



Leibniz Institute for Financial Research SAFE  
Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

## SAFE Finance Blog

### Making greater use of banks in times of crises

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Thomas Huertas: Some simple steps on how to prevent the coronavirus pandemic from causing a financial crisis



The measures imposed to halt the spread of Covid-19 threaten to stop the global economy in its tracks. Governments and central banks have already introduced massive support programs but they are struggling to get cash to companies, and some of the aid is expiring. We can address both problems by making greater use of banks. Here are some practical ways we can do that.

#### **Speeding up money transfers into businesses**

First, use banks to move money quickly into the hands of businesses, especially small and medium sized enterprises (SMEs), so they can pay suppliers and meet current expenses. To do so, governments should guarantee 100 percent of credit extended to smaller and micro enterprises and simplify the application

process, as Germany and the UK have done. Central banks should then confirm they are willing to accept such guaranteed loans as collateral. Banks must then integrate the origination and servicing of these loans into their procedures and processes. Taken together, these steps will accelerate disbursement so that money can reach companies while it can still do some good.

Second, it is rapidly becoming clear that SMEs will need the option to extend the maturity of loans that come due while the restrictions are in effect. Ordinarily, they would have to pay a premium to do so and post additional collateral on terms negotiated with the bank. However, there is no time to conduct such individual negotiations. Therefore, central banks should encourage banks to do this by increasing the interest it pays on the bank's reserves, provided it gives eligible borrowers the right to extend the maturity of any obligation due before the end of the year.

### **Credit extensions**

Banking supervisors should instruct each bank to take this option and assure the lenders that the maturity extension will not push these loans into the non-performing category, nor raise the capital charges for loans to punitive levels. Collateral posted by the borrower should continue to support existing credits, not be diverted to support the new government-guaranteed credit. This will help prevent "good" borrowers from going into administration while quarantines are in effect.

Over the next year, as restrictions are eased, government support for the economy should taper off. Loans under the 100 percent guarantee scheme outlined above must either be repaid or refinanced on commercial terms. Banks should triage their credit portfolio into two categories: loans that are performing and are likely to stay that way, and those that are non-performing or likely to become so.

### **Non-performing loans**

To handle the latter, banks will need to scale up their non-performing loan (NPL) organizations, increase the staff devoted to helping borrowers work out of debt and build in controls to ensure that workouts conform to conduct regulations. Banks did this successfully in the 2008 financial crisis, but workouts this time around will probably have a greater order of magnitude and span a wider range of sectors. Many companies will need some form of recapitalization as part of this process, so that they emerge without a significant debt overhang.

### **Draw a line under the crisis**

Beyond these short-term measures, authorities will need to draw a line under the coronavirus crisis at some point. To do so, governments should create asset protection schemes that will — in exchange for a premium paid by banks — cap the loss that banks could incur on non-performing loans. In addition, governments should create asset management companies that can conduct workouts on a collective basis so as to maximize value.

Both the schemes and companies involved should be subject to a public interest test and conform to new state-aid rules put in place to deal with the current crisis. Such a program would strengthen banks as well as lower the risk to deposits and deposit guarantee schemes.

Taken together, these practical steps will speed up the implementation of measures that governments have already announced and diminish distress for borrowers. They will also help keep banks safe and sound. We can prevent the health crisis from causing a banking crisis. This will make the recession shorter and shallower, as well as revive the economy sooner.

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