BANK OF BOTSWANA

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Public Notice

Repayment Holidays Explained

Introduction

The forced closure of economies globally, Botswana included, aimed at containing the spread of the Covid-19 disease has brought economic hardships to individuals and companies, alike. In the case of Botswana, most businesses, formal and informal, were closed effective April 2, 2020, – for a period of 28 days – except those designated as providing essential services, such as banks. Realising that economic closure meant increased credit risk on businesses and individuals, the banking industry in Botswana, collectively, resolved to offer repayment moratorium, in deserving cases, for a minimum period of 3 months, extendable to 6 months, where warranted. This note sheds light on the meaning and implications of repayment holidays in practice.

Material Issues for the Moratorium

Recall that there are essentially two components to a loan, i.e., principal amount (P) and interest rate (i). A bank would provide a loan, essentially an income-earning asset, for an agreed period of time (n) such that by end-period its expected earnings (P^e) would be derived in the following way:

$$P_n^e = P(1 + i)^n$$

At the time of loan origination, a typical bank would be aware that there may arise unanticipated circumstances that could derail it from earning P^e or losing its original investment P. In this case, steps would be taken at the time of credit creation and/or during the life of the loan to protect the balance sheet. Such practices as collateral requirements and provision of loan guarantees are aimed at preserving the value of the investment and are drawn upon when the repayment capacity of a customer is impaired.

In the present circumstances, banks have determined that economic disruptions brought about by the Covid- 19 disease will impair the ability of (some existing) customers, with a good credit history, from servicing their obligations on a regular basis, as has been the case. Therefore, they have resolved to provide temporary loan repayment relief to these customers by offering *a grace period of some 3 months. However, it is worth bearing in mind that where the moratorium is granted neither the principal amount nor the interest rate are forgiven; there is just a temporary reprieve (3 – 6 months) from repayments. Furthermore, since periodic repayments are accumulating during the time of loan payment delays, loan tenors may need to be extended in order to keep monthly payments the same.*

It is important to point out that the decision to avail repayment holidays is essentially a credit risk management strategy, by banks, and avoids raising provisions as they effectively negatively affect the income statement and, by implication, the soundness of banks. Equally, customers benefit as the moratorium helps them ride through the temporary cash flow deficit, even as arrears accumulate.

Conclusion

Banks in Botswana have resolved to offer loan repayment holidays, on various loan types, to customers with good credit history that have been negatively affected by the Covid-19 disease. However, repayment holiday is not loan forgiveness and whatever conditions have been agreed upon at the time of the inception of the loan have to be fulfilled, in the final analysis, albeit, in most instances, over a longer period.

Ultimately, a loan contract is a binding legal arrangement and customers would do well to abide by it, after accounting for interim measures such as repayment holidays. In the event of failure to repay the amount due, banks resort to liquidation of collateral (or pledged items of value), such as financial assets, stocks, movable and fixed assets. The Bank, therefore, encourages the public to be aware of their loan repayment obligations after the repayment holiday.

Reference

Nicholson, Robert, H., (1986), 'Mathematics for Business and Economics', McGraw-Hill. Inc., New York.

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