Opinion of the European Economic and Social Committee on 'Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic'

(COM(2020) 310 final — 2020/0066 (COD))

(2020/C 311/10)

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Referral	Council of the European Union, 6.5.2020
	European Parliament, 13.5.2020
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Bureau decision	30.4.2020
Adopted at plenary	10.6.2020
Plenary session No	552
Outcome of vote	208/2/5
(for/against/abstentions)	

1. **Conclusions and recommendations**

1.1. The EESC welcomes the European Commission proposal amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic.

1.2. The EU is facing an unprecedented crisis, and so an equally extraordinary response is required. The proposal must be adopted with all speed so that the resources thus freed up can be used as effectively as possible in order to deal with the present and future impact of COVID-19.

1.3. The EESC agrees with the decision to postpone the implementation of the consolidated Basel III framework introduced by the Basel Committee and approved by the European Commission. However, this postponement must not simply confirm the existing rules, and so the proposal to review the directives and regulations is appropriate.

1.4. The EESC also suggests that before starting the implementation process once again, the changes which will inevitably be imposed on economic and financial institutions at this difficult time must be carefully evaluated, a crucial step for any adjustment in the European regulatory system. Further impact assessments might be necessary.

1.5. The EESC is also concerned that it might not be possible to meet other regulatory deadlines at this stage, in view of the operational challenges facing banks (and the authorities). This is clearly the case as regards the new framework for the interest rate risk in the banking book (IRRBB): it should be in effect as from June 2021 but the enacting rules are not yet available. It is also the case for the NSFR (which should be in force as from June 2021).

1.6. It might therefore be appropriate to establish a reasonable postponement for the CRR II and the CRD5 aspects, as well as for the EBA guidelines on loan origination and monitoring and the guidelines on the new definition of default. Alternatively, as in the case of the NSFR, it might be appropriate to provide for a three-year phase-in period (similar to the LCR), preserving the legislators' original intention of giving banks one year from the time of adoption to implement the new rules.

1.7. The same applies to compliance with the requirements introduced by Directive (EU) 2019/879 of the Parliament and of the Council and Regulation (EU) 2019/877 on the loss-absorbing and recapitalisation capacity of credit institutions. In view of the pressure on loan activity and the requests made by the supervisory authorities themselves to use capital reserves to avoid a credit squeeze, the deadlines stipulated by this directive and regulation for meeting the binding objectives of the MREL should be reviewed and postponed as necessary.

1.8. The EESC agrees with the Commission proposal on adjusting the transitional arrangements that allow credit institutions to alleviate the impact from expected credit-loss (ECL) provisioning and corrections under IFRS 9 on their own funds. Nonetheless, the EESC considers that the proposal is merely a first step towards meeting the objective of mitigating the impact of the recession but that it is neither effective nor adequate for maintaining the level playing field between European intermediaries. Accordingly, it considers that the following measures should be added to the proposal:

— extending the 'new' dynamic component as gauged on 1 January 2020 to loans which became non-performing from 1 January 2020 (or any successive date deemed appropriate and in line with the date on which the pandemic began);

— not substituting the scale factor with a single weighting of 100 %, used for retail client financing. This would fail to recognise the different degree of riskiness of the categories of typical borrowers of commercial banks in general and, far more importantly, local banks. This specifically concerns households and SMEs. In terms of capital requirements, there is a specific prudential treatment for exposures associated with this category of borrowers. Furthermore, substituting the scale factor with a single weighting of 100 % would pose significant, and at times insurmountable, difficulties in implementation for banks that use the standard method and apply the protocol procedure for reporting purposes. As an alternative to the provision proposed by the Commission, and as an effective streamlining measure, consideration could be given to acting on the treatment of the associated taxation as referred to in paragraph 7(a), rather than deleting point (b);

— extending the phase-in period to the static component as measured on 1 January 2018, with the introduction of the new IFRS 9 accounting principle, which requires banks to pay particular attention to the impact on them of First Time Adoption (FTA) and affects the evaluation procedures in the sales scenario, including of impaired positions, which are now the most significant component of the entire amount posted to the FTA.

