LESSONS LEARNED FROM THE REGULATORY MEASURES IMPLEMENTED TO FACE THE COVID-19 EMERGENCY

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I. INTRODUCTION

The global health emergency caused by COVID-19 triggered an unprecedented crisis, accentuated not only by the uncertainty surrounding its length, intensity, and aftermath, but also by the impact it has had on economic growth and financial stability in the affected regions.

Against this background, governments and financial supervisory and regulatory authorities in Latin America and the Caribbean implemented a series of measures and facilities aimed at mitigating the effects of the pandemic and avoiding disruptions in payment systems and the financial sector.

These measures can be grouped as follows according to their nature in crisis management: credit risk, liquidity risk, solvency, business continuity risk, digital channels, and regulatory reporting.

This document arises from the project "Lessons learned from the regulatory measures implemented to face the COVID-19 emergency", conducted by the Association of Supervisors of Banks of the Americas (ASBA) with the aim of identifying the characteristics of the regulatory and supervisory facilities implemented by the authorities of the countries in the region (including the term of moratoriums, capitalization of interest, extension of credit terms, adjustments to provisioning policies, reclassification of credits and restructuring of overdue debts).

The intention is to outline the measures implemented, as well as the potential implications and unintended effects they had on ASBA member countries, in order to provide a reference from which it will be possible to define short and medium-term actions for financial authorities in the event of similar events that may occur.

It is important to point out that, although this research has a regional focus and the measures applied share certain similarities, each country has specific needs, so their impact was different in each jurisdiction. This is due to the fact that, on one hand, the situation before the pandemic was not equitable among all countries in the region and, on the other, neither were the containment and vaccine coverage strategies.

The following is an executive summary of the project "Lessons learned from the regulatory measures implemented to face the COVID-19 emergency", followed by a description of the methodology employed in the process and an analysis based on available documentation, a description of the measures designed to mitigate the effects of the pandemic on the financial system, as well as the impacts of their implementation, and, finally, the lessons learned from their application.

For the preparation of this document, collaborative working sessions were held with regulatory entities of some countries in the region, focusing on understanding the characteristics of the measures implemented, their objectives, scope, implications, and results, as well as the unintended consequences. The authors of this document are grateful for the valuable collaboration of the Central Bank of Brazil, the Superintendency of Finance of Colombia, the Central Bank of the Bahamas, the Financial Market Commission of Chile, the Superintendency of Panama, the Superintendency of Banking, Insurance and Pension Fund Administrators of Peru, the Superintendency of Banks of Ecuador, and the National Banking and Securities Commission of Mexico.

II. EXECUTIVE SUMMARY

Rapid and coordinated action by Latin American and Caribbean supervisory and regulatory authorities has been a key factor in managing the economic crisis caused by COVID-19. Authorities have worked closely with other government agencies and with the financial institutions themselves to implement measures to mitigate the monetary impact in the region.

The measures focused on issues such as credit risk, liquidity, solvency, and business continuity, as well as digitalization and regulatory reporting.

Although the adopted measures have been similar, certain characteristics vary from country to country, such as the periods of validity, the treatment of accrued interest, the specific conditions to be met by debtors and credit institutions to access these facilities, the use of capital buffers and restrictions on the distribution of dividends. Depending on their nature, these facilities have had, and could have, different effects on financial institutions and debtors.

The authorities sought to ensure the operational continuity of financial institutions through the rescheduling of a portion of the loan portfolio, without affecting the credit rating of debtors.

Thus, financial institutions were granted facilities to avoid increasing the level of their provisions and, consequently, to be able to record accrued interest as financial income. The latter contributed to entities seeking to reschedule loans without reducing the interest burden for debtors.[1]

Some authorities observed an increase in the number of complaints and in the reputational risk of financial institutions, probably as a result of inadequate communication strategies developed by the institutions and a lack of financial education among users.

On the other hand, the constant monitoring of the loan portfolio gained relevance in view of the need of identifying clients with difficulties in maintaining the capacity to normalize the payment of their obligations once the terms of the regulatory facilities have expired.

In addition, it was noted that the failure to increase the level of credit provisions[2] could be perceived as a practice to hide the true level of risk of the institutions. Therefore, in some jurisdictions it was considered necessary to set up additional provisions, some voluntary and others mandatory, based on projections and stress tests. At the same time, in response to specific needs, the use of accumulated provision cushions was allowed during periods of economic expansion. This practice was monitored by supervisors to prevent the use of a large number of resources needed to face contingency situations.

Within the region, there have also been specific conditions for the treatment of collateral, such as considering their real value as updated and the possibility of using them for several credit operations. However, these measures can lead to a failure to maintain coverage levels and an increase in the credit risk exposure of financial institutions' portfolios.

It should be pointed out that, at the beginning of the crisis, most of the region's financial institutions had strong liquidity positions. However, many of them continued to increase their liquid assets to maintain market confidence.[3] In other cases, reserve requirements on time deposits were eased and the minimum requirements of the liquidity coverage ratio (LCR) were temporarily relaxed, reducing, for certain institutions, the margin to face bank runs.

1/ Financial income from creditors increased by allowing the rescheduling of the payment of obligations without reflecting an impairment of loan portfolios and, therefore, allowing accrued and uncollected interest to be recorded as income.

2/ Increases in credit risk exposure are offset by increases in loan loss reserves, in which credit portfolio rating methodologies reflect increases in exposure by determining loss severity based on the value of collateral.

3/Bank for International Settlements (2021), "Early lessons from the Covid-19 pandemic on the Basel reforms".

Throughout the crisis, the liquidity and solvency of most institutions remained stable. This was supported by the fall in demand for credit -which allowed banks to invest their excesses in low-risk, highly liquid securities- and the actions taken by a number of monetary authorities to provide liquidity conditions in the market. Nevertheless, some financial institutions experienced pressure on their liquidity positions[4], decreasing their normal LCR values.

As part of the solvency measures, the financial authorities recommended, and in some cases even restricted, profit distribution, share buybacks and any other mechanism aimed at remunerating shareholders. These actions, although not implemented by all institutions, promoted the preservation of capital buffers and the reinvestment of resources in strategic areas that became more important during the pandemic, such as technology, digitalization of financial services and financial inclusion processes.

