ALERT MEMORANDUM

COVID-19 – First Measures Adopted by EU Banking Authorities

March 17, 2020

As reported by the World Health Organization, the epicentre of the Coronavirus Disease 2019 ("CoViD-19") has shifted to Europe, with Italy and France among the hardest hit to date.

In addition to posing increasing threats to public health systems, CoViD-19 is expected to severely affect a number of economic sectors, which may in turn test financial institutions' soundness and resilience.

This memorandum is intended to give a brief overview of the initiatives recently announced by the European Central Bank, the European Banking Authority and by French and Italian authorities, aimed at providing relief to financial institutions and notably at ensuring their ability to continue financing the European economy.

We plan to update this memorandum as further measures are adopted and implemented by the EU authorities and by the Member States.

If you have any questions concerning this memorandum, please reach out to your regular firm contact, the following authors or our COVID-19 task force directly by clicking here.

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A. Measures adopted at the EU level

1. Monetary policy

The ECB package announced on March 12, 2020 comprises a set of monetary policies decisions, including, among other things:

i. The introduction of additional longer-term refinancing operations (LTROs), providing liquidity during the period until the fourth operation of TLTRO-III (*i.e.*, June 24, 2020);

ii. The application of more favourable terms to TLTRO-III operations, with the aim of supporting the granting of credit facilities towards households and businesses that will be most affected by the CoViD-19 crisis (with particular regard to SMEs);[1] and

iii. The introduction of an additional Euro 120 billion of net asset purchases to be distributed until the end of the year.

2. Supervision and resolution

The ECB package includes supporting measures aimed at ensuring that banks and financial institutions will continue to be able to effectively support the real economy, without compromising their current prudential robustness, such as:

i. The possibility for banks to temporarily operate below the capital requirements set forth in the Pillar 2 Guidance (P2G) or required by the rules relating to the capital conservation buffer (CCB) and the liquidity coverage ratio (LCR). Considering the aim of these measures, it appears reasonable to expect that the ECB will consequently refrain from taking enforcement action against banks that will avail themselves of this possibility in the coming weeks, although it is not clear whether banks would still be required to submit a plan aimed at restoring compliance with capital and/or and liquidity requirements pursuant to art. 16.2(c) of Regulation No. 1024/2013;

ii. The possibility for banks to partially use non-CET1 instruments (such as AT1 or T2 instruments) in order to meet Pillar 2 requirements. The ECB specified that it will bring forward a measure already included in CRD V, expected to come into force starting from January 2021.[2] In practice, it seems likely that, for the moment, this possibility will be granted by the ECB through *ad hoc* discussions with supervised entities, as part of the generally broad discretion of the ECB in determining the amount and composition of Pillar 2 capital requirements; and

iii. Individual measures to be agreed upon between banks and the ECB, as regards adjustments to timelines, processes and deadlines, the potential re-scheduling of on-site inspections and possible extensions of deadlines for the

[1] The more favourable terms announced by the ECB include, in particular: (i) a reduction of interest rates on TLTRO-III operations between June 2020 and June 2021; (ii) an increase of borrowing allowance under TLTRO-III from 30% to 50% of banks' eligible loans; (iii) the removal of the 10% limit for funds borrowed in a single operation; (iv) a reduction to 0 of the lending performance threshold required to obtain the minimum interest rate under TLTRO-III; and (v) the availability of early repayment options one year after settlement (instead of two years) starting from September 2021.

[2] In particular, the paragraph 4 of art. 104a of CRD V provides that (a) at least three quarters of Pillar 2 requirements shall be met with Tier 1 capital and (b) at least three quarters of the Tier 1 capital referred to in point (a) shall be composed of CET-1 capital.

implementation of remediation plans and internal model investigations.

The ECB has clarified that banks are expected to use regulatory capital released by these measures to provide support to the real economy, not to carry out dividend distributions or increase variable remuneration.

On March 12, 2020, the EBA announced its decision to postpone the 2020 stress tests to 2021, in order to allow banks to focus on continuity of operations and ongoing support to customers. This measure should allow banks to save on operational costs as well. For 2020, the EBA announced that it will carry out an additional EU-wide transparency exercise, in order to obtain updated information on banks' exposures and asset quality.

Furthermore, both the ECB and the EBA have invited national authorities to make use of the "flexibility" embedded in existing regulations – as regards, among other things, the relaxation of countercyclical buffers and the treatment of non-performing and forborne exposures by banks – as well as to evaluate extensions or postponements of current deadlines for non-critical supervisory activities and data requests.

It is difficult at this stage to anticipate the practical impact of such increased flexibility with respect to the treatment of non-performing and forborne exposures – where banks will need additional clarity from regulators.

It will be crucial for banks to have more clarity on the way in which competent authorities intend to use such flexibility so as to be in a better position to understand how it may translate into actual capital relief, while ensuring that a level-playing field is maintained.

In particular, given the current fragmentation of initiatives in favour of borrowers at the Member State level, banks will need to understand to what extent a statutory moratorium, or a bank's decision to adhere to a voluntary moratorium supported by industry associations will trigger a reclassification of the relevant exposures.

From a resolution standpoint, the EU Commission has clarified that it will interpret the term "extraordinary public financial support" in the Bank Restructuring and Resolution Directive (BRRD) as excluding aid aimed at compensating banks for direct damage suffered as a result of COVID-19 under Article 107 (2) (b) TFEU. The upshot of this interpretation is that receipt of this aid will not *ipso facto* trigger placement in resolution.

B. Measures adopted by the *Banque de France* and the *Banca d'Italia*

On March 13, 2020 the *Banque de France* announced its decision to propose a complete relaxation (from 0.5% to 0) of the current countercyclical buffer, maintaining that this has been built up by French banks precisely to face emergency situations like the CoViD-19 crisis.

The *Banque de France* also announced that it will extend the range of banks' exposures towards SMEs that it is prepared to refinance, in order to provide additional facilities for banks that lend to SMEs.

It has mobilized the Credit Mediation Unit (*Médiation du Crédit*) so that it is ready to intervene if companies face difficulties in accessing credit with their local banks as a result of CoViD-19.

Finally, the *Banque de France* also announced that it will closely monitor the situation and liquidity conditions of SMEs throughout France, in order to identify additional measures to be adopted to quickly and effectively address the CoViD-19 emergency.

The *Banca d'Italia* is also currently evaluating measures to support the banking and financial sectors in Italy, with the support of industry associations. In this respect, it should be noted that the countercyclical buffer in Italy is already set at 0.

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