

## **ANNEX: Regulatory adjustments**

### **1. Leverage ratio adjustments to exclude State guaranteed exposures, as well as sovereign bonds, and postponement of SA-CCR**

#### **1.1. Leverage ratio exemptions**

According to the European Commission's "quick fixes" to the CRR<sup>1</sup>, the leverage ratio requirement will officially enter into force in 1 January 2023. However, in practice, the current experience with the market demonstrates that it is already treated as a binding requirement, penalising banks with low leverage ratios. As such the current disclosure requirement already acts as a significant constraint on bank balance sheets.

EBF welcomes the Commission's proposal to exempt central bank reserves from the leverage ratio. However, since the disclosure of the leverage ratio also constrains institutions at the moment, we suggest immediately adjusting the offsetting mechanism for central bank reserves in Article 429a (7) of the CRR. Excluding central bank reserves from the leverage ratio exposure measure combined with deleting the requirement to fully offset the excluded exposure would avoid an unlevel playing field.

As Covid-19 requires banks to make use of their capital buffers, the EBF furthermore suggests to temporarily remove the requirement that exposures guaranteed by governments, as well as sovereign bonds will have to be counted towards the leverage ratio. This would also reflect measures taken in other jurisdictions, such as the US<sup>2</sup>. The exclusion of state-guaranteed loans from the basis for calculating the leverage ratio would be a suitable step towards achieving a level playing field and fostering the granting of publicly guaranteed loans. The existing exemptions under Article 429a (1)(e) of CRR II simply needs to be extended.

Exempting in those exceptional circumstances European government bonds as done in the US would also allow European primary dealers to support the significant increase in issuance by EU governments and institutions, ensure market making and therefore contribute, jointly with the ECB purchase programs, to the downward pressure on spreads and the avoidance of fragmentation. Moreover, an overly stringent treatment would impose too many balance sheet limitations and therefore also limit the effectiveness of the ECB's liquidity support and the guarantees provided by governments.

In addition, in order to soften the expected pressure on the leverage ratio we also recommend bringing forward the already agreed leverage ratio treatment of pending settlements (Art. 429 g CRR II), which allows banks to net cash receivables and payables for certain unsettled trades for calculating the leverage ratio.

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<sup>1</sup> [https://ec.europa.eu/finance/docs/law/200428-banking-package-proposal\\_en.pdf](https://ec.europa.eu/finance/docs/law/200428-banking-package-proposal_en.pdf)

<sup>2</sup> [www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm](http://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm)

Lastly, we would also call on the Commission to consider whether it would be necessary to free up capacity further by excluding reverse repos with European Union central banks from the leverage ratio exposure measure.

To enhance the impact of the leverage ratio adjustment we would like to propose the following regulatory amendments:

**Proposed amendments to the new the European Commission legislative proposal amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic**

**Recital 8**

Current Text	Proposed amendment
<p>Evidence emerged in the context of the COVID-19 pandemic has made apparent that the possibility to temporarily exclude certain central bank exposures from the calculation of an institution's total exposure measure, as laid down in Article 429a of Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876, could prove essential during a crisis situation.</p>	<p>Evidence emerged in the context of the COVID-19 pandemic has made apparent that the possibility to temporarily exclude certain central bank exposures from the calculation of an institution's total exposure measure, as laid down in Article 429a of Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876, could prove essential during a crisis situation. <b>Such temporary discretion should be brought forward at the date of entry into force of this regulation, and apply to the current disclosure requirement, with the relevant central bank being allowed to declare that exceptional circumstances exist from the beginning of the COVID-19 pandemic, and no sooner than 31st Dec 2019.</b></p>

The amendment of recital 8 brings forward the exemption for central bank deposits to avoid a temporary constraint on banks' ability to expand their balance sheets in support of economic activity in the Union before the capital requirement becomes Union law. Given the likely entry into force of this measure being June 2020, i.e. at a point in time where significant CB deposits inflation is likely to have already happened, and given the envisaged off-setting modification, it is necessary to allow the central bank to declare exceptional circumstances at the beginning of the Covid-19 pandemic.