In terms of business continuity, although institutions already had the resources and capacity to deal with extreme events, the crisis highlighted the need to strengthen contingency plans and implement more controls and financial efforts to ensure operational continuity during stress periods.

The pandemic also required improvements in online platforms for financial institutions to continue to serve their customers and provide access to neglected population groups. In addition, the increased use of digital media showed the importance of developing new controls against cyber-attacks and fraud.

On the other hand, to ensure the transparency of operations and the measures used, the authorities postponed the introduction of international standards, but placed greater emphasis on requesting additional reports from the institutions. This implied an increased investment in information systems and the adoption of technological tools to generate reliable and secure data.

Finally, some supervisors also established measures to strengthen financial consumer protection processes in five key areas: legal framework and institutional structure of supervision, transparency, fair treatment and adequate supply, confidentiality, and data protection, as well as mechanisms for resolving disputes and complaints.[5]

Generally speaking, the measures have been effective in combating the economic and financial effects of the crisis, alleviating credit so that debtors can meet their obligations effectively. In its application, this research highlighted the importance of fluid communication between local and international institutions and the maintenance of standards that can improve the provision of financial services.

4/ Bank for International Settlements (2021), "Early lessons from the Covid-19 pandemic on the Basel reforms".

5/ Arregui Solano, Ruth and Rosa Matilde Guerrero Murgeytio (2021), International Seminar "Financial Services Consumer Protection. De la Teoría a la Praxis", Superintendencia de Bancos–Ecuador.

III. METHODOLOGY

The analysis of the effects and unintended consequences of the measures implemented by the region's regulators and supervisors to preserve financial stability in the midst of the COVID-19 pandemic was conducted in two stages. First, a compilation and analysis of publicly available documentation on financial measures applied in the region was done, leaving aside those of a monetary and fiscal nature. Subsequently, a more specific documentation process was performed, which, in turn, was divided into four phases:

1. Consolidation of available information from public sources and interviews conducted with supervisors.[6]

2. Analysis of the context, external and internal factors and similarities and differences in the implementation of measures in other regions.

3. Grouping of the most relevant measures according to their typology:

    - Credit risk: deferral of debt payments to grant relief to debtors in the financial system, avoiding the deterioration of their credit rating and the constitution of additional provisions.

    - Liquidity: increase in the volume of resources available in the system, through the relaxation of reserve requirements.

    - Solvency: in some cases, measures were established for the conservation of capital buffers in order to counteract negative impacts on income; in others, the payment of dividends was suspended, and the percentage of minimum capital requirements demanded by current regulations was reduced.

    - Business continuity: strengthening contingency plans to ensure operational continuity.

    - Use of digital channels: through regulatory flexibility in terms of non-face-to-face customer identification for opening bank accounts and granting loans, and improvements in cybersecurity standards.

    - Regulatory reporting: relaxation of the dates for the implementation of international standards and requirement of reports to follow up and guarantee the transparency of the measures implemented.

4. Documentation that consolidates the main conclusions and potential implications of financial measures.

6/ Sessions of rapport have been held with the supervisors of Bahamas, Brazil, Colombia, Panama, and Peru.

IV. MEASURES IMPLEMENTATION AND ASSOCIATED IMPACTS

The pandemic caused by COVID-19 represents a historic challenge due to the magnitude of its worldwide economic and social effects. Unlike other crises, such as that of 2008, it is not explained by failures in financial regulation or an overpricing of financial products, but by its exogenous, uncertain, and global origins.[7]

Also, compared to previous historical events, this time financial institutions had prominent levels of capital and liquidity and were less leveraged at the time of the crisis. In addition, technological advances in recent years have facilitated the continuity of several financial operations through remote means.

All of the above has made it possible to efficiently cushion the macroeconomic effects[8] of the pandemic and of the containment measures imposed to mitigate the effects on the health of the population.

In turn, central banks and financial authorities around the world have adopted measures to preserve the stability of the financial system, ensure the protection of depositors and support the global economy.

In this sense, transparency and communication of regulatory and supervisory actions have been of particular relevance, in order to ensure the lending of essential services and the mitigation of immediate impacts on the economy.[9]

Initially, the measures were designed to preserve the operational continuity of financial services and to avoid a generalized liquidity crisis, through regulatory facilities that would allow the possibility of continuing to provide remote services, in addition to the rescheduling of payment obligations. Subsequently, the measures were also aimed at preserving the solvency of the institutions. In this way, and despite having experienced an unprecedented global recession, the global financial system has been able to perform its critical functions and continue to grant credit.[10]

The following is an analysis of the measures adopted by financial and supervisory institutions, grouped according to their nature to address the crisis (credit risk, liquidity risk, solvency, business continuity risk, digital channels, and regulatory reporting), as well as their associated impacts and unintended consequences.

CREDIT RISK MEASURES

Each individual country has taken different decisions to address the impacts of the crisis, depending on the effect it has had on the banking system and the goals set to mitigate its impact.

This section groups the financial measures established in relation to credit rescheduling[11], the creation and use of provisions and the treatment of guarantees.

Modification of loan agreements and renegotiation facilities

The purpose of these measures was to provide temporary relief to debtors (individuals or companies) and to recognize the limitations they might face in conducting their normal operations, especially in the countries that implemented the most rigid quarantines.

7/ Bank for International Settlements (2020), "The prudential response to the Covid-19 crisis".

8/ Financial Stability Board (2021), "Lessons Learnt from the COVID-19 Pandemic from a Financial Stability Perspective".

9/ International Monetary Fund and World Bank (2020), "COVID-19: The Regulatory and Supervisory Implications for the Banking Sector".

10/ Bank for International Settlements (2021), "Early lessons from the Covid-19 pandemic on the Basel reforms".

11/ The term "rescheduling" includes, in addition to deferring payment, changes in other credit characteristics such as term, interest rate and installments.

i. Characteristics of the measures

The flexibility in the debtors' payment plan[12] was aimed at preventing a break in the payment chain, benefiting illiquid but solvent borrowers, continuing with the provision of services by financial institutions and protecting depositors and guaranteeing the stability of the financial system.

