Bank of Uganda Guidelines on Credit Relief and Loan Restructuring Measures during the COVID-19 Pandemic: What they mean for Supervised Financial Institutions and Borrowers

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Prior to the outbreak of the COVID-19 pandemic, loan transactions would follow a typical loan cycle that began with a prospective borrower applying for a loan from a financial institution. The loan would be processed, closed and serviced in accordance with a repayment schedule agreed between the borrower and the financial institution. The outbreak of the pandemic and the ensuing lockdown of movement and operations around the world has given rise to an unprecedented drop in both the demand and supply of goods and services. In turn, this has negatively affected the revenues of businesses and individuals and their ability to service their loans. This state of affairs makes the restructuring of loans necessary and crucial for borrowers to avoid default and ensure business survival and for financial institutions to stand a reasonable chance of recovering their funds. Restructuring refers to the alteration or reorganization of the terms of the loan to avoid default because of weaknesses in the borrower's financial position or the non-payment of the debt as arranged.

Bank of Uganda Intervention

In recognition of the prevailing circumstances, the Bank of Uganda ("BOU") on the 14 April 2020 issued a number of guidelines on Credit Relief and Loan Restructuring Measures for Financial Institutions which are supervised by the Bank of Uganda ("SFIs"). These are commercial banks, credit institutions and microfinance deposit taking institutions. The guidelines followed an earlier statement by the BOU in which it undertook to put in place measures to limit the impact of COVID-19 on financial stability and economic growth.

As the regulator of the SFIs, the BOU restricts the SFIs' ability to restructure loans because they use depositors' funds to extend loans and BOU has a duty to protect those funds from being continually made available to borrowers who are not in a good financial position to pay. These restrictions are also meant to ensure that SFIs maintain adequate capital levels as an overall financial stability and depositor protection measure.

The Financial Institutions (Credit Classification and Provision) Regulations 2005 ("FICCP Regulations") require an upfront settlement of arrears before a loan can be restructured and the loan cannot be restructured more than twice over its life. By the time of the lockdown, it would not be surprising if certain categories of facilities had already reached their restructuring limits. Some borrowers may not be in position to afford the required upfront cash payment in the prevailing pandemic circumstances. In the absence of flexibility to restructure loans, the highlighted requirements of the FICCP Regulations would cause borrowers to default and the SFIs would be at risk of falling foul of their legal obligations to maintain minimum liquidity levels. In the circumstances, it would be reasonable to conclude that this would be through no failure on the SFIs' part but rather through the unforeseen circumstances of the COVID-19 pandemic and its ripple effect on their customers.

BOU therefore issued the guidelines to allow the SFIs to restructure loans so they can recover depositors' funds and maintain the required levels of liquidity. The guidelines issued by BOU can be summarized as follows:

- SFIs may only offer a maximum of two restructurings per credit facility in the 12-month period beginning 1 April 2020, irrespective of the number of times it has been restructured in the past. Any more restructurings will require BOU approval.
- The settlement of arrears as a condition for restructuring a credit facility is suspended for 12 months with effect from 1 April 2020.
- SFIs are permitted to give a repayment moratorium to borrowers who, in the assessment of the SFIs, are or will be affected by the COVID-19 pandemic. A moratorium is an authorization to a borrower to postpone payment. The moratorium can only be granted before 31 March 2020 and for a maximum period of 12 months.
- SFIs still carry the responsibility of assessing the likeliness of borrowers to default and the appropriateness of the credit reliefs offered to them pursuant to these guidelines. They are also required to put in place a policy for implementation of the guidelines.
- Consumer protection remains paramount, and any credit relief offered must be in the best interest of customers as a whole, and with full disclosure.
- Restructuring of a facility arising from the impact of the COVID-19 pandemic will not be treated as an adverse change in the borrower's credit risk profile. The requirement for SFIs to report to the Credit Reference Bureau (CRB) on a credit facility subject to a moratorium is suspended until the expiry of the moratorium.
- Borrowers are encouraged to request, and SFIs may offer, credit relief. In either case, the borrower must consent to any credit relief granted.

What the Guidelines Mean for SFIs

As a general observation, the guidelines do not, in our view, constitute an amendment of the existing laws and regulations. They only provide guidance on the credit reliefs that SFIs may offer in the exceptional circumstances created by the pandemic without fear of being penalized by the regulator. SFIs are not bound to implement the proposed measures. Specific implications are further discussed below.

