



Banking Credit Restructuring in Indonesia: Quo Vadis?

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Abstract

This research aims to analyze the impact of Coronavirus Disease (Covid-19) on the accounting practices in banks associated with Indonesian Financial Accounting Standards (PSAK) 71 – Financial Instrument, particularly the allowance for impairment losses (CKPN) to respond to the Indonesian Financial Service Authority's Regulation (POJK) Number: 11/POJK.03/2020 concerning credit restructuring program and quality assets assessment. The research methodology is triangulation. This study reveals that the restructuring program helps banks from a significant jump of weak quality credits. Banks need to analyze the recovery rate of debtors as a basis for the stage of PSAK 71 with the Expected Credit Loss approach. The higher the CKPN, the smaller the net income. Besides, a tremendous amount of CKPN will pressure the Capital Adequacy Ratio (CAR). Therefore, shareholders should increase the capital, or the Indonesian Financial Service Authority (OJK) forces the bank(s) into a merger or acquisition.

Keywords: *Banking Credit; Covid-19; PSAK 71; restructuring policy*

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Introduction

The Coronavirus Disease 2019 (Covid-19), originating in Wuhan in December 2019, has spread quickly worldwide and become a major public health challenge (Meng et al., 2020; Singh & Misra, 2020). Governments in many countries begin implementing strict policies to reduce Covid-19 cases after the World Health Organization (WHO) declared it a global pandemic on March 11, 2020. These, therefore, negatively affect the global economy that relies on international trade and cooperation (Ibn-Mohammed et al., 2020). Furthermore, the outbreak has reduced social interactions and activities.

In Indonesia, Covid-19 erodes the economy. The weak growth of Gross Domestic Product (GDP) in the first three months in 2020 signals that the economy is at risk and potentially plunges into recession. This situation influences the capability of debtors, including Small and Medium-sized Enterprises (SMEs), to repay their loans that would have a direct and indirect impact on the performance of the banking sector and the stability of the financial system in Indonesia (Disemadi & Shaleh, 2020). (Disemadi & Shaleh, 2020).

The Indonesian Financial Service Authority (OJK) responds by issuing regulation number 11/POJK.03/2020 concerning National Economic Stimulus as a Countercyclical Policy Impact of the Spread of Coronavirus Disease 2019. There are two main points in the stimulus policy. First, assessing the quality of productive assets such as credit and financing is only based on the ability to pay principal and/or interest payments for credit and financing up to IDR 10 billion. Second, restructured credits are categorized as performing loans. In October 2020, OJK announced to extend the loan restructuring program until March 2022.

Besides, banks have just started to implement Indonesian Financial Accounting Standards (PSAK) 71 – Financial Instruments on 1 January 2020. It has significantly changed banking accounting practices, particularly the credit impairment method. By adopting Expected Credit Loss (ECL), banks need to establish more significant credit impairment than previous standards (Rizal & Shauki, 2019).

A few research studies related to banking and Covid-19 in Indonesia capture risk management for restructured credits Disemadi and Shaleh (2020) focus on credit risk management by preventing risks through various schemes. However, with the increasing number of restructured loans, the allowance for impairment losses (CKPN) also becomes essential. It is one of the main aspects of credit risk management that is crucial for sustainability and the growth of the bank's business (Van Greuning & Brajovic Bratanovic, 2020).

Covid-19 will impact increasing Non-Performing Loans (NPLs) due to decreased productivity of the debtors to pay in installments. Thus, restructuring

credit policy will help both debtors and banks (Bidari & Nurviana, 2020). Tahliani (2020) that banks can minimize the NPLs to survive during the Covid-19 pandemic by restructuring credits, referring to POJK Number: 11/POJK.03/2020. However, it neglects credit risk management. Therefore, this research primarily analyzes the impact of the Covid-19 on the accounting practices in banks associated with PSAK 71 for credit impairment losses based on the ECL approach in managing the loan risks to respond to the extension of POJK Number: 11/POJK.03/2020.

Method

This research employs the triangulation method that refers to a study combining various data sources to develop a comprehensive understanding (Patton, 2002). This research not only examines POJK Number: 11/POJK.03/2020 concerning National Economic Stimulus as a Countercyclical Policy Impact of the Spread of Coronavirus Disease 2019 and its implication on the accounting practices in banks associated with PSAK 71 for credit impairment losses based on the ECL approach but also explore the impact of the pandemic on the accounting practices regarding IFRS 9 in the United Kingdom (UK), the European Union (EU), and Malaysia. The collection technique of qualitative data is library research or literature study. It is a technique of collecting, summarizing, and processing library documents (Zed, 2008). Besides, this study uses quantitative secondary data obtained from OJK, such as NPLs and Covid-19 restructured loans in Indonesia, to provide a comprehensive discussion.

