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Mr Valdis DOMBROVSKIS

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**SUBJECT: Follow-up to EBF call for European measures to face COVID-19 outbreak**

Dear Executive Vice-President Dombrovskis,

On 11 March the EBF sent a communication to the Commission, the EBA, the ECB, the SSM and the SRB, calling for certain European measures to be adopted to face the financial challenges posed by the COVID-19 outbreak. The following day, the ECB published its monetary policy decisions and temporary capital and operational relief measures. Since then, all EU authorities have announced a range of policy measures in their respective statements.

At this point, the challenge for authorities and banks is to make those measures fully effective and useful for the objective of maintaining the level of financing to the European economy, while at the same time, ensuring that its banking system withstands the current crisis situation. The whole European banking system is devoted to this endeavour. As we get deeper into the implementation of those measures some impediments and questions arise, which in our view, should be resolved if we are to harness the full potential of the COVID-19 mitigation programme.

Following the structure of themes of our original letter, we are giving you an update with the assessment from the viewpoint of banks, indicating the points that should be completed and the unexpected impediments found. Please see the annex:

1. Moratorium tool (including accounting, NPE-related issues and State guarantees)
2. Prudential buffers (capital, liquidity and leverage)
3. Monetary policy
4. Ceasing procyclicality and increases of regulatory requirements
5. MREL and SRF flexibility
6. Reporting requirements

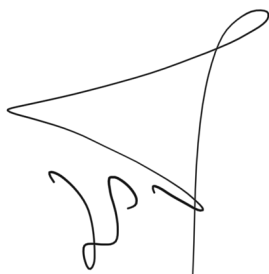
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We are confident that this information will help authorities fine tune their COVID-19 programmes in a coordinated fashion and we remain at your disposal to work out the details in due course.

Yours sincerely,



Jean-Pierre Mustier  
EBF President



Christian Ossig  
EBF Executive Committee Chair



Wim Mijs  
EBF CEO

Copy to:

Mr John BERRIGAN, Director-General DG FISMA, European Commission

Ms Christine LAGARDE, President of the European Central Bank

Mr Andrea ENRIA, Chair of the Supervisory Board of the European Central Bank

Mr José Manuel CAMPA, Chairperson of the European Banking Authority

Dr Elke KÖNIG, Chair of the Single Resolution Board

Mr Luis DE GUINDOS, Vice-President of the European Central Bank

## **ANNEX**

### **1. Moratorium tool**

As requested in the EBF letter, the moratorium *ex-lege* envisaged in level-2 legislation will be extended to private moratoria, according to EBA and ESMA communications. The EBA guidelines on legislative and non-legislative moratoria of 2 April are very welcome, as they specify the terms for general moratorium which is not considered a forbearance measure and should not be considered distressed restructuring, during the moratorium period<sup>1</sup>. In this process, the following questions arise and may require a clarification from the EU authorities:

- 1.1. **National competition law** restrictions could mar the implementation of the EBA moratoria guidelines across Member States. In some countries the slightest coordination in the banking sector, even an informal press release, could be seen as a violation of antitrust legislation. There is need for a swift supporting action from the Commission to remove competition law restrictions for the purpose of COVID-19 moratoria actions at national level.
- 1.2. **NCA notification of non-legislative moratorium:** for the sake of expediency, National Banking Associations (NBA) put in place private moratoria schemes, following the EBA guidelines, without the need to go through an approval process with their National Competent Authorities (NCA). We understand that NCA will only notify to the EBA those schemes when they adapt to the EBA guidelines. This information is valuable for NBA as banks need to ensure that loans affected by the private moratorium will have the same treatment as those affected by the legislative moratorium. It is therefore important to clarify how NBA will be informed about the notifications of their respective NCA to the EBA.
- 1.3. **Ex-ante pan-European coordination:** the EBA requests NCAs information about the moratoria schemes in their jurisdictions for pan-European coordination. However, it would be beneficial to set up an exchange forum of moratoria experiences ex-ante for which purpose the NBAs of the EBF stand ready to participate in coordination with their NCAs and the EBA.
- 1.4. **Extension of SSM measures to the whole EU:** the EBA could make the SSM measures extensible to non-Eurozone countries for the sake of consistency and to harness the full potential of those measures across the entire Union.
- 1.5. **Syndicated loans:** There is need to adopt an automatic recognition criteria of country-specific moratoria schemes in order to be applied by lenders located in different countries. This should be applicable to syndicated loans and loans booked in foreign subsidiaries. In the case of non-EU subsidiaries, there should be a mutual recognition process with at least the key countries where EU banks operate.
- 1.6. **Joint Task Force EBF-NBAs with EU authorities:** the EBF has been very rapid in proposing key measures to mitigate the financial effects of COVID-19, including moratoria schemes. However, we are conscious of the new challenges that the management of these schemes will pose to EU authorities and banks from EU Member States. In the next months we will face important questions like the

