HARNEYS

Effects of the COVID-19 pandemic on the banking sector and credit acquiring companies

The COVID-19 outbreak has forced the government of the Republic of Cyprus to introduce aggressive and severe emergency measures and restrictions on movement for the public, through relevant Decrees issued by the Minister of Health, in an attempt to contain the spread of COVID-19, impacting all sectors of industry and the economy in Cyprus, including the banking sector, and by extension Credit Acquiring Companies (***CYCACs***).

Credit Acquiring Companies are special purpose vehicles set up, usually, by international investment funds investing in Cypriot credit institutions' non-performing loans (***NPL***s) and licensed to operate and regulated by the Central Bank of Cyprus (***CBC***).

The COVID-19 measures taken to date in the banking sector, which are analysed below, include recommendations to credit institutions, by the Central Bank of Cyprus, for the provision of liquidity to all adversely affected businesses and households, the temporary suspension of all auctions and foreclosure procedures, enacted legislation for the suspension of loan repayments and interest and a bill for loans to households and business up to €2 billion, 70 per cent of the value of which is to be guaranteed by the government.

Suspension of auction and foreclosure procedures

Since the 2013 economic crisis in Cyprus and at the behest of the European Central Bank and the Central Bank of Cyprus, credit institutions have been attempting to reach a much coveted accounting equilibrium in relation to their balance sheets by off-loading carefully packaged NPLs portfolios onto special purpose vehicles, that is CyCACs, and then selling the shares to those CyCACs to the highest international bidder. There are, currently, underway, at different stages, an important number of major such NPLs acquisitions in Cyprus with an aggregate sum of billions of Euros in value. These acquisitions processes are expected to face a temporary hold amid the COVID-19 pandemic not by any measure taken by the government of the Republic of Cyprus but rather by the overall worldwide market conditions and stagnating economic climate which has set in.

Specifically, due to COVID-19, the Association of Cyprus Banks (***ACB***) announced, on 18 March 2020, that all auctions and foreclosure procedures performed by its members, which include a number of CyCACs, will be temporarily suspended for three months, that is, until 18 June 2020. Another announcement followed on 19 March by which the ACB stated that its members shall take steps to support the Cypriot economy.

Announcements/recommendations of the Central Bank of Cyprus

Furthermore, the Central Bank of Cyprus issued three COVID-19-related announcements on 16, 18 March and 6 April 2020: the first announcing what decisions and measures have been taken at the level of the Board of Directors of the European Central Bank on 12 March 2020 in relation to supporting the Cypriot banking sector, in terms of continued liquidity provision to credit institutions and the support for favourable conditions for financing for businesses and households; while, the second, declaring specific alleviating measures towards credit institutions as well as a number of recommendations towards credit institutions and CyCACs, urging them to adopt corresponding and appropriate measures towards their customers, in an effort to minimise the impact of COVID-19 on the banking sector and the economy as a whole; and, lastly, the third announcement addresses the Less Significant Credit Institutions in relation to dividend distributions and share buy-backs:

- Release of capital reserves and liquidity to credit institutions so as to allow them, in turn, to provide financial relief to their incumbent business and household loan customers

- Relaxation of lending criteria and qualifications so as to make it easier and immediate for banks to provide new short-term loans and credit facilities to businesses and households that are facing financial difficulties allowing the latter, thus, to meet their current financial obligations
- Recommendation to credit institutions to provide more favourable terms for short-term loan and credit facilities restructurings to adversely affected customers (who have been compliant with their loan obligations until today) such as, for instance, postponement of capital or interest, or both, for a term of nine months, depending on each bank's policy and each customer's financial situation, provided such customers apply for this by 30 June 2020
- Recommendation to credit institutions to provide more favourable interest rates in relation to the aforementioned new loans and credit facilities as well as the short-term restructured loans and credit facilities, and to do so with nil charges or fees
- Recommendation to CyCACs to provide short-term restructurings from CyCACs to their customers who have been affected by the announcements of the Government of the Republic of Cyprus and permission granted to CyCACs to utilise fast-track procedures in doing so by allowing them to digress from their statutory requirement for following a detailed procedure of evaluation and approval of restructurings, when this has to do with the said short-term 9 month restructuring period
- Recommendation to Less Significant Credit institutions, until 1 October 2020 to refrain from any dividend distribution, any issuance of irrevocable commitments to pay out dividends for the financial years 2019 and 2020 and any own share buy-backs aimed at remunerating shareholders

The overall goal and purpose of the above measures and recommendations is the provision of liquidity to all adversely affected businesses and households so as to allow them to survive the financial difficulties they may be facing due to the effects on the economy of COVID-19.

