BANKING STAKEHOLDER GROUP

To José Manuel Campa 12th March 2020

Chairman of the European Banking Authority (EBA)

Dear Mr Campa,

Due to the exceptional emergency created by the spread of the Covid-19 infection in Europe, the Banking Stakeholder Group (BSG) welcomes the EBA Communication to Competent Authorities on how to temporarily adapt prudential and, if necessary, consumer protection regulation, and bank supervision.

Some BSG members, however, believe that while such urgent measures are needed, they should not necessarily include a temporary suspension or easing of existing banking regulation under the remit of the EBA. Rather, these measures should be fiscal including, for example, loan guarantees by the state or public entities[1]. Other members caution, however, that state or public guarantees backing troubled SME loans, would transfer economic risk to the sovereign balance-sheets and reinforce the bank/sovereign nexus, by "socialising the losses". Instead, ensuring targeted, coordinated and temporary flexibility might assist taxpayers, although it must be carefully managed and phased-out when conditions are back to normal.

This health emergency has put at risk the life of thousands of persons in Europe bringing national health care systems under unusual pressure. At the same time, it has hampered world trade and the confidence of households and firms. In addition, the drastic containment measures that governments are taking to limit the contagion and soften the pressures on the health care system, have a direct negative impact on various economic activities, such as logistics (including transportation, warehousing, commercial distribution), tourism, fairs, recreation and retail distribution. Firms are sharply increasing teleworking and paid leave, while a number of government activities (such as education, justice, etc.) have been suspended. There are already signs that simultaneous demand and supply shocks, hitting the European economic environment that is already marked by signs of slowdown, will have a dramatic impact on European economic growth. Financial markets are already disrupted. As confidence deteriorates further, liquidity may become scarce. Hopefully, this double shock will only last a few months, but the effects may be devastating. According to some base scenarios, the economic downturn may last in Europe until Q3.

In this situation, banks and payment institutions are already adopting all measures possible to adapt to the emergency situation. Contingency plans have been activated to ensure the extent of possible business continuity and support for customers (notably by providing payment delays and moratoria to families and small firms in difficulties). However, operational activities (engagement with stakeholders, staff performance, performance of contractors and outsourced service providers, and business development) are already negatively affected. Funding costs are increasing, however, and capital markets are more

[1] Economists argue for the activation of the procedure under Article 122.2 of the Treaty on the Functioning of the EU allowing the European Council to grant financial assistance to a member state facing "severe difficulties" caused by "exceptional occurrences beyond its control." https://www.project-syndicate.org/commentary/avoding-eurozone-covid19-economic-crisis-by-daniel-gro-2020-03

difficult to access, if not totally closed for higher risk/lower liquidity instruments, such as MREL and securitisation. Foreclosures and Non-Performing Exposures are likely to increase abruptly.

In these exceptional and temporary circumstances, the BSG welcome the Communication issued by EBA to the competent authorities on the use the supervisory and regulatory tools that are available (such as waivers, release of buffers, postponement of deadlines), in order to:

1. avoid or limit adverse liquidity effects on European businesses and households;
2. secure the continuation of credit transmission by banks, without major disruption to their prudential status;
3. secure the continuation of payment services, including those provided by payment institutions and electronic money institutions;

The BSG recommends to:

1. allow banks to change the payment schedule of borrowers which are affected by the consequences of the Covid-19 (e.g. a moratorium tool for instalment payments for sound borrowers) along with other exceptional measures deemed necessary to minimise the impact of COVID-19 on consumers and SMEs (for instance, exceptional delays in payment, in the event of a disruption to revenue streams). The moratorium tool would allow banks to restructure the payment schedule of borrowers which are affected by the consequences of the COVID-19, without detriment to their prudential evaluation. The moratorium would be applied to viable and resilient firms, which are temporarily facing liquidity challenges due to exceptional circumstances. The moratorium tool shouldn't be used as a way of preventing defaulted exposures from being identified. Accordingly, the EBA should explore the definition of default and consider the possibility of a special treatment of the exposures temporarily affected by the coronavirus situation as it exists, in case of a moratorium by force of law. This should be applied in a consistent manner across member states;
2. ensure that these measures are available and put in place without an increase in costs and burden upon distressed consumers and firms;
3. facilitate the debt restructuring of firms which are in temporary distress but still economically viable;
4. consider supporting banks' lending capacity by easing the level of combined buffer requirements (remove/reduce countercyclical buffer and domestic systemic buffers, provide an explicit statement that all buffers are usable to cover losses in stress periods[2]). These buffers have, indeed, been intended to provide room for manoeuvre in crisis situations;
5. consider supporting the ability of banks to use part of the liquidity buffer (which is currently well above the minimum of 100%, and represents more than €1trn) below minimum requirement, in order to provide temporary liquidity to non-financial business – without any detriment to the banks' prudential evaluation;
6. establish a clear expiration date for the temporary measures, aimed at stabilising the financial system, together with a plan for a return to compliance with current regulatory requirements.

In addition, the BSG welcomes the decision of EBA to postpone the current timeline of the 2020 stress test exercise to 2021 not to put undue pressure on banking participants.

Eventually, after the emergency is over, the BSG recommends EBA to foresee carrying out an impact assessment of temporary measures, including their impact on consumers.

[2] See Bank of England March 11th 2020, "The release of the countercyclical capital buffer reinforces the expectations of the FPC and the PRC that all elements of banks' capital and liquidity buffers can be drawn down as necessary to support the economy through this temporary shock" https://www.bankofengland.co.uk/news/2020/March/boe-measures-to-respond-to-the-economic-shock-from-covid-19

More generally, the current situation is an essential test of the resilience of our current monetary and financial system and the efficiency of regulatory and institutional measures in stabilising external shocks. It is a test for the institutional framework to manage a crisis in a powerful and coordinated way, in the best interests of society.

The BSG is ready to discuss and provide advice on this most urgent issue.

Best regards

On Behalf of BSG

Rym Ayadi, BSG Chair

Sergio Lugaresi, BSG Vice Chair