Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic (Text with EEA relevance)

REGULATION (EU) 2020/873 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 24 June 2020

amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank[(1)],

Having regard to the opinion of the European Economic and Social Committee[(2)],

Acting in accordance with the ordinary legislative procedure[(3)],

Whereas:

(1) Regulation (EU) No 575/2013 of the European Parliament and of the Council[(4)] establishes, together with Directive 2013/36/EU of the European Parliament and of the Council[(5)], the prudential regulatory framework for credit institutions and investment firms (‘institutions’) operating in the Union. Adopted in the aftermath of the financial crisis that unfolded in 2007-2008, and largely based on international standards agreed in 2010 by the Basel Committee on Banking Supervision (BCBS), known as the Basel III framework, that prudential regulatory framework has contributed to enhancing the resilience of institutions operating in the Union and to making them better prepared to deal with potential difficulties, including difficulties stemming from possible future crises.

(2) Since its entry into force, Regulation (EU) No 575/2013 has been amended several times to address remaining weaknesses in the prudential regulatory framework and to implement some outstanding elements of the global financial services reform that are essential to ensuring the resilience of institutions. Among those changes, Regulation (EU) 2017/2395 of the European Parliament and of the Council[(6)] introduced transitional arrangements in Regulation (EU) No 575/2013 for mitigating the impact on own funds of the introduction of International Financial Reporting Standard – Financial Instruments (IFRS 9). Regulation (EU) 2019/630 of the European Parliament and of

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the Council[7] introduced in Regulation (EU) No 575/2013 a requirement for minimum loss coverage for non-performing exposures, the so-called prudential backstop.

(3) Furthermore, Regulation (EU) 2019/876 of the European Parliament and of the Council[8] introduced in Regulation (EU) No 575/2013 some of the final elements of the Basel III framework. Those elements include, among other things, a new definition of the leverage ratio and a leverage ratio buffer, both of which prevent institutions from excessively increasing leverage, as well as provisions for the more favourable prudential treatment of certain software assets and for the more favourable treatment of certain loans backed by pensions or salaries, a revised supporting factor for loans to small and medium-sized enterprises (SMEs) (the 'SME supporting factor'), and a new adjustment to own funds requirements for credit risk for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services (the 'infrastructure supporting factor').

(4) The severe economic shock caused by the COVID-19 pandemic and the exceptional containment measures have had a far-reaching impact on the economy. Businesses are facing disruption in supply chains, temporary closures and reduced demand, while households are confronted with unemployment and a drop in income. Public authorities at Union and Member State level have taken decisive action to support households and solvent undertakings in withstanding the severe but temporary slowdown in economic activity and the resulting liquidity shortages.

(5) Institutions will have a key role in contributing to the recovery. At the same time they are likely to be impacted by the deteriorating economic situation. The European Supervisory Authority (European Banking Authority) (EBA) established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council[9], the European Supervisory Authority (European Securities and Markets Authority) (ESMA) established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council[10] and the competent authorities have provided temporary capital, liquidity and operational relief to institutions to ensure that institutions can continue to fulfil their role in funding the real economy despite the more challenging environment. In particular, the Commission, the European Central Bank and EBA have provided clarity regarding the application of the flexibility already embedded in Regulation (EU) No 575/2013 by issuing interpretations and guidance on the application of the prudential framework in the context of COVID-19. Such guidance includes the interpretative communication of the Commission of 28 April 2020 on the application of the accounting and prudential frameworks to facilitate EU bank lending – Supporting businesses and households amid COVID-19. In reaction to the COVID-19 pandemic, the BCBS has also provided some flexibility in the application of international standards.

(6) It is important that institutions employ their capital where it is most needed and the Union regulatory framework facilitates their doing so while ensuring that institutions act prudently. In addition to the flexibility already provided in the existing rules, targeted changes to Regulations (EU) No 575/2013 and (EU) 2019/876 would ensure that the prudential regulatory framework interacts smoothly with the various measures that address the COVID-19 pandemic.

