BANKING & FINANCIAL SERVICES - AUSTRIA

COVID-19 pandemic and banking in Austria – lessons learned?

14 July 2020 | Contributed by Schima Mayer Starlinger

AUTHOR

Stephan Schmalzl

Introduction
What has happened – banking regulation as an obstacle for banking in distressed situations?
Bad banks – a reasonable alternative scenario?

Introduction

Austria was one of the first EU countries to be affected by the COVID-19 pandemic and the government imposed a large-scale lockdown affecting almost all areas of public, work and private life. The domestic economy faced and still faces unprecedented hurdles, including revenue cuts – almost to zero in some cases – in virtually every industry, including the service industries.

To mitigate the financial effects of the pandemic, the government initiated a significant subsidy programme which aimed to provide expedient assistance to parties that needed it. A significant part of the (initially) €28 billion (plus an additional €10 billion in suspended tax) subsidy programme was structured as government guarantees for bridging loans to be granted by banks to provide the economy with liquidity. Now, less than three months after the start of the programme, small and medium-sized enterprises (SMEs) regard this approach as disastrous, with many complaining that the granting of loans has been slow and cumbersome, despite the state guarantee, if a loan has been granted at all.

What has happened – banking regulation as an obstacle for banking in distressed situations?

Starting with the financial crisis in 2008, banking regulation has increasingly restricted banks' freedom of movement when granting loans and has led to ever-higher demands on the credit worthiness of borrowers. EU and Austrian financial market regulators have recognised that these high-level requirements may cause a systemic problem on the banking industry in this worldwide distressed situation. Accordingly, the European Central Bank (ECB) and the Financial Market Authority issued statements supporting all initiatives aimed at providing sustainable solutions to temporarily distressed debtors in the context of the current crisis, also offering supervisory flexibility regarding the treatment of non-performing loans, in particular to allow banks to benefit fully from guarantees and moratoria put in place by public authorities.

Further, the Austrian legislature enacted new laws:

- providing for a statutory two-month moratorium on repayments and interest payments;
- providing for a statutory limitation of interest on arrears; and
- prohibiting debtors' obligations to reimburse costs for collection.

In addition, legislative measures were enacted to ensure that unsecured bridging loans dedicated to ensuring that the (unbureaucratic) interim financing of wages until public short-time work subsidies are paid out are not subject to challenge in insolvency proceedings.

However, these measures were insufficient. The statutory moratorium was limited to consumer credits or micro entrepreneurs (ie, SMEs) which faced, in case of a delay of or failed repayment of an existing loan, an acceleration of the need to ask banks for an adequate waiver or deferral. Although the EBA proposed that banks provide individual assessments "in a careful manner, which does not entail any automatism", Article 178 of the EU Capital Requirements Regulation (575/2013) (CRR) nonetheless imposes strict obligations on banks when determining an obligor's default. In particular, the assessment that an obligor is unlikely to pay its credit obligations and convince banks that a business model is sustainable became major, almost insurmountable obstacles for SMEs experiencing major slumps in sales or which have no income at all, but have to pay employees, rent,

mortgages and service loans without any reliable evidence on how long the COVID-19 pandemic will affect their business. Accordingly, obtaining a bridging loan with the (partial) state guarantee under the COVID-19 measures was problematic, but maintaining pre-existing loans also set a high barrier for entrepreneurs. Finally, the statutory requirements for granting such subsidies barred businesses on the brink of insolvency from receiving a loan. From an economic point of view, the reluctance to disburse new loans also cut banks' potential revenues needed to cover future risks, and as such may not have been the wisest business decision.

However, this should not be understood to imply that banks alone are to blame for the liquidity problems of SMEs. Rather, the situation is rooted in the fact that less than optimal legislation and an attempt to avoid direct subsidies delegated tasks to banks which, after 10 years of ever tighter regulation, are too afraid to share the risks that COVID-19 poses to the overall economy.

Bad banks – a reasonable alternative scenario?

Following the credit crisis, several countries set up bad banks to manage impaired assets in an orderly manner and outside the scope of the expensive requirements under the CRR and with a view to participating in positive economic developments of the impaired assets. In particular with respect to banks, equity-like instruments (eg, participation capital) were used to improve the equity side of balance sheets without directly giving the state a say in the management of banks.

Looking at the rather weak success of the liquidity supply measures – despite the undeniable efforts of the banks and further considering that at most a state continues to be creditworthy during the COVID-19 pandemic while enterprises without turnover are not – a combined approach seems to be the preferable solution: a state owned 'bad bank' or state fund offering liquidity by way of granting (repayable) equity instruments to SMEs, thereby improving debtor's equity could work wonders. An improved equity side could facilitate credit approval by banks and also leverage the credit amount granted.

However, this is not the only solution; other countries chose better and faster solutions. According to the finance minister, almost 20,000 applications for governmental guarantees were submitted and the approved total volume amounts to approximately €4 billion. By the end of June 2020, the aggregate amount (including tax suspensions) had reached approximately €24 billion. In Switzerland, where the federal government also provides guarantees for COVID-19 bridging loans, figures show that credit funds were disbursed much faster. According to the Swiss Department of Finance, approximately 125,400 loans with a total volume of Sfr15 billion had been granted by the end of March 2020 – more than three times as much as in Austria and as such an expedient assistance to those that needed it.

For further information on this topic please contact Stephan Schmalzl at Schima Mayer Starlinger by telephone (+43 1 383 60) or email (stephan.schmalzl@sms.law). The Schima Mayer Starlinger website can be accessed at www.sms.law.

The materials contained on this website are for general information purposes only and are subject to the disclaimer.