FAQs on ECB supervisory measures in reaction to the coronavirus

https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html

To be updated depending on developments. Last updated 29 March 2020.

Section 1 – Relief measures regarding asset quality deterioration and non-performing loans

You announced flexibility when implementing the ECB Guidance on non-performing loans (NPLs). Are you considering forbearance for NPLs? Are you looking at other ways to mitigate the deterioration of asset quality, for example with regard to IFRS9?

The ECB Guidance on NPLs already embeds flexibility and case-by-case assessments by Joint Supervisory Teams (JSTs).

In exercising flexibility, the right balance should be achieved between helping banks absorb the impact of the current downturn, on the one hand, and maintaining the correct risk identification practices and risk management incentives on the other, as well as ensuring that only sustainable solutions for viable distressed debtors are deployed.

It remains crucial, in times of distress, to continue identifying and reporting asset quality deterioration and the build-up of NPLs in accordance with the existing rules, so as to maintain a clear and accurate picture of risks in the banking sector. At the same time flexibility should be deployed to help banks absorb the impact of credit risk developments and mitigate the procyclicality of that impact.
Against the backdrop of these guiding principles, and to complement the case-by-case flexibility embedded in the ECB Guidance on NPLs and in the Addendum the ECB will take the additional actions described below.

In relation to all exposures that will benefit from government guarantees issued by Member States in the context of public interventions relating to the COVID-19 pandemic, the ECB will, within its own remit, act as follows.

- Exercise flexibility within the ECB Guidance on NPL and the Addendum regarding the classification of obligors as unlikely to pay, when institutions call on the COVID-19 related public guarantees, as allowed under the Guidelines issued by the European Banking Authority.

- Extend to such publicly guaranteed loans the preferential treatment foreseen in the Guidance for NPLs guaranteed or insured by Official Export Credit Agencies. Concretely, this means that banks would face a 0% minimum coverage expectation for the first seven years of the NPE vintage count. The ECB encourages the European co-legislator to consider adopting a similar interpretation for all exposures that fall within the scope of the CRR minimum requirements regarding loss coverage for NPEs (Articles 47(a-c) of the CRR).

The ECB also extends flexibility to the unlikely-to-pay classification of exposures covered by legally imposed payment moratoriums related to COVID-19 in regard to timing and scope of the assessment, taking into account all available support measures.

Accounting standards, and their implementation, do not fall within the remit of ECB Banking Supervision, which can take very limited action in this regard. Given that the IFRS9 provisions must be based on macroeconomic forecasts and that, particularly in these times of pronounced uncertainty, IFRS9 model outcomes may be excessively variable and procyclical, the ECB:

1. recommends that institutions under its supervision that have not already done so implement the transitional IFRS 9 arrangements foreseen in the CRR (Article 473(a) of the CRR). The ECB stands ready to process in a timely fashion all applications received in this context
2. recommend on the basis of the prudential mandate set out in Article 16(2) of the SSM Regulation, that, within the framework provided by international accounting standards, institutions give a greater weight to long-term stable outlook evidenced by past experience when estimating long-term expected credit losses for the purposes of IFRS 9 provisioning policies. This appears particularly important where banks face uncertainty in generating reasonable and supportable forecasts. In producing such forecasts banks should take into account the relief measures granted by public authorities – such as payment moratoriums
3. will provide central macroeconomic scenarios to support banks in applying IFRS 9 provisioning policies

   Adopting transitional IFRS 9 implementation measures should allow all banks to filter out from their prudential capital a large part of the additional IFRS 9 volatility from 2020 until the end of the foreseen transitional period. The measures proposed under (2) and (3) should also help mitigate procylicality in banks' published financial statements.

Will you also revise your expectations for the stock of NPLs?

In the context of the financial turmoil triggered by the COVID-19 outbreak, banks should be supported as they provide solutions to viable distressed customers. The stock of NPLs

accumulated prior to the outbreak is not the focus of our current mitigation measures. However, the ECB is fully aware that current market conditions may make the agreed reduction targets difficult to attain and somewhat unrealistic. In this vein, the JSTs will be fully flexible when discussing the implementation of NPL strategies on a case-by-case basis.

Section 2 – Relief measures regarding the operational aspects of supervision

You announced that JSTs would discuss with individual banks a more flexible approach to supervisory processes, timelines and deadlines. Can you be more specific?

Particularly during stressed times, it is of paramount importance to maintain the high quality of ongoing supervisory activities and actions. The ECB is, however, very much aware of the need to support banks at this difficult juncture, when they face not only economic distress but also an impairment of their ordinary working modalities. This means that the supervisory burden on their operations should be alleviated to the maximum extent possible.