Primary and secondary legislation for the suspension of loan and facility instalments and interest payments

In light of the COVID-19 crisis, the European Banking Authority issued an announcement on 25 March 2020 emphasising, *inter alia*, that generalised payment delays due to legislative initiatives which are addressed to all borrowers will not lead to any automatic classification in default, forborne or unlikeliness to pay.

Subsequently, on Sunday, 29 March 2020, the House of Representatives (***HoR***), sitting in an emergency plenary session, approved and enacted the Taking of Emergency Suspension Measures by Financial Institutions and Regulatory Authorities Law, L. 33(I)/2020 (Law), authorising the Council of Ministers of the Republic of Cyprus to make decisions or to authorise the competent regulatory authorities to make decisions, for the taking of emergency suspension measures by Financial Institutions (which includes a CyCAC in its definition under section 2 of the Law) and / or competent regulatory authorities allowing borrowers to apply for the suspension of loan and facilities instalments and interest payments, provided such measures, in the view of the CBC, add to the safeguarding of the Republic of Cyprus' financial stability. Suspension measures are to be decided after taking into account, amongst others, the safeguarding of the overall long-term viability of the Republic of Cypriot financial system, the promotion of public benefit and in the service of public interest. Furthermore, pursuant to section 5 of the Law, the Minister of Finance of the Republic of Cyprus, may, following the agreement of the competent regulatory authority, and based on a corresponding Council of Ministers' decision issue decrees assisting in the best application of the provisions of the Law.

Following this, the Minister of Finance proceeded with the issue of a Decree (the Taking of Emergency Suspension Measures by Financial Institutions and Regulatory Authorities Decree, RAA 134/2020) on Monday 30 March 2020, allowing for the mandatory suspension, upon application by the borrower to the pertinent Financial Institution, of the loan and facilities instalment and interest payments to a Financial Institution, for nine months, that is until 31 December 2020 (***Decree***).

In accordance with the Decree, those eligible are natural and legal persons, public-law bodies, self-employed persons and corporations who or which, as of 29 February 2020: (i) do not present any arrears in the payment of their instalments of more than 30 days from the relevant date provided for in their loan or facilities agreements and (ii) are facing financial difficulties as a result of the COVID-19 pandemic. Provided an applicant borrower meets the above criteria, a Financial Institution may not reject such applicant's application. The instalments and interests suspended are added to the balance of the amount owed under each loan or facility and the corresponding loan and facility agreements' terms are, automatically and by operation of law, extended so as to accommodate the above while the sums corresponding to the suspended instalments and interests payable shall not be deemed as immediately payable.

Similarly, the taking of recovery measures by Financial Institutions against loans or facilities covered by the suspension is also suspended under the Decree. The Decree also suspends the obligation of Financial Institutions to prepare, submit and announce financial statements for the fiscal year 2019 following a written petition by them to the corresponding competent regulatory authorities. The Decree also provides for a mirror suspension of any obligation by self-employed and businesses to submit financial statements to any Financial Institution for the fiscal year 2019.

Any applicant or borrower who or which voluntarily wishes to continue paying any amount against or towards settlement of any of the suspended instalments and / or interests may still do so after informing the Financial Institution of this.

Furthermore, on 6 April 2020, CBC issued an additional announcement informing CyCACS as to how they are expected to apply the Decree's provisions.

CBC Circulars on new loans and restructuring procedures

Additionally, the CBC issued, on 30 March 2020, a circular to all credit institutions currently operating in the Republic, pursuant to paragraph 3 (4) of its Provision of New and Restructuring of Incumbent Facilities Procedures Directives of 2016 to 2020 (***Directives***), which is to apply in conjunction with the Law and the Decree (Circular). In the said Circular, the CBC stresses that the role of credit institutions in the operation of the real economy is vital and that in the interests of protecting financial stability and of softening the impact of COVID-19 consequences to the Cypriot economy, it is deemed necessary to fast-track the provision of new lending, in the form of facilities a term of up to 12 months, by the credit institutions. The circular continues by setting out the criteria and profile of the type of borrower who would be allowed to apply and receive such new lending, until 31 December, 2020, the criteria of what type of facilities this would cover, as well as with the setting out of a reduced list of justifying documents that should be requested by credit institutions for the issuance of such new lending, including the suspension of a requirement for the applicant to be physically present for the purposes of the application and the lending as was originally the case pursuant to paragraph 16 of the Directives.

