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Supporting the flow of credit during COVID-19

Reporting Update

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Highlights

- The Australian Government is taking steps to support the flow of credit
- Key programs include the SME loan guarantee, the RBA funding facility, and a fund set up to purchase asset backed securities
- Other measures include the easing of compliance and administrative pressures
- The accounting implications arising from these measures can vary and may require careful consideration

Initiatives to ensure the flow of credit continues

Australian Government's measures to support the flow of credit

As part of their economic response to the coronavirus pandemic, the Australian Government, its agencies and the banking industry itself are taking actions to ensure the flow of credit continues through the economy.

In particular the measures are focussed on ensuring small and medium enterprises (SMEs) continue to be able to access credit as this will be critical to their ability to survive and emerge from the other side of this crisis.

To date, the initiatives to support the flow of credit include the:

- Coronavirus SME guarantee scheme
- Reserve Bank of Australia's Term Funding Facility
- Establishment of the Structured Finance Support Fund which will be administered by the Australian Office of Financial Management
- Temporary exemption from responsible lending obligations and relaxation of expectations surrounding capital targets
- Provision of an Export Capital Facility directly to businesses, and
- Australian Banking Association's Small Business Relief Package which includes the deferral of loan repayments.

This publication provides an overview of the associated accounting implications of these programs.

More detail on the various schemes can be found here.

The Government will guarantee 50% of new loans to SMEs

Coronavirus SME guarantee scheme

What is it?

The Government will provide eligible lenders a guarantee of 50% for **new** unsecured loans provided to SMEs with a maximum term of three years and an initial six month repayment holiday. Loans will be granted in accordance with lenders' normal credit approval process and the interest rates set will take into consideration the Government guarantee, and interest will capitalise during the repayment holiday.

Under the scheme, the Government will compensate the lender for 50% of any losses incurred and this amount can be claimed at the earlier of write- off or impairment.

Accounting implications for lenders

Measurement of loan assets and accounting for Government assistance

As new loans provided under the Coronavirus SME guarantee scheme will be priced at a market rate of interest that considers the benefit derived from the Government guarantee, the guarantee is seen as an integral part of the loan asset. This means that only a loan asset is recognised by the lender, and it does not separately recognise a government grant under AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*.

The guarantee impacts the **measurement** of expected credit losses (ECLs) associated with the loan by reducing the amount that the lender may expect to lose in the event a default occurs, that is, it affects the "loss given default" estimate.

Disclosure

The disclosure of information about the credit enhancement held on such loans will enable users of financial statements to understand how the credit risks are being managed. This may be achieved by providing a narrative description of the nature, extent and duration of the guarantee, the volume of loans covered by the guarantee and how the guarantee impacts the estimation of ECLs. This includes quantifying the extent to which the guarantee mitigates the credit risk for loans that are credit impaired at the reporting date.

Accounting implications for SME borrowers

Measurement of loan payable and accounting for Government assistance

Borrowers recognise the loan payable at fair value which is the face value or amount of cash received. This is based on the assumption that as the interest rate is set by the lenders taking into account the terms of the guarantee, the interest rate inclusive of any fees paid reflects a commercial rate of interest.

There is discussion on whether borrowers should recognise a government grant for the government guarantee. Consistent with the example in AASB 120 that a government guarantee is a form of government assistance which cannot be reasonably valued, such government guarantees are excluded from government grant accounting[1].

Disclosure

Borrowers should consider including information about the nature and extent of government assistance received and how it has been accounted for in the financial statements. As part of the liquidity management disclosures, the payment profile of the funding arrangement is included in the maturity analysis of liabilities.

ADIs have access to funding

Reserve Bank of Australia's Term Funding Facility

What is it?

Under the RBA's term funding facility (TFF), authorised deposit-taking institutions (ADIs) will have access to at least $90 billion in funding for three years at a fixed interest rate of 0.25 per cent. This will reinforce the benefits of a low cash rate by reducing funding costs, which in turn will help reduce interest rates for borrowers.

[1] Alternatively if there is a government grant, the borrower may elect to offset the benefit against the related interest expense over the term of the funding. Accordingly, the net interest expense will reflect the amount payable on the loan.

All ADIs that extend credit are eligible to participate in the TFF with the only condition being that the ADI must back the borrowings by nominating eligible securities as the collateral for the loan.

Accounting implications for lenders

Measurement of loan payable and accounting for Government assistance

Generally, such arrangements are accounted for as borrowings, with the securities pledged as collateral. There are no substantive conditions attached to the ongoing use of the TFF and it is not linked to the provision of specific loans to customers.

There is debate whether there is a government grant, that is, whether the arrangement is a below market interest loan from the Government.

Under government grant accounting, an ADI may elect to offset the benefit from a below market rate of interest against the related interest expense over the term of the funding. Accordingly, regardless of whether the cost of funding is at market, the net interest expense will reflect the cost of borrowing of 25 basis points.

Disclosure

Disclosure about the nature of this facility, the extent it has been drawn upon and how the lender accounts for the arrangement may provide useful information to users about the different funding sources available to the organisation.