Restructuring

The guidelines temporarily lift the restrictions on the ability of SFIs to restructure credit facilities. Restructuring of a credit facility may include the refinancing, rescheduling, rollover, or other modification of the loan.

It is expected that whatever mode of restructuring the SFIs choose, the restructuring will have to be done with a view to maintaining the SFIs' ability to meet depositors' demands. As such, in our view, SFIs may be more willing to offer longer repayment periods rather than measures like interest reduction.

SFIs' Prudential Responsibility

The issuance of the guidelines does not absolve the SFIs of their duty to assess the likeliness of their customers to repay and the appropriateness of the credit reliefs offered to them. There is no one-shoe-fits-all credit relief or restructuring measure. SFIs are still required to implement their existing credit policies, save that they will have to take into account such factors as the impact of the pandemic on the borrowers' ability to repay, the length of time it will take for the economy to recover, and the like.

SFIs that intend to grant credit relief pursuant to the BOU guidelines cannot grant them in an ad-hoc manner. They are required to establish a policy for the implementation of the guidelines. SFIs are further required to update their

policies and measures to address the credit, liquidity, market and operational risks associated with the COVID-19 pandemic period.

Consumer Protection

The guidelines emphasise that consumer protection remains a priority and SFIs are required to ensure full disclosure and to act in the interest of customers with no hidden charges. In this regard, SFIs will be required to continue acting in line with the Bank of Uganda Financial Consumer Guidelines 2011, which require them to act fairly and transparently in their dealings with customers. A borrower must consent to the restructuring and the SFI has to obtain proof of such consent. This means that if the borrower does not accept the restructuring offer made to them, the existing terms of the credit facility remain in place.

SFIs are permitted by the guidelines to make unsolicited offers for restructuring to their customers in the 12-month period. SFIs will have to make these offers in a non-discriminatory way to avoid claims by customers of unfair treatment. If the SFI makes an offer to a category of borrowers for a restructuring, an omission of any borrower in the same category who qualifies for a restructuring may be viewed as discriminatory.

Loan Classification and Provisioning

The guidelines provide that the credit classification and loan loss provisioning amount or percentage for an existing credit facility shall remain unchanged throughout the duration of a moratorium. The FICCP Regulations require SFIs to report to BOU on a quarterly basis on non-performing credit facilities. They are also required to classify loans into Normal Risk (Pass), Watch (Special Mention), Substandard, Doubtful and Loss categories according to specified criteria. SFIs then have to make special provisioning for the non-performing loans i.e. the Substandard, Doubtful and Loss categories. Provisioning means that the SFIs have to set aside capital to cover the losses from those non-performing loans.

It is expected that the effect of the pandemic on the borrowers' ability to pay will inevitably lead to some previously performing loan facilities slipping into the non-performing loan categories requiring the SFIs to make provisioning for them. The provisioning would then eat into the SFIs' capital and profits. As such, by maintaining the credit classification for affected facilities, we think that the guidelines offer relief to the SFIs that would have had to make significant provisions and it means they have more capital available for their business.

What the Guidelines Mean for Borrowers

Restructuring/Repayment Moratorium

The guidelines allow for Borrowers to approach their respective financial institutions for a restructuring of their loan facilities or for their loan repayment to be postponed for up to 12 months. As the SFIs still have the responsibility to assess a borrower's likeliness to default, borrowers whose payment ability has been affected by COVID-19, will do well to approach their SFIs with well thought out written plans for repayment and demonstrations of ability to pay that take into account the current circumstances.

The mandatory repayment of arrears before a loan facility can be restructured is also suspended. However, as part of the restructuring, SFIs are allowed to capitalize and recover the unpaid arrears less any associated penal interest or fees. This means that a lender may add the arrears to the principal amount and then charge interest going forward. By virtue of the flexibilities granted by the guidelines, the loan which would have otherwise been in default will not be treated as in default and therefore no penal or default interest will be charged on the arrears.

Borrowers who secure loan restructurings and moratoriums will need to obtain documentation from their lenders that

evidences the restructuring or the moratorium. This can take the form of among others, amendments or variations of the loan and security agreements. For completion and admissibility of the agreements as evidence in the courts of law, the relevant stamp duty will have to be paid and the agreements registered.