**Proposed amendments to the new the European Commission legislative proposal amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic**

**Article 2**

Current Text	Proposed amendment

<p>Article 3 of Regulation (EU) 2019/876 is amended as follows:</p> <p>(1) the following paragraph 3a is inserted:</p> <p>“3a. The following points of Article 1 of this Regulation shall apply from [date of entry into force of this amending Regulation]:</p> <p>...</p> <p>(d) new</p>	<p>Article 3 of Regulation (EU) 2019/876 is amended as follows:</p> <p>(1) the following paragraph 3a is inserted:</p> <p>“3a. The following points of Article 1 of this Regulation shall apply from [date of entry into force of this amending Regulation]:</p> <p>(d) Article 429a, as regards the discretion to temporarily exclude certain exposures from the leverage ratio, subject to the relevant central bank allowed to declare that exceptional circumstances exist no sooner than [6] months before the date of the declaration.</p>
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**Proposed amendments to the new the European Commission legislative proposal amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic**

**Recital 8**

<b>Current Text</b>	<b>Proposed amendment</b>
<p>...the offsetting mechanism should be modified before the leverage ratio requirement set out in point (d) of Article 92(1) of Regulation (EU) No 575/2013 becomes applicable in accordance with Union law on 28 June 2021.</p>	<p>...the offsetting mechanism should be modified <b>as of entry into force of this regulation for the current reporting requirement, as well as for the capital requirement</b> before the leverage ratio set out in point (d) of Article 92(1) of Regulation (EU) No 575/2013 becomes applicable in accordance with Union law on 28 June 2021.</p>

This amendment of recital 8 brings forward the offsetting mechanism linked to the exemption for central bank deposits to avoid a temporary constraint on banks’ ability to expand their balance sheets in support of economic activity in the Union before the capital requirement becomes Union law.

**1.2. Postpone the implementation of the Standardised Approach for Counterparty Risk (SA-CRR) by at least one year**

Article 3 of CRR2 included a new standard methodology for determining capital requirements for counterparty risk (SA-CCR). Given that the standard methodology for counterparty risk has an impact on many other parts of the Basel regulatory framework – for example the leverage ratio where the impact is particularly significant in comparison with the existing Current Exposure Method (CEM) – the Commission should consider, to postpone the SA-CCR implementation by at least 1 year. In addition, this will allow institutions to have more time to deal with deadlines and can be re-allocated the scarce resources to deal first with the COVID crisis. This decision would be taken in the same

spirit as the decision of the Basel Committee to postpone the Finalisation of Basel III. Alternatively, the Commission could decide to give institutions the option to either implement the SA-CCR with a one-year delay, or to implement it in June 2021 under the condition of supervisory approval.

## **2. Adjust CRR to reflect measures taken by the Basel Committee on transitional arrangements for expected credit loss accounting**

On April 3, the Basel Committee on Banking Supervision has published a document titled "Measures to reflect the impact of Covid-19"<sup>3</sup>. The EBF would like to ask policy makers to incorporate the additional flexibility granted by the Basel Committee regarding transitional arrangements for the regulatory capital treatment of expected credit losses. The current proposal of the European Commission only modifies the dynamic approach. However, we would like to ask the Commission to take full advantage of the flexibility granted by the BCBS and also allow an "add back" of 100% of the transitional adjustment amount to CET1 also for the static approach instead of 70%.

## **3. Deduction of NPEs and treatment of State guarantees in NPL backstop regulation**

Covid-19 outbreak will have relevant impacts on all economic and business cycles, including banking procedures. In many countries civil courts are being closed or their activity is significantly reduced and recovery processes postponed or delayed at least. This will permanently increase the length of recovery actions, with negative impacts on the NPL primary and secondary markets too, at least for some years to come.

To this end, given the extraordinary circumstances, article 47c of Regulation EU No 575/2013 (as amended by Regulation EU 2019/630) should be amended as to shift forward the provisioning curves for, at least 18 months, until the end of a reasonable transitional period, i.e. until 31.12.2023.

Such measure should apply to both secured and unsecured exposures.

In addition, the CRR should be amended in order to clarify that competent authorities should not accelerate the calendar provisioning by asking for application of such provisions significantly prior to the effective dates outlined in the CRR. This is necessary because the provisioning already applies for significant institutions since 26 April 2019 due to the guidance of their competent authority. Besides being not in line with the intention of the legislator, this is counterproductive in light of the current crisis.

