Box 2.1

CREDIT QUALITY OF EXPOSURES SUBJECT TO MATURITY EXTENSION AND GRACE PERIOD EXPIRY UNDER THE PUBLIC GUARANTEE PROGRAMME FOR LOANS TO NON-FINANCIAL CORPORATIONS

The public guarantee programme for loans to non-financial corporations was introduced by the Official Credit Institute (ICO) in response to the outbreak of the COVID-19 pandemic. The programme aims to mitigate the potential impact of the pandemic on the corporate sector, linked to the restrictions on activity imposed during different phases of the health crisis. Given the uncertainty over the duration and implications of the pandemic, these loans were originated at a relatively long maturity[1] and with the option to request an interest-only grace period, thus shoring up firms' liquidity during the particularly challenging early stages of the health crisis. Subsequently, in some cases the conditions of those guarantees were eased further, extending the maturity and the grace period, given the persistence of certain negative effects of the pandemic in 2021 and the various adverse geopolitical and economic developments that have arisen since.[2]

This greater flexibility in the State guarantee programmes was introduced through a number of regulations.[3] A portion of these relief measures served to reduce firms' debt burden at a time when other support measures, such as fiscal moratoria and furlough schemes, were coming to an end.[4]

This box aims to study the credit risk of firms that have benefited from a maturity extension or a grace period, based on the data available in the Banco de España's Central Credit Register. This is an important exercise at the current juncture, given that these firms might have resorted to such measures owing to a weakened financial position and may therefore have a higher latent credit risk.

ICO-backed loans with grace periods still in force in July 2022 accounted for just 5.6% of the drawn outstanding amount in December 2021, while those whose grace period had expired in the first seven months of 2022 accounted for 32.2% (see Chart 1, left-hand panel). Thus, the latter group represents the bulk of the loans that have benefited from a grace period at any time since 2020, for whom 2022 H2 represents a crucial period in terms of their credit quality. This owes to a higher debt service burden (since repayments will include the principal) and to a macroeconomic scenario that is expected to gradually become less benign due to the increase in both the cost of some inputs and of financing.

For maturity extensions, the ICO-backed loans that were outstanding in January 2021 and had a residual maturity of more than six months were tracked through to July 2022. These loans have been classified based on whether, in the period January 2021-July 2022, they benefited from a maturity extension or not. Credit quality developments can then be studied for each loan type. In July 2022, loans whose maturity has ever been extended represented 55.7% of the overall exposures (see Chart 1, right-hand panel).

Starting with the ICO-backed loans whose grace period expired prior to July 2022, their credit quality deteriorated

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1 According to the ICO monitoring report of May 2022, the loans under the "ICO Liquidity" guarantee facility had the following maturities: 34.4% between five and ten years, 38.4% between four and five years, 23.9% between two and four years and just 3.3% less than two years.

2 As at July 2022, the loans benefiting from maturity extensions under the Code of Good Practice (which regulates the different measures easing the conditions of guaranteed loans) increased by 13% in number and by 18% in amount as compared with the previous month. None of the loans underwent capital reduction or conversion into participating loans. A cumulative total of 12,655 loans have benefited from these measures to date, for an amount of €2,021 million.

3 Mainly Royal Decree-Law 34/2020 (see Box 2.2 of the Autumn 2021 FSR), Royal Decree-Law 5/2021 and Royal Decree-Law 6/2022. The specific eligibility conditions and requirements for the measures envisaged under Royal Decree-Law 5/2021, which included debt reduction, were subsequently determined in the Resolution of the Council of Ministers of 11 May 2021. Broadly speaking, the firms concerned could neither be in insolvency proceedings nor in arrears, and their turnover had to have fallen by at least 30% between 2019 and 2020. Firms not meeting that requirement could also apply for the measures, but granting them would be at the discretion of the financial institution since the Code of Good Practice would not apply. Royal Decree-Law 5/2021 allowed a further extension of two years if the firm had previously made use of the maturity extension under Royal Decree-Law 34/2020, or of five years otherwise. In either case, the maximum final maturity of the guaranteed loan was ten years (or eight where the State aid exceeds €2.3 million). Royal Decree-Law 6/2022 eliminated the requirement of a significant decline in revenue prompted by COVID-19 in order to qualify for these changes. It also envisaged the possibility of the Code of Good Practice determining the sectors, instances and circumstances in which the grace period can be extended by six months or an additional grace period can be established if the previous one has expired.