(7) The extraordinary circumstances of the COVID-19 pandemic and the unprecedented magnitude of challenges triggered calls for immediate action to ensure that institutions are able to channel funds to businesses and households effectively and to mitigate the economic shock caused by the COVID-19 pandemic.

(8) Guarantees provided in the context of the COVID-19 pandemic by national governments or other public entities, which are considered equally creditworthy under the Standardised Approach for credit risk set out in Part Three of Regulation (EU) No 575/2013, are comparable as regards their risk-mitigating effects to guarantees provided by official export credit agencies as referred to in Article 47c of Regulation (EU) No 575/2013. It is therefore justified to align the minimum coverage requirements for non-performing exposures that benefit from guarantees granted by national governments or other public entities with those for non-performing exposures that benefit from guarantees granted by official export credit agencies.

(9) Evidence which has emerged in the context of the COVID-19 pandemic has made it apparent that the possibility of temporarily excluding certain exposures to central banks from the calculation of an institution's total exposure measure, as laid down in Article 429a of Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876, could prove essential during a crisis situation. However, the discretion to exclude such exposures only becomes applicable on 28 June 2021. Therefore, before that date, the competent authorities would not be able to make use of that instrument to address the increase in exposures to central banks that is expected to occur as a result of monetary policy measures employed to mitigate the economic impact of the COVID-19 pandemic. Moreover, the effectiveness of that instrument appears to be hampered by the reduced flexibility stemming from the offsetting mechanism attached to such temporary exclusions, which would constrain the ability of institutions to increase exposures to central banks in a crisis situation. That could ultimately result in forcing an institution to reduce its level of lending to households and businesses. Therefore, in order to avoid any undesired consequences related to the offsetting mechanism and to ensure the effectiveness of that exclusion in the face of possible future shocks and crises, the offsetting mechanism should be modified. In addition, in order to ensure the availability of that discretion during the current COVID-19 pandemic, the possibility of temporarily excluding certain exposures to central banks should already be available before the leverage ratio requirement set out in point (d) of Article 92(1) of Regulation (EU) No 575/2013 becomes applicable on 28 June 2021. Pending the application of the amended provisions on the calculation of the leverage ratio as introduced by Regulation (EU) 2019/876, Article 429a should continue to apply in the wording as introduced by Commission Delegated Regulation (EU) 2015/62[(11)].

(10) In 2017, the BCBS revised the calculation of the leverage ratio exposure value of regular-way purchases and sales awaiting settlement in order to ensure that the treatment properly reflects the inherent leverage associated with those trades and that possible accounting differences do not affect the calculation among institutions with comparable positions. In the Union, the revision was introduced by Regulation (EU) 2019/876. However, that more favourable treatment only becomes applicable on 28 June 2021.

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Therefore, given that the revised calculation would reflect the actual leverage of a transaction more appropriately and, at the same time, would increase the capacity of an institution to lend and to absorb losses amid the COVID-19 pandemic, institutions should already have the possibility to temporarily apply the revised calculation before the provision introduced by Regulation (EU) 2019/876 becomes applicable to all institutions in the Union.

(11) Many institutions operating in the Union have been subject to IFRS 9 since 1 January 2018. In line with international standards adopted by the BCBS, Regulation (EU) 2017/2395 introduced in Regulation (EU) No 575/2013 transitional arrangements to mitigate the potentially significant negative impact on institutions' Common Equity Tier 1 capital arising from expected credit loss accounting under IFRS 9.

(12) The application of IFRS 9 during the economic downturn caused by the COVID-19 pandemic could lead to a sudden significant increase in expected credit loss provisions as, for many exposures, expected losses over their lifetime might need to be calculated. The BCBS, EBA and ESMA clarified that institutions are expected not to mechanically apply their existing expected credit loss approaches in exceptional situations such as the COVID-19 pandemic but instead to use the flexibility inherent in IFRS 9, for example to give due weight to long-term economic trends. The BCBS agreed on 3 April 2020 to allow more flexibility in the implementation of the transitional arrangements that phase-in the impact of IFRS 9. In order to limit the possible volatility of regulatory capital that might occur if the COVID-19 pandemic results in a significant increase in expected credit loss provisions, it is necessary to extend the transitional arrangements also in Union law.