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<sup>1</sup> The +/- 1% change in Net Present Value (NPV) criterion in the forthcoming EBA guidelines should be suspended and be assessed flexibly.

seniority of credits, the overlapping of existing collateral and guarantees with the new ones, the workout mechanisms and other important issues that have to be addressed during and after the COVID-19 exceptional period. As Member States are looking to gradually lift the restrictions imposed and return to some form of normality, there will be a process whereby certain sectors may need to be treated differently. This will be essential for a smooth landing into a back-to-normal situation. For that purpose the EBF offers the creation of a joint Task Force with the participation of EU authorities and representatives from the EBF and its NBAs.

- 1.7. **Accounting implications:** EU authorities support the neutralisation of the accounting effect of the moratoria. EBA and ESMA declared that the moratorium should not be considered as an automatic trigger of significant increase in credit risk in the context of IFRS9. The ECB and the PRA also made similar remarks. Likewise, the BCBS recommends that public guarantees or payment moratoriums, granted either by public authorities or by banks on a voluntary basis, should not automatically result in exposures moving to a lifetime expected credit loss measurement.

The IASB published a statement encouraging entities to follow the guidance of their regulators.

Against this background, the EBF recommends that the Commission prepares a regulatory carve-out that might be considered necessary before the closing of the second quarter 2020. It would be a temporary carve-out of the significant increase in credit risk (SICR) section of IFRS9 for exposures affected by COVID-19 that meet the following requirements:

- They were stage 1 as of 31 December 2019;
- they are affected by the COVID-19 crisis;
- there is a reasonable expectation that they will continue to be assessed as a going concern subsequent to the end of the COVID-19 crisis.

- 1.8. **NPL backstop regulation:** The COVID-19 has caused the closing of civil courts and recovery/insolvency procedures. This will provoke not only a delay in recovery timing but even an immediate deflation of NPLs recovery values in NPLs primary and secondary markets, at least temporarily. For this reason, the NPLs provisioning calendar for non-performing exposures in CRR II should be put on hold (e.g. for 18 months) to account for the time that civil court activity is halted and the slowed down recovery actions. This could be achieved through a fast-track CRR amendment, in order to provide for a general suspension clause or a postponement of the prudential backstop in case of economic crisis.

- 1.9. **State guaranteed** exposures should be:

1.9.1. Considered as fulfilling the CRR II Credit Risk Mitigation criteria for capital purposes;

1.9.2. given the same treatment as exposures covered by Export Credit Agencies (ECA):

- the same provisioning calendar, in accordance with the SSM;
- the same risk weights as ECA exposures either under standardized approach or internal rating based approach;
- the same leverage exposure.

## 2. Prudential buffers

As we outlined in our previous letter, the buffers built-up during the decade since the financial crisis should be used to continue providing credit to the economy, which has been broadly recognised by regulators and supervisors. The countercyclical buffer has been reduced significantly in countries where it was present, notably in the UK and in Ireland. Meanwhile, the national systemic buffer is being reduced in countries where it was sizeable. Banks will also be allowed to operate below the levels of Pillar 2 Guidance and the Liquidity Coverage Ratio. In addition, the Pillar 2 Requirement (P2R) could be met with various categories of capital anticipating the revised Capital Requirements Directive (CRD V).

All in all, the PRA and the SSM are clearly supporting the flow of liquidity to the economy showing the utmost flexibility within the confines of the regulatory framework.