Empirical Result

The OJK predicts that the massive spread of Covid-19 in Indonesia significantly impacts debtors' ability to pay off their loans because of a sharp decline in economic and social activities (Indonesian Financial Service Authority, 2020). Tight restriction in many regions harms SMEs as well. This situation affects Indonesia's economic growth. Indonesian Statistics reports that GDP growth contracts deeply for two consecutive quarters. It falls to -5.32% (YoY) in the second quarter of 2020 and -3.49% (YoY) in the third quarter of 2020.

A study by Ginting (2017) shows a strong correlation between GDP growth and the ability of debtors to pay in installments that influence NPLs. The lower the growth, the higher the NPLs. An increase in NPLs would hit the performance of the banking sector and slap the stability of the financial system in Indonesia. Therefore, the OJK issues regulation POJK No. 11/POJK.03/2020 concerning National Economic Stimulus as a Countercyclical Policy Impact of the Spread of Coronavirus Disease 2019.

The countercyclical policy is to restrain high economic growth during the expansion phase and accelerate low or negative economic growth during the contraction phase (Yoel, 2016). A countercyclical policy aims at maintaining the resilience of the whole financial sector to overcome systemic risks due to the failure of financial institutions or markets that have a potential impact on causing an economic crisis.

POJK Number: 11/POJK.03/2020 focuses on asset quality assessment and restructuring credit. First, assessing the quality of productive assets such as credit and financing is only based on the ability to pay principal and/or interest payments for credit and financing up to IDR 10 billion. This regulation temporarily replaces the assessment of credit quality in POJK No. 40/POJK.03/2019 concerning Assessment of Banking Assets Quality based on three pillars, namely business prospect, debtors' performance, and debtors' ability to pay.

Second, banks can determine restructured credits as performing loans for debtors affected by Covid-19, including SMEs. Even loans that are restructured because of Covid-19 before OJK issues regulation can be categorized as performing loans. It would help banks avoid a significant jump of NPLs that affect their financial stability due to an increase in credit impairment. Credit restructuring schemes refer to POJK Number: 40/POJK.03/2019 concerning Assessment of Banking Assets Quality by lowering the Credit interest rate, increasing the Credit period, reducing the principal, reducing the interest, adding credit facilities, converting credit to Temporary Equity Participation (PMS). The credit restructuring realization is as follows.

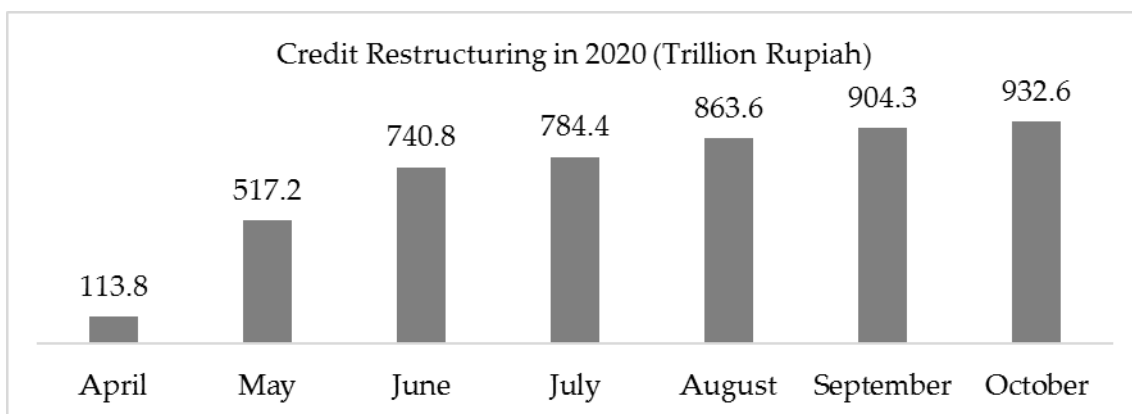


Figure 1. The development of restructured credit in 2020.

