EUROPEAN CENTRAL BANK

BANKING SUPERVISION

European banking supervision measures in the context of the coronavirus (COVID-19) pandemic

Florence School of Banking & Finance

Online debate

28 May 2020

Edouard Fernandez-Bollo

Member of the Supervisory Board of the ECB

Main features of European banking supervision measures during the coronavirus crisis

- Prompt
- Balanced
- Risk-sensitive
- Transparent

All the information about ECB Banking Supervision’s response to the COVID-19 pandemic can be found on the dedicated webpage in all official EU languages

Supervisory mitigating measures: capital, liquidity and operational relief

Press release 12 March

- Banks can fully use capital and liquidity buffers, including Pillar 2 guidance
  - Banks are temporarily allowed to operate below the level of capital defined by the Pillar 2 guidance (P2G) and the capital conservation buffer (CCB), and below the liquidity coverage ratio (LCR)
- Frontloading the change of Pillar 2 into Pillar 1 capital composition
  - Banks are allowed to partially use capital instruments that do not qualify as CET1 capital, i.e. Additional Tier 1 or Tier 2 instruments, to meet the Pillar 2 requirements (P2R)
- Operational measures such as the postponement of existing deadlines and new decisions
  - Postponement of deadlines for remedial actions by six months (e.g. on-site inspections (OSIs), targeted review of internal models (TRIM) and Supervisory Review and Evaluation Process (SREP) 2019) and postponement of ECB data requests and deep dives
  - ECB supports the decision by the European Banking Authority to postpone the 2020 EBA EU-wide stress test and extends the postponement to all banks subject to the 2020 stress test

Supervisory mitigating measures: flexibility on NPLs and IFRS 9

Press release 20 March

- Relief measures regarding asset quality deterioration and non-performing loans (NPLs)
  - Support initiatives aimed at providing sustainable solutions to temporarily distressed debtors in the context of the current outbreak
- Flexibility in prudential treatment of loans, in particular to allow banks to fully benefit from public support measures
  - Flexibility regarding the classification of debtors as “unlikely to pay”
  - Preferential prudential treatment in terms of supervisory expectations about loss provisioning for loans which become non-performing and are under public guarantees
  - Full flexibility when discussing the implementation of NPL reduction strategies with banks
  - Crucial that banks keep identifying and reporting asset quality deterioration and NPLs pursuant to existing regulations in order to maintain a clear and accurate picture of the risks in the banking sector
- Avoid excessive procyclicality in International Financial Reporting Standards (IFRS)
  - Use of transitional IFRS 9 arrangements foreseen in Capital Requirements Regulation (CRR)
  - Greater weight given to long-term stable outlook evidenced by past experience when estimating long-term expected credit losses (follow-up letter to CEOs of 1 April)

Supervisory mitigating measures: recommendation on dividend distributions

Press release 27 March

- Recommendation not to pay dividends for 2019 and 2020 and to refrain from share buy-backs aimed at remunerating shareholders until at least October 2020
  - Capital resources should be kept within the banking system amid the COVID-19 crisis so banks retain their capacity to lend to the real economy

- Recommendation does not apply to AT1 coupons
  - AT1 coupon payments will only be restricted if banks dip into the combined buffer requirement

Supervisory mitigating measures: relief for capital requirements for market risk

Press release 16 April

- Temporary reduction in capital requirements for market risk
  - Qualitative market risk multiplier set by supervisors is temporarily reduced
  - ECB responds to extraordinary levels of volatility in financial markets since the outbreak of the coronavirus

Supervisory mitigating measures: pragmatic approach to SREP 2020

Blog post by Elizabeth McCaul (Member of the Supervisory Board) and Supervision Newsletter

- Joint Supervisory Teams (JSTs) will focus on banks' ability to respond to COVID-19
- Previous SREP decisions on P2R/P2G for all banks remain in force unless changes are justified by exceptional circumstances affecting an individual bank
- Pragmatic approach to the collection of information on the internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP)
  - Submission deadline remains end of April
  - Banks are exempted from a number of formal requirements
- Supervisors will focus on collecting and assessing evidence on banks' current processes for managing capital and liquidity, including:
  - Banks' internal decision-making
  - Banks' ability to update capital/liquidity and funding plans in a timely manner
  - Banks' stress-testing scenarios
- Adjusted timeline to allow banks to deliver reliable estimates of the impact of COVID-19
  - Recommendations resulting from the SREP assessment to be communicated in November and December 2020

Supervisory mitigating measures: operational relief

Blog post by Elizabeth McCaul and ECB public FAQ

- EU-wide stress test exercise postponed to 2021
  - In May the European Banking Authority (EBA) launched an EU-wide transparency exercise to provide market participants with updated information on banks' exposures and asset quality as of 31 December 2019
- Fewer requirements for recovery plans
  - Banks with stable recovery plans can submit only the core elements (indicators, options, overall recovery capacity) of their 2020 plans, focusing on current stress related to COVID-19
  - Banks can address only key deficiencies identified in the 2019 recovery plans
- Numerous JST analyses, deep dives, data requests postponed
- Deadlines for remedial actions imposed in the context of on-site inspections, TRIM investigations and internal model investigations postponed by six months
- Issuance of future TRIM decisions, on-site follow-up letters and internal model decisions not yet communicated to banks postponed by six months

Estimated effect of mitigating measures

- Estimated impact of P2G release and change of P2R composition: €120 billion CET1 capital
  - This relief is available for banks to absorb losses without triggering supervisory actions or to potentially finance up to €1.8 trillion of loans to households and corporate customers in need of extra liquidity
- Recommendations on dividend distribution strengthens banks' capital base
  - At an aggregate level, significant institutions originally proposed paying €35.6 billion in dividends for the 2019 financial year. Of this, €27.5 billion has not been paid out, almost €6.2 billion had already been paid out by the time the ECB's recommendation was published, and just under €2 billion was paid out after the recommendation was published, for instance because it was not possible to reverse a decision taken at a general shareholders' meeting
- Temporarily reducing capital requirements for market risk and, hence, smoothing procyclicality will maintain banks' ability to provide market liquidity and continue their market-making activities
- SREP 2020 will require significantly fewer resources from banks compared with normal SREP cycles
- Postponing existing deadlines and new decisions will reduce the operational pressure on banks