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<sup>3</sup> <https://www.bis.org/bcbs/publ/d498.pdf>

**Proposed amendments to  
REGULATION (EU) No 575/2013**

**Article 47c(3) introduced by Regulation (EU) 2019/630**

Current Text	Proposed amendment
<p>3. For the purposes of point (a)(ii) of paragraph 1, the following factors shall apply:</p> <p>(a) 0,25 for the secured part of a non-performing exposure to be applied during the period between the first and the last day of the fourth year following its classification as non-performing;</p> <p>(b) 0,35 for the secured part of a non-performing exposure to be applied during the period between the first and the last day of the fifth year following its classification as non-performing;</p> <p>(c) 0,55 for the secured part of a non-performing exposure to be applied during the period between the first and the last day of the sixth year following its classification as non-performing;</p> <p>(d) 0,70 for the part of a non-performing exposure secured by immovable property pursuant to Title II of Part Three or that is a residential loan guaranteed by an eligible protection provider as referred to in Article 201, to be applied during the period between the first and the last day of the seventh year following its classification as non-performing;</p> <p>(e) 0,80 for the part of a non-performing exposure secured by other funded or unfunded credit protection pursuant to Title II of Part Three to be applied during the period between the first and the last day of the seventh year following its classification as non-performing;</p> <p>(f) 0,80 for the part of a non-performing exposure secured by immovable property pursuant to Title II of Part Three or that is a residential loan guaranteed by an eligible protection provider as referred to in Article 201, to be applied during the period</p>	<p>3. For the purposes of point (a)(ii) of paragraph 1, the following factors shall apply:</p> <p>(a) 0,25 for the secured part of a non-performing exposure to be applied during the period between the first and the last day of the fourth year following its classification as non-performing;</p> <p>(b) 0,35 for the secured part of a non-performing exposure to be applied during the period between the first and the last day of the fifth year following its classification as non-performing;</p> <p>(c) 0,55 for the secured part of a non-performing exposure to be applied during the period between the first and the last day of the sixth year following its classification as non-performing;</p> <p>(d) 0,70 for the part of a non-performing exposure secured by immovable property pursuant to Title II of Part Three or that is a residential loan guaranteed by an eligible protection provider as referred to in Article 201, to be applied during the period between the first and the last day of the seventh year following its classification as non-performing;</p> <p>(e) 0,80 for the part of a non-performing exposure secured by other funded or unfunded credit protection pursuant to Title II of Part Three to be applied during the period between the first and the last day of the seventh year following its classification as non-performing;</p> <p>(f) 0,80 for the part of a non-performing exposure secured by immovable property pursuant to Title II of Part Three or that is a residential loan guaranteed by an eligible protection provider as referred to in Article 201, to be applied during the period</p>

<p>between the first and the last day of the eighth year following its classification as non-performing;</p> <p>(g) 1 for the part of a non-performing exposure secured by other funded or unfunded credit protection pursuant to Title II of Part Three to be applied as of the first day of the eighth year following its classification as non-performing; (h) 0,85 for the part of a non-performing exposure secured by immovable property pursuant to Title II of Part Three or that is a residential loan guaranteed by an eligible protection provider as referred to in Article 201, to be applied during the period between the first and the last day of the ninth year following its classification as non-performing;</p>	<p>between the first and the last day of the eighth year following its classification as non-performing;</p> <p>(g) 1 for the part of a non-performing exposure secured by other funded or unfunded credit protection pursuant to Title II of Part Three to be applied as of the first day of the eighth year following its classification as non-performing; (h) 0,85 for the part of a non-performing exposure secured by immovable property pursuant to Title II of Part Three or that is a residential loan guaranteed by an eligible protection provider as referred to in Article 201, to be applied during the period between the first and the last day of the ninth year following its classification as non-performing;</p> <p>3b) By way of derogation from paragraph 2 and 3 until 31 December 2023 the applicable factors should be determined by adding 18 months to the date indicated thereof.</p> <p>4) The dates of application are binding for institutions and competent authorities. Competent authorities shall not apply measures that would bring the application of this rule forward.</p>
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As regards state guarantees, the European Commission, in its targeted proposal, recognised that the rules on the minimum loss coverage for non-performing exposures (NPEs) of Regulation 630/2019 need to be adjusted recognise the similar characteristics shared by export credit agencies guarantees and Covid-19 related guarantees. Therefore, the EC introduced the new Article 500a "Temporary treatment of public guarantees related to the COVID-19 pandemic", which allows banks to adopt the same provisioning path as the one used for NPEs backed by ECAs as of the entry into force of the new Regulation (probably on June 2020) for the following 7 years (until 2027).

On 20 March 2020, the European Central Bank (ECB) already allowed for a similar treatment in its FAQs on ECB supervisory measures in reaction to the coronavirus, by extending to publicly guaranteed loans the preferential treatment foreseen in the ECB Guidance for NPLs for loans guaranteed or insured by Official Export Credit Agencies. The ECB specify that this means that banks would face a 0% minimum coverage expectation for the first seven years of the NPE vintage count. The ECB encouraged the European co-legislator to consider adopting a similar interpretation, as the European Commission is doing in its proposal.

