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COVID-19 Update: European Central Bank measures relating to the european financial system

SUMMARY OF THE ECB MEASURES FOR THE EUROPEAN FINANCIAL SYSTEM ADOPTED FROM 12 MARCH 2020 TO 25 MARCH 2020

I. ECB measures adopted on 12 March 2020

Further to the spread of the Covid-19 (*coronavirus*) which has caused an economic shock in the euro area economies, on 12 March 2020 the Governing Council of the European Central Bank ("**Governing Council**") ("**ECB**") decided, *inter alia*, on a comprehensive package of monetary policy measures to mitigate impacts by providing support of liquidity and funding conditions for the euro area financial system (including households, businesses and banks) and help to preserve the smooth provision of credit to the real economy, along with the decision on certain measures related to banks-specific supervisory matters[1].

<u>1. Measures to support bank liquidity conditions and money market activity</u>

First of all, the Governing Council: (*i*) for the period from 17 March 2020 to 24 June 2020, decided to establish an additional longer-term refinancing operations ('LTROs') measures designed to support bank liquidity conditions (in terms of bridge of liquidity needs) and the normal functioning of the euro money market activity; and (*ii*) since 24 June 2020 (which will be the settlement date of the fourth operation of the third series of targeted longer-term refinancing operations ("TLTRO III")), decided to modify (through easing of conditions) certain key parameters of the TLTRO III to provide immediate liquidity support to the euro area financial system[2].

[1] For further information, please refer to:
https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.mp200312~8d3aec3ff2.en.html and https://www.ecb.europa.eu/press/govcdec/otherdec/2020/html/ecb.gc200313~24bd0fa810.en.html.

[2] For further details, please see the related ECB press release of 12 March 2020: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312_2~06c32dabd1.en.html

The TLTRO III operations will support the continued access to bank lending by those affected most by the spread of the coronavirus, in particular small and medium-sized enterprises. Throughout the period from 24 June 2020 to 23 June 2021, more favourable terms will be applied to the TLTRO III: *(x)* the interest rate on all TLTRO III operations will be 25 basis points below the average rate applied in the Eurosystem's main refinancing operations over the same period; *(y)* the maximum total amount that counterparties will henceforth be entitled to borrow will be raised from 30% to 50% of their stock of eligible loans as at 28 February 2019 for all future TLTRO III operations; *(w)* the limit of 10% of the stock of eligible loans for the amount of funds that can be borrowed in each operation will be removed on all future TLTRO III operations; and *(z)* in view of the changing economic environment, the lending performance threshold that needs to be met in the period between 1 April 2020 and 31 March 2021 in order to attain the minimum interest rate on TLTRO III operations will be lowered to 0%, from 2.5%[3].

Moreover, a temporary envelope of additional net asset purchases of €120 billion will be added until the end of the year, ensuring a strong contribution from the private sector purchase programmes.

Furthermore, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00%, 0.25% and -0.50% respectively.

Reinvestments of the principal payments from maturing securities purchased under the existing asset purchase programme (APP) will continue, in full, for an extended period of time past the date when the Governing Council starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

2. Temporary capital and operational relief

Besides the provisions of capital and liquidity buffers designed to allow banks to withstand stressing situations like the current one, by the 12 March 2020 decision the ECB will allow banks to operate temporarily below the level of capital defined by the Pillar 2 Guidance (P2G), the capital conservation buffer (CCB) and the liquidity coverage ratio (LCR), considering such temporary measures to be enhanced by the appropriate relaxation of the countercyclical capital buffer (CCyB) by the national macroprudential authorities[4].

In addition, by bringing forward a Capital Requirements Directive (CRD V) measure originally scheduled to be effective from January 2021, banks will also be allowed to partially use capital instruments that do not qualify as Common Equity Tier 1 (CET1) capital, for example Additional Tier 1 or Tier 2 instruments, to meet the Pillar 2 Requirements (P2R).

Such measures are designed to provide banks with significant capital relief in support of the economy, provided that banks are expected to use the positive effects coming from these measures to support the economy and not to increase dividend distributions or variable remuneration.

[3] Please see ECB press release dated 13 March 2020 available at: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312_1~39db50b717.en.html.

[4] Reference is made to the following ECB press release dated 12 March 2020 on this subject matter: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312~45417d8643.en.html.