Modifications in credit conditions through credit rescheduling were important to provide financial relief to the most vulnerable debtors[13], as well as to companies and families that, due to the economic impact of the pandemic, faced limitations in the payment of their obligations.

As mentioned above, although the measures applied were similar throughout the region, their characteristics varied from one country to another. The most important general aspects of these rescheduling are as follows:

- Not applying changes in the credit rating of debtors.
- Freezing the computation of days of loan arrears.[14]
- Granting different grace periods, which ranged from 3 to 12 months, with the possibility of extending the term upon compliance with certain requirements such as the payment of some installment of the debt within the grace period.
- Modifications in interest rates.
- Reductions in installments.

The deferral of payment obligations by the authorities and financial entities played a key role in the relief of companies and households, to the extent that credit growth was even observed in some jurisdictions. This favored the absorption of the impact of the economic crisis caused by COVID-19, in contrast to the 2008 crisis.

Significantly, some authorities allowed massive rescheduling without direct contact with the debtor during the first months of the pandemic. Subsequently, the entities were instructed to assess the implementation of individual rescheduling, having contact with the debtors, and adjusting the new safety and hygiene conditions to their specific needs.[15]

Also, the supervisory and control authority requested the entities to have information and accounting systems that allow the follow-up of operations with financial relief measures and with specific policies, processes and procedures for the management, control and monitoring of credit risk.[16]

For their part, the institutions established different requirements for debtors to be able to benefit from the rescheduling of their loans. For example, in general, only loans classified as normal, with a certain number of days in arrears (30, 60 or 90, depending on the institution) or in deferred status, but with payments up to date before the pandemic began, were eligible.

In this sense, it is expected that, as their financial conditions improve, debtors will return to the pre-pandemic payment system. For this reason, the loan portfolio was sized to define who are the debtors with a normalized payment capacity that will allow them to exit the deferred or modified loan category.

ii. Associated impacts

The rescheduling of loans has allowed a large number of debtors to avoid default and, therefore, maintain their credit rating. However, this has not prevented delinquency rates from increasing as the grace periods granted expire, which, in turn, increases the credit risk to which financial institutions are exposed, triggers increases in provisions and erodes their capital and capacity to grant new loans.[17]

Thus, significant increases in institutions' delinquency rates could jeopardize their financial sustainability.

12/ These measures consisted of the issuance of special accounting criteria to facilitate the partial or total deferral of principal and interest payments.

13/ International Monetary Fund and World Bank (2020), “COVID-19: The Regulatory and Supervisory Implications for the Banking Sector”.

14/ This measure was aimed at debtors who, at the beginning of the pandemic, were in arrears and could not use the facilities to reschedule their debts.

15/ Bank for International Settlements (2021), “Early lessons from the Covid-19 pandemic on the Basel reforms”.

16/ *Idem*

17/Unidad de Apoyo a la Gobernanza Económica (2021), “When and how to unwind COVID-support measures to the banking system?”.

One consequence of granting grace periods -in which there is no obligation to pay interest or principal- was that, in some jurisdictions, debtors interpreted this fact as a cancellation of their debts.

This resulted in countless complaints at the end of the grace period and forced both the authorities and financial institutions to closely monitor comments on social networks to avoid reputational risks that could have a greater impact.

Meanwhile, some financial institutions observed a double effect on their financial statements: on the one hand, a significant increase in uncollected accrued interest (higher than historically recorded) and, on the other hand, a drop in the volume of provisions, due to the fact that the rating of debtors did not experience any deterioration.

This exposed financial institutions to new risks, especially those that did not have robust mechanisms for monitoring their portfolios or timely information on the financial situation of their debtors.

Not being able to quickly identify the increase in the risk of default of their debtors prevented financial institutions from timely setting up the necessary provisions to face more adverse scenarios. Therefore, in general, financial institutions had to increase the monitoring of their loan portfolios.

In short, measures should be evaluated to minimize reputational risk for both financial institutions and the regulator. The goal is to avoid losing public confidence in the financial system, while facilitating the reestablishment of the credit cycle. Therefore, these measures should be of limited duration, contain a clear exit strategy, avoid the benefit of increased terms for borrowers who were already delinquent before the pandemic, and ensure incentives to resume payments at the end of the moratoriums, thus avoiding a negative effect on the culture of payment of financial obligations.

Finally, the temporary measures highlighted the need for authorities and financial institutions to develop more inclusive financial education programs, with optimal content and a focus on consumer protection, allowing users to clearly understand the conditions of the assorted products and services in order to be able to make better informed decisions in the future.

Creation and use of provisions

Based on the relief granted to debtors, additional measures were implemented to maintain the credit risk coverage of financial institutions, recognizing a higher portfolio risk, and creating additional voluntary and, in some cases, mandatory provisions.

These provisions were also allowed to be used for other purposes.

i. Characteristics of the measures

Under normal conditions, when clients are unable to meet their obligations, the terms and rating of the debt will deteriorate, which has an impact on the level of provisions that a financial institution should make.

Therefore, although the measures implemented in several countries have allowed clients facing temporary liquidity difficulties to avoid deterioration of their credit rating, these measures can hinder the recognition of real losses and the true financial situation of the entities.

In order to recognize part of this risk, some institutions have set up additional provisions that allow this component of uncertainty to be evidenced in their balance sheets. In cases where institutions did not do so, some authorities requested a detailed evaluation of their portfolio to determine whether there was a higher unrecognized credit risk that required the creation of provisions.

In this sense, some institutions made prudent estimates for voluntary provisioning based on stress scenarios designed to provide buffers in the event of a prolonged crisis.

When an institution's situation required it, some authorities allowed the use of additional provisions per economic cycle, which are increased during expansion phases, creating resources for adverse circumstances that may arise. However, the reduction of these additional provisions was monitored to avoid early utilization and subsequent lack of this provision cushion.

