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Coronavirus: regulatory measures for Dutch banks (update 20 April 2020)

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The spread of the coronavirus (COVID-19) has caused a severe global public health emergency which also has a major disruptive impact on the financial markets and the real economy. Consequently, the financial services industry is also faced with unprecedented scenarios and challenges. Below, we discuss a number of financial regulatory law aspects of this corona crisis for Dutch banks, including measures that competent authorities (the European Central Bank (**ECB**), the Dutch Central Bank (*De Nederlandsche Bank*, **DNB**), the Single Resolution Board (**SRB**) and the European Banking Authority (**EBA**) have taken so far.

Since this is an ever-evolving situation, there will highly likely be follow-up measures aiming to mitigate the negative effects, both by the banks themselves and their competent authorities. These measures may relate to e.g. mitigation of credit, operational or market risk or preparation for recovery and resolution. As soon as further measures have become clear we will update you.

Capital requirements

Pursuant to the Capital Requirements Directive and Regulation (**CRD IV** and **CRR**), banks are subject to capital and liquidity requirements. The purpose of maintaining capital is to absorb unexpected losses that banks suffer. If their credit risk, market risk and operational risk increase, which shall be the case in a crisis of this magnitude, banks are required to hold more capital. Generally speaking, Dutch banks are well-capitalized. However, capital that a bank maintains for meeting its own capital requirements cannot be used for lending and other banking activities funding the real economy.

ECB measures

In order to support banks in serving the economy and addressing operational challenges, the ECB announced a number of measures in respect of significant banks under its direct supervision on 12 March 2020:

- It will allow banks to operate temporarily below the level of capital defined by (i) the Pillar 2 Guidance (P2G), (ii) the capital conservation buffer (CCB) and (iii) the liquidity coverage ratio (LCR).
- It will allow banks 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 their Pillar 2 Requirements (P2R).[1]
- Also at the level of individual banks, the ECB is considering measures that provide relief.

Update 23 March 2020: On 20 March 2020, the ECB announced further flexibility. The ECB:

- will give banks further flexibility in prudential treatment of loans backed by public support measures;
- encourages banks to avoid excessive procyclical effects when applying the IFRS 9 international accounting standard;
- activates capital and operational relief measures announced on March 12, 2020.

The ECB estimates that the capital relief provided by the possibility to operate below the Pillar 2 Guidance (P2G) and the frontloading of the new rules on the Pillar 2 Requirement (P2R) composition amounts to EUR 120 billion of CET1 capital. This relief is available for banks to absorb losses without triggering any supervisory actions or to potentially finance up to EUR 1.8 trillion of loans to households and corporate customers in need of extra liquidity. The ECB also published a Q&A with further explanation to the measures.

Update 6 April 2020: On 27 March 2020, the ECB published a recommendation in which it asks banks not to pay dividends (for 2019 and for 2020 until at least 1 October 2020) and not to buy back shares aimed at remunerating shareholders as long as the Corona crisis lasts.[2] The ECB prefers banks to fund households, small business and corporates. EBA made a similar statement on 31 March 2020 and also urged banks to refrain from paying variable remuneration.

Update 6 April 2020: On 25 March 2020 (press release with related statements), EBA firstly provided more clarity to banks on the application of the prudential framework during the Corona crisis. Secondly, EBA reminded institutions of their consumer protection obligations. Thirdly, EBA urged a step-up in contactless payments and announced further actions to support banks' focus on key operations, for example by extending deadlines for public consultations.

Update 20 April 2020: On 16 April 2020, the ECB announced a temporary reduction in capital requirements for market risk, as a response to the extraordinary levels of volatility recorded in financial markets since the outbreak of the coronavirus. As well as smoothing procyclicality, the measure aims to maintain banks' ability to provide market liquidity and to continue market-making activities. The ECB is also temporarily reducing the qualitative market risk multiplier, which is set by supervisors and is used to compensate for the possible underestimation by banks of their capital requirements for market risk. The temporary reduction of the *qualitative* multiplier should compensate for currently observed increases of the *quantitative* multiplier. The latter can rise when market volatility has been higher than predicted by the bank's internal model. The ECB will review this decision after six months on the basis of observed volatility.

