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COVID-19 FAQ 4: When is debt forbearance required?

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This FAQ is intended to provide financial institutions with an overview of the requirements imposed on them by governmental authorities to provide relief to consumer and businesses affected by the COVID-19 pandemic.

In the space of a few short weeks, across the US and EMEA we have seen the roll out of debt forbearance measures aimed at easing the financial repercussions of the COVID-19 crisis on household and SME debt. Household and SME debt payments to service mortgages, credit cards and personal loans, generally remain due and payable even during times of widespread economic distress. The purpose of debt forbearance measures is to alleviate some of the economic burden for financially vulnerable customers. Such measures may result in a permanent loss of income for the banks or lenders as interest payments, as well as late or missed payment fees, are irretrievably waived. A significant loss of such income from an "over-application" of forbearance could initiate a domino effect and have far-reaching consequences for the financial system.

Given the variables between short and long-term loans, secured and unsecured loans and the retail and wholesale debt markets, added to the fact that different classes of debt can be housed within domestic different legal frameworks, regulators have struggled to provide detailed guidance and have, with some exceptions, approached the issue by way of guidance rather than rule change. The challenge our clients are finding with "one-size-fits-all" guidance or expectation setting, is that they are left with a number of critical decisions to take in an uncertain legal context:

- To what extent do lenders need to perform normal affordability assessments, particularly where additional interest accumulates and/or the subsequent capital repayment profile will require higher periodic repayments? If affordability assessments are required, is regulatory guidance available as to shortcuts or assumptions that can be made?;
- How does the expectation on firms fit within the normal rules applying to forbearance activities and are any waivers provided? In some jurisdictions, varying or modifying consumer agreements without following a particular process can render the loans unenforceable; and
- Any forbearance will inevitably impact a lender's own economic position, but this in itself may be set within a framework of funding conditions and securitization covenants that mean any forbearance outside of "business-as-usual" could trigger a series of other legal consequences.

As you will see from the below tracker table, there is a contrast between top-down mandated measures required by law (*see*: US CARES ACT and Spain's RDL 8/2020) and softer regulatory (perhaps even moral) pressure on banks and lenders to "do the right thing" (*see*: the UK regulator's response). We expect to see government and regulator responses rush to provide more detail as industry feedback reaches them. At the EU level, the European Banking Authority ("EBA") has provided guidance to the effect that payment moratorium schemes should not be treated as forbearance, if the measures taken are "*based on applicable national law or on an industry or sector-wide private initiative agreed and applied broadly by the relevant lenders.*" Early reviewers suggest that the EBA's Guidelines do not go far enough in assisting banks and lenders with resolving the key questions of detail identified above.

Responses in specific jurisdictions

Jurisdiction	Debt forbearance considerations

United States	• **Federal**
	  ◦ Relief is available for homeowners with federally backed mortgage loans under regulatory action and the CARES Act. Federal and state financial regulators also released joint guidance intended to provide supervisory flexibility and facilitate residential mortgage servicers' ability to place consumers in short-term payment forbearance programs;
	  ◦ The CARES Act provides temporary automatic suspension of principal and interest payments on federally held student loans; and
	  ◦ Federal and state financial regulators issued an interagency statement (subsequently revised) encouraging financial institutions to offer payment accommodations to their customers affected by COVID-19, including by modifying terms on current loans, if consistent with safe and sound banking practices.
	• **New York**
	  ◦ A March 21, 2020, an executive order temporarily amends New York Banking Law to provide that any bank subject to NYDFS jurisdiction that does not grant a 90-day forbearance to any person or business that has a financial hardship due to the COVID-19 pandemic is deemed to have engaged in an unsafe and unsound business practice. NYDFS has issued implementing regulations that suggest that this order, in practice, should only apply to requests for consumer mortgage forbearances. The executive order expired in late April 2020 and has not been extended.
	• **California**
	  ◦ State regulators have encouraged California banks and credit unions, as well as other DBO-regulated lenders, to provide loan accommodations to affected customers, such as restructuring debt, easing terms for new loans and making other payments modifications consistent with prudent banking practices.
	  ◦ Several large national banks, state-chartered banks, credit unions, and mortgage lenders and servicers agreed to provide relief to California homeowners impacted by COVID-19.