In this regard, the countries that had already opted to implement the provisioning methodology provided by International Financial Reporting Standard 9 maintained it by having a prospective approach and basing it on expected losses instead of incurred losses.

ii. Associated impacts

By failing to modify credit ratings and not creating new provisions, there is a possibility that some financial institutions may find themselves with insufficient resources to face the losses that could arise when some debtors are unable to meet their obligations at the end of grace periods and payment plans. In addition, failure to set up the corresponding provisions may result in the failure to identify, in a timely manner, the follow-up alerts of debtors with significant problems. This is why, in most cases, it has been observed that rescheduling has not been granted for very long periods of time. In addition, in particular cases, the authorities have required additional provisions, as well as an analysis of the risk of the portfolios and their impact on solvency exercises.

On the other hand, massive rescheduling can affect the collection of essential information on clients' payment behavior history. This, in turn, impacts the risk models used by companies.

Finally, these measures may have effects due to the potential temporary opacity of companies' financial statements. This is particularly relevant for stress tests conducted by authorities at the systemic level.

Treatment of collateral

These measures were intended to complement the relaxation of the flexibilization of the treatments given to the portfolio and the valuation of collateral in credit portfolios, thereby stimulating the credit market.

i. Characteristics of the measures

As part of the loan modification, specific conditions were established for the treatment of collateral: first, in several cases, the actual value of the collateral was allowed to be considered updated until the end of the state of emergency, regardless of whether a new appraisal was required; second, in some countries, the same collateral was allowed to serve as backing for several transactions.

In order to comply with the objective of stimulating the credit market and preserving financial stability, in general, no prohibitions were identified in the enforcement of collateral.

ii. Associated impacts

In the event that clients do not recover their payment habits after the due date, these measures may increase their credit exposure and make it impossible for financial institutions to maintain the coverage levels defined within their credit risk management.

Likewise, materializing credit risk and using the same collateral for multiple transactions may be insufficient to cover the amount of the debt, which would prevent the financial institution from recovering the value owed.

LIQUIDITY MEASURES

The purpose of this block of measures was to continue to increase the liquid assets of financial institutions in order to maintain market confidence[18] and cash flow in the system.

i. Characteristics of the measures

Unlike previous crises, the one caused by COVID-19 developed in a framework in which financial institutions were in a solid position; they had a cushion of liquid assets sufficient to face a decrease in cash inflows in case debtors were unable to meet their obligations.

In some countries, liquidity levels even increased during the pandemic as the volume of deposits increased, due to a decrease in current spending by economic agents.

In this sense, some studies suggest that the crisis did not imply a prolonged and generalized liquidity stress in financial institutions.[19]

18/ Bank for International Settlements (2021), "Early lessons from the Covid-19 pandemic on the Basel reforms".

19/ *Idem*

However, in order to encourage funding to institutions and inject liquidity into the system, some authorities reduced reference rates and relaxed reserve requirements on time deposits, in order to compensate for the reduction in deposits that banking institutions would have had.

At the same time, most authorities temporarily reduced the minimum LCR requirements, in addition to ceasing the application of certain corrective measures when institutions reported an LCR ratio below the regulatory minimum.

In addition, some authorities allowed the exclusion of margin calls or valuation changes that occurred during the first few months of the pandemic from the retrospective liquidity approach calculations.

From the supervisor's perspective, the update of the Liquidity Contingency Plan was requested, whose objective was to evaluate that liquidity risk was adequately managed in the short and medium term.

For their part, some institutions indicated that, although liquidity pressures did not materialize as expected, these measures, coupled with the reduction of internal liquidity targets, helped to support the loans originated during this period.

ii. Associated impacts

By relaxing these requirements, in the event of a stress scenario, financial institutions may have problems meeting their liquidity needs if they do not have an adequate volume of high-quality liquid assets.

In short, as mentioned in previous paragraphs, financial institutions were very well capitalized and had high liquidity ratios at the beginning of the crisis and no liquidity problems materialized that could compromise the normal operation of their activities.

SOLVENCY MEASURES

Most financial institutions had solid capital levels at the beginning of the crisis and liquidity levels well above their minimum requirements, partly because some authorities-imposed restrictions on the distribution of profits. This made it possible to establish other measures to promote the preservation of capital buffers and the reinvestment of equity in strategic areas.

i. Characteristics of the measures

These provisions were aimed at preserving capital buffers to counteract negative impacts on revenues and provisioning levels during the pandemic, increasing the placement of loan resources, increasing investment in technology of greater value for financial consumers (digital and adapted to events such as COVID-19), and improving depositor protection and financial inclusion processes.

However, contrary positions were observed throughout the region, since, while some regulators increased capital requirements by implementing new regulations, others defined temporary measures that sought to reduce them.

Some countries that had already begun the convergence towards Basel III capital requirements and created capital conservation, countercyclical and systemic risk capital buffers enabled the accumulation of sufficient capital in times of economic growth to face losses in the event of a crisis.

In these cases, some entities allowed the reduction of the volume of capital conservation buffers and defined additional periods for their gradual reestablishment, with the objective of strengthening the confidence of financial entities and credit institutions.

Other countries also reduced the percentage of minimum capital requirements to cover unexpected losses and maintain solvency levels in crisis situations.

ii. Associated impacts

Aside from the implemented measures in terms of solvency, some analyses expose the reluctance of supervisors and financial institutions to make use of accumulated capital buffers, albeit maintaining a higher margin than the minimum requirements. Among the reasons for this behavior is the market's stigma of considering the use of buffers as a sign of weakness, which can have negative impacts on the entities' share price, credit rating or access to low-cost financing, and uncertainty about the future -as there is concern about their capacity to rebuild buffers and choose to be cautious in dealing with future losses-.[20]

On the other hand, the restrictions imposed on the distribution of profits, the accumulation and decumulation of capital buffers and the relaxation of minimum capital requirements ensured that there were no pronounced impacts on the solvency ratios of the institutions.[21]

It should be stressed that reducing capital requirements may weaken the capacity of financial institutions to absorb unexpected losses, so that, since there is the possibility of rescheduling loans, it is important to maintain a capital buffer that will allow them to weather unfavorable financial conditions and guarantee their stability. Once the crisis is over, banks will have to rebuild their capital reserves to avoid future losses due to credit deferral.

