

The end of non-classification of restructured loans: What next for lenders and borrowers?

The emergency measures announced by the Central Bank of Kenya (the **CBK**) in March 2020 have lapsed. The measures were intended to enable banks to work with their customers to alleviate the adverse effects they may face from Covid-19 while safeguarding the strength of the banking system.

The measures included restructuring by banks of loan facilities that were performing as at 2 March 2020. Banks were given room to determine the reliefs that they will grant to individuals, SMEs and corporate borrowers based on their specific circumstances, subject to certain restrictions. Where the relief granted for a personal loan was an extension of the repayment period, the maximum extension period was one year from 2 March 2020. Additionally, all loans restructured due to Covid-19 were not to be subject to the loan classification criteria of CBK Prudential Guideline CBK/PG/04 for a period of one year from 2 March 2020 - specifically, clause 3.2 (classification of loans), 3.3 (classification of categories) and 3.5 (classification of renegotiated loans and advances) of that Guideline.

The measures expired on 2 March 2021 and the CBK has issued guidance on the expiry of these emergency measures via a [press release](#) dated 23 March 2021.

Under ordinary circumstances, loans would be classified into one of 5 main categories: Normal, Watch, Sub-standard, Doubtful and Loss. Restructured loans will usually remain in the same class in which they were before the restructure although the loans can move to a better classification if past dues (principal and interest) are settled by the borrower within a certain timeframe.

Loans classified as sub-standard, doubtful and loss are considered to be non-performing loans and Banks are required to provision for such loans at a minimum of 20% for sub-standard and 100% for doubtful and loss loans. The impact of provisioning on a bank's P&L is that the more provisions a bank has to take, the lower its profits become. The CBK emergency measures regarding non-classification therefore helped banks to have more cash at their disposal.

Now that the CBK deadline of 2 March 2021 has lapsed in relation to non-classification of restructured loans, what can we expect? For starters, banks are likely to be more cautious about on-boarding new clients or new loans from existing clients. We are also likely to see banks take more provisions in 2021. For restructured facilities, we expect that restructuring fees going forward will be passed on to borrowers. The CBK had previously shielded borrowers from such fees by requiring the fees to be borne by banks.

Where loans are restructured due to the impact of Covid-19, there may be different pricing implications for borrowers because of a change in the borrower's risk profile – especially if the loan tenor is increased.

In terms of enforcement, we may also see banks taking more enforcement actions on collateral in 2021 in spite of the slump in the real estate market. Other remedies that banks are likely to take against defaulting borrowers include calling on guarantees, commencement of legal action for debt recovery or institution of insolvency proceedings.

Following the new partial lock down restrictions imposed by the Government of Kenya on 26 March 2021, the CBK has indicated that it is keeping an eye on the impact that these new restrictions will have on the market and if additional relief measures are needed, the CBK is ready to take action. Importantly the CBK has indicated that it will be a delicate act to balance the need for additional relief measures against the cost of those measures- and the cost here is potentially to the bank depositors.

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