Jurisdiction	Debt forbearance considerations
European Union	ECB has provided flexibility when implementing the ECB Guidance on non-performing loans. EBA clarified that offering/accepting terms of general moratoria do not lead to automatic reclassification as forborne exposures. *See*: ECB flexibility when implementing ECB Guidance on NPLs EBA statement on the application of the prudential framework in light of COVID-19 measures EBA Guidelines on treatment of public and private moratoria in light of COVID-19 measures
United Kingdom	The FCA has made it clear by way of guidance that accommodation is expected. *See*: FCA Final Guidance and Rules (Credit Cards) (firms) FCA Final Guidance and Rules (Overdrafts) (banks) FCA Final Guidance and Rules (Personal Loans) (lenders) FCA Guidance (Mortgages) (mortgage providers) FCA Guidance (Motor Finance) (motor finance providers) FCA Guidance (RTO/BNPL/Pawnbrokers) (rent-to-own, BNPL and pawnbrokers) FCA Guidance (HCSTC inc. Payday Loans) (high cost short-term credit providers)
France	All penalty payments, penalty clauses or termination provisions that punish non-performance are neutralized as from 12 March 2020. These may only take effect at the end of a period of one month from the end of the state of health emergency if the debtor has not performed. This measure does not apply to financial obligations and related collaterals mentioned in Articles L. 211-36 et seq. of the Monetary and Financial Code (implementing Directive 2002/47/EC on financial collateral arrangements), as well as agreements entered into within the framework of a payment system and systems for the settlement and delivery of financial instruments mentioned in Article L. 330-1 of the same code. *See*: Ordinance 2020-306
Germany	Forbearance regarding retail loans (whether secured or not) based on a temporary rule change measure.
Italy	Secured and unsecured debts of Italian SMEs and self-employed professionals are subject to a general payment moratorium ending on September 30, 2020. Payment holiday provisions were introduced also with respect to home mortgage loans, while a separate voluntary moratorium regime has been set out by the Italian association of banks.
Spain	New legislative debt forbearance initiative in connection with credits/loans (whether secured by a mortgage or not) extended to individuals in a vulnerable economic situation (as this is defined in article 9 of RDL 8/2020). The forbearance will apply to principal and interest and the term thereof will be of three months. *See*: RDL 8/2020

Jurisdiction	Debt forbearance considerations
Belgium	The financial sector undertakes to grant a payment moratorium until 31 October 31, 2020, to (i) viable non-financial companies, (ii) viable self-employed persons, and (iii) residential mortgage borrowers experiencing payment difficulties as a result of the COVID-19 crisis. Retail, wholesale, secured and unsecured loans are covered by the initiative. This undertaking is part of a public-private sector agreement in the context of the state guarantee for private sector loans. *See*: Payment Moratorium (NL/FR).
Sweden	The Swedish regulator has issued a decision that allows banks and other providers of residential mortgages to grant forbearance on mortgage loans. More specifically, banks are allowed to waive the legal requirement for borrowers to amortize on mortgages. The exemption will apply until August 2021.
UAE	Targeted Economic Support Scheme (*See*: TESS). The substance of TESS as it relates to lending to "private sector corporates, SMEs and individuals" is as follows: • Banks are directed to offer payment deferral relief for a period up to six months on instalment of loans/financing (principal and/or interest/profit) to their respective private sector corporates, SMEs and individuals affected by COVID-19; and (ii) the maturity of these loans/financing may be extended by the period of the relief and repayment schedules to resume as normal following the expiration of the temporary relief period; • CBUAE expects that the IFRS 9 staging and classification under CBUAE Circular 28/2010 of customers receiving relief under TESS shall normally remain unchanged during the period of the scheme, not downgraded.

Our FIA team has developed the ***COVID-19 Regulatory and Legislative Dashboard*** *as a resource to help clients and affected institutions, companies, governments, other entities and individuals around the world navigate the complexities of the crisis and the policy response. Please refer to the Dashboard for our periodic updates and insights on the issues addressed in this FAQ.*

Find out more about the business response to the Coronavirus outbreak: ***Coronavirus: Managing business impact and legal risks*****.**

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