Broadly speaking, several analyses indicate that strong capital levels in banks helped ensure that businesses and households had access to credit during the pandemic. Thus, the banking system complemented and supported the efforts of monetary and fiscal authorities with countercyclical measures to sustain economic activity during the COVID-19 crisis.[22]

However, authorities should keep in mind that financial institutions are likely to show lower profitability in the coming months, which may imply a reduction in capital and solvency ratios in the near future.

BUSINESS CONTINUITY MEASURES

In recent years, financial institutions have promoted the development and dissemination of best practices and international market standards, as well as new regulatory requirements to meet the expectations of stakeholders (customers, shareholders, supervisors, etc.).

The critical context has also been analyzed to ensure the continuity of operations in the event of the materialization of certain risks and, thereby, minimize the impact on critical functions. As for the conventional risk assessment, which considers the impact and probability of occurrence of an event, although a pandemic may represent an important impact, the probability of occurrence is very low, so that, in most risk assessments for the entities, it was imperceptible or irrelevant. This led to the definition of measures that boosted the operational continuity of financial institutions.

i. Characteristics of the measures

Financial institutions must have a structured response to deal with unpredictable and changing situations during the pandemic, which may affect or interrupt the normal operation of their activities and the execution of their critical processes.

In this sense, operability may be affected by interruptions in operating systems or telecommunications, failures in physical infrastructure, cyber-attacks, dependence on third parties to provide critical products and services for the entities, the adoption of remote work -which implies the execution of additional tools to ensure an agile and secure result- or the limited availability of staff to provide services and respond to customer complaints, thus increasing reputational risk.

20/ Bank for International Settlements (2021), "Early lessons from the Covid-19 pandemic on the Basel reforms".

21/ In several cases, decumulation was not necessary because, in the absence of accelerated credit growth, there was no higher capital requirement.

22/ Bank for International Settlements (2021), "Early lessons from the Covid-19 pandemic on the Basel reforms".

Therefore, business continuity plans are relevant to determine the degree of preparedness of the institutions for contingencies and to ensure that operations are maintained under crisis scenarios.

While institutions had the resources and capabilities to deal with extreme events, in some jurisdictions in the region, specific measures to deal with the pandemic were not in place. Therefore, financial institutions found it necessary to strengthen contingency plans and establish a greater number of controls to guarantee operational continuity in the current scenario -considering its extension over time- and in future situations of uncertainty.

In other cases, regulations in some jurisdictions required banks to have a business continuity plan, which they implemented at the beginning of the pandemic and during its duration. In these cases, banks were able to provide services within the constraints required by health authorities.[23]

ii. Associated impacts

The crisis put business continuity plans to the test and demonstrated that some entities had not correctly identified the risks that a pandemic represents both for people and for the organization's systems. Therefore, established methodologies were revised and strengthened to consider the scope of the crisis scenarios.

Similarly, it is worth mentioning that the outsourcing of external suppliers can affect the reputation, business continuity and subsequent increased costs of financial institutions, so it is necessary to have a clear strategy for the selection, approval, and management of these third parties.

To create an effective risk management system within the current situation, a work plan must be established to restore the critical business processes necessary to operate.

USE OF DIGITAL CHANNELS

Prior to the pandemic, financial institutions were in a process of digital transformation, which has been accelerated by COVID-19 and the need to respond immediately with digital solutions that automate processes and provide facilities for remote work. Entities that did not evolve at the required pace have been forced to halt their operations.

i. Characteristics of the measures

As this was a health crisis, financial institutions had to adhere to the protocols issued by their jurisdictions to keep certain offices open or closed and to manage and process cash. The containment measures and protocols for operating credit institutions highlighted the growing importance of technology and, in particular, digital channels to ensure the sustainability of financial services in stressful times and in the face of a crisis, as well as to provide biosecurity scenarios that reduce the spread of the virus.[24]

In order to reduce the concentration of people in physical branches and create a safe environment for both staff and customers, financial authorities encouraged institutions to expand the range of services offered through digital media, the increasing use of which provided an opportunity to improve financial inclusion by highlighting the need to offer services to underserved population groups.[25]

In this regard, some jurisdictions reformed their regulations for protecting and defending the rights of consumers of financial products, as well as their financial education programs. Some countries also encouraged the use of remote channels to complete transactions. Likewise, in order to guarantee access to digital channels and payment instruments and to count on the necessary technological infrastructure to support the increase in transactions during the quarantine, measures were designed to facilitate the use of digital finance and reduce the risk of cyber-attacks, by reinforcing diagnostics, security mechanisms, monitoring capacity and the tools of banking entities. As a result, some jurisdictions implemented reforms in their remote customer identification regulations (digital onboarding) to achieve greater robustness, security, flexibility, and inclusion in digital processes.

23/ This was the case of the supervisory agency in Mexico, which followed up on the application of these plans and performance with special attention to CCL, ICAP, IMOR, cyber fraud and credit granting indicators in favor of economic reactivation.

24/ Bank of International Settlements (2020), "Covid-19: Boon and bane for digital payments and financial inclusion".

25/ *Idem*

ii. Associated impacts

The confinement measures increased the speed of digital transformation of the financial sector, while at the same time reducing the bureaucracy of some of its services. Although a large part of the banks had digitalization strategies in place, a sizable number of services were only offered physically in the branches.

The digitalization of banking has made it possible to execute operations and obtain information on account movements at any time, facilitating the control of personal and business finances.

Meanwhile, the increase in the use of and dependence on digital channels for financial services has raised the exposure of banking institutions and users to greater cyber and fraud risks, which could have an impact on financial stability and customer confidence.[26]

In view of this scenario, it is necessary for financial institutions to invest more resources in technology and the constant training of specialists and staff in general to solve and prevent cyber-attacks such as identity theft -through two-factor authentication or backups to recover sensitive information, for example-, as well as to increase the number of specialized personnel in cybersecurity, redefine the methodology of remote work to maintain staff efficiency, establish protocols and behavioral guidelines, among others.

