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Corporate debt moratoria: extend, amend or unwind?[1]

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The purpose of this contribution is threefold. First, we document uptake of the Belgian corporate debt moratorium and highlight its successful role as a liquidity-relief instrument. Second, as the pandemic unfolded, policymakers were faced with the challenge of whether to extend, amend or unwind the moratorium. We discuss a set of relevant considerations and compare them with the actual policy decisions. Finally, as the corporate moratorium ended in June 2021, we take a first look at how non-financial firms (NFCs), once taken off this lifeline, have fared (so far).

The Belgian corporate debt moratorium

Under the initial Belgian debt moratorium scheme (as embodied in *Charter I*, Febelfin (2020a)), viable NFCs could apply to their institutional lenders for a deferral of repayments on their business loans. The payment holiday was allowed to run from April 1st (2020) for a maximum of six months and was capped at the 31st of October (2020). The suspension only applied to the principal: the interest on these loans remained due. Once the deferral period had lapsed, payments had to resume. Hence, the duration of the loan was extended by the deferral period and borrowers would finish repaying their loan a maximum of six months later than the original deadline. Important eligibility criteria, mostly reflecting pre-pandemic viability, applied.[2]

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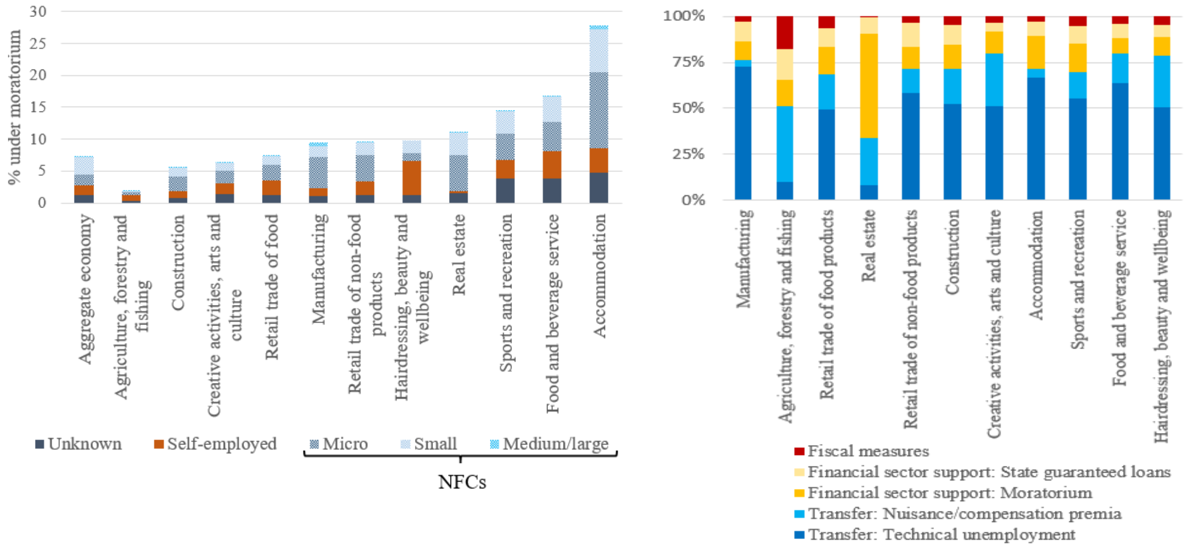
[1] The views expressed in this contribution are those of the author and do not necessarily reflect the views of the National Bank of Belgium or any other institution to which the author is affiliated. All errors are my own.

[2] One of the criteria is that on 1 February 2020 the requesting entity must not have been in arrears with its outstanding loans, tax or social security contributions (see NBB (2020) for details). In addition, applicant firms should have payment problems attributable to the COVID-19 crisis, i.e., through (i) a drop in turnover or activity, (ii) recourse to (temporary) unemployment, or (iii) the legal obligation imposed by governmental authorities to close the company or organisation.

