EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Press release

12 March 2020

ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus

- Banks can fully use capital and liquidity buffers, including Pillar 2 Guidance
- Banks will benefit from relief in the composition of capital for Pillar 2 Requirements
- ECB to consider operational flexibility in the implementation of bank-specific supervisory measures

The European Central Bank (ECB) today announced a number of measures to ensure that its directly supervised banks can continue to fulfil their role in funding the real economy as the economic effects of the coronavirus (COVID-19) become apparent.

"The coronavirus is proving to be a significant shock to our economies. Banks need to be in a position to continue financing households and corporates experiencing temporary difficulties. The supervisory measures agreed today aim to support banks in serving the economy and addressing operational challenges, including the pressure on their staff," said Andrea Enria, Chair of the ECB Supervisory Board.

Capital and liquidity buffers have been designed with a view to allowing banks to withstand stressed situations like the current one. The European banking sector has built up a significant amount of these buffers. 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). The ECB considers that these temporary measures will be enhanced by the appropriate relaxation of the countercyclical capital buffer (CCyB) by the national macroprudential authorities.

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). This brings forward a measure that was initially scheduled to come into effect in January 2021, as part of the latest revision of the Capital Requirements Directive (CRD V).

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The above measures provide significant capital relief to banks in support of the economy. 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.

In addition, the ECB is discussing with banks individual measures, such as adjusting timetables, processes and deadlines. For example, the ECB will consider rescheduling on-site inspections and extending deadlines for the implementation of remediation actions stemming from recent on-site inspections and internal model investigations, while ensuring the overall prudential soundness of the supervised banks. In this context, the ECB Guidance to banks on non-performing loans also provides supervisors with sufficient flexibility to adjust to bank-specific circumstances. Extending deadlines for certain non-critical supervisory measures and data requests will also be considered. In the light of the operational pressure on banks, the ECB supports the decision by the European Banking Authority to postpone the 2020 EBA EU-wide stress test and will extend the postponement to all banks subject to the 2020 stress test.

Banks should 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.

These actions follow a letter sent on 3 March 2020 to all significant banks to remind them of the critical need to consider and address the risk of a pandemic in their contingency strategies. Banks were asked to review their business continuity plans and consider what actions could be taken to enhance preparedness to minimise the potential adverse effects of the spread of the coronavirus. ECB Banking Supervision will engage with banks to ensure the continuity of their critical functions. The ECB Supervisory Board is monitoring developments; these measures will be revised as necessary.

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Notes

- Banks need to have own funds in sufficient quantity and quality on the liabilities side of their balance sheet to be able to absorb losses.
- European banking law defines three elements of own funds. **Common Equity Tier 1 capital** (CET1) is the highest quality of own funds and is mainly composed of shares and retained earnings from previous years. **Additional Tier 1 capital** (AT1) and **Tier 2 capital** can be equity or liability instruments and are of lower quality.
- **Pillar 2 capital** consists of two parts. One is the **Pillar 2 Requirement or P2R**, covering risks which are underestimated or not sufficiently covered by **Pillar 1**. The other is the **Pillar 2 Guidance or P2G**, which indicates to banks the adequate level of capital to be maintained in order to have sufficient capital as a buffer to withstand stressed situations, in particular as assessed on the basis of the adverse scenario in the supervisory stress tests.

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- Under the new Capital Requirements Directive V (CRDV) banks can fulfil Pillar 2 Requirements with a minimum 56.25% CET1 as a general principle. The remaining P2R can be filled with Additional Tier 1 and Tier 2 instruments. This law was initially scheduled to come into effect in January 2021 as part of the latest revision of the CRDV.
- There are also **capital buffers** mitigating specific risks, such as the **capital conservation buffer** (CCB) and the **countercyclical capital buffer** (CCyB) (the latter being set by the national macroprudential authorities). These capital buffers are designed to absorb losses in times of stress.
- In 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.

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