REGULATORY REPORTING

The broad regulatory and supervisory reaction to COVID-19 is becoming a distinctive feature of the management of the current crisis, highlighting the actions implemented in terms of the form and intensity of regulatory reporting during the critical stage of the pandemic.

i. Characteristics of the measures

In order to maintain confidence in the financial system, it is essential that there be transparency in the measures implemented by the entities. In order to limit risk, financial authorities requested additional reports to facilitate the monitoring of measures and assess their impact[27], which required more timely and frequent data collection compared to traditional regulatory reports.[28]

In terms of credit granted, the entities were requested to have information and accounting systems that would allow them to follow up on operations with financial relief measures, to report the number of clients that received a grace period and the performance of the rescheduled portfolio in order to monitor and evaluate which entities had a greater impact in terms of consumer loans, residential mortgage deferrals and commercial loans. In turn, the number of delinquent lines of credit and their values prior to the pandemic were requested, as well as the detail of debtors grouped according to segmentation levels and operations in order to identify changes in payment date, type of installment, rate applied, etcetera.

Despite the implementation of new measures to generate reports that guarantee the operability of the entities, some countries decided to extend the deadlines for reporting on certain international standards, being the particular case of Pillar III of Basel III -which requires the publication of information related to the risk profile and capital structure of an entity- and of the stress test exercises -which allow evaluating weaknesses in the face of extreme scenarios that may put the economic and financial situation of banks at risk.

ii. Associated impacts

The demand for additional reports requires, first, greater management of information to ensure its availability, accuracy, and speed, and second, the adoption of technological tools to generate and organize reliable and secure data. In addition, it may imply a greater operational burden on the entities and an increase in their costs, as they did not have the necessary infrastructure to cope with the new claims, being more prone to make mistakes or neglect other types of internal tasks.

Likewise, delaying the implementation of regulations under international standards may show that the region is lagging behind best practices in the financial sector at the international level.

26/ International Monetary Fund (2020), "El ciberriesgo es la nueva amenaza para la estabilidad financiera".

27/ International Monetary Fund and the World Bank (2020), "COVID-19: The Regulatory and Supervisory Implications for the Banking Sector".

28/ Financial Stability Board (2021), "Lessons Learnt from the COVID-19 Pandemic from a Financial Stability Perspective".

V. LESSONS AND SUGGESTIONS

This section analyzes the main lessons learned from the implementation of measures to mitigate the adverse effects of the COVID-19 pandemic on the financial system.

ADEQUATE CREDIT RISK CONTROL

The authorities in each country adopted their own regulations to relax the application of payment deferrals and granted relief to debtors during the crisis. In order to prevent any long-term negative impact of these measures on the solvency of the institutions, it was considered that the rescheduling of debts should be accompanied by adequate control measures, as well as close monitoring of the loan portfolios that benefited from some regulatory facility and an analysis of credit concentrations by different institutions in the economic sectors most affected by the crisis.

Given the unusual and untimely manner in which the crisis emerged and the speed at which it spread around the world, it was impossible to have the necessary information to assess the impact of the COVID-19 crisis on the financial system in a timely manner. It is also important to consider that the same models for portfolio monitoring were affected by the grace periods, which hindered the collection of information on the payment behavior of debtors.

In addition, it should be considered that it is not feasible to monitor each segment of the loan portfolio. Therefore, financial institutions should identify and prioritize those segments they consider most important by including unemployed clients, clients whose income has been reduced, clients employed in sectors that have been designated as "substantial risk", among other categories.

Portfolio dynamics and trends will be very short-term, and changes will occur much more frequently than before the pandemic, requiring constant monitoring, forecasting and continuous forecasting and re-forecasting of key metrics.

It is critical that financial institutions document the actions they take and create a portfolio chronology for future reference when customers, boards or regulators inquire what happened, what was done, why was it done, and what was the impact to the customer and the organization?

In addition, supervisors should ensure that these types of measures do not affect the long-term credit life of borrowers who benefited from regulatory relief.

REDEFINING RISK APPETITE

The emergence of COVID-19 has prompted financial institutions to reconsider their risk appetite. In some cases, they have opted to abandon segments considered higher risk or more vulnerable to the effects of the pandemic; in others, they have evaluated the convenience of retaking segments considered higher risk, but with greater profitability.

The activities, processes and procedures related to credit granting of the different organizations had to change in response to the pandemic in order to adapt to the new reality, such as the change of restrictions on loans to unemployed or underemployed, the new methods to define income limits for certain client segments that are not relevant and should be reviewed, among others.

In the case of microfinance and cooperatives, which are characterized by close contact with clients, it will be necessary to use models and technologies that enable a rebalancing between remote and face-to-face evaluation.

MANAGEMENT STRUCTURE FOR MASSIVE LOAN RESTRUCTURING MODELS

Massive credit restructuring measures have brought with them accounting and operational consequences that require prior preparation by financial institutions. For this reason, supervisory agents should encourage institutions to define conditions that allow them to restructure the affected loans in an optimal manner so that they can be put back into force as soon as possible, ensuring that the lending capacity of the institutions is not affected in the long term by capital or liquidity issues.

Furthermore, it is advisable that, after moments of crisis and massive restructuring, financial institutions should consider setting up an internal restructuring team - based on the reassignment of existing teams, both credit and customer service - or the creation of experienced teams to avoid confusing the management of functional operations with those affected by the pandemic.

There is also a need to rethink the way credit is managed throughout the customer lifecycle, particularly prioritizing efforts in the collections function and portfolio sales. The conventional approach of selling portfolio to "debt buyers" will be disrupted by COVID-19 and potentially lead to price fluctuations, so the immediate focus is on collections as lenders work with their most vulnerable clients to provide them with access to better payment arrangements.

PROPER COLLATERAL VALUATION

Another point worth considering is that collateral, under normal conditions, generates the necessary coverage to recover the loan. However, in a crisis situation, the economic effects of supply and demand taint companies and the real estate market, diminishing their value and increasing the difficulty of making them liquid. Thus the need to carefully evaluate the effects of the pandemic on the so-called "loan to value" arises, in order to avoid future credit risk problems.