Figure 1: Uptake and role of the corporate debt moratorium (April 2020)

Panel a: Uptake across a selection of sectors (%) Panel b: Role as a liquidity relief measure (%)



Source: Panel a – BECRIS (exclusively S11 & S14 sectors in ESA classification) / Panel b – Tielens et al. (2021)

From its inception in April 2020, this instrument was often solicited by Belgian firms. Figure 1, panel (a), documents that in April 2020, across the board, around 7.5% of all Belgian bank-borrowing entities had at least one of their eligible debt instruments placed under moratorium. Uptake was disproportionately skewed towards self-employed and micro/small NFCs, i.e. subpopulations known to have smaller pre-pandemic liquidity buffers and less ability to downscale costs in the face of declined revenues (Tielens et al., 2021). Recourse to the moratorium was furthermore correlated with the impact of the crisis, as it was mostly sectors severely affected by public health measures (e.g. “Accommodation”, “Food & Beverage establishments”, etc.) that relied heavily on this relief measure. Panel (b), shows that the moratorium represented an important pillar of the policy mix targeted to alleviate liquidity stress. Beyond outright transfers, such as short-time work schemes and compensation premia, debt moratoria served as the most important patch to liquidity shortfalls.

Corporate debt moratoria: extend, amend, or unwind?

Charter I of the corporate moratorium was drafted in April 2020. As the pandemic unfolded, policymakers needed to form views on whether, when and how to extend, amend or unwind the corporate debt moratorium. Such a decision is not straightforward in the face of an uncertain outlook for the pandemic and for the economy. Removing the safety net for corporations before their cash flows are sufficiently restored could trigger bankruptcies of inherently viable firms. The ensuing damage to the economic fabric would lead to a permanent reduction in the growth potential of the economy. Moreover, capacity constraints in the judicial system and inefficient restructuring procedures could lead to congestion externalities that would amplify the effects of a first wave of bankruptcies (a concern voiced by the IMF (2021) in the Belgian context). Finally, insolvencies in niche sectors risk bringing collateral to markets at fire-sale prices which, in turn, will have repercussions on banks’ recoverable losses (Becker & Oehmke, 2021).

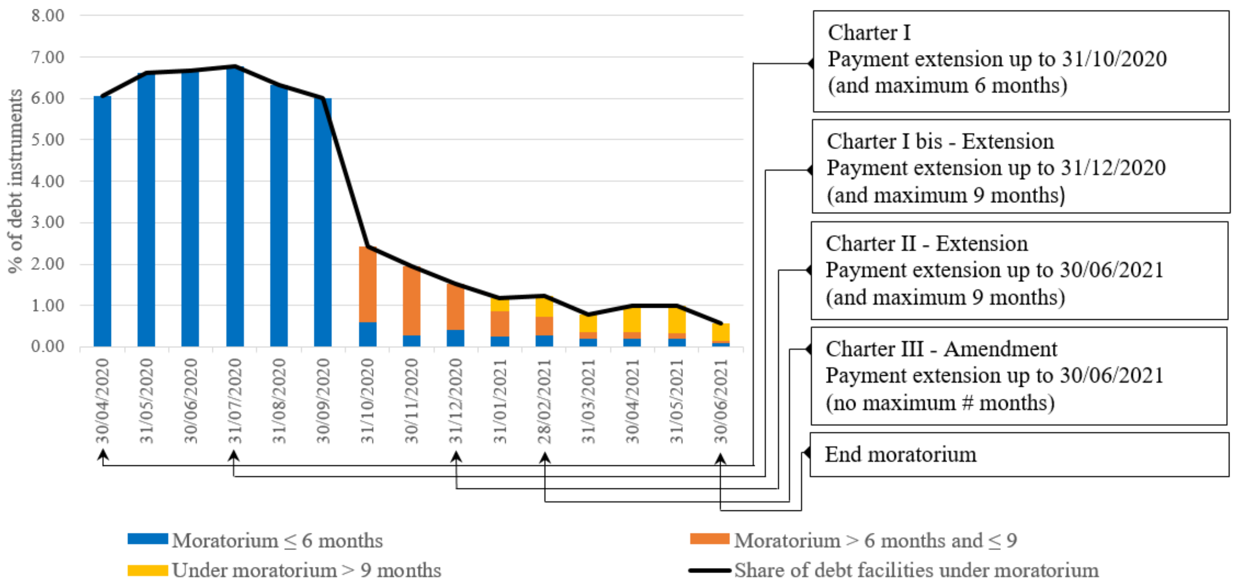
Conversely, there are risks involved in withdrawing the debt moratorium too late. First, extending the moratorium for too long risks postponing necessary structural adjustments in the economy (Di Mauro & Syverson, 2020). More precisely, some of the changes in demand brought about by the pandemic are likely to be permanent: e.g. travel and tourism patterns (less business travel), household consumption behaviour (shift from onsite to online) and supply chain restructuring (more local procurement or in-house production). Such structural shifts are expected to last beyond the pandemic. Protracting lifelines discourages the affected firms from adapting to this new normal. Second, the lack of periodical debt repayments is likely to hamper monitoring by banks as they would find it harder to sort between solvent and insolvent borrowers in the absence of periodical cash flows from both debtor categories (Beck et al., 2021). Third, prolonging moratoria may increase systemic risk because debtors (including sound ones) may develop a “non-payment culture” and that keeps firms artificially alive, leading to an increased risk of zombification (Ellul, Elel & Rajan, 2020).