4 See European Systemic Risk Board (2021), *Financial stability implications of support measures to protect the real economy from the COVID-19 pandemic;* Financial Stability Board (2021), *COVID-19 support measures. Extending, amending and ending;* E. Rancoita, M. Grodzicki, H. Hempell, C. Kok, J. Metzler and A. Prapiestis (2020), "Financial stability considerations arising from the interaction of coronavirus-related policy measures", *Financial Stability Review,* November, Special Feature A; and E. Johannes and R. Zamil (2020), "Prudential response to debt under Covid-19: the supervisory challenges", *FSI Briefs,* 10, on the discussion of the effect of withdrawing these COVID-19-related relief measures.

as compared with December 2021. Specifically, measured in terms of amount drawn, the proportion of Stage 2 loans rose from 21.9% to 26.4% and that of non-performing loans from 3.6% to 5.7% (see Chart 2, left-hand panel). However, this performance does not differ greatly from that of total ICO-backed loans (see the black diamond in Chart 2, left-hand panel), although in this case the increase in the proportion of Stage 2 loans is somewhat smaller (from 20.3% to 23.2%). Overall, there is no indication that the grace periods coming to an end has entailed an abrupt deterioration in the quality of these loans.

From the sectoral point of view, and in relation to ICO-backed loans with expired grace periods, those extended to the sectors hardest hit by the pandemic had a higher proportion of both Stage 2 and non-performing loans at the outset (in December 2021) than ICO-backed loans

Chart 1
GRACE PERIODS AND MATURITY EXTENSIONS: SITUATION IN JULY 2022 (a)

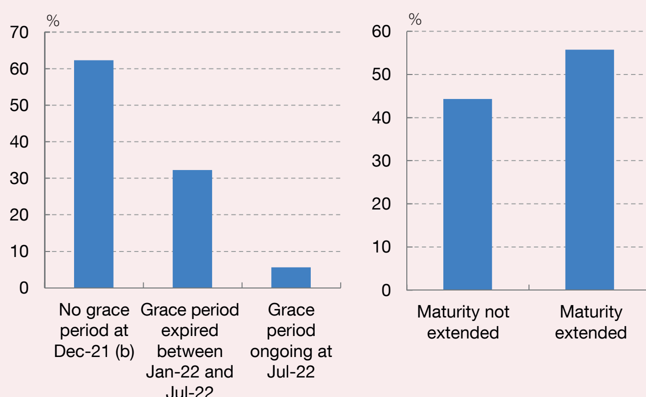


Chart 2
CREDIT QUALITY OF ICO-BACKED LOANS WITH EXPIRED GRACE PERIOD: TOTAL (l-h panel) AND SECTORS MOST AFFECTED (r-h panel)

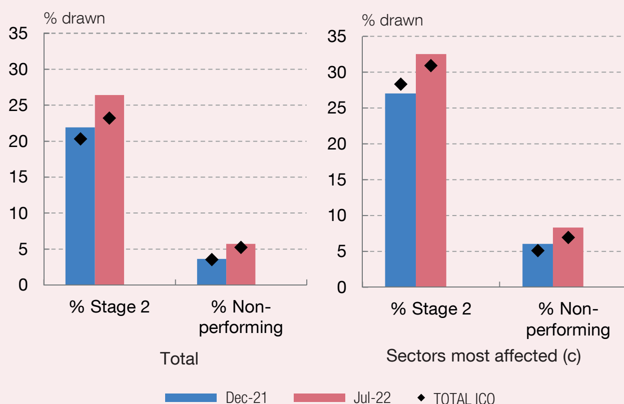


Chart 3
PERCENTAGE OF TROUBLED LOANS BY MATURITY EXTENSION: TOTAL (l-h side) AND SECTORS MOST AFFECTED (r-h side)