1.9. The EESC considers that it would be helpful to extend the treatment currently applicable to non-performing exposures (NPE) guaranteed or ensured by official export credit agencies to NPE resulting from the impact of the COVID-19 pandemic and which are covered by the various guarantee regimes set up by the Member States. However, if the aim of this amendment is to recognise that public guarantees have the same risk mitigating effects as those provided by export credit agencies (ECA), the timeframes should also be aligned. If the aim is the complete alignment of the treatment of these guarantees, the seven-year deadline for implementing the treatment proposed by the Commission should be amended.

1.10. Given that every effort must be made to push banks to support the real economy as effectively as possible, the EESC supports the proposal to bring forward the dates for implementing some of the most correct capital absorption calibrations provided for in the CRR but not yet applicable, such as the provisions on the treatment of some types of pension- and salary-backed loans, or the supporting factor for SMEs and the new supporting factor for financing infrastructure.

1.11. Infrastructure investments will shortly become very important, and so the EESC considers that steps must be taken to simplify the combined and burdensome criteria set out in Article 501a of the CRR regarding projects that would allow for easier recognition for the purposes of the preferential prudential treatments stipulated (for instance, by eliminating the obligations set out in points (b), (d), (g), (i) and (l) of paragraph 1 and point (a) of paragraph 2).

1.12. A crucial element in the broader context of the review of the European multiannual budget is the new *#NextGenerationEu plan* recovery strategy presented by the Commission on 28 May, which provides for measures of extraordinary scope to respond to the crisis triggered by the pandemic. This strategy should incorporate the Green Deal Investment Plan published in the first quarter of 2020 to support the transition towards a sustainable European economy.

1.13. With regard to CRR supporting factors, the EESC upholds the need to introduce a green and social supporting factor, which will reduce capital absorption, for financing granted by banks for social economy enterprises and those enterprises genuinely involved in sustainable and inclusive development programmes.

1.14. With regard to the regulatory framework on non-performing loans, it should be pointed out that COVID-19 will inevitably influence the NPL market in a number of ways. In this context, and given that the present emergency would inevitably affect the market and slow down transfer procedures, the EESC calls for a temporary amendment to Regulation (EU) 2019/630 of the Parliament and of the Council as regards minimum coverage of losses on non-performing exposures.

1.15. It is of the utmost importance to establish private markets of non-performing loans with the largest possible number of participants and purchasers so as to avoid any transfer of wealth from the banking sector to the funds sector (which is not bound by the same rules) and from local, national and European economies to operators with different legal and tax residences.

1.16. The EESC considers that the so-called ‘prudential filter’, already provided for in the Basel II framework, needs to be introduced on a temporary basis to remove unrealised assets and losses from balance sheets. One of the effects of the pandemic has been a marked increase in volatility of securities which have always been less sensitive to shocks. In these market conditions and taking account of the significant support provided by banks for the public debt, the impact of volatility on securities other than those in the trading book must be reduced in order to boost the stability of regulatory capital.

1.17. Alongside the Commission proposal and with reference to market risk, in line with the ECB guidelines issued on 16 April, the level I framework should be amended to remove the current links between volatility and banks’ capital absorption (which multiplies VaR). This is imperative since, due to COVID-19, the market has already displayed a high level of volatility resulting in a significant increase in institutions’ capital absorption.

2. **General comments**

2.1. The serious repercussions that will result from the COVID-19 crisis mean that urgent measures must be adopted to support the European economy and help get economic activity going again in the EU Member States. In this situation it is essential to ensure that, without suitable legislative safeguards, the recession does not further undermine the already at-risk diversity of the EU banking sector; we consider in particular that the specific role of community and territorial banks — particularly those with the locally owned model typical of cooperative banks — must be protected and reinforced.