Finally, on 3 April 2020, the CBC issues a new circular, addressing all credit institutions within the Republic, including their subsidiaries licenced by other member states of the EU and the CBC acts as their overseeing authority. In said circular, the CBC informs credit institutions of the EBA Guidelines on Legislative and Non-legislative Moratoria on Loan Payments applied in light of the COVID-19 Crisis published by the European Banking Authority (***EBA***) on 2 April, 2020 and that it has received certain clarifications by both the EBA and the Single Supervisory Mechanism on pertinent, important issues. Specially, the CBC clarifies in its new circular that the application of general moratoria is not a forbearance measure, shall not be considered distressed restructuring and that the performance of diminished financial obligation testing by credit institutions is, therefore, not required for the purposes of recognition of potential new non-performing loans. Consequently, any potential financial exposure which may be suffered by a credit institution within the period of such moratoria shall be exempt from the appraisal required for the recognition of non-performing loans under article 178 (3) (d) of Regulation (EU) 575/2013. Last but not least, the CBC directs through said circular the credit institutions to apply the aforementioned provisions in a homogeneous manner to all borrowers / beneficiaries falling within the scope of the emergency suspension measures.

CBC best practises announcement

In a further best practices Announcement, issued on 31 March 2020 by the CBC, it notes that the Decree is in line with the framework announced by the EBA on 25 March 2020.

The CBC, in addition, indicates in its Announcement that credit institutions should be acting with the aim of channelling liquidity to the real economy and not for the purposes of profiting themselves. On the contrary, out of the released funds, credit institutions are expected to finance the persons adversely affected by the COVID-19 consequences and / or absorb themselves any losses stemming from incumbent loans which have been negatively impacted. Credit institutions are further reminded that they should act with full transparency, process suspension applications in a prompt way and with due attention and that it is expected that credit institutions shall avoid imposing charges during the restructuring process which are not fully explained and comprehensible to the borrowers. Any such charges should in any case be kept to low and reasonable levels, adds the CBC.

Furthermore, the CBC emphasised the importance of the newly imposed measures for the smooth-running of the economy both short and long-term and noted that it expects the credit institutions to ensure that there will be no positive net present value to the loans (for instance, through interest compounding) that will be suspended pursuant to the Decree and urged all credit institutions to closely monitor their credit exposure.

As the Decree only applies to performing loans, it is not expected to have an impact on non-performing loans, and, by extension, a significant impact on CYCACs.

Legislation for loans guaranteed by the government

As mentioned above, the HoR is also currently discussing a bill aiming to the issuance of government guarantees for an amount of up to 2 billion euro to the benefit of credit institutions in return for the latter providing for low-interest loans to businesses and self-employed individuals. However, recently the mechanics of how such liquidity will find its way in the real economy is being discussed and argued extensively and there are significant dissenting voices in the HoR as to whether such amounts should not be directly be paid to the beneficiaries in cash rather than be given using credit institutions which may abuse the process and partly and covertly convert such governmental subsidies for their own benefit. Which approach finally prevails remains to be determined.

While undeniably drastic, the aim of the above measures is to ensure the endurance of the market through the COVID-19 outbreak, including the NPL market which is a key contributor to the positive growth of the banking sector..

The announcements and circular of the CBC dated 16, 18, 30 and 31 March 2020, can be found here, here, here and here respectively *(only available in Greek)*.

The announcements of the CBC dated 3, 6, and 6 April 2020 can be found here, here and here respectively *(only available in Greek).*

The announcement and guidelines of the European Banking Authority can be found here and here respectively.

The announcement of ABC dated 18 March 2020 can be found here *(only available in Greek)*.

The Law and the Decree issued by the Ministry of Finance can be found here and here *(only available in Greek)*.

For more information and key contacts please visit **harneys.com**

Harneys is a leading international offshore law firm. From locations around the globe, Harneys advises the world's top law firms, financial institutions and corporations on the laws of British Virgin Islands, Cayman Islands, Cyprus, Luxembourg, Bermuda, and Anguilla. For more information about Harneys please visit www.harneys.com or contact us at marketing@harneys.com.