The main difference between the treatment proposed by the ECB and the European Commission is the time limit. In fact, while the ECB recognises that state guarantees should be considered as equal to ECAs guarantees and specifies what is the treatment for loans backed by the ECAs, i.e. 0% minimum loss provisioning for the first 7 years of vintage count, the European Commission limit this treatment to the first 7 years by the entry into force of the new Regulation.

By temporarily limiting the treatment, the Commission will prevent several loans, originated as of the entry into force of the new Regulation, from reaping the benefits of the amendment. Moreover, this treatment is based on the assumption that these guarantees have comparable credit risk mitigation effects, which seems to be inconsistent with the final proposal of the application of a 7 years-time limit, which is not anchored to the vintage count but to the date of entry into force (probably June 2020).

**Proposed amendments to the new Article 500a introduced by the European Commission legislative proposal amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic**

Current Text	Proposed amendment
<p>By way of derogation from Article 47c(3), until [date of entry into force of this amending Regulation + 7 years] the factors set out in Article 47c(4) shall also apply to the part of the non-performing exposure guaranteed by an eligible provider referred to in points (a) to (e) of Article 201(1), where, subject to compliance with Union State aid rules, where applicable, the guarantee or counter-guarantee is provided as part of support measures to assist borrowers amid the COVID-19 pandemic.</p>	<p>By way of derogation from Article 47c(3), until <del>[date of entry into force of this amending Regulation + 7 years]</del> the factors set out in Article 47c(4) shall also apply to the part of the non-performing exposure guaranteed by an eligible provider referred to in points (a) to (e) of Article 201(1), where, subject to compliance with Union State aid rules, where applicable, the guarantee or counter-guarantee is provided as part of support measures to assist borrowers amid the COVID-19 pandemic.</p>

**4. Regulatory amendments related to market risk**

**4.1. VaR multipliers for Internal Model Approaches in market risk**

Due to Covid-19, we see currently extraordinary levels of volatility in financial markets. As a result, institutions’ Value at Risk (VaR) metrics have increased significantly and it has been observed that for some institutions the VaRs have trebled in just a few weeks. This will lead to a number of overshootings within the regulatory backtesting programme and institutions are expected to reach the maximum allowed number of backtesting exceptions in a rather short time frame. Even a daily recalibration of the VaRs (i.e. daily incorporating new events in its tails as they unfold in the market) will not appropriately capture the new environment as the markets keep generating larger extreme events. As banks will quickly

reach the maximum add-on to the multiplier, the automatic mechanism of the quantitative market risk multiplier will increase the VaR metric by around 30% for one year even though this metric has already been adjusted to reflect the extraordinary volatility. Although the analysis of the reasons for an overshooting is essential under all conditions, the case-by-case analysis of each exception cannot alone provide a sufficient remedy under the current conditions. Moreover, the Stress VaR window, which is typically referencing the post-Lehman period, will most likely shift to the current window. As a consequence, VaR and Stressed VaR will reference the same period, will capitalise the same market events, leading to a double counting in regulatory requirements and the procyclicality of the Stress VaR.

Therefore, the EBF proposes to suspend the automatic increase of the multiplier until the extreme events of the COVID Crisis will be driving the current VaR window. To this end we would suggest amending the CRR as explained below. Furthermore, we would suggest suspending mandatory model reviews that might result from backtesting overshootings in order to account for the unfolding of a new stress window, which is already capitalised through the Stressed VaR, rather than IMA deficiencies.

**Proposed amendments to  
REGULATION (EU) No 575/2013  
Article 366 (4)**

Current Text	Proposed amendment
4. The competent authorities may in individual cases limit the addend to that resulting from overshootings under hypothetical changes, where the number of overshootings under actual changes does not result from deficiencies in the internal model.	The competent authorities may in individual cases <del>limit</del> <b>decide not to increase</b> the addend to <del>that resulting from overshootings under hypothetical changes, where the number of</del> <b>and</b> overshootings under actual changes <b>that</b> does not result from deficiencies in the internal model.

**4.2. Remove the asymmetrical treatment on Funding Valuation Adjustment (FVA) and Credit Valuation Adjustment (CVA) and their market hedges.**

The unprecedented market volatility of market risk factors (in particular interest rate and exchange rates) observed during the COVID period has translated, for many institutions, into a very substantial RWA inflation linked to xVA market risk exposures and its associated xVA market risk hedges.