Charter I - extended and Charter II

Belgian policymakers have taken the view that the costs of premature withdrawal of support could be more significant than maintaining support for too long. Hence, in September 2020, once it became apparent that the crisis would last longer than expected, the initial option to defer payments up to the 31st of October 2020 (as specified in *Charter I*) was extended twice: first, until the end of 2020 (*Charter I bis*, Febelfin, 2020a) and, subsequently, up to June 2021, provided the total combined deferral period did not exceed nine months (*Charter II*, Febelfin, 2020b).

Despite the initial September 2020 extension, Figure 2, documents that most corporate debt instruments under moratoria in September were not prolonged as many firms had returned to a better financial position and business activities had again settled around pre-pandemic levels (Tielens et al. 2021). A deliberate relinquishment of payment holidays suggests that fears of a non-paying culture (supra) did not materialise, thus mitigating the potential creation of zombie firms (or support for incumbent zombies).

Figure 2: Maturity of debt moratorium in the aggregate economy



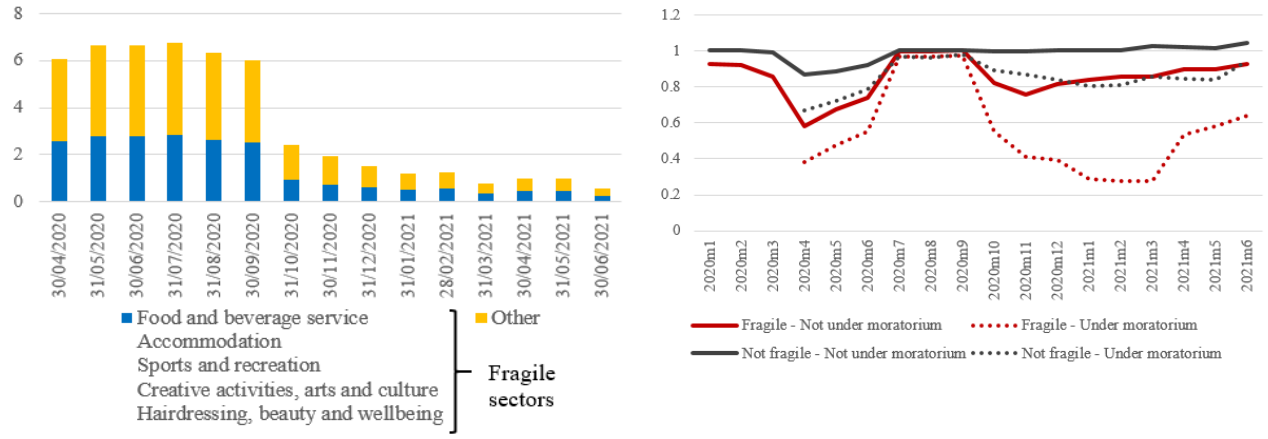
Source: Panel a – BECRIS (S11 & S14 sectors in ESA classification)

