Box 2
Credit risk management of domestic banks in undertaking pandemic relief loans

When the COVID-19 pandemic broke out in early 2020, governments around the world successively launched large-scale relief measures to help corporations and individuals out of their financial predicaments. As the global economy gradually recovered, international organizations, such as the Bank for International Settlements (BIS), the Financial Stability Board (FSB) and the International Monetary Fund (IMF),* have sequentially issued press releases or research reports on the possibility that prolonged relief measures could increase the risk of financial instability and on the impact arising from the withdrawal of relief measures on banks' credit risk. Meanwhile, domestic banks in Taiwan have provided various types of relief loans for corporations and individuals affected by the COVID-19 pandemic since 2020. The Bank visited some of those domestic banks with larger scales of self-run relief loan schemes to have a good grasp of their credit risk management in extending such loans.

1. Relief loans extended by domestic banks

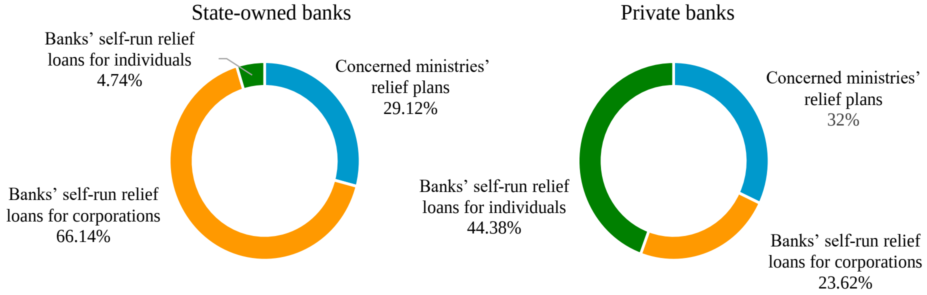
1.1 State-owned banks had played a more active role in relief loan programs

Since relief loan programs were introduced in 2020, domestic banks had approved 572,700 applications with the amount totaling NT$4,884.5 billion as of December 27, 2021. Among them, state-owned banks had approved 388,100 applications totaling NT$4,126 billion, indicating that they had been more active in extending relief loans in coordination with government policies.

1.2 Corporations were the major borrowers of relief loans; lending exposure differed between state-owned and private banks

Corporate loans accounted for the primary shares of the relief loans. The proportions of corporate loans (including those provided under concerned ministries' relief plans and banks' self-run relief loans for corporations) extended by state-owned and private banks were 95.26% and 55.62%, respectively. As for self-run relief loans for individuals, 44.38% of them were extended by private banks, a much larger share than the 4.74% extended by state-owned banks (Chart B2.1).

Chart B2.1 Relief loans by counterparty

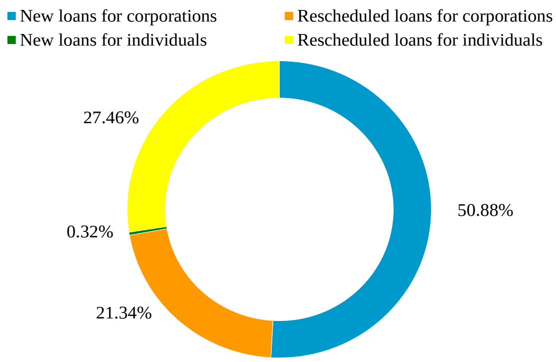


Note: Figures are as of December 27, 2021.
Source: FSC.

1.3 Banks' self-run relief loans were held in almost equal proportion between rescheduled loans and new loans

Among visited banks' self-run relief loans, the proportion of rescheduled loans granted with a grace period (both those for corporations and individuals) was 48.8% (Chart B2.2), mainly because these banks, with the aim of customer retention, offered loan forbearance solutions to help viable customers get through pandemic hardship. In addition, most of these new loans were provided for corporations, which accounted for 50.88% of visited banks' self-run relief loans.

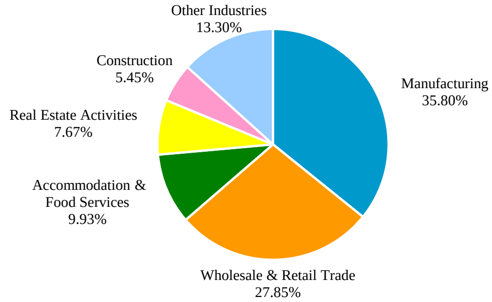
Chart B2.2 Banks' self-run relief loans by type



Note: Figures are as of the end of 2021.
Source: Visited banks.