In some institutions, this is exacerbated by an inconsistent internal capital treatment of these two components (Pillar 1 vs Pillar 2) – and these banks are looking for swift ways to address this inconsistency, which would allow deployment of capital to the real economy and benefit end-user of the derivative market



## 5. Revision of provisioning calendar for export credit exposures

As Covid-19 will negatively impact the amount of NPLs in the EU the EBF would like to call on policy makers to give a more appropriate recognition of export credit insurance. As also remarked by the EBA in their *Policy advice on the Basel III reforms: Credit risk*<sup>4</sup> of August 2019, it would be desirable to align article 213 CRR (see drafting proposal below) with the Basel standards on the treatment of guarantees, which grants the possibility for the guarantor to either make a lump sum payment or assume future payment obligations of the defaulted obligor. This would lead to a more sensible use of prudential provisions, which is particularly relevant given the current situation.

Flexibility should also be granted in order to interpret the term “timely manner” contained in Article 215 CRR. Public guarantees provided under COVID could be permitted to comply with the “timely manner” requirement in a flexible way.

Moreover, article 47c of the NPL backstop regulation<sup>5</sup> should be amended to remove the need for prudential provision for the secured part of an NPL as long as the guarantor has complied with its obligations and is expected to do so in the future. This should apply to all guarantees issued by an eligible provider of guarantee as defined in the CRR. This is also justified by the current experience with the repayment by Export Credit Agencies, which demonstrates that the cover does work and there is therefore no need for additional provisioning of the secured part.

**Proposed amendments to  
REGULATION (EU) No 575/2013  
Article 213 (1)**

Current Text	Proposed amendment
<p>1. Subject to Article 214(1), credit protection deriving from a guarantee or credit derivative shall qualify as eligible unfunded credit protection where all the following conditions are met:</p> <p>(a) the credit protection is direct;</p> <p>(b) the extent of the credit protection is clearly defined and incontrovertible;</p> <p>(c) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the lender, that:</p> <p>(i) would allow the protection provider to cancel the protection unilaterally;</p>	<p>1. Subject to Article 214(1), credit protection deriving from a guarantee or credit derivative shall qualify as eligible unfunded credit protection where all the following conditions are met:</p> <p>(a) the credit protection is direct;</p> <p>(b) the extent of the credit protection is clearly defined and incontrovertible;</p> <p>(c) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the lender, that:</p> <p>(i) would allow the protection provider to cancel the protection unilaterally;</p>

<sup>4</sup> EBA [POLICY ADVICE ON THE BASEL III REFORMS: CREDIT RISK](#), p. 91

<sup>5</sup> REGULATION (EU) 2019/630 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures

<p>(ii) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;</p> <p>(iii) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purposes of recognising guaranteed residual value under Articles 134(7) and 166(4);</p> <p>(...)</p>	<p>(ii) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;</p> <p>(iii) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purposes of recognising guaranteed residual value under Articles 134(7) and 166(4). <b>The condition of timely repayment should be considered as satisfied if the guarantor makes a lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal action in order to pursue the counterparty for payment;</b></p> <p>(...)</p>
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### Proposed amendments to

### REGULATION (EU) No 575/2013

### Article 47c introduced by Regulation (EU) 2019/630

Current Text	Proposed amendment
<p>4. By way of derogation from paragraph 3, the following factors shall apply to the part of the non-performing exposure guaranteed or insured by an official export credit agency:</p> <p>(a) 0 for the secured part of the non-performing exposure to be applied during the period between one year and seven years following its classification as non-performing; and</p> <p>(b) 1 for the secured part of the non-performing exposure to be applied as of the first day of the eighth year following its classification as non-performing.</p>	<p>4. By way of derogation from paragraph 3, the following factors shall apply to the part of the non-performing exposure guaranteed or insured by an official export credit agency:</p> <p>(a) 0 for the secured part of the non-performing exposure to be applied during the period between one year and seven years following its classification as non-performing; <b>and</b></p> <p>(b) 1 for the secured part of the non-performing exposure to be applied as of the first day of the eighth year following its classification as non-performing-; <b>and</b></p>

	<p>(c) by way of derogation from point b of paragraph 4, a factor of 0 should be applied to the secured parts of an exposure as of the first day of the eighth year following its classification as non-performing if the guarantor has complied with its obligations and is expected to do so in the future. This treatment should be to all guarantees issued by an eligible provider of guarantee as defined in article 201 and 202, including by export credit agencies.</p>
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