If it has been drawn upon, AASB 7 *Financial Instruments: Disclosures* has specific disclosure requirements on, for example, the assets pledged as collateral such as the carrying amount and the terms and conditions of the pledge (the loan-to-value ratio required to be maintained and the duration of the pledge). The payment profile will also be included in the maturity analysis for liabilities.

Non-ADI lenders and smaller ADIs will be supported by purchases of asset backed securities

Structure Finance Support Fund

What is it?

The Government has established the Structured Finance Support Fund with funding worth $15 billion, which will be administered by the Australian Office of Financial Management (AOFM). The funds will be used to invest in securities issued in securitisation markets by smaller lenders, including non-ADIs and smaller ADIs that are not able to access the RBA's TTF.

Accounting and disclosure implications

Lenders assessing this type of securitised funding commonly create a securitisation vehicle so that it can transfer its loan assets to this vehicle, and the vehicle issues loan-backed securities into the securitisation market. Generally the lender will consolidate the securitisation vehicle and account for the arrangement as borrowings.

The accounting and disclosure implications for lenders accessing this funding are similar to those for ADIs assessing the RBA's TTF. The net interest expense will reflect the amount payable to the SFSF regardless of whether there is a government grant if the lender elects to present the benefit net of the related interest expense.

Disclosure

Disclosure about the nature of the arrangement, the amount the organisation has borrowed from this market and how it accounts for the arrangement provide useful information to users. For example, it provides information about the lender's management of liquidity risk.

There are other disclosures such as including the payment profile of the funding into the maturity analysis for liabilities and information about the assets pledged as collateral.

Forbearance Special Purpose Vehicle (SPV)

The AOFM is currently working with the Australian Securitisation Forum to find a solution to assist securitisation vehicles that are impacted by cash flows collections from the underlying loans due to COVID-19. The AOFM is considering investing in a newly constituted industry wide "Forbearance" SPV. Lenders looking to access the funding from this SPV will need to consider the details of the arrangement once finalised to determine the accounting implications.

Other schemes

Temporary exemption from responsible lending obligations

Consider impact on ECL estimates

What is it?

Lenders have received a temporary exemption from responsible lending obligations for the provision of credit to existing small business customers. This exemption is for six months, and applies to any credit for business purposes, including new credit, credit limit increases and credit variations and restructures. This change is designed to help small businesses get access to credit quickly and efficiently.

Accounting implications

There are no specific accounting or disclosure impacts arising from this scheme. This exemption provides administrative relief to lenders, there is no government assistance nor does it impact the fair value of loans granted to borrowers as the loans are expected to be priced at market rates.

However, there may be flow-on measurement effects such as the estimation of ECLs on loans originated under this exemption.

APRA adjusts bank capital expectations

What is it?

APRA has announced temporary changes to its expectations regarding bank capital ratios.

Provided banks are able to demonstrate they can continue to meet their various minimum capital requirements, APRA has acknowledged that they may need to utilise some of their current buffers to facilitate ongoing lending to the economy during this period of disruption caused by COVID-19.

Accounting and disclosure implications

Whilst there is no specific accounting or disclosure impact arising from this announcement, any changes to a bank's capital structure and capital ratios will flow through to the relevant capital management disclosures in the financial statements.

Export capital facility

What is it?

The Australian Government has established a $500 million COVID-19 Export Capital Facility to assist previously profitable Australian exporters whose businesses have been impacted by COVID-19. Exporters will be able to access loans from $250,000 to $50 million under the Facility as well as bonds and guarantees.

The interest rate on the facility will be a competitive, commercial interest rate depending on the risk profile of the business and debt servicing capacity. Deferrals of principal and interest repayments may also be available, depending on the circumstances.

Accounting and disclosure implications

There is no separate government grant for loans provided by the Government at a market rate of interest.

Depending on the significance of the facility to the organisation's operation, an entity may disclose the nature, extent and duration of the arrangement as a form of government assistance and include the details of this facility in its liquidity risk management policy discussion.

Australian Banking Association's (ABA) Small Business Relief Package

What is it?

The Australian Banking Association (ABA) announced a relief package to help small businesses. Assistance includes the deferral of scheduled loan repayments and the waiving of fees and charges.

Accounting and disclosure implications

Consider disclosures during this period of uncertainty

The accounting and disclosure implications will vary depending on the nature of the assistance provided.

Where the contractual terms of a lending arrangement have been amended in order to provide relief, both the lender and the borrower will need to assess whether the amendments constitute a modification that is deemed "substantial".

The assessment of whether a modification is substantial or not may be different from the perspective of the lender compared to the borrower as there is specific accounting guidance for the borrower. However, for both the borrower and the lender, where a modification is deemed "non-substantial", the loan is re-measured using the original effective interest rate and a profit or loss may arise. Conversely, where there is a substantial modification, the entity will de-recognise the existing loan and recognise a new loan at fair value based on a market rate of interest (any change in carrying amount will be recognised in profit or loss).

The accounting for modifications, and the associated costs and fees, can be complex and requires careful consideration.

"The Australian Government and the banking industry are focussed on ensuring that businesses are able to continue accessing credit during the current crisis and have announced a number of different initiatives aimed at achieving this objective. For borrowers and lenders participating in these programs, consideration will need to be given to the potential accounting implications – not just in terms of recognition and measurement but also in terms of disclosures, which will be important during these uncertain times".

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