(13) To mitigate the potential impact that a sudden increase in expected credit loss provisions could have on institutions' capacity to lend to clients at times when it is most needed, the transitional arrangements should be extended by two years, and institutions should be allowed to fully add back to their Common Equity Tier 1 capital any increase in new expected credit loss provisions that they recognise in 2020 and 2021 for their financial assets that are not credit-impaired. Those changes would bring additional relief from the impact of the COVID-19 pandemic on institutions' possible increase in provisioning needs under IFRS 9 while maintaining the transitional arrangements for the expected credit loss amounts established before the COVID-19 pandemic.

(14) Institutions that have previously decided to use or not to use the transitional arrangements should be able to reverse that decision at any time during the new transitional period, subject to receiving the prior permission of their competent authority. The competent authority should ensure that such reversals are not motivated by considerations of regulatory arbitrage. Subsequently, and subject to the prior permission of the competent authority, institutions should have the possibility of deciding to stop using the transitional arrangements.

(15) The extraordinary impact of the COVID-19 pandemic is also observed in relation to the extreme levels of volatility in the financial markets, which together with uncertainty are leading to increased yields for public debt that, in turn, give rise to unrealised losses on institutions' holdings of public debt. In order to mitigate the considerable negative

impact of the volatility in central government debt markets during the COVID-19 pandemic on institutions' regulatory capital and therefore on institutions' capacity to lend to clients, a temporary prudential filter that would neutralise that impact should be re-established.

(16) Institutions are required to back-test their internal models daily to assess whether those models generate sufficient capital requirements to absorb trading book losses. Failures in the back-testing requirement, also known as overshootings, if above a certain number per year, would result in an additional quantitative multiplier being applied to the own funds requirements for market risk calculated using internal models. The back-testing requirement is highly procyclical in a period of extreme volatility, such as the one caused by the COVID-19 pandemic. As a result of the crisis, the quantitative market risk multiplier applied to internal models has increased significantly. While the Basel III framework for market risk allows competent authorities to smoothen such extraordinary events in market risk internal models, such supervisory discretion is not fully available under Regulation (EU) No 575/2013. Therefore, additional flexibility for competent authorities to mitigate the negative effects of the extreme market volatility observed during the COVID-19 pandemic should be introduced to exclude the overshootings that occurred between 1 January 2020 and 31 December 2021 which are not a result of deficiencies in internal models. Based on the experience from the COVID-19 pandemic, the Commission should assess whether such flexibility should be made available also during future episodes of extreme market volatility.

(17) In March 2020, the Group of Central Bank Governors and Heads of Supervision revised the implementation timeline of the final elements of the Basel III framework. While most of the final elements still need to be implemented in Union law, the leverage ratio buffer requirement for global systemically important institutions has already been implemented through the amendments introduced by Regulation (EU) 2019/876. Therefore, and in order to ensure a level playing field internationally for institutions established in the Union and operating also outside the Union, the date of application for the leverage ratio buffer requirement set out in that Regulation should be deferred by one year to 1 January 2023. With the application of the leverage ratio buffer requirement postponed, during the postponement period there would be no consequences resulting from a failure to meet that requirement as set out in Article 141c of Directive 2013/36/EU and no related restriction on distributions set out in Article 141b of that Directive.

(18) Regarding loans granted by credit institutions to pensioners or employees with a permanent contract against the unconditional transfer of part of the borrower's pension or salary to that credit institution, Article 123 of Regulation (EU) No 575/2013 was amended by Regulation (EU) 2019/876 to allow for the more favourable treatment of such loans. The application of such treatment in the context of the COVID-19 pandemic would incentivise institutions to increase lending to employees and pensioners. It is therefore necessary to advance the date of application of that provision so that it can already be used by institutions during the COVID-19 pandemic.

(19) As the SME supporting factor and the infrastructure supporting factor allow for a more favourable treatment of certain exposures to SMEs and infrastructure, their application