Credit Profile

According to the guidelines, the restructuring of a loan facility arising from the COVID-19 pandemic will not be treated as an adverse change in the borrower's credit risk profile and will not be reported to a Credit Reference Bureau ("CRB") as such.

The Financial Institutions Act, 2004 mandates BOU to establish a CRB for purposes of disseminating credit information among financial institutions. All financial institutions are required to report to the CRB all details of non-performing loans classified as Doubtful or Loss, and information on customers involved in malpractices including bouncing of cheques due to lack of funds and fraud.

The CRB provides information on the debtor's credit profile and repayment history, so that lenders can make informed decisions before allocating credit facilities. This in turn is meant to reduce default probabilities of borrowers and ultimately contribute to financial stability. In our view, the CRB also helps eliminate the risk of a moral hazard by and among borrowers. It is expected that borrowers are encouraged to honor their loan agreements lest they attract an adverse profile with a CRB. This negatively affects not just their ability to borrow in future but also their business reputation.

The CRB is empowered by the Financial Institutions (Credit Reference Bureaus) Regulations 2005 to collect negative information on the background and credit history relating to the non-performing obligations of persons, entities and other organizations. It is also permitted, with the authorization of the customer, to collect positive information regarding the economic, financial and commercial obligations of persons and enterprises to determine their overall debt exposure and capacity to pay.

This information may be shared with financial institutions to enable such financial institutions to make informed choices about the repayment compliance before offering a credit facility to borrowers.

Ordinarily, the restructuring or granting of a moratorium over a loan is likely to place it in a Doubtful category requiring the lender to report to the CRB that detail. In turn, the borrower's creditworthiness will be affected and they may not easily access the credit they require or may access it on less favourable terms and conditions.

The guidelines recognize the extraordinary circumstances occasioned by the pandemic by ensuring affected borrowers' creditworthiness remains the same as it was prior to the restructuring.

Fees

A borrower whose credit facility benefits from a restructuring in the 12 month in which the guidelines will prevail is only liable to pay the legal fees and stamp duty associated with the restructuring, but no other charges. Moreover any legal fees charged have to be shown to be reasonable. At the very least, this implies that borrowers will not have to pay higher legal fees than they ordinarily pay simply because they have been offered a restructuring because of the pandemic's effect on their ability to repay the loan. Borrowers will also not be liable to pay any other fees, such as arrangement fees, for the restructuring.

In the event that the restructuring requires certain statutory filings to be made, stamp duty may have to be paid upon registration of the documents. In that case, the Borrower will be liable to pay that stamp duty.

Interest

The guidelines offer some interest payment flexibilities to the borrower. They require that interest accrued during the

period of a moratorium shall be capitalized and amortised over the tenor of the credit facility that remains after the moratorium. In simple terms, this means that the interest which accrues on a loan during the period when repayment is suspended ("accrued moratorium interest") will be added to the principal amount and repaid over the remaining loan period when the moratorium ends.

However, the guidelines also demand that the recovery of the accrued moratorium interest shall be in such a manner that the expected periodic repayments after expiry of the moratorium do not in a comparable manner exceed those the borrower had contracted to make prior to the grant of the moratorium.

The SFI may then have to exercise either of two options to ensure that the borrower does not make higher periodic payments. One option is to ring fence the accrued moratorium interest so that further interest is not charged on it in the same way that the rest of the principal accrues interest. The other is to add the accrued moratorium interest to the principal but reduce the interest charged on the principal.

Conclusion

It is clear that the Government of Uganda through the BoU is concerned about the impact of the pandemic on the economy. The measures taken through the guidelines appear to provide good basis for credit relief to businesses and SFIs. The key is in translating the guidelines and measures into tangible outcomes for borrowers and lenders alike. In order to realise the benefits, careful and creative approaches to restructuring will be required.

As observed throughout this article, most of the measures covered by the guidelines are already regulated under the FIA and regulations made under it. It would be advisable for credit institutions and their borrowers to keep the provisions of the law in mind when applying the guidelines. They need to rely heavily on experienced professionals and approach the restructuring and the attendant mechanics in such a way as would benefit the creditors and provide the much needed relief to the borrowers as well as the economy. If approached and implemented well, the guidelines relief offer and opportunity will see Uganda's businesses eventually recover.

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