Against this backdrop, the ECB clarifies that all decisions and measures taken remain valid while the ECB decides to:

- postpone, by six months, the existing deadline for remedial actions imposed in the context of on-site inspections, TRIM investigations and internal model investigations
- postpone, by six months, the verification of compliance with qualitative SREP measures
- postpone, by six months, the issuance of TRIM decisions, On-Site follow up letters and internal model decisions not yet communicated to institutions, unless the bank explicitly asks for a decision because it is seen as beneficial to the bank

JSTs will be in contact with the banks to provide clarity on the revised implementation timeline of those requirements and their specific application. The six-month delay mentioned above may be extended based on the ECB's further assessment of economic and financial developments.

Section 3 – Relief measures regarding capital and liquidity requirements

Banks will be allowed to operate below the P2G level and to frontload the rules on the composition of P2R originally scheduled to come into force in 2021 with CRD V. Concretely, how much capital relief will this provide?

A release of the full Pillar 2 Guidance (P2G) buffer makes around €90 billion of Common Equity Tier 1 (CET1) capital available to significant institutions supervised by the SSM. With the immediate implementation of Capital Requirements Directive V (CRD V) rules on the composition of Pillar 2 Requirements (P2R), which are less stringent than the composition currently requested by the ECB, around €30 billion of additional CET1 capital will be added to the relief. The two measures combined would provide banks with aggregate relief of roughly €120 billion of CET1 capital. This amount would not require banks to decrease their current management buffer.[1] Overall, this provides significant room for banks to absorb losses on outstanding exposures without triggering any supervisory action.
Taking into account that the average risk of lending to households,small businesses and corporates will most likely increase from current levels as a result of the shock, it is estimated that the capital released by the two measures considered will enable banks to potentially finance up to €1.8 trillion of loans to households, small businesses and corporate customers in need of extra liquidity.[2] Even in the most adverse scenarios, the lending capacity released by the measures remains very substantial.

These estimates do not take into account the beneficial effects of the public guarantees provided by various Member States in favour of household and/or corporate borrowers. As public guarantees substantially reduce the regulatory capital cost of lending and the amount of provisions that banks need to take against expected losses, such public measures increase the lending potential of banks.

How does allowing banks to operate below the P2G help the economy in the current situation?

P2G is a supervisory expectation about the bank's ability to maintain an adequate level of capital to be able to withstand stressed conditions. It should be built up in normal times in order to make banks' capital positions stronger in the event of a crisis. Allowing banks to operate below the level of capital defined by the P2G makes additional resources available to banks that should be used to provide more financial support to the household and corporate borrowers and/or to withstand additional losses on existing exposures to those borrowers.

You said banks can fully use their capital buffers, including the capital conservation buffer (CCB). Does this mean you expect banks' capital losses to reach levels that will deplete the CCB buffer? What are the implications if that happens?

The ECB's indication that banks can also use the CCB buffer is not linked to a specific expectation regarding capital losses. The ECB reminds banks under its supervision that, in these difficult times, all capital buffers including the CCB may be used to withstand potential stress, in line with the initial intentions of the international standard setter on

the usability of the buffers [Newsletter on buffer usability, 31 October 2019]. As indicated in the notes to the press release of 12 March 2020, in the case of banks' capital falling below the combined buffer requirement (CCB, CCyB and systemic buffers), banks can make distributions only within the limits of the maximum distributable amount (MDA) as defined by EU law (please refer also to our previous communication on dividend distribution from the ECB[3] and EBA[4]).

The ECB does not have any discretion to waive the application of automatic restrictions to distributions that are set out in the EU law. However, the ECB decision to frontload the CRD V rules on the composition of P2R reduces the MDA trigger level for banks with enough AT1/T2 capital. This said, the ECB will take a flexible approach to approving capital conservation plans that banks are legally required to submit if they breach the combined buffer requirement.

You allow banks to go below the liquidity coverage ratio (LCR) requirement. What does this imply?

Banks have made important efforts in recent years to reach good levels of liquidity buffers (evidenced by the LCR well above the 100% minimum). These buffers can now be used substantially. This is indeed one of the fundaments of the LCR, fully recognised by the international standards setter[5]. It is key that banks make use of the buffer under stress, even if that means falling substantially below the minimum 100% level, in order to ensure liquidity in the system and avoid contagion effects and chain reactions that might trigger liquidity problems in other institutions. By allowing banks to go below the 100% LCR requirement, we show flexibility while ensuring effective and close supervision of their liquidity situation. In particular, the ECB will take a flexible approach when approving LCR restoration plans which banks are legally required to submit when breaching the LCR requirement.

You will allow banks to temporarily operate below P2G, the CCB and the LCR requirement. What does "temporarily" mean? And, concretely, how much of the P2G and the CCB can be used?