Without prejudice to the above, the ECB is also discussing with banks individual measures, such as adjusting timetables, processes and deadlines, including (but not limited to) rescheduling on-site inspections and extending deadlines for the implementation of remediation actions stemming from recent on-site inspections and internal model investigations, as well as the postponement of the 2020 EBA EU-wide stress test. Furthermore, the ECB is currently considering to extend deadlines for certain non-critical supervisory measures and data requests.

This being said, banks are reminded to continue to apply sound underwriting standards, pursue adequate policies regarding the recognition and coverage of non-performing exposures, and conduct solid capital and liquidity planning and robust risk management.

II. ECB measures adopted after 12 March 2020

1. Pandemic Economic Purchase Programme (PEPP)

Following the measures adopted on 12 March 2020, and as a consequence of the continuing spreading of Covid-19 outbreak, on 18 March 2020 the ECB announced € 750 billion Pandemic Economic Purchase Programme (PEPP)[5]. More specifically, the ECB Governing Council decided:

(i) to launch a new temporary asset purchase programme of private and public sector securities;
(ii) to expand the range of eligible assets under the corporate sector purchase programme (CSPP) to non-financial commercial paper, making all commercial papers of sufficient credit quality eligible for purchase under CSPP;
(iii) to ease the collateral standards by adjusting the main risk parameters of the collateral framework.

This PEPP will have an overall envelope of € 750 billion. Purchases will be conducted until the end of 2020 and will include all the asset categories eligible under the existing asset purchase programme (APP).

2. Further flexibility to banks in reaction to coronavirus

In addition to the above, on 20 March 2020 the ECB adopted further measures to ensure that national banks can continue to fulfil their role to fund the households and corporations by mitigating the credit risk and, in the same context, to provide capital and operational relief in implementing the measures announced on 12 March 2020[6]. More specifically, ECB will:

(i) give banks further flexibility in prudential treatment of loans by public support measures.
Particularly, in order to provide sustainable solutions to temporarily distressed debtors in this context, the ECB introduced the following flexibility measures:
- supervisory flexibility regarding the treatment of non-performing loans (NPLs), allowing banks to fully benefit from guarantees and moratoriums put in place by public authorities to tackle the current distress;
- within the supervisors' functions and on a temporary basis, flexibility will be exercised with regard to classification of debtors as "unlikely to pay" when banks call on public guarantees granted in the context of coronavirus;
- the same flexibility will apply to loans under the Covid-19 related to public moratoriums; and
- full flexibility will be applied with reference to the implementation of NPL reduction strategies, taking into account the extraordinary nature of current market conditions;

[5] *Cfr.* ECB press release dated 18 March 2020 available at: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html.

[6] For further details, please see the following press release: https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320~4cdbbcf466.en.html.

(ii) encourage banks to avoid excessive procyclical effects on regulatory capital and published financial statements while applying transitional rules of IFRS 9 international accounting standards in relation to the excessive volatility of loan loss provisioning. To this end, the ECB recommends banks to opt for said IFRS 9 transitional rules and to avoid procyclical assumptions in their models in determining provisions;
(iii) activate the capital and operational relief measures announced on 12 March 2020 (as described above), by providing banks with the option to operate below the Pillar 2 Guidance (P2G) and the frontloading of the new Pillar 2 Requirement (P2R) composition rules for an amount equal to € 120 billion of CET1 Capital, which will allow banks to absorb losses (without triggering any supervisory actions) or to potentially finance up to € 1,8 trillion of lending in favour of households and corporate customers in need of extra liquidity.

In light of these Covid-19 measures, on 25 March 2020, with the aim to provide clarity to the EU banking sector, the European Banking Authority (“**EBA**”) issued a public statement to explain a number of additional aspects on the functioning of prudential framework in relation to: (i) the classification of loan defaults, (ii) the identification of forborne exposure, and (iii) the accounting treatment[7].

Such clarifications will help ensure consistency and comparability in risk metric across the whole EU banking sector.

[7] For further details please make reference to the EBA press release dated 25 March 2020 (https://eba.europa.eu/eba-provides-clarity-banks-consumers-application-prudential-framework-light-covid-19-measures).

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Our team focuses primarily on domestic extraordinary transactions (*e.g.*: M&A, capital strengthening, bancassicurance, asset management and consumer credit transactions) and corporate governance matters involving banks listed on regulated markets. Among others, our team also provides its clients with advisory activities on banking regulatory matters, drafting of legal opinions, litigation and pre-litigation legal support, as well as legal support in the context of shareholders' meetings and management of delicate issues concerning the aforesaid regulated entities.

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