DNB measures

In addition, DNB announced a number of measures on 17 March 2020:

- It will lower systemic buffers from its current 3% of global risk-weighted exposures to 2.5% for ING, 2% for Rabobank and 1.5% for ABN AMRO.
- The introduction of a capital floor for mortgage loan risk weighting will be postponed.

The strong starting position of the Dutch banking sector allows DNB to temporarily give banks (SIs and LSIs) this additional leeway to continue business lending and absorb potential losses. The measures are expected to free up an additional EUR 8 billion in capital, enabling these banks to continue lending in the face of rising losses. DNB indicates that banks must use this freed-up capital to support lending, and not to pay dividend or share repurchases.

Update 6 April 2020: Whereas the ECB has taken its capital relief measures of 12 March 2020 for significant banks, DNB has also adopted these for the less significant banks under its supervision (link).

The same goes for the ECB request for limiting the pay out of dividends and share buy-backs (link). In addition to the aforementioned postponement of the floor for mortgage loan risk weighting, LSIs will be allowed the following (in short):

- To temporarily operate below the level of capital as defined by the Pillar 2 Guidance (P2G) and the capital conservation buffer (CCB), as well as to temporarily operate below the liquidity coverage ratio (LCR).
- Pillar 2 Requirements (P2R) can partially be met by capital instruments that do not qualify as Common Equity Tier 1 (CET1) capital.

Furthermore, as part of Pillar 2 supervisory requirements DNB has on a case-by-case basis imposed limits on asset encumbrance. DNB may also consider providing operational relief to LSIs on a case-by-case basis.

DNB published a useful and detailed overview of the measures taken so for the banking sector (in Dutch only).

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Business continuity management and operational risk

Banks are expected to have business continuity policies and concrete plans in place that prepare them for severe scenarios. Although the business continuity plans may not have been officially activated in all cases, we see that banks are taking the necessary actions to ensure the continuity of its activities and services as much as possible. For example, staff is working from home and/or in shifts and from different locations to avoid entire functions within the organization being lost. Additional IT measures are also taken, also in view of the heightened cyber security risks involved with the digital working alternatives explored.

In view of the coronavirus, the ECB already announced that significant banks are expected to take appropriate actions for preparing and responding to a pandemic. The ECB has explicitly provided a number of questions that the banks should in any case take into account. Its *Joint Supervisory Teams* will monitor the business continuity actions of individual banks and significant shortfalls and need to be informed by these banks about significant developments. DNB has also asked each of the individual less significant banks it supervises what their business continuity measures are in light of the coronavirus.

Also, in the light of the operational pressure on banks and possible limited capacity of staff the coming months, EBA has decided to postpone the 2020 EBA EU-wide stress test to 2021 and will extend the postponement to all banks subject to the 2020 stress test. This way, the banks do not have to free up staff members for the extensive stress test, but can focus on their core operations.

In addition, in a statement of 31 March 2020, EBA urged competent authorities to give institutions some leeway with regard to the remittance dates for some areas of supervisory reporting. This leeway should however not put at risk the access to the crucial information needed to monitor closely institutions' financial and prudential situation. At the same time, EBA called on competent authorities to support financial institutions' ongoing efforts by sharing information on emerging ML/TF risks, setting clear regulatory expectations and using supervisory tools flexibly.[3]

Update 6 April 2020: MREL and resolution planning

The SRB has also provided guidance on its recovery and resolution activities in relation to the corona crisis. In a letter to the banking industry of 25 March 2020, the SRB announced a pragmatic and flexible approach in order to consider postponing less urgent information or data requests to banks for this upcoming 2020 resolution planning cycle. However, the following required reports are essential and should in principle still be submitted pursuant to the original deadlines: the Liability Data Report, the Additional Liability Report and the MREL quarterly template. Also, the SRB stated it is ready to use its discretion and the flexibility given by the regulatory framework to adapt transition periods and interim targets applied to banking groups, as well as to adjust MREL targets in line with capital requirements, with particular reference to capital buffers.

[1] 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).

[2] Comparable recommendations have for example been made by DNB and EIOPA directed at insurance companies and by DNB for investment firms.

[3] For all EBA measures, please refer to: https://eba.europa.eu/coronavirus.

Specialisten

Bart Bierman

T +31 (0)20 767 01 80
T +31 (0)20 767 01 85 (direct)
M +31 (0)6 31 67 03 93
bart.bierman@finnius.com