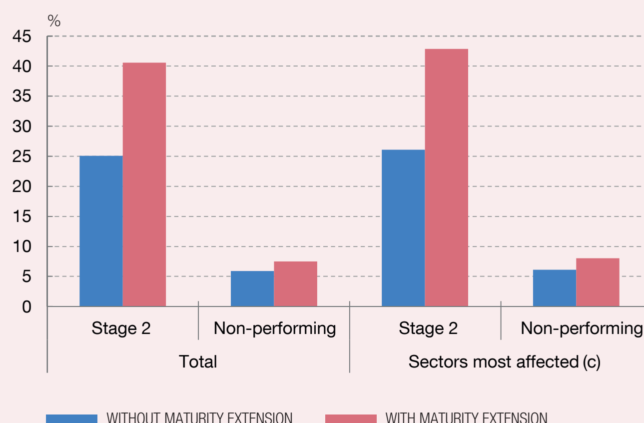
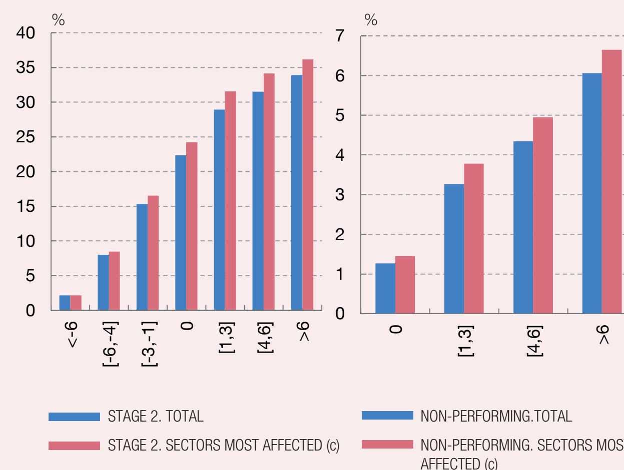


Chart 4
PERCENTAGE OF TROUBLED LOANS BY MOMENT OF MATURITY EXTENSION FROM JANUARY 2021 (d)



SOURCE: Banco de España.

a In the case of maturity extension, the ICO-backed loans that were outstanding at the start of 2021 and had a residual maturity of more than 6 months were tracked to July 2022. This allowed the loans to be classified based on whether they benefited from a maturity extension or not.
b December 2021 is used as a reference date prior to the expiry of most grace periods.
c The most severely affected sectors are proxied as the sectors with a fall in turnover of more than 15% in 2020, which can be identified in the FI-130 regulatory return. Specifically, lending to the most severely affected sectors includes hospitality, the manufacture of refined petroleum products, social services and entertainment, transportation and storage, and the manufacture of transport equipment.
d Percentage of Stage 2 or non-performing loans by date of first maturity extension (represented as t=0) from January 2021. The horizontal axis shows the number of months relative to this date of first maturity extension (t=0).

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overall. However, the subsequent increase in those proportions was on a par with those of overall loans with expired grace periods, standing at around 5 percentage points (pp) for Stage 2 loans and 2 pp for non-performing loans (see Chart 2, right-hand panel). In 2022 H1, these sectors particularly benefited from the absence of health restrictions, which may explain why they do not show a negative differential performance.

Turning to maturity extensions, 25.1% of the loans whose maturity has never been extended have been classified as Stage 2 at some point. This compares with 40.6% for extended-maturity loans. The percentage of the number of loans classified as non-performing at some point in the period analysed is also higher for the group of firms that have extended the maturity of their loans (7.5%) than for those that have not (5.9%). Further, this effect is somewhat more pronounced among firms in the sectors most severely affected by the pandemic (see Chart 3).

These extended-maturity loans are analysed to identify whether the described performance occurred only after the extension or, conversely, had been observed previously. This is significant because it indicates whether the firms' credit risk increased when the maturity was changed or whether the applicants for such extensions were firms in a worse situation ex ante.

Thus, the moment of the first maturity extension is identified for each loan benefiting from the flexibility measures under the royal decree-laws, and whether it was classified as Stage 2 or non-performing for certain time periods before and after that extension. This reveals that the credit quality of a high percentage of the ICO-backed loans benefiting from maturity extensions and classified as Stage 2 already showed signs of deterioration prior to the extension, and that said worsening continued thereafter. Further, this performance is more pronounced among the firms in the sectors hardest hit by the pandemic (see Chart 4). Loans classified as non-performing show a very similar pattern.

Therefore, maturity extensions signal firms' reduced ability to pay in the short term. However, to date this has materialised above all as a latent deterioration in the form of a higher share of Stage 2 exposures. As regards grace periods coming to an end, no significant materialisation of that risk has been observed after 2022 Q2, when the majority ended. However, these portfolios should be monitored on an ongoing basis, first, because the deterioration resulting from the end of the grace periods could take place over a longer time frame and, second, because these exposures, like those with maturity extensions, might be affected to a greater extent by the potential deterioration of the macro-financial environment.