- 2.1. **Liquidity Coverage Ratio (LCR):** The exceptional levels of market volatility are causing a pro-cyclical increase in liquidity requirements as extra collateral is posted which feeds through into estimates of future liquidity needs calculated in accordance with the Historic Look Back Approach (HLBA). The authorities could either reduce the HLBA 100% outflow assumption or also consider temporarily permitting any increase to be offset against Pillar 2 liquidity requirements.
- 2.2. **Leverage ratio:** The Leverage Ratio requirements will become applicable in Europe in June 2021 through CRR II. At this moment institutions are just required to disclose information about the calculation of leverage ratio. However, we note that the Federal Reserve has announced measures to enhance the lending space and we think that the EU should follow suit. The EBF proposes:
  - 2.2.1. In order to ensure that banks are appropriately positioned to accompany public sector support measures without undue balance-sheet limitations, the EU should exclude treasuries and cash balances from the leverage ratio as well as the exposures covered by State guarantees, while not applying any offsetting recalibration of the requirement. Otherwise, the leverage ratio will significantly limit the effectiveness of the ECB liquidity support and the guarantees granted by States. The current disclosures should be adjusted accordingly.
  - 2.2.2. Exempting in those exceptional circumstances not only Central Bank deposits, but also 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.
  - 2.2.3. The exemption for promotional loans passed through to other credit institutions granting promotional loans, should be extended to end customers.
  - 2.2.4. The Standardised Approach for Counterparty Credit Risk (SA-CCR) will significantly increase the impact on leverage ratio compared to the current longstanding methodology of the Current Exposure Method (CEM). The EBF requests a postponement of at least one year of the entry into force of the SA-CCR for leverage ratio purposes.

The EBF will continue working closely with supervisors in the monitoring of banks capital, liquidity and leverage during the crisis.

### **3. Monetary policy**

The monetary policy package announced by the ECB on 12 March includes the measures proposed by the EBF, namely the extension of the TLTRO from June 2020 to June 2021 and the bridge from March to June 2020 via weekly auctions. The scope has been enhanced and the funding price is more favourable for banks. The volume of funds that banks can borrow to provide credit to firms and households has been significantly increased.

However, certain details should be refined in order to harness the full potential of this ambitious ECB program:

- 3.1. **Credit growth period:** the condition to benefit from the favourably priced TLTRO is to maintain credit (minimum zero growth) from 1 April 2020 to 31 March 2021. This would leave out the growth experienced in the month of March 2020 when the COVID-19 was already affecting EU economies. Indeed, many borrowers have already increased the use of their credit limits in March 2020 due to COVID-19. Therefore, we think that the ECB should incorporate March 2020 to the equation.
- 3.2. **Credit growth target:** banks can only control the credit supply but not the credit demand. Given the negative GDP prospects, credit demand could be severely reduced making the zero-growth condition unrealistic. In that case, the ECB should still keep the incentive at least for banks which credit level is growing above a baseline scenario to be defined according to the level of credit demand and which could eventually be below zero.
- 3.3. **Credit quality:** for corporates with external rating, the eligibility criteria should be set according to their ratings before the COVID-19 outbreak, therefore neutralising the effect of downgrades due to this crisis. The eligibility criteria should also contemplate corporates with internal rating and non-rated corporates, in particular SMEs. Commercial paper should not be limited to investment grade.
- 3.4. **Eligibility of Asset-Backed Commercial Paper (ABCP):** It is a crucial instrument for the financing of corporate clients and should be eligible for Eurosystem refinancing in order to smoothen the transmission of the ECB monetary policy.
- 3.5. **Harmonisation of eligibility criteria:** The current collateral management system is fragmented and the processes that the different central banks use to accept or reject assets as collateral in the monetary policy framework are not harmonized across Europe. This is not only a procedural aspect but in some countries it significantly hampers the access to the enormous liquidity facility program offered by the ECB. The EBF proposes:
  - Mutual recognition of standards between National Central Banks (NCB)
  - Simplification of eligibility recognition procedures

### **4. Ceasing procyclicality and increases of regulatory requirements:**

The EBF called regulators and supervisors to cease regulatory capital increases underway. The Basel Committee has postponed in one year the implementation of the Finalisation of Basel III. This measure is welcomed because in spite of the phase-in period, it is the full final requirement that is used by investors. The SSM has announced the postponement, by six months, of the issuance of Targeted Review of Internal Models (TRIM) decisions, apart from other qualitative assessments.

The EBF advises to take the following measures in order to favour the availability of regulatory capital for lending:

4.1. **The Prudent Valuation Adjustment** should retain the calibrated charges prior to the COVID-19 turmoil as a quick fix to the pro-cyclical effect and it should be done for the closing of the first quarter. The EBF endorses the letter sent by the CFO Network<sup>2</sup> on this topic and urges the co-legislators to introduce some flexibility in the level 1 text to avoid excessive pro-cyclicality.