2.2. On 28 April 2020, the European Commission presented a package of banking measures designed to make it easier for banks to promote financing for businesses and households intended to cushion the major economic impact of COVID-19. The package confirms the recent declarations on the use of flexibility in accounting and prudential standards issued by international standards bodies and relevant European authorities, as well as several proposed amendments to EU banking standards. These amendments should be adopted with no delay in order to improve the banking system’s capacity to issue loans and absorb losses during the COVID-19 pandemic while maintaining consistency with prudential rules.

2.3. The EESC welcomes the initial measures taken and the initial indications provided by relevant European authorities, specifically the EBA, ESMA and ECB/SSM. These decisions and guidelines aiming to ensure more flexibility under the current regulatory framework are moving in the right direction to cope with the first phase of the crisis. The EESC agrees with the Commission communication which seeks to guarantee uniform interpretation and application of the measures adopted by the various stakeholders comprising the European system of supervisory authorities. Uniform interpretation and application ensure that the measures themselves are more effective.

2.4. However, the EESC does not feel that the proposed measures are up to the task of fending off the recession expected in the wake of the pandemic. COVID-19 is an extraordinary crisis with major economic and social fallout. All the European institutions must react to reduce the impact on the real economy, including by daring decisions on payment pauses.

2.5. In this field, the EESC notes that particular attention has been paid to the implementation of forbearance measures and moratoriums and their impact on the potential reclassification of debtors under prudential standards and IFRS accounting standards, as well as to the treatment of public guarantees and NPL.

2.6. In order to cope with the crisis, the EESC points out that all European financial institutions are rolling out various instruments to support the real economy. For instance, banks are rolling out moratoriums, forbearance measures, cash advances on unemployment benefits and other extraordinary forms of assistance to capital companies, middle-capitalisation companies, SMEs and families. This financial assistance is based on national decrees or voluntary schemes.

2.7. Nonetheless and in view of the serious and unprecedented impact of the pandemic, the EESC reiterates that the measures listed above will not be enough.

2.8. In light of the above points, the EESC welcomes the proposal on adjustments in response to the COVID-19 pandemic issued by the Commission on 28 April 2020.

2.9. The EESC endorses the idea that, in addition to making full use of the flexibility built into the existing framework, a number of amendments limited to specific aspects of the CRR are needed in order to maximise the capacity of credit institutions to support the economy and at the same time absorb the losses due to the COVID-19 pandemic, while also guaranteeing their continued resilience. Moreover, at international level, the BCBS has agreed to delay the deadline for implementing the final elements of the Basel III framework by a year; some elements of this framework had already been incorporated into the CRR, together with greater flexibility with regard to the impact of IFRS 9 on capital. These changes must be reflected in the existing rules.

2.10. The impact of the pandemic will affect the NPL market in a number of ways: Judicial proceedings have been suspended and/or deferred for weeks resulting in delays in NPL recovery procedures. Recovery procedures which do not go through the courts will also have to move more slowly.

2.11. As a result, procedures for the disposal of non-performing loans will also be affected and the slump in NPL prices will last for at least 24 months. This might also be to the advantage of non-bank purchasers specialising in NPL. These purchasers are not bound by European prudential rules, thus placing EU banks at a definite disadvantage and leading to the transfer of wealth from the banking sector to unregulated institutions, at the very moment when we need banks to support economic recovery and dividends have been cancelled.

2.12. In this situation and given that the present crisis will inevitably affect the market and slow down dismissal procedures, the EESC calls for a temporary amendment to the NPL backstop regulation described above.

2.13. Article 473a of the CRR sets out transitional provisions enabling institutions to return to their primary capital part of the impact of provisioning occasioned by the introduction of the ECL impairment model under IFRS 9. The new provisions firstly make it possible to partially neutralise the impact of implementing the new impairment model on exposures, and secondly to mitigate the impact of the additional increase in devaluations recorded between two points in time.