Based on the chart above, since the OJK issues POJK Number: 11/POJK.03/2020 in March 2020, banks and debtors respond quickly to the credit restructuring program. In April 2020, the restructured loans were Rp 113,8 Trillion. It jumps by 350% and reaches Rp 517,2 Trillion in May 2020. In the third quarter of 2020, the restructured credits hit more than Rp 900 Trillion.

Until October 2020, the trend still shows an increase even though its growth starts to slow down. The tremendous amount of restructured loans and economic uncertainty urge the OJK to extend the program's deadline until March 2022.

Furthermore, the Indonesian banking sector effectively implements PSAK 71 adopted from International Financial Reporting Standard (IFRS) 9 Financial Instruments on 1 January 2020. It replaces PSAK 55 – Financial Instruments. The significant difference between PSAK 71 and PSAK 55 is the methodology in determining credit quality information (Witjaksono, 2018). PSAK 55 applies Incurred Credit Loss (ICL) while PSAK 71 adopts ECL.

The ICL is that banks create the CKPN when objective evidence of a decline in credit quality, such as payment arrears and defaults. A strict management policy on the impairment and the application of ICL will recognize the CKPN when the Probability of Default (PD) is close to 100% (too late) (Novotny-Farkas, 2016). It makes the banking industry late in establishing CKPN that causes the 2008 global financial crisis. The CKPN is important as it is a provision to deal with the risk of loss resulting from investment in productive assets and maintain bank financial stability (Napisah, 2020). As a result, the ECL requires banks to periodically estimate CKPN on past loss experiences and current conditions and forward-looking information about expected events (Gomaa et al., 2019).

Besides, PSAK 71 introduces three stages of the allowance for credit losses (Surjaningsih et al., 2018). Stage 1 for performing loans with 12-month ECL, stage 2 for underperforming loans with lifetime ECL, and stage 3 for impaired loans with lifetime ECL. Referring to these stages, the issuance of POJK Number: 11/POJK.03/2020 is appropriate. In January 2020, the banking sector in Indonesia had faced low quality of credits, although NPLs remain stable below 3%. The table is as follows.

Table 1. The Proportion of credits in stages of PSAK 71 as of January 2020

	Stage 1	Stage 2		Stage 3
Category	Performing Loans	Performing Restructured	Special Mention	NPLs
Proportion	88.8%	2.6%	5.8%	2.8%
Allowance Method	12-Month ECL	Lifetime ECL		

Source: Calculation results from the Indonesian Banking Statistics (SPI), provided by OJK

Table 1 shows that 8.4% of total credits, the summation between Performing Restructured and Special Mention, is in Stage 2, and the NPLs or Stage 3 is 2.8%. Thus, the total proportion of loans in Stage 2 and Stage 3 is

11.2%, known as low-quality credits in January 2020. Although the NPLs are below 3% before the pandemic, the low-quality credit is above 10%.

In a normal situation, debtors that request to restructure their credits become a Significant Increase in Credit Risk (SICR) signal. It means that the loans will move from Stage 1 to Stage 2. Therefore, the bank should provide higher CKPN as it requires lifetime ECL. Low-quality loans above 10% at the beginning of 2020 and massive application for credit restructuring will influence banks' financial performance and make instability of the whole financial system exacerbate Indonesia's economy.

In a pandemic condition, however, POJK Number: 11/POJK.03/2020 regulates that restructured credits are categorized in performing loans that remain in Stage 1. Thus, CKPN does not increase sharply. Besides, the Institute of Indonesia Chartered Accountants (IAI) has published a press release concerning the impact of Covid-19 on the implementation of PSAK 71 that restructured loans in this situation does not immediately indicate SICR because the regulator's issue policies that permit debtors to postpone the payment of installments (Institute of Indonesia Chartered Accountants, 2020).

It is the same as the UK and EU responses to Covid-19 and ECL provisions. In the UK, for instance, the Bank of England (BoE) states that ECL provision should not be judged in isolation. However, the market is in a downward trend influencing the ability of debtors to pay because governments and central banks intervene to minimize the negative impact of Covid-19 on individuals and firms (Bank of England, 2020). Similarly, in the EU, the European Securities and Markets Authority (ESMA) emphasizes that suspension or delays in payments should not be considered an automatic trigger of SICR (European Securities and Markets Authority, 2020).