4.2. **Internal models:**

- TRIM decisions: the decision to postpone the fulfilment of obligations set out in decisions related to internal models is a suitable measure. To be fully consistent, such a postponement should be supplemented with a suspension of the add-ons that have just been communicated in the previous months in order to keep consistency. Also, the market risk IMA implementation roadmap should be postponed 6 months to account for the blackout period due to COVID-19 thus postponing the deadline of July 2021 to December 2021.
- The COVID-19 crisis could distort the outcome of internal models. There is need for regulatory and supervisory guidance on how to separate the effect of COVID-19 out of the regular estimates of internal models.

4.3. **Software assets** should be risk weighted as ordinary assets (100% risk weight). The EBA was given a mandate in CRR II to revise the deduction of software assets from capital with deadline 30 June 2020. The deadline becomes essential at a time when capital is mostly needed to enable bank lending to the economy. The implementation date should be immediate after publication of the RTS, i.e. June 2020.

4.4. **Supporting Factors to SMEs and infrastructure** should be implemented now with the new definition enshrined in CRR II, instead of waiting until June 2021.

4.5. **The Liquidity Coverage Ratio (LCR) corrigendum** that is planned to enter into force on 30 April 2020, including tighter High-Quality-Liquid-Assets (HQLA) criteria, should be postponed for at least 6 months. It should be revised in order to soften procyclicality.

4.6. **Market risk capital requirements** should not be increased. Supervisors should use the flexibility provided in the regulation (such as the Canadian, Swiss or UK authorities have rightfully done). In particular:

- to exempt the overshooting of market indicators (VaR and SVaR) in the capital requirement multiplier;
- to remove the asymmetrical treatment on Funding Valuation Adjustment (FVA) and Credit Valuation Adjustment (CVA) and their market hedges. We propose that institutions which do not include the FVA and CVA in market risk could remove market hedges of FVA and CVA from the calculation of market risk capital from the beginning of the current fiscal quarter.

4.7. **Basel Committee measures to reflect the impact of COVID-19:** Level 1 legislation should be immediately enacted to reflect the flexibility granted by the BCBS<sup>3</sup> regarding transitional arrangements for the regulatory capital treatment of expected credit losses.

<sup>2</sup> The CFO Network comprises the Chief Financial Officers (CFO) of the largest 22 banks in Europe

<sup>3</sup> [Measures to reflect the impact of COVID-19, BCBS \(April 2020\)](#).

4.8. **The implementation of the new definition of default** should be postponed.

4.9. **Initial margin requirements:** the EU should implement the BCBS-IOSCO recommendation of delaying phases 5 and 6 by one year.

## 5. **MREL and SRF flexibility:**

Two EBF recommendations on this front:

5.1. **MREL requirements** should be eased off according to the upcoming BRRD2, therefore removing the TLOF-based ratio and leaving the risk weighted-asset requirement and reducing the combined buffer requirement from the Loss Absorption Amount (LAA) calculation. All banks should be given the discretion to reach the MREL target levels after a transition period ending in December 2023.

5.2. **SRF contribution** in 2020 should be suspended. It amounts to around 175 billion of credit to the European economy. The timeline should be postponed from 31 December 2023 to 31 December 2024. In the unfortunate case that the National Resolution Authorities do not agree, the alternative would be to postpone the 2020 contribution to the following 3 years in the same proportion. In cases of suspension or postponement of the 2020 contributions, it is essential not to change the calculation method with regard to the weightings of the national/European distribution keys of the calculation bases.

## 6. **Reporting requirements:**

The EBF sent a letter to the EBA and the ECB DG Statistics with proposals for postponement of reporting requirements which are not considered essential. It has been welcomed by both institutions which are examining the proposals. The EBA has invited competent and resolution authorities to postpone by one month reports to be submitted between March and end of May.

The ECB's intention to adjust banks' supervisory programs to allow them to focus their resources on the management of the crisis is welcomed. At the same time, we note that there has been an increasing number of COVID-19-related data collections at short notice. We understand the need for the ECB to properly assess the impact of the crisis, however we would ask for enhanced institutional coordination between the ECB, the NCAs and the national Central Banks to ensure that requests at national and European levels are consistent. This crisis should be an opportunity to make further progress in the convergence between national and European reporting requirements.