STRESS TESTING MODELS AND MACROECONOMIC SCENARIO ANALYSIS

The COVID-19 crisis highlighted the importance of developing comprehensive stress and reversible stress tests for the financial system as management tools to identify early warnings of potential risks that are heightened in adverse macroeconomic situations.

INFRASTRUCTURE TO FACE MASSIVE BANK RESOLUTIONS

Institutions should have structured resolution plans detailing the strategy, processes, and procedures necessary to face stress scenarios or their own liquidation. The crisis demonstrated how important it is for banks and supervisors to have clarity on these plans so that, if necessary, controlled liquidation processes are conducted in a way that does not affect the overall market, while fostering close collaboration between countries to deal with cross-border events.

EARLY IMPLEMENTATION OF LIQUIDITY MEASURES

Although not all crises are characterized by a direct impact on the liquidity of financial institutions, the rapid and efficient implementation of measures in this area at the start of the pandemic yielded positive results in the institutions' risk management, even more so given the contagion effects that liquidity problems bring with them. In economies with monetary policy restrictions, such as those dependent on the dollar, these measures proved to be even more necessary.

However, it should not be ruled out that, as a result of the continued deterioration of economic activity, liquidity risk may increase.

In this regard, some actions that authorities may undertake to follow up on liquidity issues are:

1. intensive monitoring of liquidity ratios, daily and monthly, as well as cash flows;
2. requests for additional information on liquidity metrics with daily information;
3. close communication with financial institutions to review their liquidity positions and senior management's risk management functions.

CAPACITY TO PROVIDE DIGITAL SERVICES

The COVID-19 pandemic showed that not all institutions have the necessary infrastructure to provide digital services. Therefore, it was necessary to identify new channels to expand the range of these services and, thus, manage the concentration of people in branches.

The pandemic significantly accelerated the digital transformation processes of financial institutions, which highlighted the need to increase the levels of vendor and third-party control for digital service-related businesses. Until then, this had not been fully addressed within the entities' risk management systems.

Additionally, digitalization has permitted to decrease some bureaucratic processes and to implement some measures that facilitate the processes.

Another aspect to consider is that regulation must adapt to recent technologies, services and business models in the financial sector and respond, in a cross-cutting manner, to challenges that go beyond a specific sector, such as data privacy or the role of digital platforms.

The regulator will have the responsibility to pave the way for the benefits that digitalization brings, while closely monitoring its risks and establishing prudent rules to help mitigate them.

HAVING AN EFFECTIVE BUSINESS CONTINUITY MANAGEMENT SYSTEM IN PLACE

A resilient business continuity plan must be consistent with financial consumer protection processes and comply with aspects such as:

1. Allocate resources to create, maintain and assess continuity plans, through drills that evaluate their effectiveness and identify areas for improvement.
2. To have analysis and prediction tools to make strategic and operational changes that ensure the growth and stability of the entities.
3. To have the Business Impact Analysis (BIA) as a useful tool to estimate the impact on the entities due to an incident and to define the minimum resources to maintain operations.
4. Maximize the digitalization of processes to reduce costs, improve efficiency and minimize the impact of crises.
5. Define roles and responsibilities of emergency personnel, according to the size and complexity of the entity, and include a clear training scheme.
6. Establish communication plans to keep employees, recovery teams and stakeholders informed.

IMPLEMENTATION OF INTERNATIONAL STANDARDS

The increased quality and demand for higher capital and liquidity levels of the reforms, proposed by international standards such as Basel III, have achieved their objective of strengthening response and recovery capacity under crisis scenarios, which highlights the importance of continuing to implement these measures in the region.

DATA MANAGEMENT AND MODELING

Financial institutions must be prepared to update information and understand that customer information previously available may change.

In addition, they must recognize that this data may be affected by COVID-19 and should identify the impact of these changes for client credit management in the future, adapting models if necessary.

IMPORTANCE OF FINANCIAL EDUCATION

The crisis also demonstrated the lack of financial education. Due to the asymmetry of information, it was necessary to rethink the way of relating to and serving the financial consumer. This highlighted the need to strengthen customer service and financial education schemes to provide information and clarity on measures with a common language for all types of financial clients, as well as more inclusive systems for consumers.

REALLOCATION OF RESOURCES TO VIABLE FINANCIAL INSTITUTIONS

The pandemic favored the expansion of the degree of leverage and over-indebtedness of the non-financial sector, through the credit support provided by the entities. In this sense, policymakers can design mechanisms to assist the exit from the market of indebted companies classified as non-viable in order to promote the efficient redistribution of resources.

Similarly, it is necessary to consider the financial stability problems that could arise from an increase in corporate debt. To mitigate these risks, a distinction should be made between three types of companies: (i) companies with business models that are unaffected by the pandemic and can raise funds without friction; (ii) companies with business models that are clearly unviable; and (iii) companies with fundamentally sound business models, but face frictions in accessing private financing markets due to increased uncertainty.

Targeting fiscal measures toward the latter two types requires mechanisms for early debt restructuring and an adjustment of fiscal measures for greater solvency support specific to viable businesses.[29]

IMPORTANCE OF INTER-AGENCY COORDINATION

As this is a crisis with global impact, communication and information exchange between local and international institutions have been essential to support the effectiveness and coordination of policy measures, ensuring that global financial stability is maintained, markets are open and functioning, and the capacity of the financial system to finance growth is preserved.[30]

At the local level, if regulatory entities and central banks are not grouped under a single body, there must be a constant flow of communication and information to avoid measures with adverse impacts on any of the parties involved. Likewise, the relationship and coordination with the government is important to avoid misinformation and the implementation of popular measures that could have a negative effect in the long term.

AVOID DEPENDENCE ON THE MEASURES

The measures taken during the state of emergency should not generate dependency, since they are of a transitory nature. However, there are rules that arise from the exceptionality, and it is worth maintaining them over time, such as the periodic sending of reports and the measures on non-face-to-face identification of clients (digital onboarding).