This generally benign picture does not imply that the September extension was excessive and/or overly generous. Despite trends in the overall economy, a selection of (contact-intensive) sectors continued operating at significantly below pre-pandemic business volumes in October 2020 due to reinstatement of a lockdown regime. Consequently, Figure 3 panel (a) reveals that the extended uptake of the debt moratorium largely originates in five small but fragile sectors ("Food and beverage service", "Accommodation", "Sports and recreation", "Creative activities, arts and culture", "Hairdressing, beauty and wellbeing"). While these subsectors jointly represent only a minority of firms in the Belgian economy, these fragile sectors accounted for almost 50% of firms under moratorium from September onwards.

Figure 3: Debt moratorium & business activity of fragile sectors

Panel a: % of instruments under moratorium, by sector fragility

Panel b: Ratio of monthly sales vs. monthly sales in the same month in 2019 (median)



Source: BECRIS & VAT declarations

Figure 3 panel (b) reports average activity levels (relative to 2019) of the aforementioned fragile sectors. It shows that, after the September 2020 extension, it was mostly firms affected by the second lockdown that resorted to the prolonged moratorium scheme, while those back to operating at (or close to) 2019 levels decided not to extend (on average). For firms in non-fragile sectors, we also observe a strong correlation between the uptake of the extended moratorium and lower-than-usual activity levels. More precisely, firms in non-fragile sectors that opted for the extended moratorium were operating at 80% of historical levels, while their sector peers with restored activity levels did not apply for the extension.[3] By December 2020, activity levels of firms that applied for the first extension remained unchanged vis-à-vis October. In that context, policymakers offered a vital second extension (*Charter II*, Febelfin 2020b).

Amending Charter II: Charter III

Firms that had been under moratorium since the start of the crisis were set to breach the nine-month limit, as embodied in *Charter II*, by February 2021. While activity levels remained subdued for firms still under moratorium, it was decided to (again) extend the moratoria, including for entities that had

[3] Such self-sorting by firms in the moratorium is desirable but did not prevent a minority of firms opting for the extended moratorium while not strictly needing it (Tielens et al., 2021).

already reached the above-mentioned limit of nine months, on condition that these companies met certain viability criteria (*Charter III*, Febelfin, 2021).

Ending the corporate moratorium

From June 30th (2021) onwards, the Belgian debt moratorium came to a full stop and NFCs were instructed to turn to their lenders for case-by-case solutions (Febelfin, 2021). Interestingly, the remaining debt instruments under moratoria were mostly concentrated among firms that were still operating at far below historical levels (Figure 3 panel (b)). The question emerges how these NFCs fared once this lifeline was removed. This question is addressed in the last section.

Cliff-effects: a pending economic Armageddon?

Various commentators voiced concerns that the expiration date of the moratorium could ignite payment difficulties among firms that remained under moratorium until the very end (De Tijd, 2020). Figure 4 panel (a) attests that this fear of immediate and large cliff-edge effects did not materialise. It records the July share of non-performing loans[4] for NFCs that were still under moratorium at the expiration date in June 2021 vis-à-vis those that had never been under moratorium (despite being eligible). While we observe that the incidence of non-performance in the former group typically exceeds that in the latter, the difference remains relatively small in the first month after the closing date and mainly reflects pre-pandemic patterns of sectoral arrears. Nonetheless, the risk remains that non-performance could tick up in the coming months as fragile liquidity buffers may be depleted quickly.

