 5.48 in the *Guide*, respectively.

Accounting and regulatory treatments of provisioning may yield different outcomes depending on whether the countries use international accounting standards, a combination of accounting and prudential standards or follow regulator-imposed rules only. Supervisory provisions are normally appropriated in the income and expense statement to top-up the accounting provisions. When the supervisory provisions that are not appropriated in the income and expense statement, banks are typically required to deduct any shortage in provisioning compared to prudential requirements from their regulatory capital.[13] FSI compilers need to consider how these differences can impact the calculation and interpretation of the FSIs on nonperforming loans net of provisions to capital and provisions to nonperforming loans.

Treatment of Accrued Interest on Nonperforming Loans

There are three main ways of dealing with accrued interest income on nonperforming loans.[14]

- Under IFRS9, accrued interest on NPLs are calculated on the net carrying basis (i.e., gross carrying amount less accumulated impairment);
- National Generally Accepted Accounting Principles (GAAPs) in some jurisdictions may require banks to reverse any accrued interest income on NPLs by reversing the accounting entries in interest income and debtor accounts in the income statement and balance sheet, respectively, while for other countries in this group, accrued interest income on NPLs that have been capitalized would be offset in the loan loss provision account in the income and expense statement. For example, while the US GAAP does not prescribe any specific treatment for the accrual of interest income on NPLs, banking regulations impose some restrictions on when interest income can be accrued on nonperforming loans; and

[13] For example, for banks that use internal ratings-based (IRB) approach to credit risk, the difference between expected losses and accounting provisions is normally adjusted in regulatory capital. When expected losses are higher than the accounting provisions—whether they are derived from IAS39's incurred loss model or IFRS9's expected credit loss model—the difference is usually deducted 50 percent in Tier 1 and 2 capital under Basel II, and 100 percent in Common Equity Tier-1 capital (CET1) under Basel III.

[14] A study conducted by Financial Stability Institute in 2018 found that 7 out of 11 surveyed jurisdictions require their banks to either suspend interest payment on NPAs or to neutralize the impact on earnings by requiring a commensurate amount of provisions to be held; two jurisdictions require banks to reverse any interest income accrued nonperforming loans; and one jurisdiction requires banks to fully provision the amount through the P&L (page 35). See 2018 FSI Insights on policy implementation No 7: The identification and measurement of nonperforming assets: a cross country comparison. https://www.bis.org/fsi/publ/insights7.pdf.

- National GAAPs in some jurisdictions may also allow banks to accrue interest on NPLs in the debtor accounts on the asset side by creating equivalent position in an interest suspense account on the liabilities side of the balance sheet.

While the *Guide* defers to IFRS as the overarching framework for compiling FSIs for DTs, there are cases where the *Guide* sides with regulatory practices when they are more conservative. Thus the note recommends, consistent with paragraph 5.14 in the *Guide*, that accrued interest on NPLs are not accounted for when loans are more than 90 days past due and any residual interests that have accumulated before 90 days cut-off date need to be reversed in interest income (Line 1.ii of Table 5.1 in the *Guide*) in the income and expense statement and debtor accounts in the balance sheet. Reversing accrued interest on nonperforming loans in the income and expense statement through provisioning (Line 7.i of Table 5.1 in the *Guide*) will achieve similar outcome on the Net income (before or after taxes) (Line 8 or 11 of Table 5.1 in the *Guide*) but this will overstate those FSIs that take gross income (Line 5 of Table 5.1 in the *Guide*) as denominator including the FSI on net interest margin to gross income.

When restructured loans are classified as nonperforming loans, the same treatment would apply to any interests that have accrued during the wait and hold period or at least until the restructured loans are reclassified as performing loans. During the probation period, interest income (Line 1 of Table 5.1 in the *Guide*) would be recognized in the income and expense statement when they are received from the debtors.

FSI compilers need to understand whether banks are capitalizing accrued interest on their nonperforming loans, including any restructured loans that are classified as impaired and be ready to make the necessary adjustment to reverse the accounting entries in interest income (Line 1.ii of Table 5.1 in the *Guide*) consistent with the methodology adopted in the *Guide* (see paragraph 7.59 in the *Guide*).

Calculation of Risk-Weighted Assets for Loans That Are Past Due for More Than 90 Days

FSI compilers need to verify that banks are adjusting their risk-weighted assets (Line 40 of Table 5.1 in the *Guide*) for loans that are past due more than 90 days, that is, the denominator used to calculate the FSIs on Regulatory capital to risk-weighted assets, Tier 1 capital to risk-weighted assets, Common Equity Tier 1 capital to risk-weighted assets, consistent with the Basel regulatory framework.

Under the Basel II Standardized Approach to the calculation of capital requirements, the unsecured portion of loans net of specific provisions that are more than 90 days past due carries a 100 percent risk weight when provisions exceed 20 percent of the outstanding amount and 150 percent when provisions are below 20 percent. This treatment would also apply to restructured loans that have been classified as nonperforming loans. However, as mentioned earlier, payment moratorium periods (public or granted by banks on a voluntary basis) relating to COVID-19 outbreak can be excluded from the treatment of past due loans when borrower would likely be able to repay its debt obligation after rescheduled payments in line with the recent guidance issued by the BCBS (2020).

For banks operating under the IRB framework, the increase in nonperforming loans is reflected through higher provisions while the risk-weighted assets will increase as the probability of default increases (up to a certain level) to reflect the risk profile of the loans. For compliers implementing Basel I, the risk weights normally do not adjust when loans are classified as NPLs.

ANNEX 1. Loan Restructuring Activity in Selected Countries

The following table provides information on loan restructuring activity in selected countries in response to the COVID-19 shock. In addition to these countries, the IMF Policy Tracker provides information for other countries that have implemented restructuring measures.[15]

Country	Action
Australia	The Australian Banking Association has announced that Australian banks will defer loan repayments for small businesses affected by COVID-19 for six months. The Australian Prudential Regulation Authority (APRA) clarified that loans that have been granted repayment deferrals as part of a COVID-19 support package need not be regarded as restructured for borrowers who have been meeting their repayment obligations.
India	The Reserve Bank of India (RBI) announced a standstill on asset classifications during the three-month loan moratorium period with 10 percent provisioning requirement, and an extension of the time period for resolution timeline of large accounts under default by 90 days.
Indonesia	Indonesian Financial Services Authority (Otoritas Jasa Keuangan—OJK) has relaxed loan classification and loan restructuring procedures for banks to encourage loan restructuring.
Italy	Measures adopted by the government include a moratorium on loan repayments for some households and SMEs (applies to mortgages and overdrafts, provided the borrower has no nonperforming exposure with banks as of March 17, 2020). Government guarantee covers 33 percent of banks' credit losses related to loans under the moratorium.
Nigeria	Regulatory loan forbearance was introduced to restructure loans in impacted sectors.
Russian Federation	Parliament approved a law that guarantees the possibility for affected citizens and SMEs to receive deferrals of loan payments for up to six months. Banks are allowed not to classify such loans as restructured for loss provisioning purposes until September 30, 2020.
Spain	Three-month moratorium on mortgage payments for the most vulnerable, including households, self-employed, and homeowners who have rented out their mortgaged properties; moratorium on non-mortgage loans and credits, including consumer credits, for the most vulnerable.
Turkey	Banks postponed repayments on credit card loans for housing, consumer, and vehicle purchases. Public banks granted firms affected by the crisis a three-month moratorium on bank loan repayments (principal and interest).

[15] See IMF Policy Tracker. The information provided in the table was retrieved on May 12, 2020.

References

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