CONTINUOUS MONITORING BY THE REGULATOR OF THE DEFINED MEASURES

Supervisors are recommended to continuously monitor the situation to foresee if it is necessary to adapt or issue new regulatory facilities according to the circumstances of the crisis. Likewise, special emphasis should be placed on: (i) intensive monitoring of financial and operational indicators, as well as the corporate governance of financial entities; (ii) management and training on new risks and on the increase of existing ones; and (iii) constant communication with supervised entities to become a bridge of communication with consumers.

29/ European Systemic Risk Board (2020), "Monitoring the financial stability implication of COVID-19 support measures".

30/ Financial Stability Board (2021), "Lessons Learnt from the COVID-19 Pandemic from a Financial Stability Perspective".

VI. CONCLUDING REMARKS

As mentioned above, the crisis has been addressed by the different regulators and financial institutions in Latin America and the Caribbean through the implementation of measures in the areas of credit risk, liquidity risk, solvency, business continuity risk, digitalization, and reporting, which have similarities but significant differences according to individual contexts and possibilities.

In general, the provisions were effective in ensuring the stability of the financial system. Nevertheless, it is essential to maintain and strengthen control and monitoring systems. Likewise, in order to strengthen the financial system to face future crises, regulators should continue to follow and evaluate the evolution of the financial market in order to act in a quick and efficient manner, if necessary.

VII. ANNEXES

<table>
<tr><th></th><th>MEASURES</th><th>ASSOCIATED IMPACTS</th></tr>
<tr><td rowspan="6">CREDIT RISK MEASURES</td><td>Modification of loan agreements and renegotiation facilities</td><td rowspan="2">The rescheduling of loans has allowed a large number of debtors to avoid default and, therefore, maintain their credit rating. However, this measure has not prevented delinquency rates from increasing as the grace periods granted expire.</td></tr>
<tr><td>Providing temporary relief to debtors (individuals or companies) and recognizing the limitations they may face in conducting their normal operations, especially in countries that had implemented the most rigid lockdowns.</td></tr>
<tr><td>Creation and use of provisions.</td><td rowspan="2">By not modifying credit ratings or creating new provisions, financial institutions may not have sufficient resources to face future losses in the event that debtors are unable to meet their obligations after the end of the grace periods and payment plan.</td></tr>
<tr><td>Some institutions have set up additional provisions to ensure that the component of uncertainty becomes evident in their balance sheets.</td></tr>
<tr><td>Treatment of collateral.</td><td rowspan="2">In the event that clients do not recover their payment habits after the due date, these measures may increase their credit exposure and make it impossible for financial institutions to maintain the coverage levels defined within their credit risk management.</td></tr>
<tr><td>As part of the loan modification, specific conditions were established for the treatment of collateral, as considering that the actual value of the collateral as updated until the end of the state of emergency, regardless of whether a new appraisal was required.</td></tr>
<tr><td rowspan="2">LIQUIDITY RISK MEASURES</td><td>Financing to financial institutions and injecting liquidity into the system.</td><td rowspan="2">The implementation of these measures may reduce the capacity of financial institutions to react to unexpected bank runs derived from the global health crisis.</td></tr>
<tr><td>In order to encourage funding to institutions and inject liquidity into the system, some authorities reduced reference rates and relaxed reserve requirements on time deposits, in order to compensate for the reduction in deposits that banking institutions would have had.</td></tr>
<tr><td rowspan="2">SOLVENCY RISK MEASURES</td><td>Other countries also reduced the percentage of minimum capital requirements to cover unexpected losses and maintain solvency levels in crisis situations.</td><td rowspan="2">Reluctance of financial institutions to draw on accumulated capital buffers, despite maintaining a margin above minimum requirement.</td></tr>
<tr><td>Allowing the use of capital buffers to offset negative impacts on income and provisioning levels during the pandemic and to increase the placement of loan resources.</td></tr>
</table>

	MEASURES	ASSOCIATED IMPACTS
BUSINESS CONTINUITY MEASURES	Strengthen contingency plans and establish a greater number of controls to guarantee operational continuity in the current scenario.	The crisis put business continuity plans to the test and demonstrated that some entities had not correctly identified the risks that a pandemic represents both for people and for the organization's systems.
USE OF DIGITAL CHANNELS	As this was a health crisis, financial institutions had to adhere to the protocols issued by their jurisdictions to keep certain offices open or closed and to oversee and process cash.	The confinement measures increased the speed of digital transformation of the financial sector, while at the same time reducing the bureaucracy of some of its services. Although a large part of the banks had digitalization strategies in place, a considerable number of services were only offered physically in the branches.
	Some jurisdictions implemented reforms in their customer identification regulations (digital onboarding) to achieve greater robustness, security, flexibility, and inclusion in digital processes.	The increase in the use of and dependence on digital channels for financial services has raised the exposure of banking institutions and users to greater cyber and fraud risks, which could have an impact on financial stability and customer confidence.

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Caribbean Region

Central Bank of Belize
Banco Central de Cuba
Bank of Guyana
Bank of Jamaica
Banque de la République d' Haïti
Cayman Islands, Monetary Authority
Centrale Bank van Aruba
Centrale Bank van Curaçao en Sint Maarten
Eastern Caribbean Central Bank
Financial Services Regulatory Commission, Antigua y Barbuda
Turks & Caicos Islands Financial Services Commission
Central Bank of Barbados
Central Bank of the Bahamas
Central Bank of Trinidad and Tobago
Centrale Bank van Suriname
Financial Services Commission, British Virgin Islands

Central American Region

Superintendencia de Bancos, Guatemala
Comisión Nacional de Bancos y Seguros, Honduras
Superintendencia de Bancos y de Otras Instituciones Financieras de Nicaragua
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Superintendencia General de Entidades Financieras, Costa Rica
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North American Region

Board of Governors of the Federal Reserve System, USA
Office of the Comptroller of the Currency, USA
Federal Deposit Insurance Corporation, USA
Comisión Nacional Bancaria y de Valores, México

Southern Cone Region

Comisión para el Mercado Financiero, Chile
Banco Central do Brasil
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LESSONS LEARNED FROM THE REGULATORY MEASURES IMPLEMENTED TO FACE THE COVID-19 EMERGENCY

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