Capital Requirements Regulation: adjustments in response to the COVID-19 pandemic

2020/0066(COD) - 28/04/2020 - Legislative proposal

PURPOSE: to temporarily ease capital requirements to maximise the ability of banks to lend and absorb losses related to the COVID-19 pandemic, while preserving their resilience.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure on an equal footing with the Council.

BACKGROUND: Regulation (EU) No 575/2013 of the European Parliament and of the Council (the Capital Requirements Regulation or CRR) establishes together with Directive 2013/36/EU (the Capital Requirements Directive or CRD) the prudential regulatory framework for credit institutions operating in the Union.

Adopted in the aftermath of the financial crisis in 2007-2008 and largely based on international standards endorsed in 2010 by the Basel Committee on Banking Supervision (BCBS), known as the "Basel III framework", this prudential framework has contributed to enhancing the resilience of institutions operating in the Union and to making them better prepared to face potential difficulties, including difficulties stemming from possible future crises.

The severe economic shock caused by the COVID-19 pandemic and the exceptional containment measures are having a far-reaching impact on the economy. Credit institutions will have a major role to play in the recovery but are likely to suffer from the deterioration of the economic situation.

The competent authorities have granted banks temporary relief from capital, liquidity and operational requirements so that they can continue to play their role in financing the real economy despite a more difficult environment. As a result of the exceptional situation caused by the COVID-19 pandemic, some of these rules can now be applied more flexibly, allowing banks to focus on lending to households and businesses.

At the same time, it is essential that institutions continue to measure risks in an accurate, consistent and transparent manner to be able to monitor the effects of the pandemic on their balance sheets and avoid jeopardising the resilience of the European banking sector.

This proposal is part of a package of measures taken by the European Commission to mitigate the economic impact of the COVID-19 outbreak across the European Union.

CONTENT: the Commission proposes, as a short-term solution, to introduce targeted changes to EU banking prudential rules (the Capital Requirements Regulation) to maximise the capacity of credit institutions to lend and to absorb losses related to the Coronavirus pandemic, while still ensuring their continued resilience.

Transitional arrangements for mitigating the impact of IFRS 9 provisions on regulatory capital

The Commission proposes to amend the transitional arrangements to mitigate the potentially significant negative impact on institutions' Common Equity Tier 1 capital arising from expected credit loss accounting under IFRS 9.

The application of IFRS 9 during the economic downturn caused by the COVID-19 pandemic may lead to a sudden significant increase in expected credit loss provisions, as for many exposures expected losses over their lifetime may need to be calculated. In order to mitigate these potential negative effects, the Commission proposes to extend the current transitional provisions of the CRR by two years. Thus, the reference date for any increase in provisions that would fall under the extended transitional provisions would be moved from 1 January 2018 to 1 January 2020.

The extension of the transitional period would allow institutions to fully add-back to their CET1 capital any increase in new provisions recognised in 2020 and 2021 for their financial assets that are not credit-impaired. The amount that could be added back from 2022 to 2024 would decrease in a linear manner.

Treatment of publicly guaranteed loans under the non-performing loans prudential backstop

Non-performing loans guaranteed official export credit agencies receive a preferential treatment regarding provisioning requirements under the CRR. It is proposed to temporarily extend this preferential treatment to exposures guaranteed or counter guaranteed by the public sector in the context of measures aimed at mitigating the economic impact of the COVID-19 pandemic, subject to Union State aid rules, where applicable. This would take account of the similar risk profile of these guaranteed exposures.

Leverage ratio buffer application date

The latest revision of the CRR imposed a leverage ratio buffer requirement on global systemically important institutions (G-SIIs). The date of application of this new requirement, initially set at 1 January 2022, shall be extended by one year to 1 January 2023. This would free up credit institutions' operational capacity and allow them to focus on the more immediate challenges associated with the COVID-19 pandemic.

Offsetting the impact of excluding certain exposures from the calculation of the leverage ratio

In accordance with the Basel framework, the CRR grants discretionary power, in exceptional circumstances, to temporarily exclude certain central bank exposures from an institutions' total exposure measure. The exemption may be granted for a limited period of time not exceeding one year.

In order to facilitate the effective transmission of monetary policy actions, this discretion shall be implemented together with the leverage ratio requirement on 28 June 2021. However, the current crisis of the COVID-19 showed that the compensation mechanism was too restrictive.

In order to provide greater flexibility to act in possible future crises, the proposal amends the compensation mechanism. In particular, a credit institution that exercises the discretion shall be required to calculate the adjusted leverage ratio only once, namely at the moment it exercises the discretion. The adjusted leverage ratio will apply throughout the full period during which the discretion is exercised and will not change like under the current offsetting mechanism.

Other application dates

The Commission also proposes that the application dates of some of the capital benefits envisaged in the CRR but not yet applicable need to be anticipated, namely: (i) the provisions on the treatment of certain software assets, (ii) the provisions on certain loans backed by pensions or salaries, (iii) the revised

supporting factor for small and medium-sized enterprises (SME) and (iv) the new supporting factor for infrastructure finance. The objective is to allow credit institutions to free up capital and give their lending activity a much-needed boost during the COVID-19 pandemic and its aftermath.