The Basel Committee on Banking Supervision (BCBS) also asserts that banks should use the flexibility inherent in IFRS 9 because standard ECL measurement is not proper in these circumstances (Basel Committee on Banking Supervision, 2020). While the UK and EU regulators promote the guidance to delay IFRS 9, the International Accounting Standards Board (IASB) strengthens the implementation of IFRS 9's principles for ECL. They recommend entities whose regulators have published guidance commenting on the implementation of IFRS 9 during the Covid-19 outbreak to consider that guidance because the estimation of ECL based on reasonable and supportable information provides transparency to users of financial statements (International Accounting Standards Board, 2020). Great uncertainty conditions and interference of banking regulators affect the fundamental financial reporting of banks worldwide (Barnoussi et al., 2020).

In Malaysia, although the Malaysian Accounting Standards Board (MASB) states that it is inappropriate to directly assume restructuring or

rescheduling loans as lifetime ECL in which the regulator allows payment moratoriums, entities should consider whether obligors affected by Covid-19 could enable to continue regular payments in the foreseeable future (Malaysian Accounting Standards Board, 2020). Besides, in Indonesia, the IAI has that measurement of reliable ECL based on the ability of banks to predict the risks and probability of default is essential to provide transparency of financial statements (Institute of Indonesia Chartered Accountants, 2020). Reliable ECL assessment leads banks to quickly establish the CKPN to deal with the uncertain situation that potentially causes instability domestic financial system.

Despite various relaxation policies and extensions of the deadline of POJK Number: 11/POJK.03/2020, banks in Indonesia should carry out risk management. The main goal of the prolongation is that banks have much time to organize their financial performance and mitigate credit risk by preparing CKPN based on ECL provisions of PSAK 71. Entities should evaluate governments or regulators' programs carefully when estimating SICR in distinguishing temporary from long-term impacts (International Organization of Securities Commissions, 2020). Research by Pradesha et al. (2020) shows that there are three impacts of Covid-19 on domestic sectors, namely minimal impact (agriculture, health services, utilities, and educational services), medium impact (construction, and wholesale and retail trade), and high impact (transportation, manufacturing, hotels and food services, and entertainment). Banks also need to analyze their debtors in the restructuring program.

First, debtors that can recover quickly or with minimal impact of Covid-19 remain in the performing category (stage 1). Second, debtors with the medium and long impact of Covid-19 can move gradually to Stage 2 because of high economic uncertainty. These debtors might extend their restructured loans. Third, banks should move restructured loans from debtors that experience extreme financial difficulties and being bankrupted to Stage 3. These allow banks to form CKPN faster, so they are better prepared for the risk of credit loss. Furthermore, asset classification gives a basis for determining an appropriate stage of the CKPN as a basis for establishing the capital capacity of banks to absorb credit losses (Van Greuning & Brajovic Bratanovic, 2020).

There are two strategies for banks to provide CKPN. First, management should compromise with the stockholders that the Dividend Payout Ratio (DPR) will be lower because they increase the expense of CKPN. There is a strong relation between banks' net income and DPR in Indonesia (Nuriatullah, 2020). To generate greater CKPN, banks need to maintain the quality of new credits as well. Second, high CKPN will depress capital that affects a decline in Capital Adequacy Ratio (CAR). Thus, shareholders should enhance the capital of banks if it is under the OJK requirement. The lower the CAR, the more significant potential for insolvency. As this impacts the whole financial system,

OJK can force financial institutions to conduct mergers and acquisitions if the shareholders fail to meet the requirement of CAR.

Conclusions

The pandemic influences the capability of debtors to repay their loans that will make the financial system unstable. Consequently, OJK issues POJK Number: 11/POJK.03/2020 as a countercyclical policy that allows banks to restructure their loans and are in the performing group (Stage 1). In the fourth quarter of 2020, OJK extends the deadline of POJK Number: 11/POJK.03/2020 until March 2022. This research analyzes the impact of Covid-19 on the accounting practices in banks associated with PSAK 71 – Financial Instruments for the CKPN in managing loan risk to respond to the POJK Number: 11/POJK.03. Banks should analyze their debtors in restructuring programs that will recover in the short term, medium-long period, or bankruptcy as a basis to prepare additional CKPN. As banks generate high CKPN, it will reduce net income that needs attention from management and shareholders. Besides, high CKPN can pressure CAR that erodes the capital of banks. Low capital banks will face insolvency. The shareholders need to increase the capital, or OJK will force the insolvent banks to merge with the healthy bank(s) or ask other financial institutions to acquire the bank.

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