2.14. This provision will move closer to the objective of mitigating the critical impact of the recession, but is not sufficient to guarantee a continuing level playing field for European credit institutions. Since one of the main effects of the crisis will be a rise in impairment levels, moves to mitigate the impact of the crisis purely with regard to performing exposures must be extended to loans which became non-performing after the pandemic appeared in Europe (January 2020).

2.15. As already pointed out, the impact of the pandemic on the real economy over the next few months will place great strain on the EU's socioeconomic system. We will have to rethink the entire European production system. We therefore consider that this huge challenge can be an opportunity to build a European economic model which is more environmentally sustainable and more socially inclusive. In this scenario, due to the fact that they are decentralised and present in all areas, local banks of every legal form (whether capital or people based, i.e. cooperatives) can and must play a

key role in distributing incentives, adapting perfecting to the role of a chain for distributing value from central institutions to more remote local areas. The strategic relevance of community banks must therefore be acknowledged and reinforced.

2.16. The pandemic has shown firstly that in places where there is a strong social fabric and vigorous social economy organisations, solidarity (including in the form of social enterprises) has been a key factor in resilience; it has also shown that the presence of social enterprise organisations will be key to establishing an inclusive and sustainable economic system, averting the risk of collapse of entire economic sectors. The EESC therefore argues that a green and social supporting factor, reducing capital absorption, needs to be added to the CRR for financing issued by banks to social economy enterprises.

2.17. Article 501c of CRR 2 stipulates that by 2025, the EBA must carry out a detailed study considering whether there is any justification for introducing specific prudential treatment for exposures connected to such assets or activities.

2.18. The EESC considers that this supporting factor should be introduced before 2025, which could be fatally late, in order to adopt a support measure which would enable credit institutions to issue more loans and resources to strategic sectors that are already struggling.

2.19. During this phase of the crisis, we have seen how social enterprises have been able to make the communities they serve more resilient; in many cases, they have worked alongside or acted as substitutes for public administrations when these lack the outreach to meet needs. We therefore suggest that the end date of the mandate conferred by legislators on the EBA be brought much further forward and that the process of developing a sustainability supporting factor be speeded up. The microprudential perspective should be corrected as required and balanced by a systemic, macroprudential and at the same time social perspective.

2.20. The EESC agrees with the Commission's view that pushing forward to 1 July 2020 the date for implementing the two supporting factors (preferential treatment of certain software assets and preferential treatment of certain pension- or salary-backed loans) would free up the institutions' own funds, enabling them to step up necessary loans during the COVID-19 pandemic and its aftermath. Moving up to 1 January 2021 the supporting factors ([1]) for the real social economy and the green economy as well would clearly have a positive effect.

2.21. The Commission's proposals for amendments will not substantially change the prudential regulatory framework and would facilitate collective efforts to mitigate the impact of the crisis and thus promote rapid recovery. On this issue, it must be pointed out that current provisioning curves for non-performing loans should be deferred for 24 months in order to respond to the need to provide adequate flows of financing which can limit the impact of the pandemic. If no such steps are taken, banks would be faced with two contradictory sets of incentives laid down in the rules: on one hand, measures seeking to free up banks' capital for new financing or at any rate to avoid excessive pressure on that capital (such as the revision of the transitional standards on IFRS9) and on the other, rules which could ultimately exert enormous pressure on capital or at least discourage banks from issuing financing in an economy under strain in order to avoid negative repercussions on capital. Unless it is reviewed, the prudential backstop could be another such rule, discouraging financing in a scenario of economic stress and recession. The adjustments should apply to both guaranteed and non-guaranteed non-performing loans.

Brussels, 10 June 2020.

The President
of the European Economic and Social Committee
Luca JAHIER

([1]) See Article 501c Prudential treatment of exposures related to environmental and/or social objectives.