"Temporarily" means until further notice. The ECB will carefully monitor the situation and will review this stance when the economic and financial distress related to COVID-19 fades. Capital buffers may be used in full. Banks should be reassured that supervisors will not attach any negative judgment to those making use of these relief measures at this juncture. Once this period of financial distress is over banks will be granted sufficient time to build up the buffers again.

Section 4 – Other clarifications

You have asked the banks to refrain from paying out dividends until October 2020. How should banks apply this exactly to the dividends for financial years 2019 and 2020?

Dividends for financial year 2019

Following up on the ECB Recommendation (ECB/2020/1), Board of Directors/Supervisory Board of credit institutions may decide

- **Keeping the initial proposal** for distribution of dividends but making conditional the actual payment to the reassessment of the situation once the uncertainties caused by COVID-19 disappear (and, in any case, not before 1 October 2020); or
- **Proposing a change to the dividend policy** whereby no dividend will be distributed for financial year 2019 while committing to a possible distribution of reserves subject to the reassessment of the situation once the uncertainties caused by COVID-19 disappear (and, in any case, not before 1 October 2020).

If the former avenue is followed, the amount of dividends proposed shall continue being deducted from retained earnings for financial year 2019 and hence from CET1 calculations.

If the latter avenue is followed, the amount of dividends initially foreseen can be reintegrated into the 2019 profit and fully included in the retained earnings for this financial year. Thereafter if the situation evolves positively any payment to remunerate shareholders would need to be made out of the credit institution's reserves.

Dividends for financial year 2020

For the recognition of **interim profits** during 2020 (Q1, Q2, Q3), if no change in the dividend policy of the credit institutions has been proposed by its Board of Directors/Supervisory Board, the highest of the three pay-out ratios will need to be deducted from the interim profit: (i) pay-out ratio defined in the dividend policy, (ii) pay-out ratio of the previous year, (ii) average of the pay-out ratios of the last three years. If there is a formal proposal of the Board of Directors/Supervisory Board not to pay dividends until the uncertainties caused by COVID-19 disappear covering also financial year 2020, credit institutions may apply for recognition of the full amount of interim profits without deducting any amount as foreseeable dividends.

What other measures can we expect?

The ECB has taken decisive action to help banks in supporting the real economy. We will continue to closely monitor the developments and their implications for the banking sector, in close contact with other authorities and the banks we supervise. As this is a

rapidly evolving situation, we continue to stand ready to use the flexibility within our supervisory toolkit to take further action. This means we may reassess our course of action, taking into account potential second-round effects.

Annex:

BCBS Statement:https://www.bis.org/publ/bcbs_nl22.htm

[BCBS statement extract]

While each of these buffers seeks to mitigate specific risks, they share similar design features and are all underpinned by the following objectives:

- absorbing losses in times of stress by having an additional overlay of capital that is above minimum requirements and that can be drawn down; and
- helping to maintain the provision of key financial services to the real economy in a downturn by reducing incentives for banks to deleverage abruptly and excessively.

The Committee continues to be of the view that banks and market participants should view the capital buffers set out in the Basel III framework as usable in order to absorb losses and maintain lending to the real economy. In practice, the Basel capital buffers are usable in the following manner:

- banks operating in the buffer range would not be deemed to be in breach of their minimum regulatory capital requirements as a result of using their buffers;
- banks that draw down on their buffers will be subject to the automatic distribution restriction mechanism set out in the Basel III framework; and
- supervisors have the discretion to impose time limits on banks operating within the buffer range, but should ensure that the capital plans of banks seek to rebuild buffers over an appropriate timeframe.

[1] The management buffer is the difference between the available capital of a bank and the capital requirements and buffers set by the supervisor and other authorities (such as macroprudential authorities). The management buffer is an often-used measure for banks to estimate their capacity to cope with unforeseen crisis.

[2] This amount is calculated considering the 75th percentile of the distribution of risk weights applied by significant institutions to households and corporates, reflecting the current composition of banks' balance sheets. Hence, this estimate represents the maximum additional lending that banks could extend to households and corporates in a deteriorated risk environment if they fully use for this purpose the whole €120 billion of capital relief.

[3] Recommendation of the European Central Bank of 17 January 2020 on dividend distribution policies.

[4] EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector, 12 March 2020.

[5] BCBS Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools (January 2013): "*During a period of financial stress, however, banks may use their stock of high quality liquid assets (HQLA), thereby falling below 100%, as maintaining the LCR at 100% under such circumstances could produce undue negative effects on the bank and other market participants. Supervisors will subsequently assess this situation and will adjust their response flexibly according to the circumstances.*"