1.4 Relief loans for corporations were chiefly for those in manufacturing and wholesale & retail trade

Chart B2.3 Banks' self-run relief loans for corporations by industry



Note: Figures are as of the end of 2021.
Source: Visited banks.

The top three industry borrowers in terms of relief loans for corporations were manufacturing (35.80%), wholesale & retail trade (27.85%) and accommodation & food services (9.93%). These three industries combined to account for more than 70% of visited banks' self-run relief loans for corporations (Chart B2.3), reflecting the fact that these industries were more significantly impaired by the pandemic.

1.5 More than 80% of the relief loans were guaranteed by Taiwan SMEG or secured by real estate

More than 80% of visited banks' relief loans for corporations were guaranteed by the Small and Medium Enterprise Credit Guarantee Fund of Taiwan (Taiwan SMEG) or secured by real estate, while more than 90% of their relief loans for individuals were secured by real estate.

2. Credit approval and loan review of the relief loans

2.1 Loan forbearance was applicable to borrowers who had paid interest regularly; several banks had temporary measures for credit review

To accelerate the review process and improve operational efficiency in extending the relief loans, several of the visited banks laid down loan forbearance measures including payment moratorium, applicable to individuals paying interest regularly or corporations that were willing to continue operations and paid interest normally. They would agree to defer repayment of principal or lower the interest rates depending on borrowers' situations. New loans or incremental loans, except for the loans applicable for small-scale business entities under Program C of the Bank's Special Accommodation Facility that would be undertaken using a simplified credit score sheet, were handled according to the banks' existing internal credit score mechanisms. In addition, some of the visited banks formulated temporary measures for credit review, lowering credit authorization levels depending on the loan amount and collateral quality.

2.2 Most banks conducted post-lending reviews of the relief loans in accordance with existing internal rules while several banks also performed stress testing

Visited banks conducted post-lending reviews of the relief loans in accordance with their existing internal rules and early warning reporting procedures, while paying special attention to the impact of the pandemic on borrowers' revenues. Moreover, they regularly monitored the lending condition of the relief loans, status of non-performing loans and non-accrual loans, and their exposures to borrowers affected by the pandemic. Several banks also voluntarily conducted stress testing for the relief loans, and the results showed that they maintained sound risk bearing capacities.

3. Credit quality of the relief loans

To ensure that banks prudently evaluate credit risk of the relief loans, the FSC required banks to earnestly classify credit assets and assess expected credit losses in accordance with the IFRS 9 and the five-category classification method stipulated in the relevant regulations. Among visited banks' relief loans, the NPL ratios of rescheduled loans ranged between 0.13% and 0.81%, while the NPL ratios of new loans were below 0.5% as of the end of 2021. These two NPL ratios were below 1%, indicating that the credit quality of the relief loans remained sound.

4. While credit risk remained under control, the impact of the exit of relief measures on banks' asset quality warrants close attention

Given that over 80% of domestic banks' relief loans were guaranteed by Taiwan SMEG or secured by real estate, coupled with ample liquidity in the banking system and the recent housing market boom, the overall credit risk in the banking system remained controllable. In addition, most of the visited banks had planned relevant response measures in advance, tracked changes in the exposures to the relief loans continuously, adjusted credit policies as needed, and reverted to the regular debt collection or negotiation mechanisms, so as to protect their debt claims. As many of the relief loans are still in the principal moratorium period, any overdue cases could show at a later time. Therefore, domestic banks should strengthen post-lending tracking, conduct risk assessments or stress testing of their relief loan exposures, and develop response measures where necessary. The Bank will also pay close attention to the impact of the withdrawal of COVID-19 relief measures on domestic banks' asset quality in the future.

Note: *BIS (2022), "Newsletter on Covid-19 related credit risk issues," March; FSB (2021), "COVID-19 support measures: Extending, amending and ending"; IMF (2021), "Unwinding COVID-19 Policy Interventions for Banking Systems," *Special Series on COVID-19*, March.