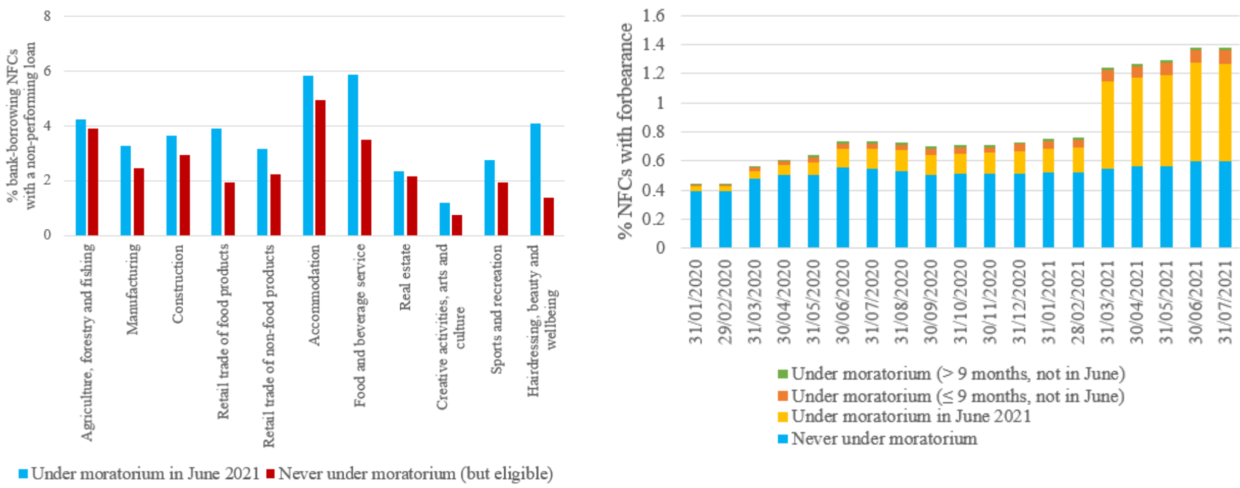
In tandem with the rising non-performance risk, Figure 4 panel (b) shows the share of credit instruments that have benefitted from forbearance measures. Loans with forbearance measures are loans for which banks have made concessions (e.g. modifications of the initial contract or debt refinancing) to debtors facing (or about to face) financial difficulties in meeting their commitments. We observe that the share of forborne loans has grown throughout the crisis. While the one-off spike in early 2021 reflects EBA reporting guidelines[5], the number of firms offered forbearance continues to increase in all categories of firms, especially those under moratorium in June 2020. Altogether, this indicates that - to some extent – banks proactively offer forbearance solutions to borrowers in order to minimise losses and avoid unnecessary defaults. They will need to continue to do so going forward in order to support their borrowers and the economy in general, while using their available buffers (forbearance solutions often lead to higher provisions or costs for banks) to suppress rising NPLs.

[4] Non-performing loans are loans that may not be repaid due to their borrower getting into financial trouble, or that are already in arrears.

[5] EBA guidelines class payment extensions granted in excess of nine months as forbearance measures (EBA, 2021).

Figure 4: Non-performance and forbearance measures

Panel a: Non-performing debt facilities Panel b: Incidence of forbearance measures



Source: Panel a/b – BECRIS (author calculations). Panel b: All facilities under moratorium for more than nine months are classified as forborne due to EBA guidelines

Conclusion

The Belgian corporate debt moratorium was a heavily used and successful liquidity-relief instrument. Its timeframe was extended multiple times and amended to cope with uncertainty and economic stress in (particular segments of) the economy. While commentators voiced concerns about cliff-edge effects once it was finally terminated, we see no indications that payment arrears are dramatically different among firms that were still under moratorium at the closing date and those that were not. This finding does not rule out a potential uptick in NPLs in the coming periods. On the upside, we find that forbearance measures are, to some extent, offered to fragile entities, and that would help to flatten the NPL curve in the coming months.

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